DELICTUAL LIABILITY OF A BANK ON THE BASIS OF MISREPRESENTATION

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ABSTRACT

This study will specifically focus on the delictual liability of a bank where misrepresentation with regards to a letter of comfort is the cause of damages suffered by a client. Ultimately, the goal of this study is to answer the legal question: Under what circumstances can a bank, with specific reference to letters of comfort, be held delictually liable for damages suffered by a client as a result of a misrepresentation by the bank?

This study will be based on a comparison between the South African law and the English law. The English law is a statutory system based on the "Law of Commons" and it has had a marked influence on the South African law. Although South Africa is a third world country, its banking law is based on British legislation and also influenced by the case law of this first world country. During the past decade there has been a definite shift in the way South African courts view the legal relationship between banks and their customers. It is clear that the courts more readily hold banks liable for damages caused to their customers. (*Bernert v Absa Bank Limited,* case number 14302/03, is an unreported case heard in the North Gauteng High Court of South Africa on 15 October 2008).

Nationally and internationally banks have gained a vast influence on the economic development of a country. As a result banking has become a controlled and regulated profession. Nevertheless, South African banking law is known to be conservative and very hesitant to change with regards to modern ideas and the constantly changing circumstances of our times. From the developments in the case of *Bernert v Absa Bank Limited* lessons may be learned from the English law.

Although England has a system of parliamentary sovereignty while South Africa is now a constitutional democracy, it would nevertheless be recommended that South African courts more readily take into consideration the decisions made by

the English courts as our commercial law legislation is based on English law. It would reduce the legal costs of the parties involved and more importantly have a positive effect on international trade as it would create legal certainty which could lead thereto that international traders would feel more comfortable and secure to bring their money into South Africa, make investments in our country and enter into import en export contracts with South African companies.

AFRIKAANS SUMMARY

Hierdie studie sal spesifiek fokus op die deliktuele aanspreeklikheid van 'n bank waar ‘n wanvoorstelling met betrekking tot 'n brief van troos die oorsaak is van die skade wat gely word deur 'n kliënt. Uiteindelik is die doel van hierdie studie om die volgende genoemde vraag te beantwoord : Onder watter omstandighede kan 'n bank, met spesifieke verwysing na briewe van troos, deliktueel aanspreeklik gehou word vir skade wat 'n kliënt lei as gevolg van 'n wanvoorstelling deur ‘n bank?

Hierdie studie sal gebaseer word op 'n vergelyking tussen die Suid-Afrikaanse reg en die Engelse reg. Die Engelse reg is 'n statutêre stelsel gebaseer op die "Law of Commons" en het 'n merkbare invloed op die Suid-Afrikaanse reg gehad tot dusver. Hoewel Suid-Afrika 'n derde wêreld land is, is sy bank wetgewing gebaseer op die Engelse wetgewing. Gedurende die afgelope dekade is daar 'n duidelike verandering in die wyse waarop Suid-Afrikaanse howe kyk na die wetlike verhouding tussen banke en hul kliënte. Dit is duidelik dat die howe meer geredelik banke aanspreeklik hou vir die skade wat hulle kliënte lei. (*Bernert v Absa Bank Beperk*, saaknommer 14.302 / 03, is 'n ongerapporteerde saak wat in die Noord-Gautengse Hoë Hof van Suid-Afrika op 15 Oktober 2008 aangehoor is).

Nasionaal en internasionaal het banke 'n groot invloed op die ekonomiese ontwikkeling van 'n land. As gevolg hiervan het die beroep, bankier, 'n beheerde en gereguleerde beroep geword. Nietemin, is die Suid-Afrikaanse bank wetgewing konserwatief en is Suid – Afrika baie huiwerig om hierdie wetgewing te verander met betrekking tot moderne idees en dit sodoende in lyn te bring met die voortdurend veranderende omstandighede van ons tyd. Uit die ontwikkelinge in die saak *Bernert v Absa Bank Beperk* kan ons lesse leer by die Engelse reg.

Alhoewel Engeland 'n stelsel van parlementêre soewereiniteit het, terwyl Suid-Afrika 'n konstitusionele demokrasie is, sou dit nogtans aanbeveel word dat die Suid-Afrikaanse howe meer geredelik die besluite wat geneem is deur die Engelse howe inagneem aangesien ons kommersiële reg gebaseer is op die Engelse reg. Dit kan regskoste van die betrokke partye verminder en 'n positiewe uitwerking hê op internasionale handel. Laasgenoemde sal regsekerheid bevorder wat verder daartoe sal lei dat die internasionale handelaars meer geredelik sal wees en veilig sal voel om hul geld in Suid-Afrika in te bring, beleggings te maak in ons land en invoer en uitvoer kontrakte met Suid-Afrikaanse maatskappye te sluit.

KEY WORDS

1. Bank

2. Delict

3. Letters of Comfort

4. Liabilty

5. Misrepresentation

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1 Introduction and research problem

'The customer is king.'[1]

The former phrase is regarded by the general public as a tired aphorism. [2] Nevertheless, numerous individuals in the commercial world sturdily believe that the said phrase holds the key to success for anyone and or any business that renders a service to another person and or business whether the service is of a public or of a private nature.

Nationally as well as internationally banks are regarded as the trustees of the public's money.[3] Therefore, the business of banking is seen as the rendering of a service to the public. *"Le rôle du banquier est de faire commerce de l'argent."*[4] The banker-customer relationship has always been based on the common law and bankers have had to act in good faith to ensure that their customers do not withdraw their funds from the banks.[5] Consequently, banks gained a vast influence on the economic development of a country.[6] As a result banking has become a controlled and regulated profession.[7]

Regardless, the South African courts have made many controversial decisions in the past decade with regards to the professional responsibility of bankers. In South Africa it is generally accepted that the legal liability of a bank, when dealing with a financial instrument such as a cheque, is regulated by the *Bills of Exchange Act* 34 of 1964.[8] During the last decade there has been a tendency to hold banks liable on grounds other than those included in the *Bills of Exchange*

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1 Debono J The Customer is king http://jamesdebono.com/the-customer-is-the-king/; Hunter D 2004 The customer is still king http://allafrica/com/stories/200404060666/html.
2 Modjadji L The customer is king, but not in South Africa, says Lauretta. http://www.btimes.co.za/97/0622/btmoney/money8.htm.
3 Malan *Professional Responsibility* 327.
4 Malan *Professional Responsibility* 327.
5 Fourie *Aspects of Banking Law* 2.
6 Malan *Professional Responsibility* 327.
7 Fourie *Aspects of Banking Law* 2.
8 Malan *et al Malan on Bills of Exchange* 34.

Act 34 of 1964. In terms of the South African common law liability can, generally speaking, also be incurred by banks in terms of the law of contract and the law of delict.[9] The relationship between a bank and its customers is based on contract. If a bank is in breach of its contractual obligations, the customer may have a contractual claim against the bank.[10] In principle the customer could also have a delictual claim against the bank, if the five elements of a delict are present.[11] The delictual liability of a bank can be based on the breach of a duty of care.[12] However, there is still legal uncertainty if and under what circumstances a bank can be held legally liable either on the basis of contract or delict, specifically in the case of misrepresentations.

During the past decade there has been a definite shift in the way South African courts view the legal relationship between banks and their customers. It is clear that the courts more readily hold banks liable for damages caused to their customers. (*Bernert v Absa Bank Limited,* case number 14302/03, is an unreported case heard in the North Gauteng High Court of South Africa on 15 October 2008). This is the latest South African case based on the delictual liability of a bank, where the court held the bank delictually liable because of a misrepresentation.[13] The court *a quo* declared that the customer suffered damages as a result of a misrepresentation contained in a letter drafted by the legal representatives of the bank with regards to another letter, a letter of undertaking (also known as a letter of comfort) that was issued by an employee of the bank. This decision by the court *a quo* went on appeal.[14] The Supreme Court of Appeal of South Africa upheld the appeal and the order of the court *a quo* was set aside on the basis that the letter that was the cause of the misrepresentation by the bank was not unlawful although it contained a false statement. The reason for the former decision was that the letter that was issued

9 Neethling *et al Deliktereg* 6.
10 Malan *et al Malan on Bills of Exchange* 335-337.
11 Neethling *et al Deliktereg* 4.
12 Neethling *et al Deliktereg* 144-146.
13 *Bernert v Absa Bank Limited* paragraph 50.
14 *Absa Bank Limited v Bernert* (99/09) [2010] ZASCA 36 (29 March 2010).

by an employee of the bank, is not a financial instrument that is used on a day to day basis during the regular business of the bank. Accordingly, the bank could not be held legally liable because they attempted to prevent the further exchange of the letter of undertaking to third parties.[15] Legal certainty in South Africa with regards to the legal liability of banks is therefore needed.

This study will specifically focus on the delictual liability of a bank where misrepresentation with regards to a letter of comfort is the cause of damages suffered by a client. Ultimately, the goal of this study is to answer the legal question: Under what circumstances can a bank, with specific reference to letters of comfort, be held delictually liable for damages suffered by a client as a result of a misrepresentation by the bank?

This study will be based on a comparison between the South African law and the English law. The English law is a statutory law system based on the "Law of Commons" and it has had a marked influence on the South African law. Although South Africa is a third world country, its banking law is based on British legislation and also influenced by the case law of this first world country.[16] Nevertheless, South African banking law is known to be conservative and very hesitant to change with regards to modern ideas and the constantly changing circumstances of our times.[17] From the developments in the case of *Bernert v Absa Bank Limited* lessons may be learned from the English law.

15 *Absa Bank Limited v Bernert* paragraph 73-76.
16 Malan *Professional Responsibility* 327.
17 Malan *Professional Responsibility* 326.

2. South African Legislation

2.1 Instruments of payment, credit and investment[18]

2.1.1 Introduction

Instruments of payment, credit and investment can be defined as commercial paper.[19] Commercial papers such as bills of exchange, cheques and promissory notes are the most commonly known and internationally utilised instruments of payment, credit and investment in commercial transactions.[20] All commercial papers are embodied by personal rights that can be enforced only through possession of the instrument itself whether the instrument is negotiable or not.[21] In South Africa commercial papers such as bills of exchange, cheques and promissory notes are governed by the *Bills of Exchange Act* 34 of 1964.[22]

2.1.2 Legislative history: "Bills of Exchange Act 34 of 1964"

Wisselrecht was the first common law in South Africa governing negotiable instruments until 1887. The *wisselrecht* was based on the common law and rules with respect to negotiable instruments in Holland.[23] During 1887, firstly the colony of Natal and shortly thereafter the Cape, Transvaal and the Orange Free State all adopted their own statutes with regards to negotiable instruments that overruled the common law known as the *wisselrecht.* All of these latter colonial

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18 Hereafter also referred to as 'financial instruments', 'financial documents' or 'commercial Instruments'.

19 "Not all commercial papers are negotiable instruments although all negotiable instruments are commercial papers. Examples of commercial papers that are not negotiable instruments are: non-transferable cheques, postal orders marked 'not transferable', bills of lading and share certificates. It should be noted that the latter is not a closed list." Malan *et al Malan on Bills of Exchange* 6 – 7.

20 Malan *et al Malan on Bills of Exchange* 1.

21 Malan *et al Malan on Bills of Exchange* 4-5.

22 Hereafter referred to as: 'The Act'.

23 The common law known as the Roman – Dutch law.

statutes were based on the English Bills of Exchange Act of 1882.[24] Although South Africa was unified in 1910, the pre-Union legislation of the former four South Africa colonies regulated all the negotiable instruments until 1964 when a unified and consolidated legislation, today known as the Bills of Exchange Act 34 of 1964, was enacted to achieve uniformity between the four pre-Union colonial statutes. To date the Bills of Exchange Act 34 of 1964 has been amended four times.[25] The South African common law which, as previously mentioned, is based on the Roman-Dutch law must be used as background for the interpretation of all South African legislation. Although the Act[26] was modelled on the English Bills of Exchange Act of 1882 as well as on the English Cheques Act of 1957, it should not be interpreted with regards to only the English Bills of Exchange Act. The English court decisions should also be taken into consideration when interpreting the said Act. It should be noted that the South African courts are not bound by the decisions of the English courts.[27] Section 39 of the Constitution declares that[28] :

> *When interpreting the Bill of Rights, a court, tribunal or forum -*
> *(a) must promote the values that underlie an open and democratic society, based on human dignity, equality and freedom;*
> *(b) must consider international law;*
> ***(c) may consider foreign law.***

2.1.3 Liability in terms of the Bills of Exchange Act 34 of 1964

The basis of liability when dealing with financial instruments is either contract or delict. The liability of a party to a financial instrument depends on the legal

[24] Malan *et al Malan on Bills of Exchange* 34.
[25] Malan *et al Malan on Bills of Exchange* 35.
[26] Act 34 of 1964.
[27] Malan *et al Malan on Bills of Exchange* 36-37.
[28] Section 39 of the Constitution of South Africa, 1994.

capacity of the particular party.[29] Therefore, if a person has the legal capacity to incur liability then the provisions of the Act will apply to him or her. The legal capacity of a person is determined by the general principals of contract law.[30] Regardless of whether or not one of the parties to a financial instrument does not have the required legal capacity to be held liable for his or her duties and responsibilities in terms of the said financial instrument, the mutual independence of the obligations remains to be effective. Latter statement simply entails that the liabilities of the parties to a financial instrument are not affected by the lack of legal capacity by one or more of the other parties to the said financial instrument.[31] There can be various parties to a financial instrument. All of these parties have different rights, obligations and liabilities based on the contractual relationship between one another and the financial instrument itself. A short summary of the basis for liability applicable to the various different parties when dealing with a financial instrument will surely lay a sound foundation for achieving the goal of this study. The liabilities of the following parties to a financial instrument are as follows:

2.1.3.1 Liability of co-debtors[32]

The liabilities of co-debtors, co-acceptors and/or co-indorsers are not specifically governed by the Act. Although, since 1844 in terms of the South African common law, these named parties to a financial instrument are liable *in solidum*[33] unless it appears otherwise from the face of the financial instrument.[34]

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29 S20(1) 34 of 1964, "capacity to incur liability as a party to a bill is co-extensive with capacity to contract".

30 Malan *et al Malan on Bills of Exchange* 221.

31 Malan *et al Malan on Bills of Exchange* 221-222; S20(2) 34 of 1964, "If a bill is drawn or indorsed by a minor or a corporation having no capacity or power to incur liability on a bill, the drawing or indorsement of the bill entitles the holder to receive payment of the bill, and to enforce it against any other party thereto."

32 "Co-debtors are two or more persons that signed a negotiable instrument thereby promising to make payment"; Malan *et al Malan on Bills of Exchange* 223.

33 "Liable jointly and severally";.Heimstra and Gonin *Trilingual Legal Dictionary* 207.

34 Malan *et al Malan on Bills of Exchange* 223 ; S89 34 of 1964.

2.1.3.2 Liability of the drawee[35]

The drawee is not liable in terms of a financial instrument merely because he or she agreed to accept the financial instrument or because he or she is indebted to the drawer.[36] The Act provides that the drawee of a financial instrument cannot be held liable if he or she did not accept the said financial instrument.[37] When the drawee accepts the financial instrument he or she becomes the principal debtor as well as the final debtor upon the financial instrument. The reason for latter statement being that the drawee, by accepting the financial instrument, agrees to make payment to the holder of the said financial instrument.[38]

2.1.3.3 Liability of the acceptor[39]

The concept acceptance with respect to financial instruments is based on a written contract. The liabilities of the acceptor as well as the liabilities of the other parties to the written contract can be gathered from the terms for the said contract itself.[40] The Act also contain three "statutory estoppels" that prevent the acceptor from relying on these matters in a defence against the holder in denying the holder in due course his personal rights with regards to the financial instrument.[41]

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35 "The drawee is the party to a negotiable instrument who is instructed by the drawer to effect payment to a specific person"; Malan *et al Malan on Bills of Exchange* 41.

36 Malan *et al Malan on Bills of Exchange* 224.

37 S51 34 of 1964; "A bill, of itself, does not operate as an assignment of funds in the hands of the drawee and available for the payment thereof, and the drawee of a bill who does not accept as required by this Act, is not liable on the instrument"; Malan *et al Malan on Bills of Exchange* 223.

38 S52(a) 34 of 1964 ; Malan *et al Malan on Bills of Exchange* 224.

39 "The acceptor is the final debtor in terms of the negotiable instrument because payment made by the drawee or acceptor releases the other parties from their duties and responsibilities"; Malan *et al Malan on Bills of Exchange* 224.

40 S52(a) 34 of 1964; "The acceptor undertakes to pay the bill according to the tenor of his acceptance" ; Malan *et al Malan on Bills of Exchange* 228.

41 S52(b) 34 of 1964; "(a) the existence of the drawer, the genuineness of his signature, and his capacity and authority to draw the bill; (b) in the case of a bill payable to the drawer's order,

2.1.3.4 Liability of the drawer[42]

The liability of the drawer is based on two grounds, being the drawing of the financial instrument and the delivery thereof in concluding the contract between the parties. As the liability of the drawer cannot be absolute if it is only determined by the contents of the financial instrument, the liability of the drawer should rather be determined by the agreement between the parties to the financial instrument when the said financial instrument is delivered.[43]

2.1.3.5 Liability of the indorser[44]

The liability of the indorser to the indorsee is a contractual liability. Therefore the indorser can raise defences against the indorsee which he or she would have been entitled to raise against a typical contractual partner.[45] The Act prevents the indorser from raising certain defences against any party who is a holder in due course.[46]

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the then capacity of the drawer to indorse, but not the genuineness or the validity of his indorsement; (c) in the case of a bill payable to the order of a third person, the existence of the payee and his then capacity to indorse, but not the genuineness or the validity of his indorsement."

42 "The drawer plays the primary role in transactions based on a negotiable instrument as the drawer initiates the said transaction by drawing the negotiable instrument and making the first delivery thereof "; Malan et al *Malan on Bills of Exchange* 224.

43 S60 and 65 34 of 1964 ; Malan *et al Malan on Bills of Exchange* 230 ; S53(1)(a) 34 of 1964 : "The drawer of a bill by drawing it engages that, on due presentment, it shall be accepted and paid according to its tenor, and that if it is dishonoured he will compensate the holder, or an indorser who is compelled to pay it, provided the requisite proceedings on dishonour are duly taken"; Malan *et al Malan on Bills of Exchange* 229-230.

44 The words 'indorser' and 'indorsee' comes from the word 'indorsement' which is derived from the expression 'in dorso' that means 'on the back' ; Malan *et al Malan on Bills of Exchange* 230. The indorser guarantees that payment in terms of the negotiable instrument is genuine by signing at the back of the negotiable instrument and then indorsement is concluded when the indorser delivers the negotiable instrument to the indorsee.

45 Malan *et al Malan on Bills of Exchange* 230 – 231.

46 S53(2)(a) 34 of 1964, "engages that, on due presentment, it shall be accepted and paid according to its tenor, and that if it be dishonoured he will compensate the holder, or a subsequent indorser who is compelled to pay it, provided the requisite proceedings on dishonour are duly taken"; Malan *et al Malan on Bills of Exchange* 230-231.

2.2 Delictual liability

When discussing the liability of a bank, specifically the delictual liability of a bank, in terms of the South African law, as is the primary focus of this study, there is no better starting point than the legal responsibility of the drawee and/or the collecting bank towards the owner of a cheque, the reason being that the said responsibility of the collecting bank is, lawfully spoken, a question of delictual liability and the professional responsibility of a bank in dealing with cheques have to date been duly researched.[47]

2.2.1 Cheques in general

Cheques are also regulated by the Bills of Exchange Act.[48] A cheque can be seen as an instruction given by a customer to his or her bank to make payment on his or her behalf. The cheque as an instrument of payment originated in 1530 in Italy and was further developed in England. The cheque can be defined as a bill that is drawn on a banker payable on demand thereof.[49] Cheques are very seldom negotiated; they are more often deposited into the bank account of the payee. There are millions of cheques presented for payment annually. These cheques represent billions of Rand collected each year.[50]

2.2.2 The liability of the paying bank[51]

The liability of the drawee bank is neither based upon fault nor is it based upon contract as the owner of the cheque or negotiable instrument is not usually in a contractual relationship with the drawee thereof.[52]

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47 Malan *Professional Responsibility* 329.
48 S71 – 86 34 of 1964.
49 Malan *et al Malan on Bills of Exchange* 291.
50 Malan *et al Malan on Bills of Exchange* 292.
51 The Paying Bank also known as the Drawee Bank.
52 Malan *Professional Responsibility* 330 – 331.

Usually, the drawee bank can only be held liable if it effected the payment of a cheque or any other negotiable instrument while having knowledge of the fact that the possessor of the said cheque or negotiable instrument was not the true owner thereof.[53] The liability of the drawee bank in terms of crossed cheques is not as complex as it is with uncrossed cheques, the reason being that in terms of the provisions of the Act[54] the drawee bank that effects payment contradictory to the instructions in the crossing of the cheque shall be held liable to the true owner of the cheque for the loss that he or she suffered with regards to the wrongful payment of the cheque by the drawee bank.[55] In other words, a bank, be it the drawee bank or any other bank, that disregards the crossing of a cheque in contravention of the applicable legal norms, pays at its own risk. Latter liability can be categorised as strict liability.[56]

Accordingly, the question regarding the liability of the drawee bank towards the owner of a cheque is a delictual question.[57]

2.2.3 The liability of the collecting bank

A cheque is more often presented by the holder thereof to his or her own bank[58] to collect payment on his or her behalf than it is presented for payment by the payee to the drawee bank.[59] The collection of payment by the collecting bank should be effected not only in good faith but also without negligence on its part.[60] In order for a bank, or rather a banker, to act in good faith and without negligence, the banker has to apply the duty of care by taking reasonable care in

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53 Malan *Professional Responsibility* 330.
54 S78(4) 34 of 1964.
55 Malan *Professional Responsibility* 330.
56 Malan *Professional Responsibility* 330 – 331.
57 Malan *Professional Responsibility* 333.
58 "The collecting bank therefore also plays an important role in the cheque payment system" ; Malan *Professional Responsibility* 333.
59 Malan *Professional Responsibility* 333.
60 Malan *Professional Responsibility* 335.

itself by confirming the financial position of the customer and his or her character. It is stated that bankers should take up the "practice of reasonable men carrying on business of bankers". [61] The decision is made by the collecting bank whether or not it wants to accept the cheque when a cheque is presented over the counter or is delivered through the post.[62] Banks are required to act properly and correctly as everyone has an interest therein.

In terms of the South African law there is no concept of liability that is based on exchange and as a result thereof there are no specific measures to protect the collecting bank against a strict form of liability.[63]

2.3 Letters of Comfort

2.3.1 Background

Although letters of comfort are commonly used in South Africa in legal practice as well as in the auditing sphere, there have to date not been many direct references made to letters of comfort in any South African court case, textbook, legal journal or dictionary.[64] Therefore letters of comfort, comfort letters or letters of undertaking, as they are also known, are not a very well-known legal or even business instruments. During 1988 an article was published in the *De Rebus* regarding comfort letters and whether or not they are binding under South African law. Latter article was written by G Radesich and A Trichardt, two South African legal professionals, who formally introduced the letter of comfort and its legal nature to the South African legal profession in general.[65] The goal of the said article was to define letters of comfort, discuss the concept of liability and provide guidelines for the drafting of these legal instruments.[66] As it is one of the very

61 Malan *Professional Responsibility* 336.
62 Malan *Professional Responsibility* 336.
63 Malan *Professional Responsibility* 337.
64 Radesich and Trichardt *Comfort letters are they binding under South African law?* 795.
65 Radesich and Trichardt *Comfort letters are they binding under South African law?* 795 – 799.
66 Radesich and Trichardt *Comfort letters are they binding under South African law?* 795.

few legal references made specifically to this unique legal instrument, I will devote more time to it.

2.3.2 Letters of comfort and guarantees: an introduction and brief comparison

A letter of comfort should be seen as a simple alternative to a guarantee. The reason for latter statement being that a comfort letter is a legal instrument that may be given by a parent company to a creditor of its subsidiary company instead of a general guarantee that is usually given under the same circumstances to a creditor.[67]

There can be various reasons why a parent company would want to issue a letter of comfort instead of a guarantee to a creditor. Although the wording of each letter of comfort differs from the other, the content contained in each letter of comfort basically stays the same.[68] When we look at the letter of comfort as a whole the concept "*gentleman's agreement*" [69] comes to mind as the true intention of all the parties to a letter of comfort is not always very clear and certain. Latter 'agreement' can be defined as follows: [70]

> *A gentleman's agreement is an agreement which is not an agreement, made between two persons neither of whom is a gentleman, whereby each expects the other to be expressly bound without himself being bound at all.*

Nevertheless letters of comfort do not fall exactly within the definition of a "gentleman's agreement" as defined above. Therefore each provision contained in a letter of comfort should first be looked at separately and thereafter all the provisions should be considered as a whole before concluding what precisely the

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67 Radesich and Trichardt *Comfort letters are they binding under South African law?* 796.
68 Radesich and Trichardt *Comfort letters are they binding under South African law?* 796.
69 Radesich and Trichardt *Comfort letters are they binding under South African law?* 799.
70 Radesich and Trichardt *Comfort letters are they binding under South African law?* 799, Footnote 12; Straughton J adverted in Chemco Leasing Spa v Rediffuston PLC supra.

parties have legally agreed upon and willingly bound themselves to in terms of the letter of comfort. [71] Some of the most common provisions found in a letter of comfort are the following: [72]

1. *The parent company indicates that it is aware of its subsidiary's loan.*
2. *The parent company states that it will not reduce its shareholding or participation in the sis diary during the currency of the loan.*
3. *The parent company states that it will provide its subsidiary with the financial means to meet its obligations.*
4. *The parent company states that it will do everything in its power to ensure that the subsidiary is properly managed in accordance with prudent fiscal policies so as to ensure repayment of any loan.*
5. *The parent company states that it will exercise its influence on the subsidiary to meet its obligations.*
6. *The parent company states that it is its policy to ensure that the subsidiary is in a position to meet its obligations.*
7. *The parent company states that it is its policy to support its subsidiary.*
8. *The parent company states that it has complete confidence in the management of its subsidiary.*
9. *The parent company sites that it has always regarded its subsidiary's obligations as its own.*
10. *The parent company states that it will arrange for the subsidiary's commitments to its creditor to be performed in a satisfactory way.*
11. *The parent company states that it will exert its full influence over the subsidiary to repay the credit on maturity.*

When we take the above concept provisions into consideration, then the following reasons may be taken into account when deciding whether a parent

[71] Radesich and Trichardt *Comfort letters are they binding under South African law*? 799, Footnote 12.

[72] Radesich and Trichardt *Comfort letters are they binding under South African law?* 796.

company should provide a creditor with a letter of comfort as opposed to a guarantee:[73]

(a) avoiding legal obligations by making a mere moral commitment;
(b) no contingent liability;
(c) avoidance of tax consequences (although in South Africa this reason may not stand its ground);
(d) the credit rating of the company may not allow the company to issue a guarantee;
(e) avoidance of the payment of stamp duty on a guarantee (this reason is no longer applicable in South Africa as stamp duty no longer exists);
(f) avoiding compliance of foreign exchange legislation and regulations;
(g) company may be prevented from issuing a guarantee in terms of an existing loan agreement or pledge.

The main differences between a letter of comfort and a guarantee are that a letter of comfort does not create a legal obligation between the parties thereto whereas a guarantee is legally binding.[74] A very important difference between these instruments is furthermore that the language in a letter of comfort is often unclear and leads to legal uncertainty, whereas the provisions of a guarantee are usually clearly expressed and create legal certainty between the parties thereto. Therefore a letter of comfort should be carefully drafted so that it transpires the true intentions of the parties very clearly transpire.[75] Also the claims in terms of a letter of comfort are generally for damages and not for a liquidated sum of money. The quantification of the said damages can be a difficult and very complicated process. On the other hand a guarantee, warranty or suretyship, as it is also known as in South African law, has the connotation of an undertaking between two parties creating a contractual obligation or performance of a third party to the said contract. A guarantee consists of detailed provisions and in the

[73] Radesich and Trichardt *Comfort letters are they binding under South African law?* 796.
[74] Radesich and Trichardt *Comfort letters are they binding under South African law?* 797.
[75] Radesich and Trichardt *Comfort letters are they binding under South African law?* 797.

case of default by the principal debtor a claim for a liquidated amount with a precise and ascertainable figure may be claimed by the plaintiff.[76]

It is clear that a letter of comfort creates a semblance of an agreement between parties where no actual agreement really exists and will therefore be useful in situations where disagreements arise between two parties with regard to their undertaking. Regardless, the disadvantages of letters of comfort may seem to be more that the advantages as there are legal uncertainty regarding the enforcement thereof by a court of law as well as the damages that a court will award as a letter of comfort is an instrument that creates liability for damages where there has been a breach of contract in a contractual relationship between parties where an obligation in the letter of comfort has been dishonoured.[77]

2.3.3 Liability

The provisions in a letter of comfort contain commitments. Latter commitments may create legal obligations or they may only be a moral commitments between the parties and not create any legal obligations, the reason being that parties often formulate letters of comfort in such a way as not to create any legal obligations because a mere moral commitment between two parties does not appear on the financial statements specifically the balance sheets of a company as it involves no actual money.[78] This may create a very dangerous situation if the parties thereto are in disagreement with one another and a dispute arises that can only be settled before a court of law. In such a situation it must be determined whether or not this instrument does contain any legal obligations or not.[79]

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[76] Radesich and Trichardt *Comfort letters are they binding under South African law?* 796.
[77] Radesich and Trichardt *Comfort letters are they binding under South African law?* 799.
[78] Radesich and Trichardt *Comfort letters are they binding under South African law?* 796.
[79] Radesich and Trichardt *Comfort letters are they binding under South African law?* 796.

A letter of comfort will only create contractual obligations if the instrument itself is a contract and it can only be seen as a contract if an agreement was concluded between the parties with the intention to create legal obligations. There must therefore be a common intention and/or a consensus should have been reached between the parties to create legal obligations.[80] The true intentions of the parties to a letter of comfort can be determined as follows:[81]

(a) the language used should reflect the mutual intention of the parties;
(b) every word should be given its grammatical meaning if the word was not used in a technical sense[82];
(c) background circumstances should be taken into consideration;
(d) if no intention can be determined because the language is too obscure then the instrument should be void as it is vague and embarrassing.

Not only can a party be held contractually liable but delictual liability may also or alternatively be present if all the requirements for delict are present. The reason or argument that may be upheld in the case of delictual liability with regards to a letter of comfort is that one of the parties has a legal duty towards the recipient of the letter of comfort to provide the correct information to latter party. Another argument may be that if the one party knew or that same party should have subjectively foreseen who and how there would be responded to information contained in the letter of comfort, the said party may be held delictually liable if it is proven that the information is wrong and the wrongful information caused damages to another party.

Although there are still many legal uncertainties with regard to the legal nature of a letter of comfort, latter instrument is used daily in South Africa by various

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80 Radesich and Trichardt *Comfort letters are they binding under South African law?* 797.
81 Radesich and Trichardt *Comfort letters are they binding under South African law?* 797.
82 Please note : the rules of interpretation has changed since the coming into operation of the Constitution. Thus rules are not necessarily automatically given their grammatical meaning anymore as stated in this article written in 1988 by Radesich and Trichardt.

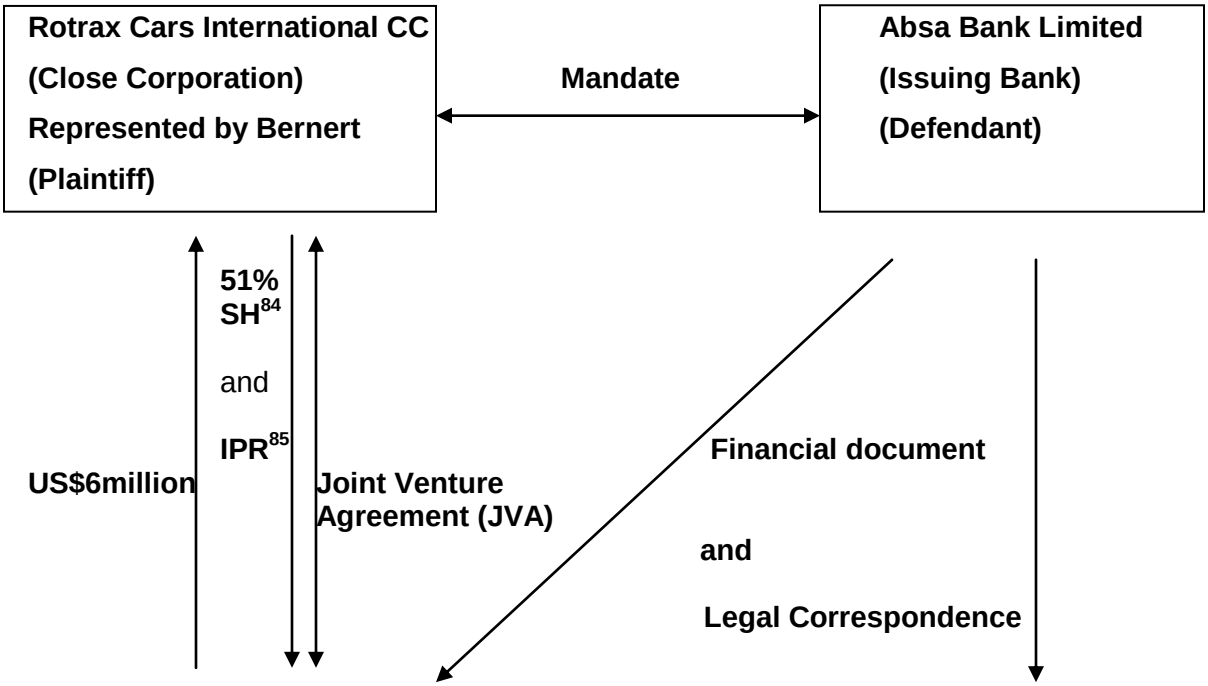
companies and is especially used by international as well as South African banks as a security arrangement for large credit facilities between parties.

2.4 *Bernert v Absa Bank Limited* (14302/03) [2008] ZAGPHC 337[83]

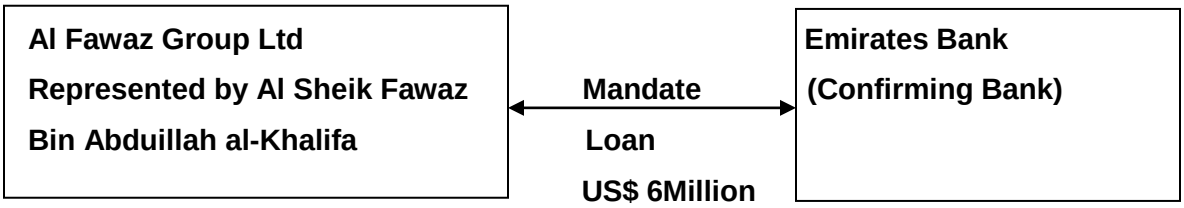
2.4.1 Introduction

To date there has not been many South African court cases dealing with the delictual liability of a bank on the basis of misrepresentation, specifically where a letter of comfort or a letter of undertaking (as it is more often referred to) is either directly or indirectly involved in the matter. Therefore, the above said matter that was heard in the North Gauteng High Court of South Africa on 15 October 2008 brought some new insight into this uncertain segment of the South African law.

2.4.2 Diagram



[83] Hereafter *Bernert v Absa Bank Limited.*
[84] Shareholding or Members interest.
[85] Intellectual property rights.



2.4.3 Facts

Rotrax Cars International CC (hereafter 'the Close Corporation'), a close corporation duly registered in terms of the laws of the Republic of South Africa, was duly represented by the Plaintiff. The Plaintiff entered into a written agreement, a Joint Venture Agreement, with the Al Fawaz Group (hereafter 'the Group'), duly represented by Sheik Fawaz Bin Abduillah al-Khalifa (hereafter 'the Sheik), who were both situated in Dubai. It would seem that the primary reason the Plaintiff entered into the said written agreement with the Group was to obtain finance for the manufacturing of the El Macho Jeep.[86] Thereto, on the other hand, the Group would be purchasing 51% of the controlling members' interest in the Close Corporation for the amount of US$6 million (six million dollars)[87] and receive the intellectual property rights attached to the named vehicles. The written agreement between the named parties stated that before latter amount would be paid into a bank account in South Africa the Plaintiff had to obtain a 'formal undertaking for a fix deposit account at a guaranteed interest rate from a AAA-rated Bank in South Africa.'[88] An agent for the Plaintiff received a letter referred to as the 'Verbiage of Bank Guarantee' (hereafter 'the financial document') from an employee of the Defendant and the said financial document was forwarded to Emirates Bank (hereafter 'the confirming bank').[89] The Plaintiff was informed that the said financial document was accepted by the confirming bank as well as the Group as a formal undertaking as was required in terms of the said written agreement between the parties.

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86 *Bernert v Absa Bank Limited* , ad paragraph 2.
87 *Bernert v Absa Bank Limited* , ad paragraph 3.
88 In terms of clause 2.1 of the Joint Venture Agreement of the parties.
89 *Bernert v Absa Bank Limited* , ad paragraph 2.

The financial institution used by the Group, the confirming Bank, was informed in writing by the legal representatives of the Defendant that the financial document that was issued by the Defendant, was issued in irregular circumstances by Mr. Coetzee, a Relationship Manager of the Defendant, who was not authorised to issue the said financial document on behalf of the Defendant and therefore it should be ignored by the confirming Bank.[90] It can be implied that not only was the financial document issued under irregular circumstances but also that the Plaintiff obtained the financial document fraudulently from the Defendant.[91]

Consequently, the Plaintiff was blacklisted with the International Chamber of Commerce by the Defendant. Latter conduct of the Defendant allegedly led thereto that the Group cancelled the said agreement between themselves and the Close Corporation as they were no longer willing to do any business with the Plaintiff. Furthermore, the blacklisting of the Plaintiff led thereto that no financial institution would do business with him and/or the Close Corporation. As a result the Plaintiff claimed damages up to the amount of R186 650 000.00 (one hundred and eighty six million and six hundred and fifty thousand rand) from the Defendant.[92]

The Plaintiff in this matter had three alternative claims against the Defendant. The Plaintiff decided only to continue with the second claim against the Defendant which was a delictual claim for damages suffered by the Plaintiff as a result of the Defendant's negligent misstatement.

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90 *Bernert v Absa Bank Limited* , ad paragraph 4.
91 *Bernert v Absa Bank Limited* , ad paragraph 2.
92 *Bernert v Absa Bank Limited* , ad paragraph 2.

2.4.4 Legal question(s)

(a) Whether or not the written agreement, the Joint Venture Agreement, between the Plaintiff and the Group was a valid and/or a lawful, enforceable agreement in terms of the South African law;[93] and

(b) Whether or not the letter, the 'Verbiage of a bank guarantee', that was issued by the Defendant to the confirming bank was a fake financial document; and

(c) Whether or not the letter, the 'Verbiage of a bank guarantee', that was issued on the letterhead of the Defendant, was issued by an unauthorised employee of the Defendant[94]; and

(d) Whether or not the Defendant can be held delictually liable for the damages that the Plaintiff suffered as a result of the Defendants' negligent misstatement?[95]

2.4.5 Considerations[96]

2.4.5.1 Delictual liability

For the Plaintiff to succeed with his delictual claim against the Defendant he had to proof that the 5 (five) elements of a delict were present.[97]

The five elements of delict are the following: -

a. conduct;

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93 *Bernert v Absa Bank Limited* , ad paragraph 6 and 56.
94 *Bernert v Absa Bank Limited* , ad paragraph 4.
95 *Bernert v Absa Bank Limited* , ad paragraph 48,56 and 57.
96 Please note that for the sole purpose of this study, the only considerations that will be discussed are those concerning the legal question stated in 2.6.4 (d) with specific reference to the issuing of an ambiguous financial document (doubtfully referred to by the parties as: a letter of undertaking, guarantee and letter of credit) by the Defendant.
97 *Bernert v Absa Bank Limited* , ad paragraph 48.

b. negligence;
c. wrongfulness or unlawfulness;
d. legal and factual causation;
e. damages.

The claim against the Defendant is based upon a negligent misstatement that caused pure economic loss to the Plaintiff.[98]

The 'negligent misstatement' was contained in the letter that the legal representatives of the Defendant wrote to the confirming bank. According to the confirming bank and the Group the 'negligent misstatement' by the Defendant implied that the financial document (a letter that was also misleading in itself as a whole and/or in part) was unlawful and/or unenforceable as it specifically stated that the said financial document was fraudulently issued by an unauthorised employee of the Defendant.[99] Latter said 'negligent misstatement' was an action that was conducted by the Defendant and therefore proof the first element of a delict.

To determine whether or not the conduct was negligent, Ranchod AJ referred to the reasonable man or person test. The judge determined that the reasonable man in the position of the Defendant would have foreseen the likelihood that the written agreement between the Plaintiff and the Group would fail as a result of the writing and issuing of the letter by the representatives of the Defendant and would furthermore have safeguarded against such a result.[100] Consequently the conduct, in this case the misstatement by the Defendant, was made negligently.

'Pure economic loss' was caused to the Plaintiff as the Group cancelled their written agreement with the Plaintiff because the Bank and the Group

98 *Bernert v Absa Bank Limited* , ad paragraph 48.
99 *Bernert v Absa Bank Limited* , ad paragraph 49 - 51.
100 *Bernert v Absa Bank Limited* , ad paragraph 53.

were misled by the letter they received from the legal representatives of the Defendant. It implied that the said financial document could not be regarded as a formal undertaking as were required from the Plaintiff in terms of the written agreement between the parties. As a result thereof the Plaintiff was blacklisted which furthermore led thereto that no other financial institution would provide the Plaintiff with the much needed finance he required. A conduct is not purely wrongful and/or unlawful because it caused 'pure economic losses'.[101] Thus the question to determine the wrongfulness and/or unlawfulness of the conduct is based on whether or not there rested a legal duty on the Defendants to have exercised better care by insuring that the allegations that were made in the letter were as far as possible true and correct to the best of their knowledge. The judge also took into consideration the legal convictions of the community and determined that the community would expect that such a conduct by the Defendants, as mentioned above, should be actionable in a court of law.[102]

The judge furthermore and finally with regards to the delictual liability of the Defendant determined that factual and legal causality was established by the misstatement of the Defendant.[103]

2.4.5.2 Letter of Comfort

Despite the fact that volumes of evidence were led on the nature of the financial instrument issued by the Defendant, which was indirectly the cause of this dispute between the parties, same was neither defined nor was it characterised by the learned judge Ranchod in his considerations. The only consideration concerning the said financial instrument, that was

[101] *Bernert v Absa Bank Limited* , ad paragraph 54.
[102] *Bernert v Absa Bank Limited* , ad paragraph 54.
[103] *Bernert v Absa Bank Limited* , ad paragraph 55.

clear, was that the employee of the Defendant that signed the said financial document was authorised to do so.[104]

The following descriptions were used by the different parties to describe the said financial document during the court case: -

(a) **letter**[105] (as referred to by the legal representatives of the Defendant);
(b) **verbiage of bank guarantee**[106] (as stated on the financial instrument itself);
(c) **financial instrument** (as referred to by the Defendant in his applications);
(d) **formal undertaking**[107] (as interpreted by the Plaintiff, the Bank and the Group);
(e) **undertaking**[108] (as referred to by the agent of the Plaintiff);
(f) **letter of understanding**[109] (as referred to by the Defendant in a letter to the ICC[110]).

It is apparent that the said financial document was on its face and in itself as a whole and in part an ambiguous document and therefore it could not be defined or truly, with all certainty, be defined by any party to this matter or even the learned judge Ranchod, as a specific financial document.

2.4.6 Judgment

After taking the above mentioned considerations into account the honourable judge Ranchod found in favour of the Plaintiff and declared that the Defendant

[104] *Bernert v Absa Bank Limited* , ad paragraph 50.
[105] *Bernert v Absa Bank Limited* , ad paragraph 2.
[106] *Bernert v Absa Bank Limited* , ad paragraph 2.
[107] *Bernert v Absa Bank Limited* , ad paragraph 11.
[108] *Bernert v Absa Bank Limited* , ad paragraph 28.
[109] *Bernert v Absa Bank Limited* , ad paragraph 36.
[110] International Chamber of Commerce.

liable for the damages suffered by the Plaintiff. The Defendant was granted appeal.

2.5 Absa Bank Limited v Bernert (99/09) [2010] ZASCA 36[111]

2.5.1 Introduction

The above-mentioned case was heard in the Supreme Court of South Africa on 18 February 2010 and the judgment was delivered on 29 March 2010. This case is the appeal on the case as discussed in 2.6. The judges that heard the appeal were: Nugent JA, Cachalia JJA, Malan JJA, Tshiqi JJA, and Majiedt AJA.

2.5.2 Considerations

2.5.2.1 Delictual liability

The question with regards to the delictual liability of the bank, the appellant herein, was again under consideration in the appeal case. Thus, it had to be decided whether or not the appellant could indeed be held delictually liable towards the respondent in that all five elements of a delict were established by the action(s) of the appellant. As far as the court of appeal was concerned, the ruling of the court *a quo* with regards to delictual liability was incorrect as two of the elements of delict could not be verified, namely: causation and wrongfulness or unlawfulness.[112]

With regards to the first element of delict in question, namely causation, the court *a quo* decided that the actions of the defendant[113] led thereto that the transaction between the plaintiff[114] and the Sheik failed.

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111 Hereafter *Absa Bank Limited v Bernert.*
112 *Absa Bank Limited v Bernert* , ad paragraph 26.
113 Hereafter the appellant in the appeal case.
114 Hereafter the respondent in the appeal case.

> Therefore, the latter court found that causation was established as the actions of the appellant were factually and legally the cause of the failing of the said transaction.[115] None the less, the honourable judge Nugent stated in his considerations during the appeal hearing that he did not agree with the decision of the court *a quo* that a causative link was established as he was of the opinion that there was no evidence to prove that the transaction between the parties would indeed have been carried out as planned in terms of the written agreement. Therefore judge Nugent determined that the claim against the defendant could have failed on the element of causation alone as it was too speculative to begin with.[116]

Regarding the second element of delict in question, namely: wrongfulness and or unlawfulness, judge Nugent stated that delictual claims boil down to assessing how the appellant acted when it became aware of the said document.[117] The action on which the plaintiffs claim was based, was whether or not the letter that was sent by the legal representatives of the defendant to Emirates Bank was wrongful and or unlawful despite the fact that the statements that was made therein was incorrect. The appellant acted as follows:

The appellant retrieved the financial document after it became aware of its circulation by instituting proceedings against the respondents' agent, Mr. Franjek, requesting an order from the High Court to compel Mr. Franjek to return the said financial document.[118] Thereafter the appellant instructed its legal representatives to write a letter to the Bank, Emirates Bank, advising them that the said financial document was issued by an unauthorised person.

The plaintiff claimed that latter action of the appellant was wrongful, in that the letter falsely stated that Mr. Coetzee was authorised to sign the said financial

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115 *Absa Bank Limited v Bernert* , ad paragraph 22.
116 *Absa Bank Limited v. Bernert* , ad paragraph 22-25.
117 *Absa Bank Limited v Bernert*, ad paragraph 3.
118 *Absa Bank Limited v Bernert* , ad paragraph 55 – 57.

document although he had the authority to solicit fixed deposits,[119] and furthermore the plaintiff claimed that the letter was unlawful as it led to the cancellation of the written agreement between the respondent and the Sheik.[120] Therefore the drafting and issuing of the said financial document was also .considered by the appeal court. Mr. Els, an independent broker, attended to the drafting of the said financial document although he was not authorised to do any business on the part of the appellant as he was not an employee of the appellant.[121] On the one hand it can therefore be argued that the appellant may not be held liable for the actions of a private individual. Even so, in this particular matter the said financial document, although drafted by Mr. Els, was signed by Mr. Coetzee who was an employee of the appellant.[122] Mr. Coetzee stated in his evidence that he gave in the court *a quo* that Mr. Els advised him that a foreign client requested assurance in writing from the appellant that his money would be safe if he invested it with the appellant. Regardless, Mr. Coetzee was authorised to sign the said document and admitted in doing so. On that basis alone the court *a quo* ruled that the appellant was liable towards the respondent as the appellant negligently made misstatements which resulted in pure economic loss for the respondent.[123] Whereto judge Nugent stated that: [124]

> *I think it goes without saying that whatever authority Mr. Coetzee might have had, he had no authority to issue gibberish that had the potential to mislead, and that the issuing of gibberish that might mislead does not fall within the regular business of a bank.*

Consequently, the court of appeal declared that the said statements were not made to the respondent but to Emirates Bank. Therefore the loss that the

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[119] *Absa Bank Limited v Bernert* , ad paragraph 70.
[120] *Absa Bank Limited v Bernert* , ad paragraph 60 – 61.
[121] *Absa Bank Limited v Bernert* , ad paragraph 34.
[122] *Absa Bank Limited v Bernert* , ad paragraph 46.
[123] *Absa Bank Limited v Bernert* , ad paragraph 66.
[124] *Absa Bank Limited v Bernert* , ad paragraph 73 – 74.

respondent led was not incurred from his reliance on the statements.[125] According to the court of appeal the factual question that should be answered to decide whether or not the appellant acted wrongful and or unlawful was:

whether or not the appellant was obliged to permit Emirates Bank, and any other third party to whom the said document might have been presented, to rely upon the authenticity thereof?

The court of appeal answered the latter question by relying on the oral evidence of expert witnesses, Mr. Merritt and Mr. Van Tonder, who provided proof that the said document was without a doubt capable of misleading third parties**.** Consequently, judge Nugent declared that the appellant was clearly not obliged to allow any third party to rely on the said document if it would mislead them.[126] Therefore the court of appeal stated that the action that the appellant took when it became aware of the said financial document could not have led to the failing of the said written agreement between the respondent and the Sheik and furthermore the action could not be declared wrongful or unlawful on the part of the defendant.

2.5.2.2 Letters of Comfort

Judge Nugent declared that this matter is primarily based on documents, specifically the letter that was issued on the letterhead of the appellant. Although the court *a quo* stated that the document was 'strange and confusing' it was of the opinion that such a document is issued by banks on a regular basis. Whereas the honourable judge Nugent declared in the appeal hearing that: [127]

> *The document when read as a whole, was an aggregation of nonsense, decorated with financial terminology.*

[125] *Absa Bank Limited v Bernert* , ad paragraph 66.
[126] *Absa Bank Limited v. Bernert*, ad paragraph 71.
[127] *Absa Bank Limited v Bernert*, ad paragraph 15-16.

Latter statement was based on the evidence that was led that Mr. Franjek, the plaintiff's agent, composed the content of the financial document himself.[128] As a result thereof the content of the financial document was suspicious in itself.[129] The letter that was issued under the letterhead of the appellant was requested by the Sheik in terms of the written agreement between the Group and the respondent. The written agreement stated that: [130]

> *Once a formal undertaking and guaranteed interest rate is received in writing from the South African Banking Institution …*

The word 'undertaking' supposed a written assurance made by the appellant to the respondent. According to judge Nugent the assurance that was required by the Sheik could just as easily have been established by a telephone call from Emirates Bank to the appellant confirming same.[131] Nevertheless, the document in question was definitely complex.[132] Judge Nugent stated that: [133]

> *When all the terms are read together the document is a compendium of gibberish. I have no doubt that a document containing gibberish on the letterhead of a major financial institution is capable of misleading third parties as to its meaning…*

It is general knowledge that it is not normal banking practise to allow a client or his or her agent to draft financial documents and thereby binding a bank legally to the contents of the said document, as such actions will lead to further legal uncertainty with regards to the liability of a bank and create chaos in the banking industry.

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128 *Absa Bank Limited v Bernert*, ad paragraph 36.
129 *Absa Bank Limited v Bernert*, ad paragraph 36.
130 *Absa Bank Limited v Bernert*, ad paragraph 36.
131 *Absa Bank Limited v Bernert*, ad paragraph 41- 42.
132 *Absa Bank Limited v Bernert* , ad paragraph 47.
133 *Absa Bank Limited v Bernert* , ad paragraph 73.

2.5.3 Judgment

The Defendants' appeal was upheld and the order of the court *a quo* was set aside and substituted with an order that dismissed the claim of the Plaintiff with costs.[134] All the judges mentioned in 2.7.1 above, concurred in the latter judgment led by the honourable judge JA Nugent.

3. English Law

3.1 Instruments of payment, credit and investment[135]

3.1.1 Introduction

Instruments of payment, credit and investment, as defined and briefly discussed in paragraph 2.1.1 of this study, are internationally recognised financial instruments whether such instruments are negotiable or not. The reason for latter statement is that bills of exchange, cheques and promissory notes are not confined to commercial transactions in a specific country but are used world wide.[136] Furthermore we learned in paragraph 2.1.2 of this study that the South African legislation, the *Bills of Exchange Act* 34 of 1964, that regulates these instruments of payment in South Africa was derived from the English legislation namely the "*Bills of Exchange Act* of 1882". Therefore, it is essential for this study, being a comparative study, that we briefly consider the history and key rudiments of this mature English legislation that helped to construct and shape our young South African legislation as we know it today.

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134 *Absa Bank Limited v Bernert,* ad paragraph 76.

135 Hereafter also referred to as 'financial instruments', 'financial documents' or 'commercial Instruments'.

136 Malan *et al Malan on Bills of Exchange* 23.

3.1.2 Legislative history : " Bills of Exchange Act of 1882"

The Bills of Exchange Act of 1882[137] was drafted by a member of the English Bar, Sir MacKenzie Dalzell Chalmers, and became law on 18 August 1882 in England, as well as Scotland. The main purpose of the BEA was to codify the various laws that regulated bills of exchange, cheques and promissory notes as there were thousands of case law as well as a few statutory enactments which related to these said financial instruments. The predecessor of the BEA was the *Digest of the Law of Bills of Exchange* of 1878. It should be noted that the BEA did not replace the common law but only replaced the court decisions and legislations that preceded it. In *Bank Polski v KJ Mulder & Co* 1942 1 All ER 396 (CA) 398 the BEA was described as "the best drafted Act of Parliament that was ever passed".[138] Therefore, it is no wonder that the BEA was used to structure the South African *Bills of Exchange Act* 34 of 1964.

3.1.3 Liability in terms of the Bills of Exchange Act of 1882

As discussed in 2.1.3 the basis for liability of the parties to a financial instrument can either be based on contract or on delict depending on the claim and the circumstances that surround the specific matter. As we have already discussed how liability can occur to the different parties to a financial instrument in terms of their contractual relationship towards each other and, as the same applies to the BEA, we will only refer to the definitions, duties and responsibilities as regulated by the BEA pertaining to the most frequently used financial instruments such as bills of exchange and more specifically cheques as this study focuses on the liability of a bank. The reason for this is that the duties and responsibilities referred to create the basis for liability applicable to the various parties to a financial instrument whether the liability is contractual or delictual.

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[137] Hereafter referred to as : 'BEA'.
[138] Malan *et al Malan on Bills of Exchange* 24.

A cheque is a specific bill of exchange, therefore it is important to begin with the definition of a bill of exchange in terms of the BEA: [139]

> *A bill of exchange is an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future date, a sum certain in money to or to the order of a specified person or to bearer.*

From this definition all the duties and responsibilities of the different parties to a bill of exchange can be assembled. It is unambiguous that a bill of exchange is addressed by one party to another, a bill of exchange is payable at either a fixed or determinable future date or on demand thereof, and the amount payable is a sum certain in money.[140] The most important points that arise out of the above stated definition, but are not dealt with in the definition itself, are: [141]

(a) that the bill of exchange can only be 'unconditional' if the duty to pay is not subject to the occurrence of a unforeseen event and the bill of exchange is expected to embody a general duty of the party to whom it is addressed;
(b) that the party to whom the bill of exchange is addressed, does not become liable to meet the terms of the bill of exchange unless he or she accepts the duty by signing the bill of exchange;[142]
(c) that if the bill of exchange is not complete then the recipient thereof may be at liberty to complete the bill of exchange and the drawer may then be banned from denying the legality and content of the bill of exchange against the drawee bank and certain other parties.

Furthermore in terms of the BEA a cheque is defined as:[143]

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139 S 3(1) of 1882 ; Proctor *The Law and Practice of International Banking* 314.
140 Proctor *The Law and Practice of International Banking* 315.
141 Proctor *The Law and Practice of International Banking* 314-315.
142 "Take note that acceptance by a bank of a cheque neither occurs if the bank has assumed liability for the payment of the cheque nor does acceptance occur by the issue of cheque forms" ; Proctor *The Law and Practice of International Banking* 316.

> *… a bill of exchange drawn on a banker payable on demand …*

Accordingly, a cheque has two extra requirements that are not applicable to bills of exchange in general. Firstly a cheque must be addressed to a bank and secondly it must be payable on demand thereof.[144] It is therefore once again clear that these duties and responsibilities that apply to the different parties to a bill of exchange establish a contractual relationship between the parties. Thus the general principals of the law of contract apply.

3.2 Banker – customer relationship

3.2.1 Introduction

To understand the concept 'banker-customer relationship', we first have to try to define or describe the lawful meaning of 'bank', 'banker', 'banking business' and 'customer'.[145]

3.2.1.1 Description of a 'bank', 'banker' and 'banking business'

To ultimately answer the question : 'What is a banker?' is not a simple task, the reason being that the business of banking is constantly evolving. Consequently, there is no longer only one type of institution that can be labelled as a 'bank' seeing that what was universally known to be a 'banking business' is not convincing anymore.[146] To date there have been many common law as well as statutory definitions or rather descriptions given to 'banking business' and/or 'bankers', but none of which, in reality,

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143 S73 of 1882 ; Proctor *The Law and Practice of International Banking* 315.
144 Proctor *The Law and Practice of International Banking* 315-316.
145 Megrah and Ryder *Paget's Law of Banking* 3; Proctor *The Law and Practice of International Banking* 297.
146 Megrah and Ryder *Paget's Law of Banking* 3.

present universal suitable descriptions. Therefore, the said descriptions should be read in the context of the statutes in which they are found and the background of the cases in which they were given.[147]

Probably the most respected common law description of 'banking business' is that of the court in *United Dominions Trust Ltd. v Kirkwood* 1966 2 QB 431 (CA). In latter case the court drew on the usual characteristics of banking as set out in the textbook: *Paget's Law of Banking*. Lord M R Denning stated:[148]

> *There are, therefore, two characteristics usually found in bankers today: (i) They accept money from, and collect cheques for, their customers and place them to their credit, (ii) They honour cheques or orders drawn on them by their customers when presented for payment and debit their customers accordingly. These two characteristics carry with them also a third, namely: (iii) They keep current accounts, or something of that nature, in their books in which the credits and debits are entered.*

The latter common law definition was given before the demeanour of deposit-taking formed part of the 'banking business' and before such conduct was regulated by legislation such as the *Banking Act* of 1979 in England. Therefore, as nowadays, the 'banking business' entails the acceptance of deposits from customers which in itself requires authorization or consent. Consequently, a 'bank' also refers to an institution that can grant such an authorization or consent to a customer. It should further be noted that an institution that only takes on the business

147 Megrah and Ryder *Paget's Law of Banking* 3-4.

148 Megrah and Ryder *Paget's Law of Banking* 3-4; Cranston *Principles of Banking Law* 4; Proctor *The Law and Practice of International Banking* 298.

of lending its own money will not and cannot be distinguished as a 'bank.'[149]

Given that, we have established the lawful meaning of 'bank' and 'banking business'. The BEA provides a simple statutory definition of a 'banker', namely: [150]

> *Banker' includes a body of persons whether incorporated or not who carry on the business of banking.*

3.2.1.2 Description of a customer

Now that we have comparatively established what a banker is, the second question that we must answer is : 'Who is a customer?' Again, the question cannot be answered in one simple sentence as there does not appear to be a sufficient definition for a 'customer' that is universally applicable in all circumstances where a service is rendered.[151] If we take the discussion of the meaning of a 'bank', 'banker' and 'banking business' in 3.2.1.1 above into consideration, it is logical that a 'customer' must be a person that makes use of the services provided by a 'bank' and/or a 'banker' whose services represent the 'banking business'.[152] Although, as mentioned previously, there is no universal definition for a 'customer', one of the earliest common law descriptions that is definitely worth pointing out, is the decision that was held in *Commissioners of Taxation v English, Scottish and Australian Bank* 1920 A.C. 683[153] where it was determined

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149 Proctor *The Law and Practice of International Banking* 298.
150 Megrah and Ryder *Paget's Law of Banking* 4.
151 Proctor *The Law and Practice of International Banking* 298.
152 Proctor *The Law and Practice of International Banking* 298.
153 It was decided by the Judicial Committee of the Privy Council in 1920 that : *"Their Lordships are of opinion that the word 'customer' signifies a relationship in which duration is not of the essence. A person whose money has been accepted by a bank on the footing that they undertake to honour cheques up to the amount standing to his credit is, in the view of their Lordships, a customer of the bank in the sense of the statute, irrespective of whether his connection is of short or long standing. The contrast is not between a habitué and a*

that the duration of the relationship between a bank and a customer is not essential to determine whether or not a banker-customer relationship has been established.[154] It should, however, be kept in mind that not each and every transaction between a bank or banker and a member of the public will be granted the status of 'customer to the particular person'.[155]

3.2.2 Nature of the relationship

First and foremost it should be settled that the banker-customer relationship is based on a general contract. The said contract that arises between a banker and his or her customer is an unwritten contract, thus an implied contract, better known as a mandate.[156] The mandate between the said parties can be described as that of a debtor and creditor.[157] The contract comes into being the instant the said parties agree to enter into a contractual relationship with each other and the agreement will only come to an end by mutual consent or the revocation by either party.[158] Although several implied terms of the banker-customer contract have been developed by the courts over the years, the situation with regards to the terms of a banker-customer contract has changed.[159] The reason for this is that in this day and age there is a need for lucidity and fair dealing as the customer wants to be properly informed by the banker about the services for which he or she has to pay and the costs that such services will entail. Therefore, if a bank does set out the terms of the banker-customer contract in a written agreement between the parties, the express terms contained

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newcomer, but between a person for whom the bank performs a casual service, such as, for instance, cashing a cheque for a person introduced by one of their customers, and a person who has an account of his own at the bank."; Megrah and Ryder *Paget's Law of Banking* 22.

154 Proctor *The Law and Practice of International Banking* 298.

155 Proctor *The Law and Practice of International Banking* 299-300.

156 Megrah and Ryder *Paget's Law of Banking* 69; Proctor *The Law and Practice of International Banking* 302.

157 Megrah and Ryder *Paget's Law of Banking* 69-70.

158 Megrah and Ryder *Paget's Law of Banking* 69.

159 Proctor *The Law and Practice of International Banking* 302.

in the said written agreement will not usually be considerably different from the implied terms which have been developed by the courts.[160]

In view of the fact that a bank is a financial service provider with the objective of generating a profit out of its business activities, it is only reasonable that its duties, or rather obligations to its customers, are fairly more comprehensive than the obligations of the customers to the bank itself whether or not the terms of the contract are express or implied.[161] Consequently, for the purpose of this study, it is necessary to point out some of the core obligations of a bank to its customer and *visa versa* as these obligations and also any other obligations that may arise out of the banker-customer contract will place a liability on the said relevant party. Therefore, although it is not possible to provide a complete list of each and every obligation and right a bank may incur, the following obligations and rights are but a few that may arise in a banker – customer contract:[162]

(a) the collection of cheques and the receiving of funds for the account of the customer ;
(b) the repayment of the customer's account balance on demand at the account-holding branch ;
(c) the honouring of the customer's written orders against the account ;
(d) in order to permit the clearance of outstanding cheques the bank must give reasonable notice to the customer before terminating the bank-customer relationship by repayment of the credit balance to the customer ;
(e) unless it is requested by the customer, a bank is not obliged to give advice regarding the tax position of a customer or the insight of a course of action which it intends to take ;

[160] Proctor *The Law and Practice of International Banking* 302.
[161] Proctor *The Law and Practice of International Banking* 303.
[162] Proctor *The Law and Practice of International Banking* 303-304.

(f) it is not a requirement that the bank advise a customer when it offers a new product which may offer conditions more beneficial than the current product used by the customer ;

(g) there is no obligation on a bank to give notice to a customer of a decision to deny margin finance on future transactions ;

(h) **the bank has the right to hold over fulfilment of the customer's instructions whilst there is uncertainty as to their legality and or outcome ;**

(i) a bank's primary relationship is with its own customer, therefore a bank does not have a duty of care to a future beneficiary of an intended payment in the event that the payment is not effected, although it may incur a liability to its own customer for the consequences of its failure to act on instructions ;

(j) a collecting bank has no general obligation to protect a paying bank from the theft and/or fraudulent amendments to a cheque.

On the other hand, the obligations and rights that the customer may incur in terms of the banker-customer contract have fairly distinct boundaries. The following are a few of the obligations and rights of a customer that may arise out of banker-customer contract:[163]

(a) the customer has a general duty of care that he or she must exercise when drawing a cheque ;

(b) the customer has an obligation to disclose any known forgery to the bank ;

(c) the customer has an obligation to protect the bank against the consequences of forgery or fraud relating to their accounts.[164]

[163] Proctor *The Law and Practice of International Banking* 304-308.

[164] "The courts however have been very hesitant to extend the duties of the customer with regard to this obligation" ; Proctor *The Law and Practice of International Banking* 307.

3.3 Delictual liability

3.3.1 The liability of a bank : advice liability

In 3.2.2 we settled that the banker-customer relationship is based on contract which contractual relationship enforces various rights and duties on the different parties. In order to recognize and understand the liabilities that these rights and duties may impose on the said parties, we need to identify their different derivations.[165] The derivations, the different delict, equity, restitution and statute.[166] As this study solely focuses on the delictual liability of a bank we will only discuss 'delict' as the basis of a bank's liability.

There are two main legal issues regarding the giving of advice to a customer by a bank or rather a banker. The first issue that we need to deal with is: Under what circumstances is there an obligation on a bank to provide a customer with advice? To answer this question, the general rule with regards to the giving of advice is that a bank is under no obligation to give advice to its customer about the nature, prudence or the other features of a transaction. There have been many court cases where the English law has decided that there was no obligation on one party to reveal matters to the other party although the matters that were not revealed were especially relevant to the transaction.[167] Nevertheless, there are several situations that have been recognized by the English law that impose a duty to advice on a bank and circumstances where a bank is required to provide the customer with advice, namely: [168]

(a) when there is a misrepresentation by the bank;[169]

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165 Cranston *Principles of Banking Law* 184.
166 Cranston *Principles of Banking Law* 184.
167 Cranston *Principles of Banking Law* 206.
168 Cranston *Principles of Banking Law* 207 – 209.
169 A failure to speak or act can amount to conduct which may mislead. Where a statement is made falsely a bank must correct the false statement before the transaction is closed. Conduct which is capable to lead to an estoppel may also bring forth a claim for misrepresentation. Reliance is essential to a misrepresentation claim and a customer may

(b) where there is a voluntary assumption of the responsibility to disclose information during pre-contractual negotiations ;

(c) if a bank commences by giving advice to its customer it is obliged to *"explain fully and properly";*[170]

(d) when the relationship between the bank and its customer has a fiduciary character disclosure is necessary in order to avoid liability as liability may be incurred if interest is set above duty or duty to one customer is set above duty to another customer;

(e) in terms of the English common law a bank that takes a guarantee is bound to disclose abnormal features in the transaction which has been guaranteed;

(f) a duty to advise can also be incurred in terms of regulation.[171]

Secondly, what is the liability of a bank if the advice that it gave to its customer was faulty and the customer suffered loss as a result of the faulty advice he or she received from the bank or rather banker"?[172] To start with, it should be noted that advice could be given by a bank to its customers or to third parties. Delictual liability allows a customer or a third party to sue a bank for negligent and/or fraudulent advice. Nevertheless, it may still be necessary to prove a contractual nexus between the negligent and/or fraudulent advice given by the banker and the damages suffered by its customer or a third party. To date, fraudulent advice is atypical when dealing with a misrepresentation, although it is not entirely unknown. Although there is generally no liability in English law for pure economic loss. Negligent advice has been made out as the main exception to latter rule.

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not always be able to show that he or she was led to believe the misrepresentation that was being made and that it solely relied on it ; Cranston *Principles of Banking Law* 207.

170 Held by judge Glidewll LJ in *Cornish v Midland Bank* 1985 3 All 513, 520 ; Cranston *Principles of Banking Law* 207.

171 The UK Banking Codes was adopted as a governing principle and proclaims that banks will seek to give customers a good understanding of banking services and products ; Cranston *Principles of Banking Law* 208.

172 Cranston *Principles of Banking Law* 210 – 212.

Hedley Byrne & Co. Ltd. v Heller & Partners Ltd 1964 AC 465[173] is the decisive case in English law with regards to delictual liability as a result of negligent advice.[174] It was determined in latter case that liability depends on the following:[175]

(a) the conjecture of responsibility by a bank ;
(b) an acceptably close relationship between the bank, its customer and/or a third party ;
(c) a reliance on a statement made by the bank or rather banker.

In the '*Hedley Byrne'* case the bank avoided liability as a result of a provision in the reference. The decision by the English court would appear to be correct, the reason being that, as a matter of policy, a bank should be able to avoid the consequences of giving negligent advice if it provides the parties that received the advice with proper notice that the advice they received was false. Therefore, as a matter of policy, whether this is regarded theoretically as terminating liability or as being exempted from liability, it does not matter and is beside the point. Regardless, it is essential to note that, the crucial problem, the false statement, is made evident by the bank to the parties receiving the advice. Thus, the said parties can not be in any doubt that the bank is washing its hands of the consequences if the advice proves to be inappropriate or wrong. A small print clause in a document given to the customer or third party is not regarded as being appropriate advice as stated above. The English law will in this regard apply the unfair contract terms legislation to determine whether or not appropriate advice was given by the bank.[176]

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173 Hereafter referred to as : '*Hedley Byrne'* case
174 Cranston *Principles of Banking Law* 184 and 210 – 212.
175 In the '*Hedley Byrne'* case the court took into consideration: the purpose for which the statement was made and communicated to the customer and or third party, the knowledge of the bank with regards to the particular advice that was needed for the specific purpose, the relationship between the bank and the persons relying on the advice, and also the size of the class to which the latter belongs ; Cranston *Principles of Banking Law* 184 and 210 – 211.
176 Cranston *Principles of Banking Law* 212.

Not only is a bank able to incur liability for negligent advice when it gives false information and/or make a false statement but also in a range of other matters in which a bank becomes involved in such as:[177] (i) the failure to pass on information when a bank takes on the task of advising a possible borrower about the risks of a specific facility; **(ii) the statements made by a bank that it will make obtainable to a customer sufficient funds to enter into a contract with a third party**; (iii) advice about investments; (iv) guarantees that procedures are heading in the right direction and that the bank is positive about an agreement being reached.

3.3.2 Cheques in general

As we have already introduced and briefly discussed cheques as an instrument of payment in 2.2.1, there is no need to discuss cheques in detail with regards to the English law as they are international instruments of payment and the basic rules of payment thereof remain the same in each and every country. Nevertheless, it should be noted that during December 2009 the Payments Council Board of the United Kingdom determined that the central cheque clearing system should close by 31 October 2018. This decision will be reviewed during 2016 to make sure that the 2018 target date remains realistic. The decision by the said counsel to manage the phasing out of the cheque as instrument of payment in general, is primarily based on the sudden decline in cheque use in the United Kingdom and the unreasonable cost implication it would have if the use of cheques would be allowed to die a slow death. [178] As a result of the phasing out of cheques as an instrument of payment, the use of electronic payment instruments will increase drastically and consequently lead thereto that regulations such as the Payment Services Regulations 2009 will become even more important in the future.[179]

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[177] Cranston *Principles of Banking Law* 211.
[178] Proctor *The Law and Practice of International Banking* 313 and 321.
[179] Proctor *The Law and Practice of International Banking* 314.

3.3.3 The liability of the paying bank

In 3.3.1 we considered the liability of a bank in general with specific reference to advice being given by a banker to a customer and or a third party. In the present paragraph we will discuss the liability of the paying bank towards its customer and/or third parties to the transaction. First and foremost, a bank is regarded as a paying bank when its main duties include: (i) meeting cheques and (ii) making payments at the request and account of its customer.[180]

Before we discuss the circumstances in which a paying bank may be held liable to its customer and/or third parties, we must first acknowledge and point out the various statutory provisions intended to protect the paying bank.[181] With regards to payment made 'in due course', section 59 of the BEA protects the paying bank.[182] Regardless, in this day and age the modern systems for cheque clearance make it difficult for this provision to be applied in reality as the paying bank simply receives an electronic message and will often not receive the original cheque until after payment has been made.[183] Section 64 of the BEA protects the paying bank in that a cheque which is 'materially altered' without the consent of the drawer is to be avoided by the paying bank.[184] Furthermore, the paying bank is protected by section 60 of the BEA as it will be considered that payment of a cheque was done in due course, when it pays a cheque that is payable to order in good faith and in its regular course of business, even though the indorsement of the payee or a subsequent indorsee made on the instrument is forged or unauthorised.[185] Also, if all the requirements stated in section 80 of

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180 Proctor *The Law and Practice of International Banking* 321.

181 Proctor *The Law and Practice of International Banking* 331 - 332.

182 S59 of the BEA provides as follow : (a) a cheque is discharged by 'payment in due course' by the bank upon which it is drawn and (b) 'payment in due course' means payment on or after the date of the cheque to the holder in good faith and without notice that his title to the cheque is defective ; Proctor *The Law and Practice of International Banking* 332.

183 Consequently, the paying bank does not know the identity of the 'holder' of the cheque nor can it examine the cheque to determine whether the 'holder's' title may be defective.

184 'Materially altered' in this context has the meaning of : a change that was made to the date or the sum payable on the cheque.

185 Proctor *The Law and Practice of International Banking* 333.

the BEA are met, the paying bank is protected in that it is deemed that it has effected payment in due course to the true owner of the cheque whether of not that is truly the case.[186] Finally, section 1 (1) of the *Cheques Act* 1957 also protects a paying bank and provides that the bank does not incur liability where the bank acted in good faith and in its regular course of business in paying out a cheque drawn on it in circumstances where the cheque is not indorsed or irregularly indorsed.[187]

Even though the paying bank is entitled to the protection of the statutory provisions as mentioned in the former paragraph because it is based on a contractual relationship between the paying bank and its customer, the bank will not be protected against the payee and or any other third party as there is no contractual relationship between the said parties.[188] Thus, a payee and or third party seeking recourse against a paying bank for actions that were taken by the said bank, will have to rely either on conversion, negligence, and/or a claim based on 'dishonest assistance' in breach of trust.[189] Latter two grounds for liability are especially relevant to this study therefore will be discussed briefly.

With regards to negligence as a ground for liability, it appears as though there is no basis on which a paying bank could be obliged to exercise a duty of care to the payee of a cheque in deciding whether or not the instrument should be paid, the reason for the former statement being that a duty of care towards the payee could clash with the bank's reasonable obligation to its own customer.[190] 'Dishonest assistance' as a ground for liability entails that if a payee bank unlawfully assists in the fraud of money by a trustee or other fiduciary may incur a liability to the beneficiaries or principal as a consequence thereof. In *Royal Brunci Airlines Sdn Bhd v Tan* 1995 AC 378 (PC) the Privy Counsel stated that

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186 The requirements under section 80 of the BEA include the following : (i) a bank pays a cheque that is drawn on it in good faith and (ii) without negligence to a banker or to another bank as its agent for collection ; Proctor *The Law and Practice of International Banking* 334.

187 Proctor *The Law and Practice of International Banking* 334.

188 Proctor *The Law and Practice of International Banking* 335.

189 Proctor *The Law and Practice of International Banking* 335.

190 Proctor *The Law and Practice of International Banking* 335.

(i) a person who deliberately and fraudulently assists in the communication of a breach of trust or a related fiduciary duty may be liable to reimburse the beneficiaries of that duty for their loss, (ii) the defendant, the paying bank, must have taken certain steps which may assist in the breach of trust or any other duty, (iii) the assistant party can only be made liable if he or she acted fraudulently therefore the sheer knowledge of a fraudulent plan on the part of the trustee would not be enough to impose liability on the assisting party.[191]

3.3.4 The liability of the collecting bank

After discussing the liability of the paying bank, we now turn to the collecting bank and the liability that it has to its customer and or third parties. Before we can discuss the liabilities of the said bank we will briefly mention the role of the collecting bank in the payment process. In short, the collecting bank seeks payment from the paying bank on the customer's behalf. It should be noted that the collecting bank is entitled to an agent's general indemnity where it acted without any fault on its part. The said indemnity entails that the collecting bank may reverse the relevant entry and also debit the account of its customer accordingly in a situation where a cheque, which is in the interim credited to the customer's account, is later dishonoured by the paying bank.[192]

Not only the paying bank but also the collecting bank is protected by statutory provisions. Nonetheless, it should be noted that almost all the cheques in our modern society are non-transferable cheques which have a considerable impact on the availability of the statutory protections.[193] The first statutory provision to be mentioned that provides protection to a collecting bank is found in section 2 of the Cheques Act 1957.[194] This section provides that a collecting bank which has given value for a cheque, a cheque that was delivered to it for collection and is

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[191] Proctor *The Law and Practice of International Banking* 336.
[192] Proctor *The Law and Practice of International Banking* 340.
[193] Proctor *The Law and Practice of International Banking* 341.
[194] Section 2 of the Cheques Act 1957; Proctor *The Law and Practice of International Banking* 341.

payable to order, has the same rights as if the cheque had been indorsed to it. The former implies that the collecting bank could become a holder and given the right to sue the drawer on a cheque accordingly.[195] Also, section 27(3) of the BEA provides that if a bank, a collecting bank, has a lien on a cheque it is considered to be a holder for value to the amount of the lien. Thus, as mentioned above, in our modern day and age these provisions will not be applicable with regards to non-transferable cheques.[196]

On the other hand, section 4 of the Cheques Act 1957 has been amended in terms of the Cheques Act 1992 and is an important source of protection for the collecting bank as the said provision provides that when a banker, who acts in good faith and without negligence, receives payment for a customer of an instrument or has credited a customer's account with the amount of an instrument and receives payment for himself or herself and the said customer has no title or a defective title in terms of the instrument, the banker will not incur any liability to the true owner of the said instrument.[197] The said instruments of payment may include a cheque (also non-transferable cheques) and or any other instrument issued by a customer allowing a person to acquire payment from the said banker for the sum stated in the document. [198]

All in all, there are four potential causes of action on which a collecting bank may incur liability to the true owner of a cheque if a banker collects payment for a person who is not entitled to receive payment in terms of the said cheque.[199] We will again only briefly discuss negligence as a cause of action. Therefore, with regards to negligence as a cause of action, it has been held by the English courts in *Abou-Ramoh v Abacha* 2005 1 All ER (Comm) 247 that a collecting bank does

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195 Proctor *The Law and Practice of International Banking* 342.
196 Proctor *The Law and Practice of International Banking* 342.
197 Section 4(1)(a) and (b) of the Cheques Act 1957 as amended; Proctor *The Law and Practice of International Banking* 342.
198 Section 4(2) of the Cheques Act 1957 as amended; Proctor *The Law and Practice of International Banking* 342.
199 The four causes of action are : (1) conversion, (2) monies had and received, (3) knowing receipt and (4) negligence ; Proctor *The Law and Practice of International Banking* 346.

not owe any duty to the drawer of a cheque collected by the said bank for the account of its customer. The former decision was based on the following grounds:[200]

(a) there is no assumption of a duty of care between the collecting bank and the drawer ;
(b) the obligation of a duty of care might cause conflict between the collecting bank and its own customer as they must perform their contractual duties owed to each other ;
(c) the collecting bank has no contact with the drawer of a cheque until it receives the instrument for payment.

Furthermore, it has been decided in *Yorkshire Bank plc v Loyds Bank plc* 1999 2 All ER (Comm) 153 that a collecting bank does not owe a duty to protect the paying bank against losses flowing from the theft and fraudulent changes made to a cheque. Thus, to conclude, the collecting bank will only in exceptionally unusual circumstances incur liability towards the drawer of a cheque when funds are misappropriated as a result of a fraud coordinated by the collecting bank's own customer or as a result of the loss or theft of the cheque.[201]

3.4 Letters of Comfort[202]

3.4.1 Background

Letters of comfort emerged on the commercial scene in the 1960's when they attracted the attention of lawyers world wide.[203] Even so, letters of comfort only

[200] Proctor *The Law and Practice of International Banking* 347.
[201] Proctor *The Law and Practice of International Banking* 347.
[202] Also referred to in English as : comfort letter, letters of support, letters of awareness, letters of responsibility and/or keep–well letters, and sometimes these letters are even seen as letters of intent. In Afrikaans they are referred to as 'gerusstellingsbriewe'. ; Trichardt "Comfort letters are like boomerangs... they tend to come back" 57 footnote 1 ; Trichardt "Comfort letters – quartet of decisions interrupts the judicial quiescence" 162 footnote 1.
[203] Trichardt "Comfort letters – quartet of decisions interrupts the judicial quiescence" 162.

received the attention of the English courts in 1985 in two court cases, namely : *Chemo Leasing Spa v Rediffusion plc*[204] and *Re Augustus Barnett & Son Ltd.*[205] However, the legal status of letters of comfort was somewhat uncertain in terms of the common law until they were brought into the spotlight in 1988 by the English courts in *Kleinwort Benson Ltd v Malaysia Mining Corporation Bhd* 1989 1 All ER 785[206] where it was held that a letter of comfort was held to be contractually binding on the parties thereto and that it could impose liability on the writer thereof.[207] After said court decision, letters of comfort received the attention of various high courts in many common law countries.[208] Thereafter, the English Court of Appeal overruled that said decision and stated that the letter of comfort used in the *Kleinwort Benson* case was not adequately promissory to find a legal obligation because it merely referred to the policy of the holding company with regards to its subsidiary.[209] Latter decision opened up a world wide debate.

3.4.2 Introduction

A lender is not always in a position to insist that a borrower provide it with a traditional form of security such as a guarantee, mortgage or other form of surety in order to secure a loan.[210] Equally, a borrower may also not always be in a position to provide such security as mentioned.[211] Therefore, the business world developed, a financial instrument, namely a letter of comfort. Letters of comfort are financial instruments that are often used in business transactions as a replacement or an alternative to traditional forms of security and also to add onto

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[204] Unreported QBD, 19 July 1985 ; Trichardt "Comfort letters – quartet of decisions interrupts the judicial quiescence" 163.
[205] [1986] BCLC 170 (ChD) ; Trichardt "Comfort letters – quartet of decisions interrupts the judicial quiescence" 163.
[206] Hereafter referred to as : "*Kleinwort Bensen*".
[207] Trichardt "Comfort letters – quartet of decisions interrupts the judicial quiescence"163.
[208] Trichardt "Comfort letters are like boomerangs... they tend to come back" 54.
[209] Trichardt "Comfort letters – quartet of decisions interrupts the judicial quiescence"163.
[210] Trichardt "The comfort letter trap" 46.
[211] Trichardt "The comfort letter trap" 46.

or shed light on loan documents for commercial considerations.[212] Despite their name, letters of comfort are definitely not letters that contain statements of commiseration, pity and or sympathy. In contrast, letters of comfort can be defined as letters that are often written by a parent company or a holding company to lenders providing comfort by acknowledging a liability concerning a loan made to its subsidiary.[213] Thus, it may as well be said that a letter of comfort was designed or intended to find a middle ground between a guarantee provided by the parent company and a concession which gives no undertaking at all by the parent company of the debts of its subsidiary.[214] A transaction that is based on a letter of comfort entails three different relationships, namely : (i) the relationship between the lender and the subsidiary, (ii) the relationship between the lender and the parent company and (iii) the relationship between the parent company and the subsidiary.[215]

Letters of comfort frequently contain vague or undependable words and/or expressions by suggesting promises and/or commitments and then evading those promises and/or suggested commitments.[216] The reason would most likely be that none of the parties involved in a business transaction regularly pay a great deal of attention to a letter of comfort unless the financial position of the borrower changes for the worse and there is a chance that the loan may not be paid back to the lender. Only if the former situation arises will a lender attempt to enforce the letter of comfort against the borrower.[217] On the other hand, the parent company or holding company will insist that the letter of comfort was not intended to be a legally binding document and that it was merely a "gentlemen's agreement". Furthermore, the borrower will uphold an unbiased position as he or

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212 Trichardt "Comfort letters are like boomerangs... they tend to come back" 54 ; Trichardt "The comfort letter trap" 46.

213 Trichardt "Comfort letters are like boomerangs... they tend to come back" 54.

214 Trichardt "The comfort letter trap" 46.

215 Trichardt "Comfort letters are like boomerangs... they tend to come back" 57.

216 It has been ascribed to Stewart Chaplin's story "Stained Glass a Political Platform" that letters of comfort may contain "weasel words". "Why, weasel words are words that suck the life out of the words next to them, just as a weasel sucks the egg and leaves the shell." ; Trichardt "Comfort letters are like boomerangs... they tend to come back" 55 footnote 4.

217 Trichardt "Comfort letters are like boomerangs... they tend to come back" 54.

she will not be in a position to do anything.[218] Nevertheless, depending on the language used in the letter of comfort and the circumstances of the transaction in general, the letter of comfort may not only be a moral obligation, but also constitute a binding declaration or legal obligation.[219]

3.4.3 Liability

In recent court cases held in America and Australia the legal enforceability of letters of comfort have been revised as it was decided that legal liability based on a letter of comfort is a genuine possibility.[220] Two of the latest court cases that dealt with letters of comfort were *Lasalle Bank National Association v Citicorp Real Estate Inc* (Unreported July, 18, 2003)[221] heard in New York, America, and *Gate Gourmet Australia Pty Ltd v Gate Gourmet Holding AG* 2004 N.S.W.S.C 149 (Sup Ct (NSW))[222] heard in New South Wales, Australia. In both these two cases it was decided what the right approach is in determining whether or not a letter of comfort is legally binding. Consequently, it was held that in order to give proper effect to commercial transactions where a letter of comfort is involved, the meaning of the words "contained in the letter of comfort" must be examined against what the particular circumstances where at the time when the letter of comfort was drafted and presented.[223] In *Lasalle Bank* it was decided that the enforceability of a letter of comfort depends on the following factors[224] : (i) the language of the letter of comfort (whether the letter of comfort contain the words : 'guarantee', 'contract' and or any other word that may be seen as a promise), (ii) the context in which the letter of comfort was written and provided (external factors such as: the sophistication of the parties, whether or not the parties required legal advice as to the meaning and implication of the letter of comfort,

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218 Trichardt "The comfort letter trap" 46.
219 Trichardt "Comfort letters are like boomerangs... they tend to come back" 54.
220 Trichardt "Comfort letters are like boomerangs... they tend to come back" 54.
221 Hereafter referred to as : "*Lasalle Bank*".
222 Hereafter referred to as : "*Gate Gourmet*".
223 Trichardt "The comfort letter trap" 50 ; Trichardt "Comfort letters are like boomerangs... they tend to come back" 57.
224 Trichardt "The comfort letter trap" 47 – 48.

oral representations and preceding dealings between the parties, the way in which the letter of comfort are recognized in a specific trade, profession or business, the parties' reasons for issuing and accepting a letter of comfort, the role the letter of comfort played in the transaction) and (iii) if the lender relied on the terms, whether express or implied, in the letter of comfort.[225] Furthermore, both of the decisions confirmed that a letter of comfort could lead not only to contractual liability but also to liability based on promissory *estoppel* or misleading conduct.[226]

A letter of comfort may therefore in certain circumstances constitute a legal obligation that could cause the parent or holding company to incur liability on behalf of the subsidiary contrary to the objective of the parent company in issuing the letter of comfort.[227]

4. Comparative analyses

As this is a comparative study, the South African law will be compared with the English law in order to see whether or not the South African courts should consider the decisions made by the English courts as lessons that may be learned from the English law.

Firstly, it has been established that both the South African legislation, the Act, [228] as well as the English legislation, the BEA, [229] regulate the rights and obligations of the different parties to instruments of payment, specifically negotiable instruments such as cheques. Latter statement does not come as a surprise as the said South African legislation is based on and influenced by the said English legislation.[230] Thus, we have established what can be seen as an instrument of

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225 Trichardt "The comfort letter trap" 47 – 48.
226 Trichardt "The comfort letter trap" 50.
227 Trichardt "Comfort letters are like boomerangs ... they tend to come back" 54.
228 34 of 1964.
229 The Bills of Exchange Act of 1882.
230 Malan *et al Malan on Bills of Exchange* 34; 36 – 37.

payment and that the liability of the different parties to a negotiable instrument is usually based on contract as a contractual relationship exists between the said parties in both South Africa and England.[231] The former statement is important as it will enable us to recognise whether or not a contractual relationship has been established between the parties to an instrument of payment or any other financial document and whether or not the said instrument of payment or financial document can be seen as a financial instrument or document utilised on a day to day basis by a financial institution.

Secondly, we now turn to the delictual liability of parties to an instrument of payment. In order to establish whether delictual liability can exist between the parties of an instrument of payment, we discussed the liability of the paying bank and the collecting bank towards their customers where a cheque was used as an instrument of payment between the said parties. We established that in terms of both the South African law and the English law that the question regarding the liability of the drawee bank (the paying bank) and the collecting bank towards the owner of a cheque is a delictual question.[232] Accordingly, we learned that a true owner of a cheque or a third party who wants to take recourse against a paying bank would have to rely either on conversion, negligence or a claim based on 'dishonest assistance' in breach of trust as a cause of action and where a collecting bank is involved, the true owner or third party would have to rely on conversion, monies had and received, knowing receipt or negligence as a cause of action.[233]

We took a closer look at a few English court decisions[234] and established that the relationship between a bank and a customer, which we referred to as the banker-

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231 Malan *et al Malan on Bills of Exchange* 228; 230 – 231.

232 Malan *Professional Responsibility* 333; Proctor *The Law and Practice of International Banking* 335 ; Malan *Professional Responsibility* 337 ; Proctor *The Law and Practice of International Banking* 346.

233 Proctor *The Law and Practice of International Banking* 335 ; Proctor *The Law and Practice of International Banking* 346.

234 *Royal Brunci Airlines Sdn Bhd v Tan* 1995 AC 378 (PC) ; *Abou-Ramoh v Abacha* 2005 1 All ER (Comm) 247; *Yorkshire Bank plc v Loyds Bank plc* 1999 2 All ER (Comm) 153.

customer relationship, is based on contract, namely a mandate between the said parties.[235] As with all contracts, the parties thereto receive certain rights and obligations in terms of the said contract.[236] The said nature of the banker-customer relationship has been recognised by both the South African law and the English law in terms of the common law, case law and legislation.

Up to this point, with regards to liability in terms of negotiable instruments, contractual liability, delictual liability and the banker-customer relationship, the South African law and English law are very similar to each other although the English courts have heard more cases where the cause of action is based on an act or omission by a bank on which the bank may be held delictually liable towards its customer or a third party.

Thirdly, we turn to letters of comfort. Although the basic nature of a letter of comfort is considered the same in terms of the South African law as in terms of the English law not many direct references have been made to letters of comfort in terms of the South African law to date.[237] Notwithstanding, with regards to the English law, the courts have given reference to letters of comfort since 1985.[238] The English courts have heard many decisions with reference to letters of comfort ever since their first appearance in 1985. One of the latest cases where reference was given to a letter of comfort was in the *Gate Gourmet* – case that was heard in Australia and as the Australian law is based on English law this case is of particular importance and may be taken in consideration by the South African courts. Latter court decision confirmed that a letter of comfort could lead not only to contractual liability but also to liability based on promissory *estoppel*

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235 Proctor *The Law and Practice of International Banking* 302.
236 Proctor *The Law and Practice of International Banking* 303.
237 Trichardt "Comfort letters are they binding under South African law?" 795.
238 Trichardt "Comfort letters – quartet of decisions interrupts the judicial quiescence" 163.

or misleading conduct.[239] Therefore, the misleading conduct, misrepresentation, of a party to a letter of comfort may lead to a delictual claim against said party.

Thus, furthermore we have now established that in terms of the South African law and the English law a party to an instrument of payment or a financial document such as a letter of comfort may be held liable by another party or a third party thereto on the basis of contract and or delict, that is to say if a contractual relationship exists between the said parties and the five elements of delict can be proven.

Lastly, we refer to South African court case *Bernert v Absa Bank Limited*[240] and the appeal court case *Absa Bank Limited v Bernert*[241]. The question that we need to answer herein is whether or not the decisions that were made by the South African courts in the said cases can be considered as correct after taking into consideration the recent decisions made by the English courts in similar cases with regards to a negligent misstatement made by a bank to a customer or a third party and when an instrument or document can be seen as a letter of comfort in terms of the South African law.

In short, as discussed, the court *a quo* found in favour of the plaintiff and held that the plaintiff, the customer of the bank, suffered damages ('pure economic loss') as a result of a misrepresentation ('a negligent misstatement') contained in a letter drafted by the legal representatives of the bank with regards to another letter, a letter of undertaking (also a letter of comfort) that was issued by an employee of the bank. The Supreme Court of Appeal of South Africa upheld the appeal as they found in favour of the applicant and the order of the court *a quo* was set aside on the basis that the letter that was the cause of the misrepresentation ('negligent misstatement') by the bank was not unlawful

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239 Trichardt "The comfort letter trap" 50; *Lasalle Bank National Association v Citicorp Real Estate Inc* (Unreported July, 18, 2003); *Gate Gourmet Australia Pty Ltd v Gate Gourmet Holding AG* 2004 N.S.W.S.C 149 (Sup Ct (NSW)).

240 (14302/03) [2008] ZAGPHC 337.

241 (99/09) [2010] ZASCA 36.

although it contained a false statement. [242] The reason for the former decision was based on the fact that the instrument or document that was issued by an employee of the bank is not a financial instrument, a letter of undertaking, which is used on a day to day basis during the regular business of the bank. Accordingly, the bank could not be held legally liable because they attempted to prevent the further exchange of the said instrument or document to third parties.[243] It is therefore clear that legal certainty in South Africa with regards to the legal liability of banks is therefore needed specifically with regards to letters of comfort.

Therefore, to determine whether or not the decision of the South African appeal court in the *Absa Bank Limited v Bernert* case was correct we rely on the English court case *Hedley Byrne & Co. Ltd. v Heller & Partners Ltd* 1964 AC 465 as it is the leading English court case with regards to a negligent misstatement made by a bank. As discussed in the *Hedley Byrne* case the bank avoided liability because as a matter of policy a bank should be able to avoid the consequences of giving negligent advice if it provides the parties that received the advice with proper notice that the advice they received was false. [244]

Thus, with regards to the negligent misstatement made by the defendant in *Bernert v Absa Bank Limited*, it would seem that the appeal court made the correct decision in declaring that the bank could not be held legally liable because they attempted to prevent the further exchange of an instrument or document, the "letter of undertaking", to third parties. It is therefore irrelevant whether or not a false statement was made in the letter that gave notice of the unlawful instrument or document to the plaintiff and any third party as the bank must prevent the circulation of a document and inform all the applicable parties that they cannot rely on a document that is not a financial instrument that is used

[242] *Bernert v Absa Bank Limited* paragraph 50.
[243] *Absa Bank Limited v Bernert* paragraph 73-76.
[244] Cranston *Principles of Banking Law* 212.

on a day to day basis by a bank as such a instrument or document cannot be binding upon the either of the parties

Furthermore, to determine whether or not the instrument or document that was issued by the employee of the defendant, constituted a letter of undertaking (as was intended by the parties) we have to consider the contents of the instrument or document and the intention of the said parties thereto. The appeal court in *Absa Bank v Bernert* held that : [245]

> *When all the terms are read together the document is a compendium of gibberish. I have no doubt that a document containing gibberish on the letterhead of a major financial institution is capable of misleading third parties as to its meaning…*

Thus the appeal court was of the opinion that the said instrument or document was not a financial instrument or documents used on a day to day basis by a financial institution. Therefore the instrument or document does not qualify as a letter of comfort because former is seen as a financial document or document used on a day to day business.

As discussed, in terms of the South African law the provisions in a letter of comfort contain commitments. Latter commitments may create legal obligations or they may only be moral commitments between the parties and not create any legal obligations.[246] It was also determined that according to the English law a letter of comfort may in certain circumstances constitute a legal obligation.[247] In the leading English court case *Lasalle Bank* it was decided that the enforceability

[245] *Absa Bank Limited v Bernert* , ad paragraph 73.
[246] Trichardt "Comfort letters are they binding under South African law?" 796.
[247] Trichardt "Comfort letters are like boomerangs ... they tend to come back" 54.

of a letter of comfort depends on certain factors.[248] If we take into consideration the said factors and compare them to the contents of the instrument or document that was issued in the *Bernert v Absa Bank Limted* case it is clear that the parties could not be held liable in terms of the said instrument or document. The reason for latter statement is that as an instrument or document did contain the word "guarantee" but did not contain the word "contract", the intention of the parties was not to obtain a guarantee from the bank but it was merely to attain a written undertaking from the bank that the money that will be transferred to the bank will be safe and held in a fixed deposit for a certain period and finally the parties did rely on undertaking in terms of the instrument or document.

Consequently, as the parties only requested an undertaking from the bank, thus a letter of undertaking, it was not their intention to create a legal obligation and or contractual liability in terms of the said instrument or document. What is confusing is the fact that the instrument or document contained the word "guarantee" which is in contrast to the intention of the parties as a letter of undertaking and a guarantee are two different financial instruments as explained.

Accordingly, the instrument or document could not be seen as a letter of undertaking as intended by the parties as the document was as the judge said in the appeal case "*a compendium of gibberish"* as it neither constituted a letter of undertaking nor a guarantee that is used on a day to day basis by a bank.

5. Conclusion and recommendations

Finally, letters of comfort are constructive and flexible financial instruments to be used in business transactions which have for many years been used in international trade. Considering the recent court decisions world wide, not only in England, but worldwide, and the universal change in the financial wealth of

[248] Trichardt "The comfort letter trap" 47 – 48.

businesses, legal risk management is a sensible step for banks and people in the business world who have used letters of comfort to make sure that they know the nature and effect of the letters of comfort they have issued or hold. As previously said, legal liability based on a letter of comfort is therefore a genuine possibility. Thus, like a boomerang, a letter of comfort has a tendency to return to its unsuspecting originator and can possibly be a dangerous financial instrument.[249]

This study has made it apparent that the saying 'the customer is king' is definitely not a worn-out cliché as it rings more true in this modern day and age than ever before.

The last few years South Africa has seen several pieces of legislation that are aimed at the protection, development and advancement of the rights and obligations of customers be initiated and instated. Such pieces of legislation are not only applicable to one specific business sector but have a vast influence on all the various business sectors in South Africa including the banking industry. The *National Credit Act*[250] and the *Consumer Protection Act*[251] are two of the most recently instated pieces of legislation in South Africa that focus on the customer and/or rather consumer and his/her rights and obligations not only in the trade industry but also in the broader commercial sector. Therefore, these two pieces of legislations have a vast influence on the banker – customer relationship.

Although South Africa has been seen by many as having a conservative legal system, the said pieces of legislations are proof that South Africa has come a long way in the past few decades since it became a democratic country. South Africa has not only focused on the development of individual rights but has also

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249 Trichardt A "Comfort letters are like boomerangs... they tend to come back" 57 ; Trichardt A "The comfort letter trap" 50.

250 34 of 2005.

251 68 of 2008.

been keen to implement legislation that is evident of our willingness to change with the modern times.

Although England has a system of parliamentary sovereignty while South Africa is now a constitutional democracy, it would nevertheless be recommended that South African courts more readily take into consideration the decisions made by the English courts as our commercial law legislation is based on English law. It would reduce the legal costs of the parties involved and more importantly have a positive effect on international trade as it would create legal certainty which could lead thereto that international traders would feel more comfortable and secure to bring their money into South Africa, make investments in our country and enter into import en export contracts with South African companies.

It is a known fact that growth is only possible where there is a willingness to change.

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