THE RELATIONSHIP BETWEEN BANKER AND BUYER UNDER DOCUMENTARY LETTERS OF CREDIT.*

Introduction.

The documentary or commercial letter of credit is a well-known banking instrument. Its main purpose is to finance the sale of goods to a buyer in one country by a seller in another. In a documentary letter of credit a banker, at the request of the buyer, promises to pay to the seller the price of the goods, or to accept a draft drawn by the seller for that amount, provided that the shipping documents representing the goods are tendered to the banker before a certain date.[1]

A documentary letter of credit is of advantage to the seller in two respects. Firstly, since the promise to pay is made by a banker and not merely by the buyer, it gives the seller a greater security for the price of the goods than he would otherwise receive. Secondly, instead of being obliged to wait until the goods have been delivered to the buyer, the seller can receive the price of the goods immediately upon shipment by presenting the required documents to the banker.

The buyer, too, derives benefit from this arrangement. He does not have to pay for the goods in advance (as might have been the case if no documentary credit were furnished). In most cases, he will be able to postpone payment until the goods have arrived or even afterwards, since he can arrange to reimburse the banker at a later date. He is thus in a better position than he would be in a simple sale on c.i.f. terms, when he would be obliged to pay for the goods when the seller tendered the documents. A further advantage is that he has the benefit of an expert examination of the shipping documents by experienced bankers. A banker is under a duty to examine the documents to see whether they are regular and comply with the letter of credit.[2] This is an additional safeguard for the buyer.

The banker, also, finds such an arrangement to his interest, in that he is paid a banking commission for the opening of the documentary credit.

The documentary credit transaction involves the establishment of three main relationships. Firstly, there is the contract between the

* This article is based on parts of a thesis on "Documentary Letters of Credits —A Comparative Study," submitted for the degree of D.Phil. (Oxon).

1 This purpose is not fully achieved in a "revocable credit," in which the banker does not give an undertaking. See *infra*.

2 See on this point *infra*.

buyer and the seller, in which it is agreed that payment should be by a documentary credit.

Secondly, there is the contract between the buyer and the banker. The buyer instructs the banker to open a documentary credit in favour of the seller and promises to reimburse the banker for his advances to the seller and to pay him a certain commission. The terms of the contract between the buyer and the banker appear in the application form, a document given by the banker to the buyer for completion. This document consists of a portion (usually the front page) meant for the instructions of the buyer regarding the specific details of the documentary credit to be opened. The buyer must insert the name of the seller, the price of the goods, the list of the documents to be tendered by the seller, the description of the goods and the date or period of shipment. The application form also contains (usually on its back pages) "small print" clauses specifying the general terms of the contract between the banker and the buyer.[3]

Thirdly, there is the relationship between the banker and the seller. This is regulated by the documentary letter of credit, sent by the banker to the seller, which specifies the documents to be tendered by the seller (usually those specified in the application form) and the other terms with which the seller has to comply. The documentary credit further includes a statement concerning the liability of the banker, the nature of which depends on the type of the documentary credit. If it is a "revocable credit" the banker stresses that it does not include a binding undertaking on his part. Such an instrument is, therefore, not a contract. On the other hand, if the banker opens an "irrevocable credit," he undertakes to pay a certain sum, or accept a draft, against the required documents and further promises not to revoke this undertaking. Some dicta imply that such an irrevocable credit establishes a contract between the banker and the seller.[4]

[3] As to the effect of extensive exemption clauses which some bankers tend to include in their forms, see *infra*.

[4] In England see Urquhart Lindsay & Co., Ltd. v. Eastern Bank, Ltd., [1922] 1 K.B. 318, at 321-322; Donald H. Scott & Co., Ltd. v. Barclays Bank, Ltd., [1923] 2 K.B. 1, at 14; Trans Trust S.P.R.L. v. Danubian Trading Co., Ltd., [1952] 2 Q.B. 297, at 304-305; Midland Bank, Ltd. v. Seymour, [1955] 2 Lloyd's Rep. 147, at 166; Malas (Hemzeh) & Sons v. British Imex Industries, Ltd., [1958] 2 Q.B. 127, at 129. In the United States see: American Steel Co. v. Irving National Bank, (1920) 266 F. 41, at 43; Lamborn v. National Park Bank of New York, (1925) 240 N.Y. 520, 148 N.E. 664, at 665-666; Asbury Park & Ocean Grove Bank v. National City Bank of New York, (1942) 35 N.Y.S. 2d 985, at 988.

These are the main relationships that occur in documentary credit transactions.[5]

Since documentary credits are instruments of international trade, they have been the subject of much discussion in common as well as civil law countries.[6] It is therefore of interest that in spite of varying basic premises, the law concerning documentary credits is in many respects similar in these different legal systems. This has particular importance as regards the relationship of banker and seller. Since these two parties usually reside in different countries it is essential that the law should, to the greatest extent possible, be uniform. If this were not so, the seller and the banker could not be certain as to their rights and duties. As regards the contract of banker and buyer, even though the parties usually reside in the same country, there seem to be uniform concepts in civil and common law jurisdictions. This is partly due to the fact that bankers in most countries have adopted the recent revision of the Uniform Customs and Practice for Documentary Credits, (hereinafter referred to as "the U.C.P.") promulgated by the International Chamber of Commerce.[7] But even before this codifica-

5 Further relationships arise when the "issuing-banker," *i.e.,* the banker engaged by the buyer, engages a "correspondent" or "correspondent-banker" to assist in the opening of the credit. If such a correspondent-banker is asked to "confirm" the credit, *i.e.,* to add his own undertaking to honour a draft accompanied by regular documents, a contract is established between the correspondent-banker (who in such a case is known as a "confirming-banker") and the seller. The relationship between the issuing-banker and the correspondent-banker is, too, contractual.

6 In England see GUTTERIDGE & MEGRAH, THE LAW OF BANKERS' COMMERCIAL CREDITS (3rd ed., 1962); DAVIS, THE LAW RELATING TO COMMERCIAL LETTERS OF CREDIT (3rd ed., 1963). In the United States see FINKELSTEIN, LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT (New York, 1930); WARD AND HARFIELD, BANK CREDITS AND ACCEPTANCES (4th ed., 1958). In France see MARAIS, P., DES OUVERTURES EN BANQUE DE CREDITS CONFIRMES ET NON-CONFIRMES, (thesis), (Paris, 1925); MARAIS, G., DU CREDIT DOCUMENTAIRE (2nd ed., 1929); MARAIS, G., DU CREDIT CONFIRME EN MATIERE DOCUMENTAIRE, (2nd ed., 1953), (subsequent references to MARAIS are to this work); STOUFFLET, LE CREDIT DOCUMENTAIRE (thesis), (Paris, 1957). In Germany see SIECKMANN, DAS AKKREDITIV (thesis), (Jena, 1925); KREBS, DAS AKKREDITIVGESCHAEFT (thesis), (Coburg, 1928); WIELE, DAS DOKUMENTEN-AKKREDITIV UND DER ANGLO-AMERIKANISCHE DOCUMENTARY LETTER OF CREDIT (Hamburg, 1957); LUNK, RECHTSFRAGEN DER AUSSENHANDELSFINANZIERUNG DURCH AKKREDITIV UND REMBOURS (thesis), (Mainz, 1958); ZAHN, ZAHLUNG UND ZAHLUNGSSICHERUNG IM AUSSENHANDEL (2nd ed., 1959); Liesecke, *"Das Dokumentenakkreditiv in der neueren Rechtsprechung des Bundesgerichtshofs,"* Wertpapier Mitteilungen, (1960) 210 *et seq.* All of the above works will be cited hereafter by reference only to the name(s) of the author(s).

7 The first promulgation of the U.C.P. appeared in 1933 (Brochure 82 of the International Chamber of Commerce). A second revision appeared in 1951 (Brochure 151), and the third one in 1962 (Brochure 222). According to a

tion, the law concerning the relationship of banker and buyer had already reached some uniformity.

It is the purpose of this paper to discuss the various aspects of the contract between the banker and the buyer. In so far as materials in different countries are available, an attempt will be made to compare the respective authorities. In view of the important role played in international commerce by England, the United States, France and Germany it has been decided to concentrate on the legal systems prevailing in these four countries.

THE NATURE OF THE CONTRACT BETWEEN THE BANKER AND THE BUYER.

That the relationship between the banker and the buyer is contractual is beyond doubt.[8] But it is less certain which type of contract it resembles. German lawyers have been more successful than others in analyzing this contractual relationship.

The German lawyers explain that the banker is employed by the buyer. Thus, there is between them a contract for services or employment, *i.e., a Werkvertrag*.[9] This type of contract is governed by paragraph 631 BGB which reads:

> By a contract for work the contractor is bound to produce the work promised, and the employer is bound to pay the remuneration agreed upon.
>
> The object of the contract for work may be either the production or alteration of a thing, or any other result to be brought about by labour or performance of service.[10]

There is, however, a difference between a simple contract for services and the contract between the banker and the buyer. The banker undertakes to participate in a specified business transaction. At the request of the buyer, he engages himself towards the seller. This is a *Werkvertrag* which has as its object a *Geschaeftsbesorgung* (*i.e.*, the procuration of a business). Apart from paragraph 631 BGB, it is further governed by paragraph 675 BGB, which reads:

circular of the International Chamber of Commerce, dated 24th April 1964, the 1962 revision of the U.C.P. has been adopted by bankers in 127 countries, including the United Kingdom, Australia and most Commonwealth countries.

8 See DAVIS, at 58; GUTTERIDGE & MEGRAH, at 29.

9 WIELE, at 34; ZAHN, at 18; KREBS, at 32-33, 79-80.

10 CHUNG HUI WANG, THE GERMAN CIVIL CODE (London, 1907), at 137.

> The provisions of 663, 665 to 670, 672 to 674 and, if the person bound has the right to give notice without observance of any term of notice, the provisions also of 671, para. 2, apply *mutatis mutandis* to a contract for service or a contract for work which has for its object the charge of an affair.[11]

The provisions mentioned in paragraph 675 BGB are principles of the German law of agency. Paragraph 665 allows the agent, under special circumstances, to deviate from his instructions. Paragraph 666 imposes on the agent a duty to make full disclosure to his principal. Paragraph 667 requires him to pay to his principal any sums which he receives for the execution of the mandate from third parties. The other paragraphs concern, too, the relationship between the principal and the agent.[12]

In German law, therefore, the contract between the buyer and the banker has elements of two types of contract. Firstly, it is similar to a contract for services or work. The banker's remuneration depends on the proper performance of his engagement. Secondly, due to paragraph 675 BGB, several principles of the law of agency apply to the contract as well. But the contract is to be distinguished from a simple contract of agency, since the banker undertakes an obligation of his own towards the seller.

French lawyers think that the contract between the banker and the buyer *resembles* a contract for services. In a contract for services, however, the employee does not undertake an obligation of his own towards a third party. The relationship between the banker and the buyer is not, therefore, a contract for services or a contract of mandate.[13]

In common law it is, of course, sufficient simply to say that there is a contract without assigning it to a particular category. The courts have hinted that this contract between the banker and the buyer is to a certain extent similar to a contract of agency, and have spoken of the banker as having a mandate of the buyer.[14] Moreover, some bankers use in their forms phrases indicating an agency, *e.g.*, ". . . on behalf of our principals . . ." or, ". . . we have no authority from our principals."[15] There may indeed be a certain similarity between the

11 *Ibid.*, at 148.

12 As to para. 663 BGB see *infra*.

13 STOUFFLET, at 369-371, who explains, further, that a contract for services would fail to explain the irrevocability of irrevocable credits.

14 See, *e.g.*, Devlin J. (as he then was) in Midland Bank, Ltd. v. Seymour, [1955] 2 Lloyd's Rep. 147, at 168.

15 These phrases are more frequently employed by American than English bankers.

contract of the banker and the buyer and an agency contract. Firstly, the banker receives a banking commission from the buyer for opening a letter of credit. Secondly, the instructions which the buyer gives to the banker in the application form are, to some extent, similar to a mandate in which a principal specifies the orders he gives to the agent. But the banker who opens a letter of credit at the request of the buyer is not a *mere* agent. He undertakes an obligation of his own towards the seller and, in an irrevocable credit, contracts in his own name.[16] His position is, therefore, distinguishable from that of a mere agent who creates a contract between his principal and a third party.[17]

In addition, there is between the buyer and the banker a relationship of creditor and debtor. Any "deposit" which the buyer pays to the banker is not "earmarked" or held by the banker on trust for the seller.[18] The buyer is, therefore, the banker's creditor for that amount. After the acceptance of the documents by the banker, when reimbursement becomes due, the banker becomes the creditor and the buyer the debtor. This is similar to the usual relationship between bankers and their customers, which is mainly a relationship of creditor and debtor,[19] but also of principal and agent.[20]

It should, however, be stressed that despite these similarities between the contract of banker and buyer and other contracts, the former is *sui generis*. It is a specialized type of commercial contract which, in most matters, has its own rules.

The Opening of the Documentary Credit.

The Acceptance by the Banker of the Order to Open a Documentary Credit.

In France the early stages of the relationship between the banker and the buyer are known as "the opening of the credit."[21] In the

16 That an agent is not liable towards third parties when contracting as an agent, see Jenkins v. Hutchinson, (1849) 13 Q.B. 743; Lewis v. Parker, (1852) 18 Q.B. 503. An agent can accept personal liability together with his principal: International Railway Co. v. Niagara Parks Commission, [1941] A.C. 328. In such cases, however, the agent is not a mere agent but becomes a party to the main contract.

17 Even in a revocable credit the banker is not the agent of the buyer. He does not create a contract between the buyer and the seller. He makes a promise of his own, which, nevertheless, is expressly stated to be revocable.

18 Citizens National Trust & Savings Bank of Los Angeles v. Londono, (1953) 204 F. 2d 377, at 380.

19 Foley v. Hill, (1848) 2 H.L.C. 28; Joachimson v. Swiss Bank Corporation, [1921] 3 K.B. 110.

20 London Joint Stock Bank, Ltd. v. Macmillan, [1918] A.C. 777; Westminster Bank, Ltd. v. Hilton, (1926) 43 Times L.R. 124.

21 *L'ouverture du crédit*: STOUFFLET, at 44 *et seq.*

absence of other terminology this phrase might be accepted. The opening of the credit covers the events preceding the acceptance or rejection by the banker of drafts drawn under the letter of credit.

The buyer, it has been seen,[22] signs an application form in which he requires the banker to open a documentary credit. The majority of English bankers accept the offer contained in the application form in writing. Some bankers, however, accept this offer not in writing but by acting upon it. Such a lack of formal acceptance acts in favour of the banker. If, in such cases, the banker fails to issue the documentary credit, the buyer will not be in a position to bring an action for breach of contract. It would, however, be wrong to say that, in the absence of a written acceptance, the dispatch of the letter of credit is the only mode of accepting the offer contained in the application form. The banker may accept an advance for the opening of the credit; he may debit the current account of the buyer and open a special account for the operation of the letter of credit; or he may charge the buyer with the banking commission. It can be assumed that each of these acts shows the banker's acceptance of the buyer's offer. In many cases the representative of the bank might accept the application form orally. The practice of accepting the application form in writing is, however, more satisfactory. If the banker gives a written acceptance of the application form, the buyer knows where he stands.

This is achieved in German law even when the banker does not give a written acceptance. The contract between the banker and the buyer is governed by paragraph 675 BGB.[23] This paragraph provides that paragraph 663 BGB applies to a "contract for service or a contract for work which has for its object the charge of an affair." Paragraph 663 BGB reads:

> A person who is publicly appointed or has publicly offered himself for the charge of certain kinds of affairs is bound, if he does not accept a mandate relating to such affairs, to notify the mandator of his refusal without delay. The same rule applies if a person has offered himself to the mandator for the charge of certain kinds of affairs.[24]

Bankers are considered to be persons who have publicly offered their services for opening documentary credits. In German law, they are, therefore, obliged to notify the buyer without delay if they refuse

22 See at 41 *supra*.
23 Cited *supra*.
24 CHUNG HUI WANG, at 146.

to open a credit.[25] Although there is no such provision in French, English or American law, bankers in practice notify buyers of their refusal to open commercial credits. This is a commendable practice. It should be borne in mind that the application form is a standard form supplied by the banker for completion to the buyer. If, after giving such a form to the buyer, the banker cannot or does not want to act on it, he should make this clear without delay. His failure to do so may not, in England, the United States or France, give the buyer a cause of action. The banker's reputation would, however, suffer if he misled his customers.

The Time for Opening a Credit.

In French law the banker is required to open a documentary credit with diligence.[26] It is his duty not to delay the opening of the credit and to perform it with reasonable speed. The meaning of diligence is, of course, a question of fact which depends on the circumstances of each case.

In Germany, KREBS[27] thinks that the banker must notify the credit to the seller not later than at the date at which the buyer is obliged to open it under the contract of sale. This suggestion, however, can apply only to a limited number of cases. Generally the banker is not familiar with the terms of the contract of sale. WIELE'S[28] suggestion, which is similar to the French view, is preferable. In his opinion the banker should act with the diligence of a reasonable man. It is true that this rule only lays down a test. But the circumstances in which bankers are asked to open documentary credits vary. The buyer may, for example, inform the banker that the shipping period commences within a few days. In such a case a cable credit may be necessary. But to lay down, as a general rule, that a cable message is always necessary would be wrong.

That the banker should open the credit with reasonable speed can be supported in common law countries as well. When the banker accepts the application form by acting upon it, he should do so within a reasonable time. Otherwise the buyer's offer lapses.[29] A similar rule would also apply when the bank accepted the application form in

25 KREBS, at 80 (who erroneously refers to para. 636 BGB); WIELE, at 41; LUNK, at 36-37.

26 STOUFFLET, at 193-194.

27 *Op. cit. supra* at 81.

28 *Op. cit. supra* at 43.

29 Ramsgate Victoria Hotel Co., Ltd. v. Montefiore, (1866) L.R. 1 Ex. 109 Company's failure to allot within reasonable time shares applied for by defendant).

writing. When a contract does not specify a special time for the performance, reasonable time is to be presumed.[30]

The transmission of the credit is often not done by the banker himself but through a correspondent. Bankers reserve a right to employ a correspondent in their application forms.[31] This right is now specified in article 3 of the U.C.P.,[32] which, however, applies only to irrevocable credits. Revocable credits, it should be added, are frequently sent to the seller directly.

The engagement of a correspondent, who is asked to notify the seller about the opening of a credit is, however, not always sufficient. Article 4 of the U.C.P. provides:

> When an issuing bank instructs a bank by cable, telegram or telex to notify a credit and the original letter of credit itself is to be the operative credit instrument, the issuing bank must send the original letter of credit, and any subsequent amendments thereto, to the beneficiary through the notifying bank.
>
> The issuing bank will be responsible for any consequences arising from its failure to follow this procedure.

This provision is of great importance. It avoids errors or, at least, gives a chance to rectify them in time. This article would apply more frequently when the correspondent is merely an "advising banker."[33] When the correspondent is asked to add his own "confirmation", the letter of credit is, usually, written by the correspondent.

The engagement of a correspondent for the opening of a credit is not without risk. Messages can be delayed by post, or be misinterpreted when decoded. Article 10 of the U.C.P. provides:

> Banks assume no liability or responsibility for the consequences arising out of delay and/or loss in transit of any messages, letters or documents, or for delay, mutilation or other errors arising in the transmission of cables, telegrams or telex, or for errors in translation or interpretation of technical terms, and banks reserve the right to transmit credit terms without translating them.

Article 12 of the U.C.P. adds:

> Banks utilising the services of another bank for the purposes of giving effect to the instructions of the applicant for the credit do so for the account and at the risk of the latter.

30 Ford v. Cotesworth, (1868) L.R. 4 Q.B. 127 *per* Blackburn J. at 133 (Q.B.), (1870) L.R. 5 Q.B. 544 (Exch.Ch).

31 See STOUFFLET, at 198-199.

32 It was previously set out in art. 6 U.C.P. (1951 revision).

They assume no liability or responsibility should the instructions they transmit not be carried out, even if they have themselves taken the initiative in the choice of such other bank.

The applicant for the credit shall be bound by and liable to indemnify the banks against all obligations and responsibilities imposed by foreign laws and usages.

These provisions are of major importance. They exempt the banker from responsibility for errors in messages, as well as from any liability for the negligence of the correspondent. Similar provisions can be found in British application forms. A similar provision is enacted in s. 5-109 (1) (b) of the Uniform Commercial Code (U.S.A.). That section, rightly, does not free the banker from responsibility for the acts of his own branch, presumably even if his branch abroad acts as advising or confirming banker.

The articles of the U.C.P. include, it is submitted, fair and reasonable exemption clauses. The banker must, of course, strictly adhere to his instructions. If he, himself, makes mistakes in the opening of the credit, there is no good reason to force the buyer to take up documents for which he has not bargained. The position is different if a bad tender is accepted as a result of an error of the post or a correspondent. Since the banker has no control over the activities of the post or his correspondents, he should not be responsible for their errors.

Strict Adherence to the Terms of the Application Form.

When the banker opens the commercial credit, that is to say, notifies it to the seller, he should adhere, most strictly, to the terms of the application form. He should be most careful to specify the right amount, date of expiration and, above all, the documents which need be tendered. If the banker opens a documentary credit which deviates from the buyer's instructions, he has only himself to blame when the buyer refuses to accept the documents tendered.[34]

An English authority will show the difficulties that can arise when the banker deviates from his instructions in the opening of a letter of credit. In *Midland Bank, Ltd. v. Seymour*[35] one of the issues was as follows. The defendant, an English merchant, agreed to purchase a consignment of Hong Kong duck feathers from a seller in Hong Kong. He ordered the plaintiffs, an English bank, to open a documentary

33 *I.e.*, a correspondent-banker who does not add his own undertaking, but only notifies the seller about the opening of the documentary credit by the issuing-banker. See also note 5 *supra*.

34 *Cf.* DAVIS, at 58-59; GUTTERIDGE & MEGRAH, at 30-31; STOUFFLET, at 195-196; SIECKMANN, at 32-33.

35 [1955] 2 Lloyd's Rep. 147.

credit in favour of the seller. He specified in the application form (1) that "the credit is to be available in Hong Kong," and (2) an expiry date. The plaintiffs opened a documentary credit which required that drafts be presented for acceptance in London, and permitted negotiation of the drafts in Hong Kong. The seller drew drafts and attached to them the required documents. These drafts were negotiated in Hong Kong *before* the expiry date mentioned in the application form, but were presented to the plaintiffs for acceptance in London *after* that date. The plaintiffs accepted the drafts but the defendant refused to reimburse them. He argued that the letter of credit opened by the plaintiffs was not in accord with the terms of the application form since it was made available in London instead of Hong Kong. He further argued that the plaintiffs accepted the draft after the expiry date specified by him, and on this ground, too, they were not entitled to reimbursement. Devlin J. (as he then was) dealt separately with these two defences. He first held that the specification of Hong Kong as the place in which the credit was to be available was not conclusive.[36] From the conduct of the parties in previous transactions he decided that, by opening a documentary credit available in London, the bankers were not in breach. He added that even if there had been a breach it was ratified. The learned judge, at the same time, said:[37]

> If [the bank] was authorized so to pay [*i.e.*, only in Hong Kong], then although the place of payment may be commercially immaterial, the bank has exceeded its mandate and cannot recover. It is a hard law sometimes which deprives an agent of the right to reimbursement if he has exceeded his authority, even though the excess does not damage his principal's interests. The corollary . . . is that the instruction to the agent must be clear and unambiguous.

The second question, *i.e.*, the meaning of the date of expiration, was decided against the plaintiffs. Devlin J. held that the date of expiration referred to the last date of presentation of drafts for acceptance.[38] He decided, therefore, that although the drafts were negotiated in Hong Kong before the date of expiration, the plaintiffs should have refused to accept them when presented in London after that date.[39] He found, however, that this breach was ratified by the defendant. Judgment was given for the plaintiffs.

[36] *Ibid.*, at 168-169.
[37] *Ibid.*, at 168.
[38] *Ibid.*, at 164-167.
[39] *Ibid.*, at 170.

This case shows how important it is for the banker to follow the instructions of the buyer. Had the plaintiffs made the credit available by acceptance at Hong Kong, there would have been no difficulty. Failing that, they should have requested the bank at Hong Kong to negotiate only drafts which could be presented on time in London. What, apparently, had happened was an error in the opening of the credit. It appears that the seller was notified, in the irrevocable[40] credit, that drafts should be *negotiated* in Hong Kong before the date of expiration specified by the defendant in the application form. As between themselves and the seller, the plaintiffs were, therefore, obliged to accept the drafts. Although this is not stated in the case, this deviation, or misunderstanding of the defendant's instructions, is the only explanation of the dispute. It can be assumed that had the commercial credit clearly specified that drafts were to be presented in London before the date of expiration—acceptance would have been refused.

This case also shows how important it is for the banker to demand clear instructions from the buyer. Bankers should refuse to accept any unclear instructions. General Provision *d.* of the U.C.P. reads:

> Credit instructions and the credits themselves must be complete and precise and, in order to guard against confusion and misunderstanding, issuing banks should discourage any attempt by the applicant for the credit to include excessive detail.

This is partly mitigated by article 6 of this code:

> If incomplete or unclear instructions are received to issue, confirm or advise a credit, the bank requested to act on such instructions may give preliminary notification of the credit to the beneficiary for information only and without responsibility; and in that case the credit will be issued, confirmed or advised only when the necessary information has been received.

Bankers would be wise to adhere to these provisions. Buyers, too, should make a point of giving clear instructions. This follows from the judgment on the remaining issues of *Midland Bank, Ltd. v. Seymour.*[41] In that case, the application form (which the plaintiffs gave the defendant for completion) was in a similar pattern to most current application forms. It left a blank space in which the defendant listed the documents to be tendered by the seller. Following these

40 The letter of credit was not put into evidence but the language of the judge indicates that it was an irrevocable credit, advised *but not confirmed* by the correspondents of the Midland Bank in Hong Kong.

41 [1955] 2 Lloyd's Rep. 147.

there were blank spaces meant for (1) the description of the goods, (2) the quantity and (3) the price. The description of the goods, *i.e.*, Hong Kong duck feathers *etc.*, was, thus, written beneath the list of documents. The documents which the plaintiffs, subsequently, tendered to the defendant included, when read together, a description of the goods in the words of the application form, but none of the documents, by itself, included such a complete description. The defendant argued that, since it was not expressly specified whether each document or only all the documents between them should include a full description of the goods, the application form should be interpreted against the plaintiffs. The plaintiffs argued that since the description of the goods followed the list of documents it was sufficient if all the documents—read together—gave one full description. Devlin J. said:[42]

> ". . . [counsel for the defendant] relies upon what I think may be called the *contra proferentes* principle on which a person who prepared a form is responsible for any ambiguities that it contains, or must suffer for it. In my judgment, that principle does not apply in this case. It applies (or would apply) if there were some exception, as for example in one of the conditions or clauses on the back of the document which was inserted for the benefit of the bank. If there were some exception there, no doubt the principle would apply.
>
> But this is not a case of that type. This is a printed document which shows the sort of thing that the bank wants, but it is left to the applicant for the credit to fill it up in what way he wants; and if he thinks there is some ambiguity in it there is no difficulty . . . in his filling it up in a way to make it clear."

These words, it is submitted, are a commendable pronouncement. In so far as the instructions respecting the documents are concerned, it is for the buyer to give clear orders. Small print clauses should, on the other hand, be interpreted against the banker. These are written by the banker and should, if open to more than one interpretation, be construed against him.

The Banker's Commission.

The banker is entitled to a banking commission for the opening of the credit. A correspondent, who confirms a credit is, too, entitled to a commission. If the correspondent only "advises" the credit he is entitled only to a fee.[43]

[42] *Ibid.*, at 153.

[43] See also STOUFFLET, at 168-169; WIELE, at 42-43; KREBS, at 93.

This commission is not repayable if the credit is not realized.[44] STOUFFLET, however, thinks that, if the banker unjustifiably cancels a documentary credit or refuses to accept a tender of documents, the commission is repayable to the banker as part of the damages.[45]

An American authority supports the view that the banking commission is not reclaimable if the credit is not realized. In *Baring v. Lyman*[46] the court had to decide when the commission, which a banker obtains for opening an *open* letter of credit,[47] becomes due. Story J.[48] said that when a draft is drawn under an open credit and negotiated the banker is bound to accept it. He held, therefore, that even though the draft might, subsequently, not be presented to the banker, his commission is not reclaimable. This decision can be adapted to commercial credits. In irrevocable credits the banker is bound as soon as the credit reaches the hands of the seller.[49] The commission would, accordingly, fall due at that time. In revocable credits, on the other hand, the banker can always revoke his promise to the seller before the latter's tender is accepted. If one applies *Baring v. Lyman* to revocable credits, it may be that the banker's commission is only due when he accepts a tender. Against this view it can be argued that by notifying the revocable credit to the seller, the banker performs the first request of the buyer. It is reasonable to assume that by doing so he earns his commission.

44 STOUFFLET, at 169; WIELE, at 43.

45 *Op. cit. supra* at 169. *Contrast* KREBS, *loc. cit.*

46 (1841) 1 Story 396, 2 Fed. Cas. 794 (Case No. 983).

47 The "open letter of credit" (or "traveller's letter of credit") is an older variety of letters of credit. In such an instrument the issuing-banker requests his agents abroad (or—if the instrument is a general letter of credit—the world at large) to advance money to his customer, who is the beneficiary of the open letter of credit, and promises to repay these advances, or to accept drafts for the amounts of these advances.

48 2 Fed. Cas. at 800-801.

49 In the U.S.A. see American Steel Co. v. Irving National Bank, (1920) 266 F. 41, at 43; Pan-American Bank & Trust Co. v. National City Bank of New York, (1925) 6 F. 2d 762, at 769; Bril v. Suomen Pankki Finlands Bank, (1950) 97 N.Y.S. 2d. 22, at 32, *affirmed* (no opinion) (1950) 101 N.Y.S. 2d 256; Distribuidora Del Pacifico, S.A. v. Gonzales, (1950) 88 F. Supp. 538, at 541; s. 5-106 (1) (b) of the Uniform Commercial Code (U.S.A.) (1962 revision) enacts a provision to the same effect. In France see Req. 20.10.1953, S. 1954 I 121 (note of Lescot); MARAIS, at 36; *cf.* STOUFFLET, at 299-302. In Germany see RG in 21 BANK ARCHIV 383; WIELE, at 56-57.

In England there appear to be some doubts. McNair J. in Dexters, Ltd. v. Schenker & Co., (1923) 14 Ll.L.R. 586, at 588 indicates that the documentary credit becomes binding as soon as it reaches the hands of the seller. But see contra Urquhart Lindsay & Co., Ltd. v. Eastern Bank, Ltd., [1922] 1 K.B. 381. From a commercial view the opinion of McNair J. is preferable, since the seller becomes bound to supply the goods to the buyer as soon as the letter of credit reaches his hands.

The Realisation of the Documentary Credit.

The Banker's Duty to Adhere Strictly to his Mandate.

The opening of the letter of credit is followed by its realisation. When a banker agrees to open a documentary credit he undertakes towards the buyer an obligation to accept a draft which complies with the terms of the documentary credit. If the banker fails to accept a conforming draft he is in breach of his contract with the buyer.[50] The buyer, on his part, undertakes (1) to accept from the banker conforming documents tendered by the seller, and (2) to reimburse the banker for his advances to the seller.

The banker's right of reimbursement depends on his accepting from the seller a faultless tender. "There is really no question here of . . . diligence or of negligence or of breach of a contract of employment to use reasonable care and skill."[51] The banker must, in other words, strictly adhere to the terms of the application form. If he accepts faulty documents from the seller, he does so at his own peril.

In order to satisfy himself that the documents comply, strictly, to his instructions, the banker is under a duty to examine them.[52] This examination relates, mainly, to the description of the goods in the documents and to the regularity of each document. It is not the duty of the banker to consider the legal effects of each clause in a document. It is to be doubted if "banks are under any greater duty to their correspondents than to satisfy themselves that the correct documents are presented to them, and that the bills of lading bear no indorsement or clausing by the shipowners or shippers which could reasonably mean that there was, or might be, some defect in the goods or their packing."[53]

50 In the U.S.A. see Bank of United States v. Seltzer, (1931) 233 App. Div. 225, 251 N.Y.S. 637, at 641. See also Leslie v. Bassett, (1892) 29 N.E. 834, at 835; Greenough v. Munroe, (1931) 53 F. 2d 362, at 365. In both cases it was said that the bank's inability to honour drafts drawn under a letter of credit was failure of consideration. In France see MARAIS, (1929), at 279-280; in Germany see LUNK, at 45.

51 Equitable Trust Co. of New York v. Dawson Partners, Ltd., (1927) 27 Ll.L.R. 49 *per* Viscount Sumner at 52; see also Midland Bank, Ltd. v. Seymour, [1955] 2 Lloyd's Rep. 147, at 168. In France see STOUFFLET, at 210 *et seq.* In Germany see WIELE, at 45.

52 STOUFFLET, at 210 *et seq.;* MARAIS, at 27-28; WIELE, at 45; LIESECKE, at 213-214.

53 Per Salmon J. in British Imex Industries, Ltd. v. Midland Bank, Ltd., [1958] 1 Q.B. 542, at 552. See also National Bank of Egypt v. Hannevig's Bank, Ltd., (1919) 1 Ll.L.R. 69, 3 LEGAL DECISIONS AFFECTING BANKERS, 211 at 213, cited by GUTTERIDGE & MEGRAH, at 68.

These words are good law also on the Continent.[54] A similar provision is enacted in article 7 of the U.C.P. which reads:

> Banks must examine all documents with reasonable care to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit.

On one occasion, however, the banker must scrutinize the documents with greater care, *i.e.,* if the documents, although complying with the terms of the letter of credit, contain any unusual features. Such features in a document, even if not sufficient for rejecting a tender of documents, should serve as "a 'red flag' directing the bank to scrutinize carefully all accompanying documents for all clues which would aid the banks to determine whether the terms of the letter of credit had been met."[55]

Provisions of the Application Form Inserted for Protecting the Banker.

Generally, as has been said, the banker must adhere strictly to his instructions. Conditions inserted in the application form for the sole protection of the banker, however, can be waived by him. In *Guaranty Trust of New York v. Van Den Berghs, Ltd.*[56] a firm of exporters, in Manila, agreed to sell a shipment of oil to American buyers. The buyers approached the Guaranty Trust to see whether they would be prepared to open an irrevocable credit in favour of the seller. Since however the buyers' financial stability was in doubt, the Guaranty Trust required the defendants Van Den Berghs to guarantee the performance of the obligations undertaken by the buyers. The buyers signed an application form in which they required the tender of bills of lading made out to the order of the Guaranty Trust. Due to unclear cable instructions, the correspondents of the Guaranty Trust in Manila notified the seller that the bills of lading should be made to the order of the buyers. The sellers shipped the goods and tendered a draft accompanied, *inter alia,* by bills of lading made out to the order of the buyers.

The Guaranty Trust accepted these documents. The buyers, who were in financial difficulties, refused to take up the documents. The defendants refused to honour their guarantee. It was argued that the bills of lading were not made out to the order of the Guaranty Trust and, therefore, did not comply with the terms of the letter of credit.

54 LIESECKE; STOUFFLET, at 212-213.

55 Liberty National Bank & Trust Co. of Oklahoma v. Bank of America National Trust & Savings Association, (1953) 116 F. Supp. 233, at 240, *affirmed* 218 F. 2d 831.

56 (1925) 22 Ll.L.R. 286, 447.

The Court of Appeal gave judgment for the Guaranty Trust. Scrutton L.J. said:[57]

> "A bill of lading to the order of the . . . [buyers] . . . was much better for them than a bill of lading to the order of the Trust; and if the Trust had chosen to waive that provision . . . I do not think . . . [the buyers] . . . could have complained."

There is no similar authority in Germany, France or the United States. It is submitted, with respect, that this decision should be applied with great care. It is not always easy to say off-hand which provisions of the application form are inserted for the sole protection of the banker. The latter should see to it that all the terms of the application form are incorporated in the letter of credit. The banker would, then, not be obliged to take up documents which do not comply with the terms of the application form.

The Banker is Only Concerned with Documents.

The duty of strict compliance is limited to conformity of documents. The banker is not concerned with the goods. This is clearly stated in article 8 of the U.C.P., which reads:

> In documentary credit operations all parties concerned deal in documents and not in goods.
>
> Payment, acceptance or negotiation against documents which appear on their face to be in accordance with the terms and conditions of a credit by a bank authorised to do so, binds the party giving the authorisation to take up the documents and reimburse the bank which has effected the payment, acceptance or negotiation.
>
> If, upon receipt of the documents, the issuing bank considers that they appear on their face not to be in accordance with the terms and conditions of the credit, that bank must determine, on the basis of the documents alone, whether to claim that payment, acceptance or negotiation was not effected in accordance with the terms and conditions of the credit.
>
> If such claim is to be made, notice to that effect, stating the reasons therefor, must be given by cable or other expeditious means to the bank from which the documents have been received and such notice must state that the documents are being held at the disposal of such bank or are being returned thereto. The issuing bank shall have a reasonable time to examine the documents.

[57] *Ibid.*, at 454.

This principle is supported by continental and common law writers[58] as well as by decided cases. In *Benecke v. Haebler*[59] the defendants entered into a contract of sale with one Strauss, by which they purchased from him a consignment of beans. At the order of the defendants the plaintiffs opened a documentary credit in favour of Strauss. The latter drew a draft, attached the required documents and presented the draft to the plaintiffs, who accepted it. The defendants refused reimbursement, arguing that though the documents were regular, the goods were of an inferior quality. It was held that the plaintiffs were under no obligation to examine the goods and were entitled to reimbursement.

An English case to the same effect is *Basse and Selve v. Bank of Australasia.*[60] In this case the plaintiffs ordered a German bank to open a documentary credit in favour of one Oppenheimer, of Sydney, from whom the plaintiffs purchased a consignment of cobalt ore. The German bank ordered the defendants to advise the credit to Oppenheimer and to add their confirmation. One of the documents called for in the documentary credit was a certificate of quality by Dr. Helms. Oppenheimer tendered a certificate which, on its face, complied with the requirements of the credit and obtained payment from the defendants. The defendants, on their part, tendered the documents to the German bank who accepted them and reimbursed the defendants. It was later discovered that Oppenheimer shipped worthless goods which were different from the sample examined by Dr. Helms. The plaintiffs brought an action claiming payment back from the defendants.[61] Dismissing the action, Bigham J. held that it was not the duty of the defendants "to verify the genuineness of the documents." Neither was it their duty to inquire from the shipping company if the goods had in fact been put on board the ship. It follows that whether the goods shipped comply with their description in the documents or not is immaterial. As long as the documents are regular on their face, it is not the duty of the banker to examine whether the goods are truthfully described in the documents.

This principle is closely connected with another one. The contract between the banker and the buyer (the terms of which appear in the application form) is separate and independent of the contract

58 STOUFFLET, at 212-213; MARAIS, at 29-31; WIELE, at 47; LUNK, at 40; GUTTERIDGE & MEGRAH, at 68.

59 (1899) 38 App. Div. 344, 58 N.Y.S. 16, *affirmed* (no opinion) (1901) 60 N.E. 1107.

60 (1904) 90 L.T. 618.

61 The question of lack of privity was raised but the court did not pronounce on it.

of sale.[62] The banker is not concerned with the contract of sale and its provisions.[63]

Exemption clauses.

Often bankers exempt themselves from responsibility or liability concerning the requirements of strict compliance. Clauses liberating the banker from responsibility for acts of the correspondent-banker,[64] or for delays of messages, introduced by the U.C.P., have already been mentioned.[65] Another relevant clause is article 11 of the U.C.P. which reads:

> Banks assume no liability or responsibility for consequences arising out of the interruption of their business by strikes, lock-outs, riots, civil commotions, insurrections, wars, Acts of God or any other causes beyond their control. Unless specifically authorised, banks will not effect payment, acceptance or negotiation after expiration under credits expiring during such interruption of business.

Similar exemption clauses are included in most English application forms. These exemption clauses are reasonable and fair. The banker obtains a limited remuneration for opening a commercial credit. It would be wrong to treat him as guaranteeing results.

Some bankers, especially in the United States and in South East Asia, include wider exemption clauses in their forms. Some of them go so far as to purport to exempt the bankers even from responsibility for acts or omissions of their own clerks.

The validity of such an exemption clause was tested in the High Court of Hong Kong. In *Netherlands Trading Society v. Wayne and Haylitt Co.*[66] the defendants agreed to buy a shipment of gunny bags from a Singapore firm. The defendants ordered the plaintiffs, a Dutch bank operating in Hong Kong, to open an irrevocable credit in favour

62 Moss v. Old Colony Trust Co., (1923) 246 Mass. 139, 140 N.E. 803, at 808; Liberty National Bank & Trust Co. of Oklahoma v. Bank of America National Trust & Savings Association, (1953) 116 F. Supp. 233, at 236-237 note 11, *affirmed* (1955) 218 F. 2d 831; STOUFFLET, at 217; MARAIS, at 32.

63 The banker is, further, not responsible for the genuineness of apparently regular documents and is not responsible if the documents turn out to be forgeries.

64 For a discussion of a somewhat similar exemption clause see Calico Printers' Association, Ltd. v. Barclays Bank, Ltd., (1930) 36 Comm. Cas. 71 (Q.B.), 197 (C.A.). In this case a banker exempted himself (although not in connexion with a documentary credit transaction) from responsibility for the acts of his correspondent. Wright J. (*ibid.*, at 83), whose decision was affirmed by the Court of Appeal (*ibid.*, at 206), upheld the validity of the exemption clause.

65 See at 48 *supra*.

66 (1952) 36 Hong Kong L.R. 109.

of the sellers in Singapore. The irrevocable credit so opened called for bills of lading, a "jute mills certificate" and a certificate of weight. The plaintiffs accepted a tender including a bill of lading which did not give a full description of the goods. In addition, instead of tendering one original "jute mills certificate" and one original certificate of weight, several fractional certificates were tendered. The defendants refused to take up these documents. The court held that the number of the certificates tendered was irrelevant, since these fractional certificates certified the right weight and origin of the goods. It was, on the other hand, decided that the bill of lading was a bad tender. The court decided that the bill of lading should have contained a full and accurate description of the goods in the words of the letter of credit.

The court then discussed another argument of the plaintiffs. The latter argued that the defendants were liable to reimburse them despite the non-conformity of the bill of lading. They relied, in that connection, on an exemption clause of the application form. That clause, apart from containing the usual provisions, exempted the plaintiffs from any liability for mistakes of any of their agents as well as for "failure of documents to accompany any draft at negotiation." It further provided that as long as a tender was taken by the plaintiffs in good faith the defendants remained obliged to reimburse them.

It was contended for the defendants that by accepting a non-conforming tender the plaintiffs committed a fundamental breach of their contract with the defendants. It was claimed that the plaintiffs delivered to the defendants a different commodity from the one bargained for. Gould J. rejected this argument. Giving judgment for the plaintiffs, he said:[67]

> "I think that is going too far. Other documents [than the bill of lading] gave the full description and, in my view, what happened was no more than an error committed in the performance or attempted performance of the contract. I am satisfied that it is to that matter, *i.e.*, the performance and manner of performance of the bank's obligations that Condition 5 [*i.e.*, the exemption clause] is specifically directed."

The learned judge subsequently discussed the remaining part of the exemption clause, *i.e.*, that the plaintiffs were not responsible for any deviation in a tender accepted by them in good faith. He considered it unnecessary to decide the validity of that part of the exemption clause, but pointed out that the plaintiffs would have to prove their good faith if they wanted to rely on this provision.

[67] *Ibid.*, at 129.

This judgment should be supported, but on different grounds. The better view is that it is sufficient if all the documents, between them, give a complete description of the goods.[68] The other alleged non-conformity of the case, *i.e.,* the tender of several fractional certificates instead of one original certificate of weight and one original "jute mills certificate," is, too, of little importance. In so far as fractional certificates covering the whole shipment gave the correct weight and testified to the origin of the goods, it is difficult to see why they should have been treated as a bad tender. The court could, therefore, have decided that there was compliance.

The decision respecting the exemption clause, on the other hand, cannot be supported. The very essence of a commercial credit transaction is that documents must strictly comply with the specified requirements. It is wrong to say that a different or faulty tender is "almost the same," and that its acceptance is a "mere error." Bankers are not in a good position to judge what is a fundamental deviation from the instructions and what is not. The acceptance of any faulty tender of documents, even if an "error," is incompatible with the main object of the contract. The remaining part of the clause, *i.e.,* that the buyer remains liable to reimburse the banker against any tender which the banker takes in good faith, is simply amazing. It is one thing for the banker to exempt himself from errors occurring in the transmission of documents, or from responsibility for the fault of a far-away correspondent. These are errors arising from circumstances over which he has no control. But a wholesale exemption from any responsibility arising from a breach of contract, as long as the breach is not in bad faith, is a startling provision. If bankers are unable to find responsible employees who are capable of examining a tender of documents, they should not offer their services as issuers of commercial credits. To charge customers with a banking commission, payable for *professional services,* is incompatible with an exemption clause liberating the banker from negligence or failure to perform these services properly.

It is the essence of the documentary credit transaction that all documents required need be tendered. "It is both common ground and common sense that in such a transaction the accepting bank can only claim indemnity if the conditions on which it is authorised to

68 In England see Midland Bank, Ltd. v. Seymour, [1955] 2 Lloyd's Rep. 147, at 152. In the U.S.A. see, *e.g.,* Laudisi v. American Exchange National Bank, (1924) 239 N.Y. 234, 146 N.E. 347, at 349; Border National Bank of Eagle Pass, Tex. v. American National Bank of San Francisco, Cal., (1922) 282 F. 73, at 80. *Contrast* the French view: STOUFFLET, at 220-222.

accept are in the matter of the accompanying documents strictly observed. There is no room for documents which are almost the same, or which will do just as well. Business could not proceed securely on any other lines."[69] A tender including non-conforming documents is a different commodity from the one bargained for and its tender is not anything similar to performance.

It is submitted that an exemption clause should not be interpreted in such a way as to alter the whole meaning of the main contract. Support for this argument can be found in cases concerning clauses permitting carriers to deviate from the agreed route. In such cases the "two parts of the bill of lading, the described voyage and the liberty to deviate, must be read together and reconciled, and . . . a liberty [to deviate], however generally worded, could not frustrate but must be subordinate to the described voyage."[70]

An exemption clause which liberates a banker from his duty to examine documents tendered under a commercial credit with care and skill and to accept only a good tender, is incompatible with the main object of commercial credits. It is as objectionable as an exemption clause which permits a carrier to deviate unnecessarily from an agreed route. "It is a well settled rule of construction that if one party puts forward a printed form of words for signature by the other, and it is afterwards found that those words are inconsistent with the main object and intention of the transaction as disclosed by the terms specially agreed, the court will limit or reject the printed words so as to insure that the main object of the transaction is achieved."[71] The main, or front, part of the application form specifies a list of documents against the tender of which the buyer promises to reimburse the banker. A "wholesale exemption" clause should not be interpreted in such a way as to frustrate this object.

It is submitted that extensive exemption clauses in the application form should, therefore, not be given an interpretation which would lead to substituting a duty of honesty for that of strict compliance, or which would allow a banker to claim reimbursement even if he himself had failed to exercise the required care and skill.

69 *Per* Viscount Sumner in Equitable Trust Co. of New York v. Dawson Partners, Ltd. (1927) 27 Ll.L.R. 49, at 52.

70 Frenkel v. MacAndrews & Co., Ltd., [1929] A.C. *per* Viscount Sumner at 562, cited by CARVER, CARRIAGE BY SEA (11th ed., 1963), at 604. The discussion of liberties to deviate (*ibid.*, at 602-608) is commendable. See also CHORLEY AND GILES, SHIPPING LAW (5th ed., 1963), at 176-177.

71 Neuchatel Asphalte Co., Ltd. v. Barnett, [1957] 1 Weekly L.R. 356, at 360 cited by TREITEL, THE LAW OF CONTRACT (London, 1962), at 138. See also Connolly Shaw, Ltd. v. A/S Det Nordenfjeldske D/S, (1934) 49 Ll.L.R. 183, at 190.

Although there is some doubt as to whether negligence can amount to a fundamental breach of contract[72] it is clear that the particular exemption clause in *Netherlands Trading Society v. Wayne and Haylitt Co.*[73] would have enabled the bankers virtually to disregard the primary obligation of the contract at will, and it is therefore submitted that it was inconsistent with the main purpose of the transaction.[74]

The Banker's Security for His Advances.

In most cases, the banker does not expect to be reimbursed by the buyer until after he has paid the amount of the commercial credit to the seller. The banker, therefore, needs a security for the advances he makes.

This security is provided by the documents of title which the banker receives from the seller. Possession of these documents, especially when the goods are carried by sea, gives the banker control over the goods. The documents tendered generally include (1) a bill of lading, made out in the banker's name (or made out to the seller and blank indorsed by him), (2) an insurance policy and (3) an invoice. It is usually expressly stipulated in the application form that these documents are to be pledged to the banker. The banker therefore obtains, when the documents are delivered to him, a security title.[75] It should be noted that the bill of lading represents the goods afloat, and its possession is equal to the possession of the goods themselves.[76] An indorsee of a bill of lading obtains a title to the goods even if he

72 Spurling (J.), Ltd. v. Bradshaw, [1956] 1 Weekly L.R. 461; Sze Hai Tong Bank, Ltd. v. Rambler Cycle Co., Ltd., [1959] A.C. 576; Hollins v. J. Davy, Ltd., [1963] 2 Weekly L.R. 201.

73 (1952) 36 Hong Kong L.R. 109.

74 As to "fundamental breach" see TREITEL, *op. cit. supra,* at 148-149; CHITTY ON CONTRACTS, ((22nd ed., 1961), para. 710 (at 301); Wedderburn, *Contract —Exemption Clauses—Fundamental Breach—Main Objects of Contract,* (1957) CAMB. L.J. 16; Wedderburn, *Contract—Exceptions Clause—Fundamental Breach—Agents,* (1960) CAMB. L.J. 11; Guest, *Fundamental Breach of Contract,* (1961) 77 L.Q. REV. 98 (*esp.* at 113); Guest, *Negligence and Fundamental Breach,* (1963) 26 MOD. L. REV. 301.

75 GUTTERIDGE & MEGRAH, at 137-138; DAVIS, at 185-186; STOUFFLET, at 174 *et. seq.;* MARAIS, at 25-26; WIELE, at 49; Jacoby, *"Das Akkreditiv,"* (1921) 20 BANK ARCHIV 245, at 265-266.

This is most clearly described by Scrutton L.J. in Guaranty Trust of New York v. Van Den Berghs, Ltd., (1925) 22 Ll.L.R. 447, at 452.

76 Sanders Bros v. Maclean & Co., (1883) 11 Q.B.D. 327 *per* Bowen L.J. at 341. See also CARVER, *op. cit. supra,* at 862 *et seq.* (esp. para. 1045); STOUFFLET, at 176 *et seq.;* KREBS, at 38-41.

is a pledgee.[77] The banker thus obtains a pledge over the goods themselves as well as over the documents.

It should be added that "[b]ankers' liens, or bankers' pledges, effected in such way, give, according to the views of merchants, the bankers a right of sale. Whether you talk about it as an express pledge, or whether, as Lord Campbell does, you talk about it as an implied pledge . . . such a transaction gives an independent right, a right of property, to the bank, to secure the amount which they have advanced, and the bank are not put on enquiry unless there is something obviously wrong with the transaction so as to make it not a *bonâ fide* transaction on their part."[78]

On the Continent the banker, also, obtains a right to sell the goods in order to reimburse himself. It must, however, be by way of forced sale or auction.[79]

Throughout the documentary credit transaction this security is a sufficient one. If the buyer reimburses the banker when the latter tenders the documents there is no necessity for further securities. Often, however, the buyer depends on the proceeds of the goods for reimbursing the banker. In order to sell the goods he needs the documents of title. The banker, however, is not keen to part with the documents before obtaining reimbursement or, at least, another security. In France and Germany there is no practical solution. The buyer will simply be required to give a new security.[80]

Equity provides a better answer, *i.e.*, the release of the documents under a "trust reecipt." The release of documents under a trust receipt is not part of the documentary credit contract but a new transaction. The legal problems of trust receipts will, therefore, be discussed briefly.[81]

It should be noted that the name "trust receipt" is inaccurate. The buyer does not hold the *documents* released to him as a trustee

77 Sewell v. Burdick, (1884) 10 App. Cas. 74, at 86; Brandt v. Liverpool, Brazil and River Plate Steam Navigation Co., [1924] 1 K.B. 575. See also CHORLEY AND GILES, *op. cit. supra,* at 160; CARVER, *op. cit. supra,* at 58-62.

78 Rosenberg v. International Banking Corporation, (1923) 14 Ll.L.R. 344, *per* Scrutton L.J. at 347, cited by GUTTERIDGE & MEGRAH, at 138. See also Moors v. Drury, (1904) 186 Mass. 424, 71 N.E. 810.

79 Art. 93 *C. Com.* See CORDIER, TRAITE DOCUMENTAIRE ET CREDIT DUCUMENTAIRE (Paris, 1959) at 76; Koch, *Rechtstellung der Banken bei Kreditgewaehrung gegen Uebergabe von Dispositionspapiereren,* (1921) 20 BANK AACHIV 249.

80 STOUFFLET, at 85-87; CORDIER, *op. cit. supra* at 184-188.

81 For a detailed discussion on the subject see GUTTERIDGE & MEGRAH, at 141 *et seq.;* DAVIS, at 189-201. See also HOLDEN, SECURITIES FOR BANKERS' ADVANCES (3rd ed., 1961), at 263-264.

of the banker. The banker retains the title to the documents.[82] The buyer, therefore, seems to hold the documents as an agent rather than a trustee. After the sale of the goods, on the other hand, the buyer holds the *proceeds* on trust for the banker.[83] Thus, in the words of Astbury J. in *Re David Allester, Ltd.*[84] the buyer is a trust agent.

It follows that the trust receipt offers the banker a good security against bankruptcy. If the buyer fails before the goods are sold, the banker is able to claim the documents as his own property.[85] If the buyer fails after the realisation of the goods the banker has priority over the proceeds.[86]

It is less certain whether the trust receipt protects the banker against fraud. The buyer is considered the mercantile agent of the banker, under section 2(1) of the Factors Act, 1889.[87] If the buyer, fraudulently, pledges the documents to a third party who advances money against them in good faith, the third party acquires a good title.[88]

82 This follows from the language employed in most trust receipts. See also Lloyds Bank, Ltd. v. Bank of America National Trust and Savings Association, [1937] 2 K.B. 631 (K.B.), [1938] 2 K.B. 147 (C.A.) where it was held that the pledgor is the mercantile agent of the banker-pledgee and that, together, they are the "owners" of the goods within the meaning of sec. 2 of the Factors Act, 1889 (52 & 53 Vict., c. 45); Official Assignee of Madras v. Mercantile Bank of India, Ltd., [1935] A.C. 53, at 63. (P.C.). *Cf.* DAVIS, at 190. In the U.S.A. it was held in Mershon v. Wheeler, (1890) 76 Wis. 502, 45 N.W. 95, at 96, that when bankers release documents tendered under a trust receipt to the buyer, they retain the ownership of the goods: ". . . [the bankers] could be said to be the owners of the property for security" (*ibid.*).

83 This follows from Re David Allester, Ltd., [1922] 2 Ch. 211, at 219. This case further decides that trust receipts need not be registered under sec. 93 of the Companies (Consolidation) Act, 1908 (8 Edw. 7, c. 69) (Now sec. 95 of the Companies Act, 1948 (11 & 12 Geo. 6, c. 38)), either as a bill of sale or as a charge over book debts.

84 [1922] 2 Ch. 211, at 219.

85 Property held by the bankrupt as a trust-agent or factor does not constitute part of the estate of the bankrupt. See WILLIAMS, LAW AND PRACTICE IN BANKRUPTCY (17th ed., 1958), at 278.

86 Re David Allester, Ltd., [1922] 2 Ch. 211. See also North Western Bank, Ltd. v. John Poynter, Son, & Macdonalds, [1895] A.C. 56. In the U.S.A. see Mershon v. Wheeler, (1890) 76 Wis. 502, 45 N.W. 95, at 86; Re Bettman-Johnson Co., (1918) 250 F. 657, at 661-662.

87 52 & 53 Vict., c. 45.

88 Lloyds Bank, Ltd. v. Bank of America National Trust and Savings Association, [1937] 2 K.B. 631 (K.B.), [1938] 2 K.B. 147 (C.A.): Mercantile Bank of India, Ltd. v. Central Bank of India, Ltd., [1938] A.C. 287 (P.C.) should be distniguished. In view of the special facts of that case it was not raised that the buyers were mercantile agents of the bankers. See HOLDEN, *op. cit. supra,* at 275 *n.*

In the United States this difficulty is partly avoided by the registration of trust receipts.[89] When the banker registers the trust receipt he perfects his security against all the creditors of the buyer.[90] Yet even in the United States a *bona fide* purchaser of the goods or documents acquires a good title.[91] It should, however, be borne in mind that mercantile law contemplates insolvency, not fraud.[92] The buyer might sell the goods, as he is indeed entitled to do under the trust receipt, but instead of remitting the proceeds to the banker abscond with the money, or just fritter it away. Against such possibilities there is no security.

Problems Concerning Currency Regulations.

On occasions currency regulations may lead to difficulties in the opening of a commercial credit. Currency regulations in the country of the buyer may—at any time—render the opening of the credit illegal. Similarly, difficulties can arise in the country of the seller.

In so far as the law in the country of the buyer forbids the opening of the credit, that would be the end of the transaction. It is unlikely that any court of law will allow an action against a banker who simply refuses to do an act forbidden at law. If the regulations are issued in the country of the seller, the buyer will, similarly, be unable to sue the correspondent-banker.[93]

The title of the innocent party would, it should be added, fully depend on the buyer being the mercantile agent of the banker. The buyer is not the reputed owner of the goods: Re Young, Hamilton & Co., [1905] 2 K.B. 381, at 389-390. This case further decides that a trust receipt is not a bill of sale within the meaning of sec. 4 of the Bills of Sale Act, 1878 (41 & 42 Vict., c. 31).

89 See s. 9-401 of the UNIFORM COMMERCIAL CODE (U.S.A.), replacing s. 4 of the Uniform Trust Receipts Act. The new section "does not attempt to resolve the controversy between the advocates of a completely centralized state-wide filing system and those of a large degree of local autonomy. Instead the section is drafted in a series of alternatives; local considerations of policy will determine the choice to be made." (From the comments of the American Law Institute, UNIFORM COMMERCIAL CODE—OFFICIAL TEXT WITH COMMENTS, (Philadelphia-Omaha, 1958), at 683).

90 S. 9-304 UNIFORM COMMERCIAL CODE (U.S.A.). See WARD & HARFIELD, *op. cit. supra,* at 63-69. An unregistered trust receipt is, nevertheless, valid as between the banker and the buyer. See Re Bettman-Johnson Co., (1918) 250 F. 657, at 667.

91 See WARD & HARFIELD, *op. cit. supra,* at 69; Uniform Trust Receipts Act, sec. 9.

92 See Bowen L.J. in Sanders Bros. v. Maclean & Co., (1883) 11 Q.B.D. 327, at 343.

93 Assuming that there is privity of contract between them. See on this point GUTTERIDGE & MEGRAH.

What would be the result of unfavourable currency or economic legislation issued in the country of the seller on the relationship between the buyer and the issuing-banker?[94] It may, for example, happen that the issuing-banker, at the request of the buyer, instructs a correspondent-banker in the seller's country to accept drafts of the seller. New, unexpected, currency regulations may forbid the correspondent-banker to accept the seller's draft. The seller may, as a result, refuse to deliver the goods, and the buyer might then stand to sustain a loss of profits. May the buyer, in such cases, be entitled to recover damages from the issuing-banker? Article 11 of the U.C.P. exempts bankers from any liability or responsibility arising out of the interruption of their business by causes beyond their control. It follows that if the issuing-banker's own branch acts in the country of the seller, this article would protect him, if there is any interruption in his business (*e.g.*, if his money is attached by an Act of State). If the issuing-banker engages another banker as correspondent he would, in any event, not be responsible for the acts of the latter.[95]

Problems can, however, arise if the issuing-banker keeps abroad the foreign currency needed for meeting drafts drawn under a commercial credit. An authority on this point is *China Mutual Trading Co., Ltd. v. Banque Belge Pour L'Etranger (Extreme-Orient) S.A.*[96] In this case the plaintiffs, a Hong Kong firm, agreed to purchase goods from American exporters. The plaintiffs instructed the defendants, a Belgian bank operating in Hong Kong, to open several irrevocable credits in favour of the American exporters. These credits were to be payable in United States currency. In order to induce the defendants to open these letters of credit, the plaintiffs agreed to pay, before the opening of each of these credits, 40% to 50% of their respective amounts. Originally, these margins or advances were paid by the plaintiffs in Hong Kong currency. However, in order to avoid loss through fluctuations of the rate of exchange, the plaintiffs entered into "forward exchange contracts" with the defendants. In these contracts the defendants agreed to sell the plaintiffs United States currency and to hold United States currency in place of the margins or advances paid by the plaintiffs to the defendants in Hong Kong currency. The United States currency so sold was transferred by the defendants to the United States and formed part of the balance standing to the credit of the defendant's United States dollar account with their correspondents in that country. Subsequently, the United States

94 See explanation of terminology in note 5 *supra*.
95 See at 48-49 *supra*.
96 (1954) 39 Hong Kong L.R. 144.

Government froze the defendants' account with their correspondents in the United States. The reason for this measure is not disclosed in the report. It is likely that it was connected with the boycott of Red China, which was even extended to non-American bankers accused of financing transactions with that country.[97] After the freezing of the account, the defendants secured permission from the United States treasury to pay the sum held for the plaintiffs into another blocked account, already existing in the plaintiffs' name, and to debit the defendants' blocked account with a like amount. The commercial credits were not realised. The defendants, however, refused to repay the amounts of the margins or advances to the plaintiffs. They contended that the "forward exchange contracts" were either performed or that they were excused from performance due to supervening illegality. In other words, they argued that by paying the money into a blocked account they had discharged their contracts.

Reynolds J. held that:[98]

> ". . . the forward exchange contracts effected an actual sale of U.S. dollars by the defendants to the plaintiffs. I also consider that generally in forward exchange contracts it is implied by custom or usage that delivery of the U.S. dollars sold thereunder is to be in the United States of America to the buyers or their nominees."

He decided, accordingly, that the bankers completely performed the forward exchange contracts for the purchase of the currency. He, then, decided that the rights of the plaintiffs to the amounts held in the United States were those arising out of the relationship of banker and customer, *i.e.,* a relationship of debtor and creditor. He pointed out that both the plaintiffs and the defendants were Hong Kong firms, that the contract was made in Hong Kong and that, therefore:

> "Upon the letters of credit expiring, without drafts being drawn against them I consider that the money deposited with the defendants became due as a debt to the plaintiffs localized in Hong Kong."[99]

The learned judge further held that by paying the amounts due to the plaintiffs into a blocked account in the United States, the defendants did not discharge their debt, and that the plaintiffs were entitled to be repaid in Hong Kong.

97 This, I am told by London bankers, was the background of several similar activities of the U.S. Treasury in that period.

98 (1954) 39 Hong Kong L.R. 144, at 150.

99 *Ibid.,* at 152.

In so far as the debt was reclaimable in Hong Kong, it is difficult to quarrel with the decision. Moreover, had there been only a simple request to open commercial credits, the debt would, indeed, have been repayable in Hong Kong. In simple commercial credit transactions there is no special contract to purchase currency abroad. The correspondent-banker pays the seller's draft in the currency of their country; the issuing-banker then reimburses the correspondent-banker and claims the equivalent (in the currency of the buyer's country) from the buyer. In such cases, if the account of the issuing-banker abroad is "frozen," there is no reason why the buyer should be the loser, especially when the banker brought about his own downfall by violating an embargo.

In the case under discussion, however, the plaintiffs, the buyers, made further contracts with the defendants, their bankers, for the purchase of United States currency. This amount was held, at the plaintiffs' request, for their account in the United States. It is therefore arguable that the amount so held was recoverable in the United States.[1]

The learned judge thought that even if the debt was not reclaimable in Hong Kong, the plaintiffs must succeed. He held, in that connection, that the proper law of the contracts was the law of Hong Kong. He then added that it was common ground that the performance of the forward exchange contracts became impossible in view of the currency regulations in the United States. He decided, therefore, that the money would be reclaimable under section 3 of the Law Reform (Frustrated Contracts) Ordinance of Hong Kong, which is similar to the corresponding English Act. He held that, since the defendants did not deliver any U.S. dollars to the plaintiffs or to their order, the forward exchange contracts were not completely performed and the sums were, therefore, reclaimable.

If it was the duty of the defendants to *deliver* U.S. dollars to the plaintiffs in the United States, the decision is right. But was it not the essence of the contracts that the money should be kept in the defendants' account in the United States for meeting the drafts of the sellers? Was this not one of those cases where an amount of money, kept by a bank, was "earmarked" for a specific purpose? Since the defendants paid the amount into a blocked account, and thus dealt with the money in an unauthorized manner, one can agree with the

[1] See Arab Bank, Ltd. v. Barclays Bank D.C.O., [1954] A.C. 495, where it was held that a credit balance of a current account is payable in the branch at which the account is kept.

decree of the judge. But what would have been the position, had the defendants done nothing at all after the freezing of their account?

At common law it is extremely difficult to suggest a definite answer. In *Arab Bank, Ltd. v. Barclays Bank D.C.O.*[2] the plaintiffs kept a current account with a Jerusalem branch of the defendants. The plaintiffs' account with that branch was attached by the Israeli government. The House of Lords held that the plaintiffs could not claim the money from the defendants in London. The debt was situated in Jerusalem and became subject to Israeli law. If, in the Hong Kong case, the plaintiffs instructed the defendants to keep the money in the United States until the expiration or realization of the credit, would not the position be similar? Would not an order (1) to keep a specified amount, (2) in a specified place, (3) in a special account of the bankers, be similar to an instruction to open a special account with a specified branch of a bank?

If it is agreed that the two cases are similar, then it may be difficult to support the decision that the debt was reclaimable in Hong Kong. If it was reclaimable in the United States, then the freezing of the account in that country could be regarded as an interruption of the defendants' business. Article 11 of the U.C.P. could in such a case protect the defendants.

British banking forms would avoid the type of difficulty which arose in the Hong Kong case. The following extract from an application form is a good example:

> If the Credit is in Foreign Currency, and it is desired to cover the Exchange *immediately,* the following instructions should be completed and signed and the relative form E attached:—
>
> In cover of the above mentioned Credit please purchase
>
> *(A) ..... SPOT[3]
> (Insert foreign currency and amount)
>
> *(B) ..... FORWARD[4] at
> (Insert foreign currency and amount) months option
>
> *Strike out (A) or (B)

2 [1954] A.C. 495.

3 A Spot Foreign Exchange transaction consists of the purchase or sale of one currency against another, for prompt settlement, which on the London market is two working days ahead.

4 Forward Foreign Exchange is an operation whereby a rate is fixed at once for the purchase or sale of one currency against another, for settlement at that rate at a future date.

It is understood that any currency held by you with your Correspondents as the result of the above spot purchase or as the result of a matured forward contract, will be at our entire risk.

Signed.....

The last sentence of this form gives the banker the desirable protection.

E. P. ELLINGER.*

† Addenda: To footnote 5 add: *"The Tender of Fraudulent Documents under Documentary Letters of Credit."* (1965) 7 MALAYA L. REV. 24, at 26-27. To footnote 62 add: *op. cit.*, at 29-31.

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