

COMMERCIAL LETTERS OF CREDIT

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In New Zealand it is a fact—well known and widely regretted—that income tax in all its aspects is a matter for accountants and not for lawyers. Perhaps because income tax necessarily deals with pounds, shillings and pence, soon to become dollars and cents or, perhaps, zeals and kiwis—the lawyers have allowed the position to go by default. The average businessman, confronted with an income tax problem, is likely to consult his accountant first and then, and only in case of need, his lawyer. A revision of the syllabus in the law schools seeks to amend the situation, but I am afraid the pass has been sold. Income tax problems have, in the past, been regarded as somewhat esoteric—to be confined to a charmed circle of experts. Now the profession is paying the price.

If income tax is or is supposed to be an esoteric subject, what about the subject of this paper? I suppose that even amongst this learned audience there are some who do not appreciate the operation of letters of credit and perhaps more who do not appreciate the legal problems attaching to them.

First then, as to the operation of commercial letters of credit, which Lord Chorley¹ has aptly described as the crankshaft of modern commerce. Almost without exception, they arise out of a contract for the sale of goods, the seller usually being in one country and the buyer in another, though in the United States, internal letters of credit, that is, those in which the seller carries on business in one State and the buyer in another, are not unknown. One of the terms of the contract for the sale of goods is that the buyer will pay the purchase price by means of a letter of credit. Usually there will be some description of the type of letter of credit, whether revocable or irrevocable, confirmed or unconfirmed. I shall explain some of these terms later. In order to carry out his side of the contract, the buyer will go to his banker to procure the issue by him, the banker, of a letter of credit in favour of the seller. But before the banker will issue the letter of credit, he will get his customer, the buyer, to complete and sign an application to open a documentary credit. This is a most important document from the point of view of both the buyer and the banker. In it the buyer will instruct the banker as to what documents he is to receive on the buyer's behalf, in compliance with the contract for the sale of the goods. Must the insurance be covered by a policy of insurance or is a certificate sufficient? Must the bills of lading be "shipped" bills of lading or will a "received for shipment" bill of lading suffice? Are partial shipments allowed? Is transshipment allowed? I must say that it is only with the development of the law relating to commercial letters of credit that these details have been worked out. In the early type of letters of credit, careless phrases such as "bills of lading" "insurance cover" and the like were used and the courts have been concerned to determine what the parties really intended. But more and more these details are being looked after.

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¹ *Law of Banking*, (4 ed. 1960) 179.

Another important document may be, and should, in appropriate circumstances, be asked for, and that is a certificate of quality given by an authorised person. Let me tell you of an experience of mine. A couple of young men, with the aid of a rehabilitation grant, had set up in business as importers of men's clothing, including bolts of suitings. They got into touch with a firm—not I think of manufacturers of cloth, but with an intermediate agent who sold suitings. This agent sent to the New Zealand importers, who were lucky enough to get an import licence, a sample of some tweed cloth. First rate material and the price was right. This cloth would sell on the market like the proverbial hot cakes. So the New Zealand importers—I think they were rather babes in the wood when it came to business—ordered a quantity of this cloth—as per sample—to the tune of about £600. The seller required payment by letter of credit. This was provided. But the only documents the letter of credit, following the terms of the letter of application, required were the invoice, policy of insurance and a bill of lading. These documents duly came forward, drafts drawn under the letter of credit were duly met, and finally possession was taken of the goods. But when the cases were opened it was found that the bulk was sadly inferior to the sample in quality. Indeed, one could have shot peas through most of the suiting, so loosely woven was it. Of course, there had been a breach of the condition in the contract of sale that the bulk should comply with the sample in quality. But that was not much comfort to the New Zealand importers who only had a right of action against a firm in England of whom they had got only the sketchiest of bank references—such as would certainly not have got the bank into trouble even if *Hedley Byrne v. Heller*² had been decided in those days. So the New Zealand people cut their losses, sold the cloth for what it would fetch and, so far as I know, went into another line of business. In the long run I believe the Rehabilitation Department, in other words, the taxpayer, footed the bill. Now if these returned servicemen had only been a little bit wiser, they would, in their application, have included in the documents the bank had to take up a certificate, signed by someone who had inspected the goods and whom they could trust, that the bulk corresponded with the sample in quality. There is really no limit to the documents which the buyer can call for: in *Yelo v. Machado*³ “phytopathological certificates” were required.

But to get back to the application made to the bank to issue the letter of credit: after detailing the documents required and the goods which they are intended to cover, the buyer agrees that, in consideration of the bank issuing the letter of credit, the bank shall have a pledge on all goods and documents of title over the goods which are delivered into the possession of the bank or its correspondents as a result of the opening of the credit. In addition, as might well be expected, there is a further clause exonerating the bank from liability for any error, fault, or mistake in the description, quantity, quality or delivery of the goods concerned.

Now this application for the issue of a letter of credit is a most important document. It is, of course, a contract between the buyer and the bank, supported by adequate consideration. The bank will depart from the terms of this application—sometimes called a letter of request, only at its peril. If the application calls for a full-set of bills of lading, it is no good for the banker

² (1964) A.C. 465.

³ (1952) 1 Lloyds Rep. 183.

to accept one or two. Quite an amount of the litigation which has arisen out of letters of credit, has involved the duty of the bank under the terms of the letter of request.

Being satisfied that the letter of request is all in order and being satisfied as to the credit-worthiness of his customer, the bank will issue the letter of credit. I shall not, at the moment, complicate the matter by making reference to correspondent or confirming bankers who will normally carry on business in the seller's country. For the sake of simplicity, I shall merely state that in the letter of credit which the issuing banker—for our purposes—sends direct to the seller, the banker authorises the seller to draw on him, at sight or at so many weeks or months after sight on account of the goods the subject of the contract of sale for the sum which represents the purchase price of the goods.

This does create one of the most difficult theoretical problems concerning commercial letters of credit—a problem which, however, does not seem to have worried the courts. As I have mentioned, in the case of an irrevocable letter of credit—I shall not mention here the revocable letter of credit which is rarely used—the issuing banker gives an unqualified promise to the beneficiary of the credit—the seller—that he will meet the seller's drafts provided they are accompanied by the documents specified in the letter of credit. But normally the beneficiary will be unknown to the issuing banker. He is known only as the person that his customer has named as the seller in whose favour the letter of credit is to be issued. It would be begging the question to say that there is no contract between them. But certainly there is no consideration moving from the seller to the banker sufficient to support a simple contract. Yet it is recognised throughout the common law world that the banker's promise is absolute; he cannot withdraw from it with impunity. I am not going to discuss here the various theories which have been advanced to support the irrevocability and binding nature of the banker's promise. I have discussed the question in detail in the *Law Quarterly Review*,⁴ and in outline in chapter VII of my book. Here I would merely refer to the judicial decisions in which the question has been adverted to. Of course, it might be suggested that the doctrine of *jus quaesitum tertio* might give the seller a right against the banker, even though he gave no consideration. This doctrine seemed, at one time, to be making some headway in the common law: for example, from Lord Denning in *Smith and Snipes Hall Farm Ltd. v. River Douglas Catchment Board*⁵ and in *Drive Yourself Hire Co. (London) Ltd. v. Strutt*.⁶ But it has been definitely rejected by the Court of Appeal in *Green v. Russell*⁷ and by the House of Lords in *Midland Silicones v. Scruttons Ltd.*⁸ But the relevant judicial decisions have not sought to uphold the seller's right by reference to any such theory. Rather it has been sought to uphold the banker's duty by saying that when the seller "acted on the promise" contained in the letter of credit, whatever that may mean, consideration moved from the seller and thereafter the banker could not revoke his promise. Of course, it may be said that in acting on the banker's promise, the seller was not doing anything more than he was bound to do under his contract with the buyer and, as we all know, there is much doubt whether a promise to perform or the

⁴ (1936) 52 *L.Q.R.* 225.

⁵ (1949) 2 *K.B.* 500, 514.

⁶ (1954) 1 *Q.B.* 250, 275.

⁷ (1959) 2 *Q.B.* 226.

⁸ (1962) *A.C.* 446.

performance of a duty towards a third party, already existing, does constitute consideration. But let us look at the authorities.

In *Urquhart Lindsay & Co. Ltd. v. Eastern Bank Ltd.*⁹ a contract was made between the plaintiffs and the Benjamin Jute Mills. Under the contract, the plaintiffs agreed, not merely to sell, but to manufacture and ship certain machinery, delivering it f.o.b. Glasgow for carriage to Calcutta. Payment was expressed to be made by means of an irrevocable letter of credit. The buyers arranged for the opening by the defendants of an irrevocable credit in the plaintiffs' favour. After certain drafts under the credit had been met, the buyers, finding that the sellers, the plaintiffs, were including in their invoices an addition to the prices originally quoted, in respect of an alleged rise in wages and cost of materials, instructed the defendant bank to pay only so much of the next invoices as represented the original prices. The defendants obeyed these instructions and accordingly refused to meet the next bill presented. Hence the action. Dealing with the legal position of the parties, Rowlatt, J. said:

There can be no doubt that upon the plaintiffs acting upon the undertaking contained in this letter of credit consideration moved from the plaintiffs, which bound the defendants to the irrevocable character of the arrangement between the defendants and the plaintiffs.¹⁰

What "acting on the undertaking" meant, Rowlatt, J. did not say. But in the circumstances, as the contract was to "manufacture and deliver", the beginning of the manufacturing would seem to be an acting on the undertaking sufficient to constitute consideration.

The particular document discussed in *Dexters Ltd. v. Schenker & Co.*¹¹ was not in form a letter of credit, but it was treated as such. The defendants wrote to the plaintiffs as follows:

Re 10 tons vegetable grease for Messrs. Astra. . . . we beg to inform you that today we have received the amount of . . . (£700 odd) for the above consignment. We request you to arrange shipment of this parcel by earliest occasion and let us have your shipping advice, stamped and signed B/L and certificate of insurance as soon as possible. At once after receipt of the goods at Rotterdam we will transfer the above-named amount to you.¹²

The defendants refused to pay on the ground that the goods were not as described in the contract. They also pleaded absence of consideration moving from the seller but abandoned this plea during the argument. Greer, J. said:

Now it is clear that, until the plaintiffs got a form of banker's credit which would comply with the terms of the contract, they were not bound to send the goods forward at all; and therefore, not having got the banker's credit, until there was a substituted arrangement for some other credit elsewhere, they were under no obligation to anybody to send forward the goods. Therefore, it is quite clear that there was a full and ample consideration for this undertaking, and I am not surprised that Mr. Wallington (counsel for the defendants) withdrew the contention which appears in the pleadings that there was no consideration.¹³

Authority, such as there is, in the United States, is to the like effect. In

⁹ (1922) 1 K.B. 318.

¹⁰ *Ibid.* at 321-22.

¹¹ (1923) 14 Ll. L. Rep. 586.

¹² *Ibid.* at 588.

¹³ *Ibid.*

Moss v. Old Colony Trust Co.,¹⁴ a Buenos Aires merchant sought to recover from the bank damages against the bank because it refused to accept and pay four drafts drawn by the plaintiff under an irrevocable letter of credit issued by the defendants in his favour. Dealing with the effect of such a letter of credit Rugg, C.J. said:

A letter of credit is an offer by a bank or other financial agency to be bound to the person to whom it is directed, when accepted and acted upon by the latter according to its stipulations. . . . The letter of credit, when so accepted and acted upon by the person in whose favour it is issued, becomes a contract between them wholly independent of the relations between the writer of the letter of credit and its customer.¹⁵

On the authorities, therefore, it would seem that once the seller has "acted upon" the banker's promise, whether by beginning manufacture, shipping goods or doing any other act contemplated by the original contract between buyer and seller, there is a binding contract and the banker repudiates it only at his peril. At least, it seems, he cannot plead absence of consideration.

But the seller, for his part, must strictly comply with the terms of the letter of credit if he is to hold the banker liable on it. As has been mentioned, the letter of credit will stipulate what documents must accompany the seller's drafts. These, for the protection of the banker against claims by his customer, must comply exactly with those specified in the letter of request. The banker can seek reimbursement from his customer only if he has complied with the customer's mandate. Therefore, if the buyer has told the banker that among the accompanying documents is to be a certificate of quality signed by X, then such a document must be specified in the letter of credit and accompany the seller's draft. It is no good forwarding a certificate signed by Y, even though, in the particular trade, Y may be more expert than X.

I had what, to me, is an amusing illustration of this point some years ago. A New Zealand merchant had sold some butter—not a large quantity, measured in hundredweights, to an importer in Cuba. The terms were so much a hundredweight c.i.f. Havana. According to the terms of the sales contract the seller's drafts had to be accompanied by a certificate of quality authenticated by the Cuban consul in New Zealand. A letter of credit issued by a Cuban bank had been confirmed by an Auckland bank; that is to say, the Auckland bank, the correspondents of the Cuban bank, had, in broad terms, guaranteed the Cuban bank's letter of credit. But no-one could find a Cuban consul in New Zealand so the New Zealand merchant thought it would do just as well if he got the certificate of quality from the United States consul. This was some years before the Castro regime. The geography of the foreign exchange clerk at the bank must have been a bit weak. Apparently he thought Cuba was part of the United States. In any event he accepted the United States certificate as complying with the terms of the letter of credit. Then the Foreign Manager came on the scene. Checking through what I suppose is the documents register, he found that the terms of the letter of credit had not been complied with in that an ineffective certificate of quality had been accepted and forwarded to Havana along with the other documents; and, what was more important immediately, the seller, the Auckland merchant, had been paid for the butter. His drafts had been met. That was

¹⁴ (1923) 140 N.E. 803.

¹⁵ *Ibid.* at 808.

where I came in and my advice was asked. From the legal point of view I could only advise that the bank would be liable if the Cuban bank refused to accept their drafts. But from a practical point I advised the bank to "wait and see". For one thing the Auckland merchant was a customer—and a good customer—of the bank; secondly, like the nurse's baby in "Midshipman Easy", the amount involved was small and, finally, the Cuban bank and the Cuban merchant might accept a United States consular certificate as the equivalent of one issued by a Cuban consul. The outcome was entirely satisfactory. No-one seems to have noticed the error. The Havana bank met the Auckland bank's draft. The Auckland Foreign Manager heaved a sigh of relief and the Auckland merchant was told to expunge from any future contracts for the sale of butter to Cuba any reference to a Cuban consul or a Cuban consular certificate.

But a large amount of litigation has arisen out of allegations that incorrect documents have been tendered and accepted in purported performance of the duties of the seller, on the one hand, and of the banker, on the other. It works both ways. The seller, on his part, must tender to the issuing banker or to his correspondent, documents which comply *exactly* with those specified in the letter of credit. The issuing banker must, in the letter of credit, specify exactly what documents the seller must tender and this list must correspond exactly with those specified by the buyer in his letter of request.

The necessity for *exact* compliance was stressed by the English Court of Appeal in *Rayner v. Hambros Bank*.¹⁶ The letter of credit, issued in favour of the plaintiffs, called for an invoice and bills of lading covering a shipment of "Coromandel groundnuts". The plaintiffs presented an invoice for "Coromandel groundnuts" and bills of lading describing the goods not as "Coromandel groundnuts" but as "machine-shelled groundnut kernels. Country of origin, British India". In the margin of the bills of lading were the marks: "O.T.C. C.R.S. Aarhus". The defendant bank refused to meet drafts drawn under the letter of credit on the ground that the letter of credit called for an invoice and bills of lading both covering a shipment of "Coromandel groundnuts". The bills of lading did not prescribe the goods in those terms. In an action against Hambros, evidence was given before the trial judge, Atkinson, J. and accepted by him (a) that "machine-shelled groundnut kernels" are the same commodity as "Coromandel groundnuts" and would be understood to be so in the trade in London; and (b) that the marginal mark on the bills of lading "C.R.S." was short for "Coros" or "Coromandels" and would be universally understood to be so in the trade in London. Atkinson, J. gave judgment for the plaintiffs, holding that the documents tendered covered "in the customary way" the goods mentioned in the letter of credit. His decision was unanimously reversed by the Court of Appeal. MacKinnon, L.J. quoted Bailhache, J. in *English, Scottish and Australian Bank Ltd. v. Bank of South Africa*:¹⁷

It is elementary to say that a person who ships in reliance on a letter of credit must do so in exact compliance with its terms. It is also elementary to say that a bank is not bound or indeed entitled to honour drafts presented to it under a letter of credit unless those drafts with the accompanying documents are in exact accord with the credit as opened.¹⁸

¹⁶ (1943) K.B. 37.

¹⁷ (1922) 13 Ll. L.R. 21.

¹⁸ *Ibid.* at 24.

And, added MacKinnon, L.J.:

The words in that bill of lading clearly are not the same as those required by the letter of credit. . . . I think on pure principle that the bank were entitled to refuse to accept this sight draft on the grounds that the documents tendered, the bill of lading in particular, did not comply exactly with the terms of the letter of credit which they had issued.¹⁹

Dealing with that part of Atkinson, J.'s judgment in which he said that "a sale of Coromandel groundnuts is universally understood to be a sale of machine-shelled kernels", MacKinnon, L.J. said:

. . . when Atkinson, J. says that it is "universally understood", he means that these gentlemen from Mincing Lane have told him: ". . . We understand that 'Coromandel groundnuts' are machine-shelled groundnut kernels, and we understand when we see 'C.R.S.' that that means 'Coromandels'." . . . I think that is a perfectly impossible suggestion. . . . it is quite impossible to suggest that a banker is to be affected with knowledge of the customs and customary terms of every one of the thousands of trades for whose dealings he may issue letters of credit.²⁰

Goddard, L.J. was, as usual, forthright. He said: "I protest against the view that a bank is to be deemed affected by knowledge of the trade of its various customers."

Judgment was consequently given for the defendants.

Assuming, although the matter is not free from doubt, that the relationship between the issuing banker and the beneficiary is contractual, it can readily be appreciated that, as in many cases arising out of contracts, one of the important questions is: how is this contract to be construed? What do the words of the contract mean? It certainly is amazing how businessmen—bankers also—can make their contracts in such ambiguous terms, leaving it to the courts to try to determine what they meant. Letters of credit suffer from this vice, as reference to a few of the decided cases will show.

One of the problems which has confronted the courts is: if the letter of request and consequently, if the banker has carried out his instructions properly, the letter of credit calls for a bill of lading covering the goods in question, what type of bill of lading is required? Here let me say that I hope none of my readers will ever, in relevant circumstances, describe a bill of lading just like that, for reasons which I hope now to make clear.

The first point is this: if the letter of credit merely says: "bill of lading", must the seller tender a "shipped" or "on board" bill of lading or a "received for shipment" bill of lading? Of course, if the letter of credit stipulates that "shipped" bills of lading must be tendered, "received for shipment" bills of lading will not suffice. This was decided by Sellers, J. in *Yelo v. Machado & Co. Ltd.*²¹ I am surprised that it was so late in the day before such a decision was given. But in the present state of the authorities it is difficult to say whether a received for shipment bill of lading is good tender. In *The Marlborough Hill v. Cowan & Sons*²² the Privy Council held that a "received for shipment" bill of lading was a bill of lading within the meaning of s.6 of the

¹⁹ (1943) K.B. at 40.

²⁰ *Ibid.* at 41.

²¹ (1952) 1 Lloyd's Rep. 183.

²² (1923) 1 A.C. 444.

Admiralty Court Act, 1861. That section, now repealed, dealt with the extent of the jurisdiction of the courts in admiralty matters. In *Diamond Alkali Export Corporation v. Bourgeois*,²³ McCardie, J. held that for the purpose of a c.i.f. contract, a "received for shipment" bill of lading was not a bill of lading. He held that the *Marlborough Hill* decision did not apply. So far as I know there is no decision in which the issue has come fairly and squarely before the courts in an action on a letter of credit, though there have been some statements *obiter* which suggest that the question is to be decided by determining whether, as a matter of fact, the bill of lading tendered is one which is usual in the trade in question.

However, the question has now become one of academic importance only in those countries which have adopted the Uniform Customs and Practice for Documentary Credits—to which I shall refer later. Article 18 provides:

Unless otherwise specified in the credit, Bills of Lading must show that the goods are loaded on board.

Loading on board may be evidenced by an on board Bill of Lading or by means of a notation to that effect dated and signed or initialled by the carrier or his agent, and the date of this notation shall be regarded as the date of loading on board and shipment.

Another problem which arises in connection with bills of lading tendered in purported performance of the seller's duties is whether the bill of lading must be a "clean" one. And the problem is not rendered any easier by doubts as to what exactly is a "clean" bill of lading. Cave, J., in *Restitution S.S. Co. v. Pirie*,²⁴ purported to define a clean bill of lading. But he could not even get the names of the authors of a book he was quoting correct. Or perhaps the fault lay with the reporters. At any rate the report refers to "Pollock and Druce's Law of Merchant Shipping". The authors were Pollock and Bruce. Even so, the learned judge did not, in my opinion, accurately quote the words of the authors.

The important difference between Cave, J.'s statement and that of Pollock and Bruce is that Cave, J. suggests that if there is a marginal notation "quality unknown", the bill of lading is foul. The authors do not refer to quality but only as to weight, contents and value.

The United States Circuit Court of Appeals, 10th circuit gave a good description of a clean bill of lading in *Liberty National Bank & Trust Co. v. Bank of America National Trusts and Savings Association*.²⁵ The Court said:

The printed bill of lading used by the shipping company contained the words "Received in apparent good order and condition", but the words "in apparent good order and condition" were stricken therefrom. At a different place the words "ship not responsible for kind and condition of goods" were inserted. The words "ship not responsible for rust" were stamped in the body of the document. As we understand it the general rule is that the term "clean on board ocean bills of lading" as used in the letter of credit means a bill or bills of lading which does or do not indicate by deletion, addition or otherwise, that the merchandise or commodity being shipped is not in apparent good condition. Viewed in the light of that general rule it is manifest that, in respect to a substantial

²³ (1921) 3 K.B. 443.

²⁴ (1889) 61 L.T.(N.S.) 330.

²⁵ (1955) 218 Fed. (2d) 831.

requirement, the bill of lading which accompanied the draft was not a clean bill of lading within the intent and meaning of the letter of credit.²⁶

Article 16 of the Uniform Customs and Practice says: "A clean shipping document is one which bears no superimposed clause or notation which expressly declares a defective condition of the goods and/or the packaging." That at least is clear-cut and gets rid of any of the doubts which bothered Cave, J. relating to notations concerning the quality of the goods.

When a letter of credit calls for a bill of lading without qualification, must a clean bill of lading be tendered? The answer to that question was doubtful until the decision of Salmon, J. (as he then was) in *British Imex Industries Ltd. v. Midland Bank Ltd.*²⁷ The defendant bank confirmed an irrevocable credit opened by a foreign bank and undertook to honour all drafts drawn by the plaintiffs if drawn and presented in accordance with the terms of the letter of credit. Under the credit, the drafts would be met on presentation of sight drafts accompanied by invoices and "shipped" bills of lading evidencing the shipment of a quantity of steel bars. The goods were duly shipped. Each of the bills of lading issued by the shipping company contained on its face the words: "Shipped in apparent good order and condition, weight, measure, marks, numbers, quality, contents and value unknown". The defendant bank refused to meet the plaintiffs' sight drafts on the ground that the bills of lading contained no evidence that the requirements of a certain clause in the bills of lading had been complied with. On this point, Salmon, J. held that there was no need for the plaintiffs to produce this evidence and, to that extent, the bills of lading were in order. Dealing with the question whether the letter of credit called for clean bills of lading Salmon, J. said:

The letter of credit stipulated that payment would be made against bills of lading without qualification. The plaintiffs suggest that this does not necessarily mean clean bills of lading. In my judgment, when a credit calls for bills of lading, in normal circumstances it means clean bills of lading. I think that in normal circumstances the ordinary businessman who undertakes to pay against the presentation of bills of lading means clean bills of lading; and he would probably consider that that was so obvious to any other business man that it was hardly necessary to state it.²⁸

Salmon, J. decided that the bills of lading in question were clean bills of lading. He had been careful not to define a clean bill of lading but he had said earlier in his judgment that he inclined to the view that a clean bill of lading was one that did not contain any *reservation* (my italics) as to the apparent good order of the goods or the packing. According to his view, the bill of lading does not cease to be a clean one if the shipowner says: "I know nothing about the contents", but if he says for example: "One bale torn", the bill of lading would be foul. In other words it is not a reservation if you say "I know nothing about the contents".

This is probably in line with the Uniform Customs and Practice which, as I mentioned above, refers to a clause or notation which expressly declares

²⁶ *Ibid.* at 838.

²⁷ (1958) 1 Q.B. 542.

²⁸ *Ibid.* at 551.

a defective condition. The second paragraph of Article 16 of the Uniform Customs says that banks will refuse shipping documents bearing such clauses unless the credit expressly states otherwise. In other words, bill of lading, or indeed, any shipping document, without qualification means clean bill of lading.

One question which awaits judicial determination but which Mr. Maurice Megrah has dealt with in his Gilbert Lectures for 1952, concerns "stale" bills of lading. These are bills of lading which, for some reason or another, do not reach the buyer or the issuing bank until after the arrival of the goods specified in them. Of course, with the use of airmails the situation is usually the reverse. The relevant documents are forwarded by the seller to the issuing banker and are received by him long before the goods themselves arrive—indeed it might be before the ship carrying the goods has sailed. But sometimes, perhaps because of delays in the mails, perhaps because of dilatoriness on the part of the seller or his local banker, the goods arrive and the shipping documents are not available at the port of discharge to enable delivery of the goods to be effected. In practice, many banks treat such bills of lading as unsatisfactory tender under a letter of credit, even though they are tendered before the expiration of the credit, and will accept them only if they receive a satisfactory indemnity from their customer. This practice would not appear to have any legal justification and it will be interesting to see what the decision is if the matter is ever tested in the courts.

The Uniform Customs and Practice has a vague provision (Article 41) which says that documents must be presented within a reasonable time after their issuance. Banks may refuse documents if, in their judgment, they are presented to them with undue delay.

Insurance creates another problem. If the letter of credit merely states—as has happened—"Insurance 10 per cent in excess of invoice value, covering Marine and War Risks", must a policy of insurance be tendered or is a certificate of insurance sufficient? The English courts have come down definitely on the side of the policy of insurance even though there is the practical advantage of a certificate of insurance in that it is used in a case where goods are insured by an open or floating policy which covers other goods as well as the goods described in the letter of credit and which, of course, is for a larger amount than if it covered those goods only.

In *Wilson, Holgate & Co. v. Belgian Grain and Produce Co.*²⁹ Bailhache, J. held that under a c.i.f. contract a buyer could not be compelled to accept an English certificate of insurance or cover note in place of a policy. But the learned judge went on to say that in dealing with certificates of insurance he was not referring to American certificates of insurance, which he said, stood on a different footing and were equivalent to policies, being accepted as policies in England. But in the following year *McCardie, J.* dealt with this point in *Diamond Alkali Corporation v. Bourgeois*.³⁰ In this case sellers tendered a certificate of insurance issued by an American corporation. The certificate was declared to "represent and take the place of the policy and to convey all the rights of the original policy holder as fully as if the property was covered by a special policy direct to the holder of the certificate". But *McCardie, J.* held that the buyers were entitled to reject

²⁹ (1920) 2 K.B. 1.

³⁰ (1921) 3 K.B. 443.

the certificate. He said that a document of insurance was not good tender unless it fell within the provisions of the Marine Insurance Act, 1906 as to assignment and otherwise—which this certificate obviously did not. Referring to the dictum of Bailhache, J. in *Wilson Holgate's Case*, McCardie, J. referred to the point that Bailhache, J. had said that American certificates were “accepted” in England as policies. He did not say that buyers were “bound to accept” them. Bailhache, J. appears to have had doubts about his previous decision when the question was raised in *Malmberg v. Evans*.³¹ In view of admissions by the parties he did not have to decide the point but he said he inclined to the view that the certificate was not good tender, even though, while the risks were not set out in the policy, they could have been ascertained by reference to the insurance company's policy and its rules, to which the insurance was made subject, but which were not incorporated in the certificate.

Meantime in *Donald H. Scott & Co. v. Barclays Bank*³² Scrutton, L.J. had had an opportunity of expressing his opinion on the matter. The letter of credit called for an “approved insurance policy”. What was tendered was a certificate of insurance issued by an American company which did not contain, and did not offer, any means of ascertaining the full terms of the insurance. The issuing bank was held to be entitled to refuse the certificate. Scrutton, L.J. said:

... here the insurance policy must be one to which no reasonable objection could be made. . . . What was tendered was a document called an American certificate. I am not deciding in this case that all American certificates are bad tender. . . . when this document was tendered to the appellants they could not tell what terms of insurance they were being offered as security for the loss of the goods. In my opinion they had a right to see a document or documents containing the terms, and if they are tendered a document which does not show what the terms are they are acting reasonably in refusing to accept it. A certificate in this form which does not state the terms of insurance so that they can all be seen by the person to whom it is tendered is not an approved policy; it is one to which a reasonable objection can be made.³³

The Uniform Customs and Practice provides (in Article 24) that insurance documents must be as specifically described in the credit. “Cover notes issued by brokers will not be accepted, unless specifically authorised in the credit.” Consequently if a policy of insurance is called for by the credit, then a certificate of insurance will not do.

I have referred so frequently to the Uniform Customs and Practice that I should tell you what they are and what is their effect. Their full title is “Uniform Customs and Practice for Documentary Credits”. They are the product of the work of the International Chamber of Commerce. Originally drafted in 1933 at the Seventh Congress held in Vienna, they were revised at the Thirteenth Congress held in Lisbon in 1951. But the documents there produced were not of great interest to British and Commonwealth bankers because they did not adopt the Uniform Customs and Practice. In 1961 the International Chamber of Commerce Banking Commission got to work in

³¹ (1924) 29 Com. Cas. 235.

³² (1923) 2 K.B. 1.

³³ *Ibid.* at 14-15.

Paris to revise the Customs and Practice so as to make them, if possible, more acceptable to British and Commonwealth bankers. Twenty-five countries were represented at the Commission—Australia and New Zealand were not among their number, although Canada and South Africa were. Sweden had the largest delegation of eight. The United Kingdom had three delegates: the manager of the merchant banking firm of Brown, Shipley, and Co., the Chief Manager of the Overseas Department of Lloyds Bank and the Claims Adjuster of the Provincial Insurance Company. I mention this fact because the outcome of the labours of the Commission was a set of revised rules, which, to quote the words of the International Chamber of Commerce press release, “mark a new thinking in international banking circles and differ from the old rules for they now practically follow British practice”. This represents a great triumph for British banking and marks London as still the centre of world trade. The revised version was issued in November, 1962, and adherence was recommended to date from 1st July, 1963. Great Britain and, so far as I know, all Commonwealth countries have adhered to the Customs and Practice as from that date and most of the members of the International Chamber of Commerce have done likewise. When I say “adhered to”, I do not use the phrase in a technical sense. They have not been incorporated into the law relating to letters of credit by statute. The Bankers’ Associations in the various countries have agreed that they shall apply to letters of documentary credit. In New Zealand this has been done by printing a note in large type on the letter of request and on the letter of credit itself: “Subject to Uniform Customs and Practice for Documentary Credits (1962 Revision) International Chamber of Commerce Brochure No. 222”. So that we now have a Code covering almost all aspects of letters of credit. But it is not a complete Code and, like all Codes, it needs interpreting. Its very first provision gives the right of contracting out, so to speak, because it provides that: “These provisions and definitions and the following articles apply to all documentary credits and are binding upon all parties thereto *unless otherwise expressly agreed* (my italics).”

There are six General Provisions and Definitions and 46 Articles dealing with all aspects of documentary letters of credit. Some of them are counsels of perfection rather than rules. For example, Article 7 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.” But, in general, the Uniform Customs and Practice do provide a set of rules of world-wide application which form a good example of what may be done when men of different races and nationalities really determine to agree. Needless to say Russia and China were not represented. Australia has a National Committee of the International Chamber of Commerce, but, as I have mentioned above, Australia was not a member of the Banking Commission.

But to return to some matters of purely legal import.

I said at the outset that letters of credit are most frequently used to finance a contract for the sale of goods, and so they are. But, in fact, they are, from the legal point of view, independent of the sales contract. The buyer cannot, for example, stop his banker, who will normally be the issuing banker, from paying under the credit because some term of the sales contract has not been complied with or because the goods are not up to standard. If the buyer wants protection in these matters then he must, as I

have mentioned above, ensure that the letter of credit calls for documents which will ensure—so far as documents can do so—that the terms of the sales contract are fulfilled. As Rowlatt, J. said in the *Urquhart Lindsay Case*: “So far from the letter of credit being qualified by the contract of sale, the latter must accommodate itself to the letter of credit.”

This principle is illustrated by the decision in a New York case—*Frey & Son v. E. R. Sherburne and the National City Bank of New York*.³⁴ The plaintiffs, buyers, entered into a contract with the first defendants, sellers, to buy a quantity of Java sugar. The contract provided that the plaintiffs should furnish an irrevocable letter of credit for the full amount of the sellers' invoices. A further term of the contract read:

Should any unforeseen circumstances as accidents, stress of weather, etc. prevent the steamer or steamers hereafter declared against this contract from clearing within the time specified above and the sellers or their agents be unable to supply other tonnage of equal character and capacity, the buyer has the option of cancelling such of this contract as has not cleared in the time specified above.

This provision was not embodied in the letter of credit—very unfortunately for the buyers. The buyers, as they were entitled to do in accordance with the terms of the sales contract, cancelled a portion of the contract and then brought an action to restrain the bank (the second defendants) from honouring or paying drafts covering shipments of sugar, the purchase of which, it was alleged, had been cancelled. The action failed. The buyer's remedy, it was held, was an action against the sellers for damages. The buyer had no right to restrain the banker from paying drafts drawn by the sellers in accordance with the terms of the letter of credit.

In *Davis O'Brien Lumber Co. Ltd. v. Bank of Montreal*³⁵ the letter of credit called for documents which evidenced the shipment of a quantity of lumber “in accordance with contract dated 22/12/1947 No. 47450”. The plaintiff's contention that this clause incorporated the terms of the contract in the letter of credit was rejected by the New Brunswick Supreme Court.

The duty of the banker who issues a letter of credit is to pay against documents and not against delivery of goods. Consequently, if the documents are in order it is not open to the banker to enquire into questions of quality or quantity. He is definitely not entitled to do so. This principle is illustrated by the case of *Continental National Bank v. National City Bank of New York*.³⁶ The Continental Bank issued a letter of credit covering a cargo of cement. The letter of credit called for the usual shipping and consular documents and contained a provision which read: “Cement to be of sound merchantable quality and standard of same shall meet with the requirements of the American Society for Testing Materials.” The documents which came forward in due course complied with those specified in the letter of credit and included in addition a document entitled “Certificate of Quality”. The Continental Bank refused to honour the draft accompanying these documents which had been purchased by the New York bank on the ground that the goods themselves did not conform to specification in the sales contract. But the New York bank contended that, as the issuer of a letter of credit is bound to accept drafts drawn under the letter when the documents conform to its terms, the question

³⁴ (1920) 184 N.Y. Supp. 661.

³⁵ (1951) 3 D.L.R. 536.

³⁶ (1934) 69 F. (2d) 312.

of actual conformity of the goods to the description on the documents was not material. This contention was upheld and damages were awarded against the Continental Bank.

The Court said:

Similarly appellant contends that the language of the letter before us, properly interpreted, makes shipment of cement that in fact complied with the requirements of the American Society for Testing Materials, a condition of the defendant's obligation. To accept this contention would practically undermine the general principle that the bank must honour the draft if the documents comply with the terms of the letter of credit, for any description of the goods in such a letter might quite as readily be interpreted to create such a condition. Admitting that the issuer of a letter of credit may impose such a condition if it so wishes, it should be required at least to make such an intention perfectly clear.³⁷

There is one final matter with which I am going to deal, realising how many topics I have not dealt with. This concerns the ultimate receipt of the goods, their final disposal, the repayment to the issuing bank and consequently the finish of the whole transaction.

The course of business—omitting any discussion of correspondent bankers and the like—is that the seller, relying on the letter of credit, ships the goods, having insured them and having obtained all the other stipulated documents. He now airmails all these documents, primarily the invoice, the bill of lading and the insurance policy to the issuing bank together with a draft drawn on the issuing bank in terms of the credit. If the issuing banker is satisfied that all the documents are in order, he will meet the draft, either out of funds the customer, the buyer, has already provided, or more usually—and this concerns the point I now wish to make—out of an agreed overdraft, which has been granted on the security of the goods covered by the letter of credit.

The goods themselves arrive. The buyer will want to take delivery of them and despatch them to sub-purchasers or take them into his own warehouse and sell them to provide the necessary cash to repay the overdraft. But the banker has the documents which are needed before the ship will release the goods. And he is unlikely to part with the documents so that the buyer can take delivery of the goods unless he obtains some form of charge over them. This is particularly important in the event of the customer's insolvency. To meet this situation there has been devised a document which has variously been called a "letter of hypothecation" a "letter of lien" or, more usually, a "letter of trust" with a trust receipt subjoined. This is a fairly lengthy document addressed by the banker to the customer, stating that the documents of title to the goods (now in pledge to the bank as security for advances) are handed to the customer on the customer's undertaking to hold the documents of title, the goods when received and the proceeds of sale when the goods are sold as trustees for the bank, together with a request to pay the proceeds of all sales to the bank immediately. A schedule sets out details of the documents and of the goods. The subjoined trust receipt addressed to the bank and signed by the customer reads: "We acknowledge receipt of the above-mentioned documents relating to the above-mentioned goods which we receive and/or will deal with upon the terms and conditions giving as we do hereby all the undertakings mentioned above."

³⁷ *Id.* at 317.

Two important legal issues arise out of these documents. First, do they, in law, create a charge which will result in the bank being a secured creditor in the event of the customer's insolvency; and, secondly, is the letter of trust a document which requires registration under the Bills of Sale Act, the Chattels Transfer Act or similar legislation? The answer to the first question is "Yes" and to the second question "No".

In *North Western Bank v. Poynter*³⁸ merchants pledged a bill of lading covering a cargo of phosphate to the bank as security for an advance. To enable the merchants to implement a sub-sale they had made of the cargo, the bank re-delivered the bill of lading on the terms of a letter of trust by which the merchants were constituted agents of the bank for the purpose of selling the cargo and by which they undertook to pay over the proceeds of the sale to the bank. The cargo was sold and the purchase money was received by the merchants; but, before they paid it over to the bank, they became insolvent. It was held that the bank's security was not affected and that it was entitled to the proceeds of sale in priority to the general creditors of the merchants.

The second question—registration of the letter of trust as a bill of sale—was dealt with in *Re David Allester Ltd.*³⁹ The company pledged bills of lading to a bank to secure an overdraft. When the time came to sell the goods covered by the bill of lading, the company, in accordance with what was then and has since been held to be well-established mercantile practice, obtained the bills of lading in return for a letter of trust in the usual terms. Certain of the goods had been realised when the company went into liquidation. The goods unsold and the proceeds of those sold were claimed both by the liquidator and by the bank. One of the grounds of the liquidator's claim was that the letter of trust was void on the grounds of non-registration under s.93 of the Companies Act, 1908 (now s.95, Companies Act, 1948), as being "a mortgage or charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale". Admittedly there had been no registration. The liquidator's claim failed.

Astbury, J. said:

In my judgment those letters of trust do not fall within the bills of sale definition at all. The pledge rights of the bank were complete on the deposit of the bills of lading and other documents of title. The bank's pledge and its rights as pledgee do not arise under these documents at all, but under the original pledge.⁴⁰

In any event the learned judge held that the documents were not within the definition of a bill of sale for the additional reason that they were "documents used in the ordinary course of business as proof of the possession or control of the goods"—a document excluded from the definition of instrument by s.2 of the Chattels Transfer Act, 1924 (N.Z.).

The legal validity of letters of trust has, I think, been amply confirmed.

I have not dealt with some other important aspects of letters of credit. I have not, for example, discussed terminology or considered whether one can have an "irrevocable, unconfirmed" letter of credit. I hope however that I have said enough to enable you to recognise a letter of credit when you meet one, to be able to appreciate some of its legal implications and to be able to talk letters of credit with your banking friends in a manner which shows that you are "with it".

³⁸ (1895) A.C. 56.

³⁹ (1922) 2 Ch. 211.

⁴⁰ *Ibid.* at 216.