The Legal Relationships
Under
Commercial Letter of Credit
A Comparative Study

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Ph.D.
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1993
DEDICATION

To My Parents
DECLARATION

I hereby declare that this thesis is written by me unless otherwise stated.

Ahmed A Al-Ghadyan

July 12th 1993.
ACKNOWLEDGEMENTS

It is impossible to write in the field of law without the assistance of the knowledge of others who have preceded in the subject, thus my appreciation must go to those who have contributed to the development of documentary letter of credit law whose work has greatly assisted me in writing this thesis.

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The final words of appreciation should go to the Saudi Arabian Educational Office in London, for the valuable services that they have provided.
ABSTRACT

The legal relationships under commercial letter of credit is discussed in this thesis under the United States and the United Kingdom law, with occasional reference to the law of some civil law countries.

An introductory overview of documentary letter of credit is put forward in chapter one of this thesis, in which the definition and development of documentary letter of credit, and an illustration of how it operates in an international transaction has been discussed.

The thesis is divided into two parts, the first part deals with the relationships between the main parties of documentary letter of credit. Chapter two discusses the relationship between the applicant for the credit and its beneficiary. Chapter three discusses the relationship between the applicant for the credit and the issuing bank with emphasis on the legal nature of their relationship. In chapter four the discussion is directed to the relationship between the issuing bank and the beneficiary in which a large part of this thesis is devoted to the theoretical analysis of the nature of their relationship.

In part two, the thesis discusses the relationships between the main parties of letter of credit and other participating parties. Chapter five discusses the relationships between the main parties [i.e., the issuing bank (or requesting bank) the applicant for the credit and the beneficiary] and the intermediary bank [i.e., intermediary-issuer, confirming and advising bank.] Discussed in chapter six are the relationships between the main parties of documentary letter of credit and the holder of the beneficiary's draft whether it is a collecting bank, unauthorized negotiating bank, authorized negotiating bank or discounting bank. The thesis ends with a summary and conclusion.
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INTRODUCTION

The inevitable need for other nations' products has made it necessary for merchants to travel in order to inspect, ship and make payment for the goods. However, with the aid of bankers, merchants have developed an instrument known as a commercial letter of credit. Such an instrument provides a convenient method of making an international transaction without having to travel.

The huge increase in their use during the last few decades evidences their effectiveness and the important role that they play in international trade.

The commercial letter of credit is best viewed basically as a triangle of three main parties, who are, the applicant for the credit, the beneficiary and the issuing bank. However, in some situations additional parties may be involved, which are, an intermediary bank and a holder of the beneficiary's draft. In spite of the fact that the documentary letter of credit's rules have been highly developed, the legal relationships between these parties is not always clear by any means.

It is, therefore, the main aim of this thesis to determine whether there is a legal relationship between one party and another. If no legal relationship was found, the hardship caused to each of them as a result of the lack of it was explained, and possible solutions were analyzed. If, on the other hand, a legal relationship does exist, its nature was
examined.

In doing so, the thesis compares the related law in the United Kingdom and the United States. Also an occasional reference has been made to the law in some European countries. The thesis takes into account statutory provisions, courts decisions and the views of legal commentators in these countries.

It should be noted that due to the lack of knowledge in other European languages, I have, in referring to the law there, relied upon English written texts that have referred to them.

As regards the technical terms used in this thesis, I have used the term commercial letter of credit, documentary letter of credit, letter of credit and credit to mean the same. Also I have referred to the bank who opens the credit as the opening or issuing bank and to the person in whose favour the credit is issued as beneficiary or seller. Finally, I have referred to the person who applies for the credit as the applicant for the credit, the account party or the buyer.

Because the irrevocable letter of credit is the most important type of documentary letter of credit the discussion is mainly limited to this type. However, other types of documentary letters of credit have been referred to whenever a need arose.

This thesis begins with an introductory chapter in which the definition and the historical background of documentary letter of credit are briefly discussed. It also gives a general idea to how the documentary letter of
credit operates in an international transaction.

The legal relationship between the various parties involved in documentary letter of credit has been discussed in two parts. The first part covers the relationships between the main parties to the documentary letter of credit.

Chapter two discusses the term, that initiates the whole operation of letter of credit, which agreed upon by the applicant for the credit and its beneficiary in their underlying contract.

Chapter three discusses the contract between the applicant for the credit and the issuing bank. In this chapter the emphasis is placed on the difficulty of determining the nature of their contractual relationship.

The fourth chapter, which constitutes a large part of this work, covers the area of the issuing and confirming banks’ relationship with the beneficiary under the irrevocable letter of credit. The chapter is largely devoted to the theoretical analysis of the legal nature of this relationship. This lengthy discussion is an attempt to show that all the theories put forward to explain the legal ground upon which this relationship is based are not fully suitable, except the theory that proposes the recognition of the validity of this relationship as being based upon commercial usage.

In the second part of this thesis the discussion is directed to the main parties’ relationships with the intermediary banks and the holders of the beneficiary’s draft.

In an introductory section in chapter five, the different roles assumed
by the intermediary bank [i.e. issuing, confirming or advising the credit] are explained. Much emphasise has been placed, in this chapter, on the lack of legal relationship between the buyer and the intermediary bank. It has been shown that such lack of relationship causes hardship to both especially the buyer. Solutions to these difficulties are also discussed.

The chapter also covers the difficulties arising out of the lack of legal relationship between the advising bank and the beneficiary. Finally it discusses the nature of the legal relationship between the issuing and requesting bank on one hand and the intermediary banks on the other.

The last chapter deals with the banks who either take the beneficiary’s draft for collection, negotiate the draft with or without authorization from the issuing bank or discount the beneficiary’s accepted draft. The emphasise in this chapter is directed to the effect of the existence or non-existence of a legal relationship between these banks and the letter of credit’s main parties.

Finally, in the summary and conclusion, I have summarized these chapters and with the modest experience that I have had in the subject, over the last few years, I was able to put forward a few suggestions.
CHAPTER ONE

GENERAL

1.1 Definition And Development

A documentary letter of credit can be defined in general terms as a written promise by a person (usually a bank) upon request of another (the applicant for the credit, who is usually a buyer of goods, although not necessarily) to pay to a third person (the beneficiary, who in most cases is a seller of goods) a certain sum of money, provided that the conditions set out under the promise have been complied with by the latter.

This definition demonstrates the basic idea in which a documentary letter of credit operates. It is difficult to give a precise definition that covers all types of documentary letters of credit; however, a satisfactory definition has been given by Article 2 of the Uniform Customs and Practice for documentary credit1 which reads:

any arrangement, however, named or described, whereby a bank (the issuing bank), acting at the request and on the instructions of a customer (the applicant for the credit),

(i) is to make a payment to or to the order of a third party (the beneficiary), or is to pay or accept bills of exchange (drafts)

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1983 Revision. See infra at p.10, Note 17.
drawn by the beneficiary,

or

(ii) authorizes another bank to effect such payment, or to pay, accept or negotiate such bills of exchange (drafts), against stipulated documents, provided that the terms and conditions of the credit are complied with.

This device is commonly used in financing international trade as a solution to two problems that exist in such transactions namely, giving security and raising credit. These problems can be typically explained as follows:

The first problem is that, an exporter, who agrees to sell goods to a foreign buyer, before receiving payment will be unwilling to send the goods, in reliance on the honesty and solvency of an unknown foreign buyer. On the other hand, the importer, before receiving the goods, will be equally unwilling to pay only in reliance on the exporter’s undertaking to send the goods agreed upon.

The second problem is that, in international sale, there is always a period of shipment involved; if the importer paid in advance he will be deprived of the use of such money during the time between making payment and the time when he receives and resells the goods. On the other hand, if he made payment after receiving the goods the exporter will be deprived of the use of such capital during the period between shipping the goods and their arrival to the importer in the other country.

The use of a documentary letter of credit provides a solution, which takes account of the interests of both parties; it gives the importer the
assurance that payment will not be made until the goods have been shipped, since the bank will not make payment to the exporter until it receives documents evidencing shipment. It also solves the importer's second problem, since he will not be under a duty to reimburse the bank before receiving the shipping documents; he may even arrange with the bank that reimbursement will be made after receiving and reselling the goods.

It also assures the exporter that he will receive payment from a creditworthy bank; thus, he will find no danger in parting with the goods by shipping them. Additionally, it will relieve the exporter from having to wait for payment by enabling him to obtain payment as soon as he delivers the shipping documents to the bank (unless otherwise agreed).

This will, however, be clearer when discussing the way in which letter of credit operates.\(^2\)

It is thought that documentary letter of credit developed from the old open letter of credit\(^3\) which has been known in England since the seventeenth century.\(^4\) It should be noted that this old instrument is

\(^2\)See *infra* at p.12.

\(^3\)See Ellinger, *Documentary Letter of Credits*, at p.27.

\(^4\)It was described by Malynes, *Consuetudo vel lex mercatoria* (2 ed. London, 1629) at p.76] as follows: "A merchant doth send his friend or servant to buy some commodities or take up money for some purpose, and doth deliver unto him an open letter, directed to another merchant, requiring him that if his friend ... the bearer of that letter, have occasion to buy commodities or take up moneys that he will procure him the same and he will provide him the money or pay him by exchange." See Davis, *The Law Relating to Commercial Letters of Credit*, at pp.2-3; Kozolchyk, *The Legal nature of Irrevocable Commercial letter of Credit*, at p.396.
completely different;\(^5\) since the issuing bank’s promise is made upon the request of the customer and at the same time it is made for his benefit.\(^6\)

Although it is difficult to give the precise date at which the use of the modern documentary letter of credits commenced, it could be said that they were in use around the middle of the nineteenth century.\(^7\) However, it was not until the beginning of this century that an evidence of their appearance in the form known today was found. In the case of \textit{Basse and Selve v. Bank of Australasia}\(^8\) the translation of the defendant’s cable instruction to its branch in Australasia to open an irrevocable letter of credit reads as follows:

Negotiate drafts on A. Oppenheimer at sight on Deutsche Bank (Berlin) London agency p. 800l. account. Basse Selve (against) bill of lading, policy of insurance and certificate analysis from Doctor Helms (for) 100 tons cobalt ore analysis not less than 5 per

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\(^5\)Story, J. [\textit{Commentaries on the Law of Bills of Exchange, Foreign and Inland as Administered in England and America}, 2nd ed. Boston, 1860, Ch. XIII Para. 459.] described the open letter of credit as "An open letter of request, whereby one person (usually a merchant or a banker) requires some other person or persons to advance moneys, or give credit, to a third person, named therein, for a certain amount, and promises that he will repay the same to the person advancing the same, or accept Bills drawn upon himself, for the like amount. It is called a general letter of credit, when it is addressed to all merchants, or other persons in general, requesting such advance to a third person; and it is called a special letter of credit, when it is addressed to a particular person by name requesting him to make such advances to a third person." See Ellinger, \textit{Documentary Letters of Credit}, at p.5.

\(^6\)The purpose of the open letter of credit is to enable a businessman to avoid carrying cash when travelling; such purpose at the present time is served by the use of travellers’ cheques.

\(^7\)See Ellinger, \textit{Documentary Letters of Credit}, at pp.26 et seq: Kozolchyk, \textit{The Legal Nature of Irrevocable Commercial Letter of Credit}, at p.398 Note 15.

\(^8\)(1904) 90 L.T. 618.
cent. protoxide shipped by steamer (to) Europe. Credit expires on June 15.\textsuperscript{9}

Despite the fact that the documentary letter of credit was known long before the First World War it was not until after the end of that war that it became widely used. Such increase in the use of the documentary letter of credit was due to the need of a security, at that time when the world economy and the currency exchange rates were unstable.\textsuperscript{10} The improvement in the technology of transportation and communication and the increase in international trading are also factors which have contributed to the increase in the use of the documentary letter of credit.

The frequent use of documentary letters of credit has motivated some commentators on the subject as early as 1917\textsuperscript{11} to direct attention to the need for uniform regulations. In recognition of this need in the 1920's a number of different national regulations were set up in the United States and some European countries, and these were adopted by banks in each individual country.\textsuperscript{12}

In order to provide an international uniformity in the regulations relating to documentary letters of credit the International Chamber of Commerce in 1933 issued the first edition of the Uniform Customs and

\textsuperscript{9}Ibid. at p.619.

\textsuperscript{10}Davis, \textit{The Law Relating to Commercial Letters of Credit}, at p.10.


\textsuperscript{12}Harfield H., \textit{Bank Credits and Acceptances}, at pp.201-2.
Practice for Documentary Credit\textsuperscript{13} which were revised in 1951,\textsuperscript{14} 1962,\textsuperscript{15} 1974\textsuperscript{16} and 1983.\textsuperscript{17} These regulations were first adopted by banks internationally in 1962 and by 1974 banks in 156 countries had formally adopted them.\textsuperscript{18} However, the U.C.P. is not law, it is only applicable if the parties to a documentary letter of credit expressly incorporate it.\textsuperscript{19}

In the U.S.A. although the Uniform Commercial Code (hereinafter referred to as U.C.C.)\textsuperscript{20} Article 5 which regulates letters of credit is adopted by all the jurisdictions there,\textsuperscript{21} banks in that country incorporate the U.C.P. in documentary letters of credit issued by them. This incorporation is permitted by the U.C.C. Section 1-102 which

\textsuperscript{13}ICC, Brochure No.82.

\textsuperscript{14}I.C.C., Brochure No.151.

\textsuperscript{15}I.C.C., Brochure No.222.

\textsuperscript{16}I.C.C., Brochure No.290.

\textsuperscript{17}I.C.C., Brochure No.400. This new revision came into force in October 1984. It will be referred to in this work as the U.C.P. This revision is set out in Appendix 1. It may be worth noting that I.C.C. Banking Commission has been working on a further revision of the U.C.P. since October 1989 which is expected to be completed before the end of 1993. See Todd, \textit{Bills of Lading and Bankers’ Documentary Credits}, at p.3.

\textsuperscript{18}Banks in the People’s Republic of China and Romania are the only banks that do not formally adhere to them. See Dolan, \textit{The Law of Letters of Credit}, at p.4-16; Todd, \textit{Bills of Lading and Bankers’ Documentary Credits}, at p.18.

\textsuperscript{19}U.C.P. Art. 1. In some countries the U.C.P. is applicable even if it is not incorporated. See Hedley, \textit{Bills of Exchange and Banker’s Documentary Credits}, at p.215.

\textsuperscript{20}The full article is reproduced in Appendix 2.

\textsuperscript{21}Dolan, \textit{The Law of Letters of Credit}, at p.4-10.
sanctions the freedom of contract; thus, if the U.C.P. is expressly incorporated in a letter of credit it will be regarded as a part of the credit contract and will be binding on the parties.

Moreover, the U.C.P. is applicable to the majority of letters of credit in the most important letter of credits jurisdiction in the United States which is New York. This State before adopting the U.C.C. Article 5 modified it by adding to Section 5-102 a further subsection that reads:

4: Unless otherwise agreed, this Article 5 does not apply to a letter of credit or a credit if by its terms or by agreement, course of dealing or usage of trade such letter of credit or credit is subject in whole or in part to the Uniform Customs and Practices for Commercial Documentary Credits fixed by the Thirteenth or by any subsequent Congress of the International Chamber of Commerce.22

It could be said in conclusion that although documentary letters of credit are of recent origin compared with other legal institutions, the legal principles applicable to them have developed rapidly and have achieved a high degree of uniformity worldwide within this relatively short period.

22The same modification was also made to Article 5 in Alabama, Arizona and Missouri, see White and Summers Uniform Commercial Code, Vol. 2 at Ch. 19-3 p.16.
1.2 The Operation Of Documentary Credits In International Transactions

An outline of the mechanism by which the documentary letter of credit operates in an international transaction can be explained as follows.

Firstly, the whole operation is initiated by a stipulation in the contract of sale between an importer [buyer] and an exporter [seller], to the effect that payment of the price is to be made by documentary letter of credit. The exporter in this agreement may insist that the letter of credit should be issued by a bank in his country [intermediary-issuer] or may be content with a letter of credit that is issued by a bank in the importer’s country [issuing bank].

Secondly, in pursuance of this agreement the importer will request a bank in his country to either instruct a bank [requesting bank] in the exporter’s country to issue a letter of credit in the exporter’s favour or to issue such letter of credit itself. The importer’s request will be made by completing and signing an application form supplied by his bank. The application form contains the terms which are to be set out in the letter of credit, e.g. its amount, the expiry date, its type and the documents that payment is to be made against, etc. In it also the

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23A documentary letter of credit is also used domestically and may be used to pay for services.

24It will be assumed throughout this work that the documentary letter of credit is issued by one bank but it may be issued by several banks jointly. See on this point, Ryan, Letters of Credit Supporting Debt for Borrowed Money: The Standby as Backup, 100 Banking L.J. 404 (1983).
importer agrees that the documents are to be held by the bank as a security for its advances and promises to indemnify it for such advances. The bank’s acceptance of the importer’s request completes the contract between them, the terms of which are contained in the application form.

Thirdly, after accepting the application form the importer’s bank will either instruct a bank in the exporter’s country to issue the letter of credit in accordance with the terms of the application form or issue such a letter of credit itself. It will then notify the exporter of its issuance by mailing it directly or by using the service of another bank to; 1) advise it to the exporter [advising bank], 2) advise and pay or negotiate the exporter’s draft [authorized negotiating bank], 3) advise and confirm the credit [confirming bank]. The letter of credit is regarded as the basis of the contract between the issuing bank (and confirming bank) and the exporter.

Fourthly, after receiving the documentary letter of credit the exporter will ship the goods and obtain documents (i.e., bill of lading, insurance policy, invoice, etc.) that conform with the terms of the letter of credit. Having done that, the exporter will then draw a draft [bill of exchange] for the price of the goods [the promise in the credit may be payment of cash against the documents without a bill of exchange] and himself present it together with the documents for payment, acceptance or negotiation as the case may be, before the expiry date of the credit to the issuing bank, confirming bank or another bank authorized by the issuing bank to make such payment, acceptance or negotiation. If such bank is not in the exporter’s locality he may tender the documents and the draft
to a local bank for collection [collecting bank], for negotiation [unauthorized negotiating bank], or for discounting [discounting bank](if the draft has been accepted and returned to the exporter).25

The bank after receiving the documents will examine them and reject them if they are not in compliance with the terms of the credit or accept them if they are, and pay, accept or negotiate the exporter’s draft.

The importer’s bank, whether an issuing or requesting bank, after accepting the documents and paying the exporter or reimbursing the bank who made such payment, will be in possession of the documents as a security for such payment. If the importer has put the bank in funds before issuing or requesting the issuance of the credit, the bank will reimburse itself from such funds, and will give the documents to the importer; however, usually the importer does not put the bank in funds initially, in this situation the bank will not release the documents until it has been reimbursed by the importer or given an alternative security. However, usually the importer, before selling the goods, is not in a position to reimburse the bank and has no other security to offer; in this situation the bank will not release the documents until the importer has signed a "trust receipt" in which he undertakes to hold the goods or their value after being sold as a trustee of the bank; thus, the bank will be secure even after releasing the documents.26 In this way the buyer will

25The reimbursing bank (see U.C.P. Art. 21) is not discussed in this work. As regards the position of this bank, see Watson, A., Finance of International Trade (2nd ed.) at p.181.

26As to whether the "trust receipt" is a sufficient security, see Gutteridge and Megrah, The Law of Banker’s Commercial Credits, at p.215.
be able to obtain and sell the goods, and the proceeds of the sale will put him in a position to be able to reimburse the bank and pay other charges. Making such reimbursement concludes the documentary letter of credit transaction.

As the above illustration of the operation of documentary letter of credit shows, there are several parties involved in the transaction. The following diagram may be of assistance in giving an overall picture of the position of each party in relation to the others.
The Parties' Relationships in Letter of Credit Transaction

- **Beneficiary Seller**
- **Applicant Buyer**
- **Issuing Bank**
- **Discounting Bank**
- **Collecting Bank**
- **Unauthorized Negotiating Bank**
- **Authorized Negotiating Bank**
- **Advising Bank**
- **Confirming Bank**
- **Intermediary Issuer**
- **Requesting Bank**

Relationships are indicated by lines connecting the parties. The diagram shows the flow of transactions and relationships between the parties involved in a letter of credit transaction.
PART ONE

THE RELATIONSHIPS BETWEEN THE MAIN PARTIES OF DOCUMENTARY LETTER OF CREDIT

1. The Relationship Between The Applicant For The Credit And The Beneficiary.

2. The Relationship Between The Applicant For The Credit And The Issuing Bank.

3. The Relationship Between The Issuing Bank And The Beneficiary.
CHAPTER TWO

The Relationship Between The Applicant For The Credit And Its Beneficiary.

The letter of credit and all legal relationships involved in it come into existence almost always because of a term in an underlying contract which provides that it should be opened. Such underlying contract in most cases is a contract of sale, where the seller stipulates that payment is to be made by a documentary letter of credit, stating the type of the letter of credit, the place and the time in which such letter is to be opened and the name of a bank or class of banks that it should be issued by, etc. The fulfilment of such stipulation by the buyer is a condition precedent to the seller’s duty to perform his obligation under the contract of sale.¹ So if the letter of credit was not opened or opened but not on time the seller can bring an action against the buyer under the sale contract. Moreover, if the credit which is opened does not conform to the sale contract requirements the seller can also sue the buyer for breach of the sale contract, but can not in either case take any action

against the issuing or confirming bank (if the credit was confirmed), because their obligations under the letter of credit are independent of the underlying contract and are not affected by it.2

It should be mentioned that the buyer is not discharged from his duty to pay the price by procuring the stipulated credit, because it does not constitute an absolute payment of the price of the goods, unless the contract of sale expressly stated that the opening of the credit will be final and absolute payment or it could be inferred that the parties intended it to be.3 The only effect that the issuing of the credit has is that it makes it obligatory for the seller to claim payment in the first

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place from the bank and then from the buyer if the bank fails.  

If the issuing bank, which was not put in funds by the buyer, becomes insolvent the buyer will pay the seller directly. In the situation where the issuing bank becomes insolvent after it has been put in funds by the buyer there are two possibilities; the first possibility is that the fund was allocated to meet the seller’s drafts; in this case the seller will be entitled to payment in preference over the general creditors of the insolvent issuing bank. The second possibility is that such funds

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4In the U.K. see Newman Industries Ltd. v. Indo-British Industries Ltd. [1956] 2 Lloyd’s Rep. 219 at p.236; Soproma S.P.A. v. Marine & Animal By-Products Corporation [1966] 1 Lloyd’s Rep. 367 at p.386; See also the Australian case of Saffron v. Société Minière Cafrika (1958) 100 C.L.R. 231 at pp.244-5. In the U.S.A. see Lamborn v. Allen Kirkpatrick, 135 A. 541, at pp.542-3 (1927); Greenough v. Munroe, 53 F.2d 362 (1931). Also §2-325 (2) of the U.C.C provides that "The delivery to the seller of a proper letter of credit suspends the buyer’s obligation to pay. If the letter of credit is dishonored, the seller may on reasonable notification to the buyer require payment directly from him.”


7In the U.S.A. the U.C.C. §5-117(1) reads as follows "Where an issuer or an advising or confirming bank or a bank which has for a customer procured issuance of a credit by another bank becomes insolvent before final payment under the credit and the credit is one to which the Article is applicable by paragraphs (a) or (b) of Section 5-102(1) on scope, the receipt of allocation of funds or collateral to secure
were not appropriated to meet the seller’s drafts; in this case the seller will be treated as a general creditor of the insolvent bank and will be entitled to payment from the buyer\(^8\) for the unsatisfied part of the price of the goods. It is true that it is unjust to require the buyer to pay almost twice the price of the goods, but the situation is that one of two innocent parties should bear the loss caused by the insolvency and it is fairer that it should be the buyer rather than the seller, because on the one hand the buyer is under an obligation to provide a solvent paymaster and he failed to fulfil this obligation,\(^9\) on the other hand the buyer is in a better position to evaluate the financial status of the issuing bank than

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\(^9\)Ng Chee Chong, Ng Weng Ching, Ng Cheng and Ng Yew (Maran Road Saw Mill) v. Austin Taylor & Co. Ltd. [1975] 1 Lloyd’s L. Rep. 156 at pp.159-60.
the seller.\footnote{Berger, S.R., \textit{The Effects of Issuing Bank Insolvency on Letter of Credit}. at p.179.} So if the former pays a bank with a doubtful solvency he would be expected to bear the loss rather than the seller.
CHAPTER THREE

The Relationship Between The Applicant For The Credit And The Issuing Bank

3.1 General

Following the conclusion of the sale contract the buyer, in fulfilment of his duty to arrange for the opening of the credit, will request his bank to open a letter of credit in favour of the seller [or to request a bank in the seller’s country to open such credit]. The buyer’s request is usually made by completing and signing a standard application form provided by the bank which contains the terms on which the bank undertakes to issue the credit. In this application form the buyer would be required to specify the type of credit, the duration and the place of its availability, the list of documents against which the bank will be authorized to effect payment, the description of the goods, whether part shipment is allowed, and the method by which the bank shall notify the beneficiary (for instance, by cable, mail or other means of transmission) and the name of the advising or confirming bank if requested by the seller, etc. Also, if the buyer does not put the issuing bank initially in funds or give it some form of security, the buyer would be required to confirm in the application that the documents of title of the goods are to be pledged to the bank as a security for the amount of money advanced.
to the seller\(^1\) and its commission\(^2\) until it is reimbursed by the buyer. In some cases the bank may deliver the document of title to the buyer before being reimbursed but that would be under a "trust receipt".\(^3\)

The buyer's request contained in the application form may be accepted by the bank either expressly by notifying the buyer in writing or by acting upon it.\(^4\) The bank, having accepted the buyer's request in one of these ways, must adhere strictly to the buyer's instructions set out in the application form in order to be entitled to indemnity, Lord Sumner in *Equitable Trust Co. of New York v. Dawson Partners Ltd.*,\(^5\) said in this connection:

There is really no question here of waiver or of estoppel or of negligence or of breach of a contract of employment to use reasonable care and skill. The case rests entirely on performance of the conditions precedent to the right of indemnity, which is provided for in the letter of credit.

\(^1\)As to an example of this condition see *infra* at p.163, Note 382.

\(^2\)The commission is usually calculated on the basis of a percentage of the total amount of the credit and the duration of the time it remains opened.

\(^3\)For detail see Gutteridge and Megrah, *The Law of Bankers' Commercial Credits*, at pp.215 et seq.

\(^4\)Ellinger, *Documentary Letters of Credit*, at p.152. See also by the same author, *The Relationship Between Banker and Buyer Under Documentary Letters of Credit*, University of Western Australia Law Review (7) (1965) 40 at p.46. The author explained that accepting the application by acting upon it would be in the bank's favour because if it fails to issue the credit the buyer would not be able to bring an action against it for breach of contract.

Similarly, in *Midland Bank Ltd. v. Seymour*\(^6\) the bank was instructed by the buyer to issue a letter of credit in favour of the seller specifying in the application form that it should be available in Hong Kong. The bank issued a letter of credit which provided that in order for drafts to be accepted it should be presented in London, Devlin J. in the course of his judgement said:

If [the bank] was authorized so to pay [i.e. 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 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.\(^7\)

Thus in order to make the strict compliance easier for the bank it is important that it demands from the buyer when filling the application form clear instructions. In this regard Article 5 of the U.C.P. stated:

Instructions for the issuance of credits, the credits themselves, instructions for any amendments thereto and the amendments themselves must be complete and precise.

In order to guard against confusion and misunderstanding, banks should discourage any attempt to include excessive detail in the

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\(^7\)Ibid. at p.168. (The issue of whether the issuing bank is an agent of the buyer is discussed *infra*.) See also Rayner (J.H.) & Co. Ltd. v. Hambro's Bank Ltd. [1943] 1 K.B. 37 at p.43. As regard the issuing bank's duties in general see Article 16 of the U.C.P. and §5-109 of the U.C.C.
credit or in any amendment thereto.\(^8\)

However, if the instructions, were ambiguous and the bank acted in good faith in giving it a reasonable construction the bank would be entitled to be reimbursed.\(^9\)

### 3.2 The Legal Nature Of The Contract.

In Common Law countries the buyer’s signed application form constitutes an offer which when accepted by the bank either expressly by notifying the buyer or by acting upon the application e.g. by issuing the requested credit, by accepting the commission or by accepting a fund for the opening of the credit etc., brings into existence a contract between the two parties\(^10\) the basis of which is the application form. The bank’s agreement to issue a letter of credit in favour of the seller is made in consideration of the buyer’s promise in the application form, to reimburse it after making payment or to put it initially in funds plus paying a commission. This contract is the second of the four autonomous contracts referred to by Lord Diplock in *United City Merchants (Investments) Ltd. v. Royal Bank of Canada*.\(^11\)

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\(^8\)&nbsp;See also Articles 13 and 14 of the U.C.P.


\(^10\)In the U.K. see Davis, *The Law Relating to Commercial Letters of Credit*, at p.58; Gutteridge and Megrah, *The Law of Banker’s Commercial Credits*, at p.58. In the U.S.A. see Harfield, *Bank Credits and Acceptances*, at p.103

Some German authors suggested that the buyer’s application becomes a contract binding on both parties from the time it is received by the bank or after that time but by a reasonable period of time. In Italy the view is that the application constitutes a special contract which is binding on both parties, but at the same time its binding nature depends on the creditworthiness of the parties. So before the issuance of the credit the bank’s termination of the contract will be justifiable if the buyer’s financial position changes to a degree that leads the bank to believe that he is not creditworthy.

However, the relationship between the issuing bank and the buyer-applicant is undoubtedly contractual, but the nature of this contractual relationship is not clear.

In Germany the contract between the issuing bank and the buyer was considered to be a contract for employment [i.e. the bank is employed by the buyer] to which some other principles of the law of agency apply. This contract is regulated in German Law by para. 631 of the Bürgerliches Gesetzbuch (referred to hereinafter as BGB) which


13Ibid.


15The paragraph reads as follows "Durch den Werkvertrag wird der Unternehmer zur Herstellung des versprochenen Werkes, der Besteller zur Entrichtung der vereinbarten Verguetung verpflichtet."
is translated by Wang to read as follows:

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.\(^\text{16}\)

Additionally, para. 675 of the BGB\(^\text{17}\) provided that several principles of the agency law shall apply to the contract of work. As examples of these principles; the principle embodied in para. 665 which permits the agent to exceed his authority in certain circumstances, para. 666 which makes it the duty of the agent to make a full disclosure to the principal, and para. 667 which provides that the agent should return to the principal any sum of money that is obtained from a third person for the performance of the mandate.


\(^{17}\)The para. reads as follows "Auf einen Dienstvertrag oder einen Werkvertrag, der eine Geschäfte besorgung zum Gegenstande hat, finden die Vorschriften der §§663,665, bis 670,672 bis 674 und, wenn dem Verpflichteten das Recht zusteht, ohne Einhaltung einer Kuendigungsfrist zu kuendigen, auch die Vorschriften des §671 Abs. 2 entsprechende Anwendung." This para. translated by Wang, _Ibid_. at p.148, to read as follows "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." See also Forrester, I.S., Goran, S.L., and Ilgen, H., _The German Civil Code_ at p.111.
The German lawyers’ explanation of the buyer-issuing bank legal relationship seems acceptable but neither the contract of agency nor the contract of service was capable of explaining the fact that under the law of documentary credit the issuing bank, at the request of the buyer, undertakes in addition to its obligation towards the buyer a separate obligation towards the seller.\textsuperscript{18} The same explanation was also put forward in France and rejected for the same reason.\textsuperscript{19}

In common law, despite the fact that the court has indicated that the issuing bank, in performing its duty under the credit, acts as an agent of the buyer,\textsuperscript{20} there is no attempt to classify their contractual relationship under any sort of existing law institutions.

It is worth noting that there are some similarities between the issuing bank-buyer contract and the contract of agency which leads to the view that the former relationship is one of an agent and principal. The first similarity is that the buyer pays a commission to the bank for opening the credit. The second is that the instruction contained in the application form which the buyer gives to the bank is similar to the mandate which is given by the principal to his agent.\textsuperscript{21} In Ventris’s view these similarities are sufficient to render the contract between the

\textsuperscript{18}Ellinger, \textit{Documentary Letters of Credit}, at p.150.


\textsuperscript{20}E.g. see Devlin J.’s statement in Midland Bank Ltd. \textit{v.} Seymour [1955] 2 Lloyd’s Rep. 147 at p.168 (Quoted above at p.25.)

\textsuperscript{21}Ellinger, \textit{Documentary Letters of Credit}, at p.151.
issuing bank and the buyer as one of agency.\textsuperscript{22}

However, despite these similarities, the bank’s position is distinguishable from that of an agent. Firstly, if the bank was an agent of the buyer it would create a contract between the buyer and the seller, but that is not the case; the bank, by issuing a letter of credit, puts itself under an obligation directly to the seller. Secondly an agent, as long as he does not exceed his authority, has no liability to third parties, unlike the issuing bank because it undertakes an independent obligation to the seller that renders it directly liable to the seller for the breach of such obligation.\textsuperscript{23}

There is a further relationship between the buyer and the issuing bank, namely, that of a creditor and debtor which is usually the main relationship between banks and their customers.\textsuperscript{24} Thus, when the buyer puts the issuing bank in funds before issuing the credit, the money will not be held in trust for the seller by the issuing bank\textsuperscript{25} but the bank will be a mere debtor of the buyer for that fund.\textsuperscript{26} If the issuing bank was not put initially in funds and it accepted the documents from the

\textsuperscript{22}Bankers’ Documentary Credits, at p.72.

\textsuperscript{23}Harfield, Bank Credits and Acceptances, at p.104.


seller and effected payment, the issuing bank, when reimbursement becomes due, will be the creditor of the buyer for such payment.\textsuperscript{27}

It is therefore appropriate to say in conclusion that although there is a strong resemblance between the issuing bank-buyer’s contract and the agency contract or the service contract, the former is a unique commercial contract, the special nature and the rules of which were originated by business practice.

\textsuperscript{27}Ellinger, \textit{Documentary Letters of Credit.} at p.152.
CHAPTER FOUR

The Relationship Between The Issuing Bank And The Beneficiary

4.1 General

When the issuing bank opens the irrevocable credit upon the request of the applicant, it constitutes a binding undertaking by the issuing bank towards the beneficiary.¹ [Because the discussion in this part of the work applies equally to the confirming bank and the intermediary-issuer² the irrevocable credit will mainly be assumed not to be confirmed and reference will be made only to the issuing bank.]

Although the issuing bank’s undertaking to the beneficiary must be in writing³ there is no specific form required by law.⁴ However, the forms used by banks at the present time are very similar. These forms

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¹U.C.P. Art. 10; U.C.C. §5-114(1). The nature of this relationship will be discussed later in detail.

²If the credit is issued by an intermediary-issuer the beneficiary has no relationship with the requesting bank.

³U.C.C. §5-104.

generally contain the date and the number of the credit, the expiry date, the amount of the credit, and the name of the applicant for the credit. Also in the form the issuing bank addresses the letter of credit to the beneficiary stating that it is issued in his favour and indicates the method of payment in which it is available, e.g. sight or deferred payment etc. It also contains a list of the documents against which payment will be made, e.g. shipping documents, insurance policy, invoice etc. Finally, it contains the issuing bank’s undertaking to pay if the documents tendered are in compliance with the letter of credit’s terms.

This undertaking becomes binding on the part of the issuing bank at the time when the irrevocable letter of credit is communicated to the beneficiary. This principle has been established by case law in the U.S.A..\(^5\) It is also explicitly stated by the U.C.C. Section 5-106(1)(b) the section reads:

(1) Unless otherwise agreed a credit is established...

(b) as regards the beneficiary when he receives a letter of credit or an authorized written advice of its issuance.

The situation is less certain in the U.K. Although there is no equivalent provision in the U.C.P., Article 10(a) seems to imply that it becomes binding at the time it is communicated to the beneficiary. However, Rowlatt J. in Urquhart Lindsay & Co. Ltd. v. Eastern Bank Ltd.\(^6\) was of the view that the irrevocability commenced from the time

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\(^5\) See cases cited *infra* at pp.133-4.

\(^6\) [1922] 1 K.B. 318, at pp.321-2, discussed *infra* at p.112.
the beneficiary acted on it. On the other hand, in Dexters Ltd v. Schenker & Co., Greer, J., was of the opinion that the issuing bank’s undertaking becomes irrevocable from the time at which the credit is communicated to the beneficiary.\(^7\)

The significance of determining the moment at which the issuing bank’s promise becomes irrevocable is that thereafter the issuing bank cannot revoke it or amend it without the consent of all parties concerned.\(^8\)

The issuing bank is under a duty to examine the documents to determine that they are strictly in compliance with the terms of the credit.\(^9\) If it paid against documents that are not in strict compliance with the terms of the credit it may lose the right of reimbursement from the buyer. Courts in the United States, however, recently deviated from the strict approach by adopting the test of substantial compliance,\(^10\) i.e.

\(^7\)(1923) L.I.L.R. 586 at p.588, discussed infra at p.113.


the issuing bank should pay the beneficiary against documents that contain minor discrepancies.11

Like all the other contracts involved in the letter of credit transaction the issuing bank’s undertaking towards the seller is independent of the contract between the seller and the buyer and of the contract between the issuing bank and the buyer.12 Thus, neither the seller nor the buyer can raise against the issuing bank defences arising out of the underlying contract. Equally, the issuing bank and the buyer are not allowed to raise against the beneficiary defences arising out of their application form agreement.

The issuing bank must honour the beneficiary’s draft or demand for payment if accompanied by documents that are in compliance with the terms of the credit. Failing to do so will make it liable to the beneficiary for wrongful dishonour.13 The issuing bank, however, is


12See supra at p.19.

13U.C.C. §5-115; In the U.K. see Belgian Grain and Produce Co. Ltd. v. Cox & Co (France) Ltd. (1919) 1 L.I.L.R. 256; Stein v. Hambro’s Bank of Northern Commerce (1921) 9 L.I.L.R. 433 at p.507, reversed on a different point, (1922) 10 L.I.L.R. 529; Dexters Ltd. v. Schenker & Co. (1923) 14 L.I.L.R. 586; British Imex
entitled to reject facially complying documents if they were forged with the beneficiary’s knowledge.14

However, if the issuing bank accepted documents which were facially non-conforming it would not be allowed a right of recourse against the seller15 on the ground that as the examination of the documents is its duty it should be estopped after accepting them from claiming that they are not in compliance with the terms of the credit. Furthermore, it could be asserted by the seller that the issuing bank has waived the discrepancies.16 Support to this view is found both in the United Kingdom17 and the United States.18


15Issuing and confirming banks are not allowed a right of recourse on the bill of exchange if payment was made by way of negotiation. U.C.P. Art. 10(a)(iv); 10(b)(iv).

16Gutteridge and Megrah, The Law of Bankers Commercial Credits, (at p.87) are of the opinion that a recourse should be allowed if it was claimed before the seller changes his position in reliance on the acceptance.


Article 16(e) of the U.C.P. made it clear that if the issuing bank did not return the documents accompanied by a notice of rejection, stating in it the discrepancies that led it to reject the documents, it will be precluded from claiming that they are not in compliance with the terms of the credit. Thus, the issuing bank will be more likely to be precluded from claiming a recourse in the situation where it actually accepted the documents.

If the issuing bank seeks recourse against the beneficiary in the situation where the documents tendered were forged, it will be allowed to recover the money paid on an action for deceit, but it is doubted whether it could recover the money paid to the beneficiary in the situation where the buyer failed to reimburse it, whether the failure was the result of the buyer’s insolvency or otherwise. This is because one of the main reasons behind the issuance of the irrevocable letter of credit

F. 2d 1224 (5th Cir. 1973) where the court held "Mercantile cannot lull Barclays into believing that there was no problem with the documentation where there was still time for Barclays to have attempted to cure the technical defect and then turn around and assert the lack thereof as a defense to the suit on the draft. Having informed Barclays that the documentation was proper, Mercantile, must, on the facts of this case, be held to have waived the alleged faulty documentation as a defense." Ibid. at p.1237. For an excellent view of the waiver and estoppel cases in the U.S.A. see Givray. A. Letters of Credit, [1990] 45 Business Lawyer, 2381 at pp.2422 et seq; Givray, A. and others, Letters of Credit [1991] 46 Business Lawyer 1579 at pp.1624 et seq.

19Under the U.C.C. §5-111(1) the beneficiary warrants the regularity of the documents but it is doubtful if it gives the issuing bank the right to recover the money paid in this situation. See infra, at pp.272-3.

20As regards fraud in general, see supra, at p.36 Note 14. In the U.S.A. the issuing bank will have an action against the beneficiary for breach of warranty under U.C.C. §5-111(1).
is that the seller does not trust that the buyer will pay him after shipping the goods, and therefore, he insisted on an assurance from a paymaster (the issuing bank) that it will pay him when he presents complying documents; thus, allowing the issuing bank to recover the money paid to the seller in this situation will defeat the main object of the irrevocable letter of credit.
4.2 The Nature Of The Relationship Between The Issuing Bank And The Beneficiary

Due to the substantial income\textsuperscript{21} that banks make from issuing irrevocable letters of credit, they naturally have a vested interest in making their use as frequent as they possibly can. In achieving this aim, banks who are not concerned with the legal side of the transaction have over the years maintained the reliability of irrevocable letters of credit establishing in the export market the belief that when an irrevocable credit is issued its beneficiary will definitely be paid. That, understandably, has gradually resulted in putting the commercial world under the impression that a rational legal basis does exist behind the issuing bank’s obligation to pay the beneficiary. Courts have also, in a number of cases, assumed that a binding contractual relationship does exist but do not give any explanation, being content only with the result that their decisions are consistent with the commercial practice. It is true that the question is academic in the sense that reputable banks will still honour their promises in the irrevocable credit, even if they are theoretically under no obligation to do so, and courts will reject any argument disputing their validity, but that does not dispense with establishing the legal validity of this relationship in theory at least, because it is "very undesirable that the validity in law of a commercial

\textsuperscript{21}At the present time the usual charge is between one and one and a half percent of the amount of the credit.
contract of such importance should remain in doubt."22 Moreover in the event of the issuing bank's insolvency the liquidator might be obliged to raise this defence against beneficiaries of unpaid irrevocable credits;23 thus it could be said that the question is not purely academic.

The difficulty in establishing the legal ground for the validity of the beneficiary-issuing bank relationship stems mainly from the lack of direct negotiation between the two parties, which is regarded, in the accepted sense, to be the means of creating a binding contractual relationship. Numerous theoretical attempts have been made to solve this difficulty both in the common law and in civil law countries against which similar objections were raised.

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23 Ibid. paras 33, 45.
4.2.1 Classification Theories

There has been a number of attempts in both civil and common law countries to solve the difficulty by seeking to fit the issuing bank-beneficiary relationship under the irrevocable letter of credit within the scope of an existing legal institution.

4.2.1.1 The Guarantee Theory

This theory is an attempt to classify the legal relationship between the issuing bank and the beneficiary as a contract of guarantee. It suggests that the bank’s issuance of the irrevocable credit to the beneficiary-seller constitutes a guarantee of the buyer’s obligation to pay the seller the price of the goods.

This explanation of the nature of letter of credit was suggested in both major legal systems. In the U.S.A. this theory was suggested by courts, as early as 1813, in the case of *Walsh & Beechman v. Bailie*.[24] In England the court in *The Annie Johnson*[25] indicated that letters of credit bear a resemblance to the contract of guarantee.[26] In Scotland, Bell, also suggested that letters of credit have a similar nature to that of

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[25][1819] P. 154, per Evans P. at p.162. It is important to note that all of these cases are concerned with open letter of credit.

[26]It should be noted that the issue in this case was not the legal nature of letters of credit. So the *dictum* in this case is not authority on the point.
caution contracts.\textsuperscript{27} Also the guarantee theory was suggested in Germany\textsuperscript{28} and France.\textsuperscript{29}

As a solution to the difficulties concerning the legal relationship between the issuing bank and the beneficiary under the modern irrevocable credit, this theory is faced with many objections which have rendered it unacceptable in both major legal systems.

The first objection is that classifying the irrevocable credit as a guarantee would affect the independent character of the issuing bank undertaking. Under a guarantee contract the guarantor’s obligation to pay is conditional on the main debtor’s default to pay the creditor. So the guarantee contract is dependent on the main contract between the debtor and the creditor; thus if the debt was discharged the guarantor would be released of his liability to the creditor. Also if the risk that the guarantor has undertaken changes by any alteration of the contract between the creditor and the main debtor he would also be released of his liability.\textsuperscript{30} Also against the creditor the guarantor can rely upon

\textsuperscript{27}Commentaries on the law of Scotland, 1. 389.


\textsuperscript{29}See the decision of Cour de Cassation, Req. 26.1.1926, Dalloz Per. 1926, 1, 201 at p.204.

defences that the main debtor can rely upon.31

However, under the irrevocable letter of credit the issuing bank obligation is independent of the underlying contracts. It follows that the issuing bank is not discharged from its obligation to the seller even if the contract between the issuing bank and the buyer or the contract between the buyer and the seller is altered or becomes void. Also the issuing bank cannot avoid liability by relying against the beneficiary upon defences related to the underlying contract.32

The second objection to the guarantee theory is that under the contract of guarantee the guarantor is only liable to pay the creditor if the main debtor has failed to pay the debt. Hence, the guarantor’s undertaking is a secondary obligation. However, under the irrevocable letter of credit the issuing bank’s undertaking to the beneficiary is a primary obligation. This dissimilarity between the guarantee and the letter of credit was set out in the case of American Insurance Association v. Clarke;33 the court in this case stated that:

The central distinction between the two is that standby credit creates a primary liability on an original obligation - to pay on the presentation of documents - whereas the contract of guaranty creates a secondary liability on the pre-existing obligation of

31Gutteridge and Megrah, The Law of Bankers’ Commercial Credits at p.31; See also Kozolchyk, International Encyclopedia of Comparative Law, Chapter 5, Letters of Credit, at p.137.

32See supra at p.19 Note 2.

another - to pay in the event that the other does not.\textsuperscript{34}

Moreover, in \textit{Border National Bank of Eagle Pass, Tex. v. American National Bank of San Francisco Cal.},\textsuperscript{35} the court observed that:

A guarantee is a promise to answer for the payment of some debt, or the performance of some obligation, in case of the default of another person, who is in the first instance liable for such payment or performance. A letter of credit confers authority upon the person to whom it is addressed to advance money or furnish goods on the credit of the writer.\textsuperscript{36}

This distinction shows that under the irrevocable letter of credit the issuing bank does not guarantee the debt of the buyer; it is primarily obliged to pay the seller when he presents the stipulated documents. A further dissimilarity is that the seller is obliged to claim payment initially from the bank and not the buyer.\textsuperscript{37}

Professor Dolan raised an interesting third objection to this theory, showing a further important difference between the nature of the irrevocable credit and the contract of guarantee, he argued that because the guarantor, under the guarantee contract, is not under a duty to pay

\textsuperscript{34}\textit{Ibid.} at p.1410. Although the case was concerned with standby credit it is still applicable to the irrevocable documentary credit.

\textsuperscript{35}282 F. 73 (1922).

\textsuperscript{36}\textit{Ibid.} at p.77. In Scotland Bell stated "Cautionary is an accessory obligation or engagement, a security for another, that the principal obligant shall pay the debt or perform the act for which he has engaged, otherwise, the cautioner shall pay the debt or fulfil the obligation." \textit{Principles of the law of Scotland}, at §245. In France and Germany see Ellinger, \textit{Documentary Letters of Credit}, at pp.47-8.

\textsuperscript{37}See \textit{supra} at p.20 Note 4.
unless the main debtor has failed, there has to be a determination as to whether he is under a duty to pay by establishing the main debtor’s failure, which may take a long time. This is certainly inconsistent with the objective of the irrevocable credit which is to provide an immediate payment. 38

Moreover, there are other objections which have been raised in the common law countries, firstly, Hershey 39 argued rightly that the guarantor’s promise, in order to be binding, must be accepted by the promisee. 40 In the case of the irrevocable credit the beneficiary who is the promisee does not give notice of acceptance of the bank’s offer. Also accepting the possibility that the beneficiary could be regarded to have accepted the irrevocable credit by conduct would result in a great deal of uncertainty as to when the letter of credit becomes irrevocable. However, according to the law of the irrevocable credit, the issuing bank becomes bound from the date in which the credit is communicated to the beneficiary. 41

The second objection to this theory is that in English law, in order for a contract of guarantee to be enforceable, it must be supported by

38 The Law of Letters of Credit, at §2.10 [1].


41 See supra at p.33. As regards the problem of the beneficiary acceptance see infra, The Offer and Acceptance Theory.
consideration.\(^{42}\) As there is no consideration moving from the beneficiary (promisee) to the issuing bank, it is hard to see how the irrevocable credit can be classified as a guarantee.

Hershey\(^{43}\) raised a further objection to this theory which is that the irrevocable credit does not meet the requirement of the Statute of Frauds which makes it necessary for the enforcement of a contract of guarantee the existence of a written memorandum as an evidence thereof.\(^{44}\) Although this does not constitute a strong objection to the theory, because letters of credit are generally evidenced by writing today, the theory, as we have seen, was open to many strong objections that undoubtedly rendered it an unsuitable answer to the difficulty arising from the legal relationship between the issuing bank and the beneficiary under the irrevocable letter of credit.

### 4.2.1.2 Contracting For The Benefit Of A Third Party Theory

The legal relationship between the beneficiary and the issuing bank

\(^{42}\)French v. French, (1841) 2 Man. & Gr. 644; Crofts v. Beale (1851) 11 C.B. 172.


\(^{44}\)In Scotland see Mercantile Law Amendment (Scotland) Act, 1856, §6. In England see Statute of Frauds, 1677 §4. In the U.S.A. see Cheever v. Schall 87 Hum (N.Y.) 32 (1895). Also classifying the irrevocable credit as a guarantee will render the issuing bank's undertaking void in the U.S.A., because banks regulations there do not allow banks to issue guarantees. See White & Summers Uniform Commercial Code (Vol. 2) (3rd ed.) Ch.19 p.9.
under the irrevocable letter of credit was characterized as early as 1841 in the American case of *Carnegie v. Morrison* as a contract between the account party and the issuing bank for the benefit of the beneficiary. That is to say, when the account party entered into a contract with the issuing bank to open an irrevocable letter of credit in favour of the beneficiary, he created a right for the beneficiary, who is a stranger to the contract, to enforce it and sue upon it. This right is an exception to the general principle that only the parties of the contract can enforce it and maintain an action for its breach.

The following pages will be devoted to a brief discussion about the extent of which this principle is acceptable in England, United States and Scotland, then whether this principle would offer an answer to the problem.

### 4.2.1.2[i] England

English courts faced some difficulties in accepting the doctrine of *jus quaesitum tertio* by way of contract for two reasons; the first is that

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452 Metc. (43 Mass) 381 (1841). The letter of credit in this case is the old open letter of credit. This characterization was adopted in connection with an irrevocable letter of credit in the case of *First Wisconsin National Bank v. Forsyth Leather Co.* 189 Wis. 9. 206 N.W. 843 (1926).

no consideration has moved from the promisee, and the second is the
lack of privity,\textsuperscript{47} i.e. as the beneficiary is not a party to the contract,
giving him such right would deprive the original parties of their privacy,
which confers on them alone the right to modify and cancel the contract
by mutual agreement. In the case of \textit{Dunlop Pneumatic Tyre Co. Ltd.}
v. \textit{Selfridge & Co.}\textsuperscript{48} Viscount Haldane stated that:

in the Law of England certain principles are fundamental. One
is that only a person who is party to a contract can sue on it. Our law knows nothing of a \textit{jus quae\-situm tertio} arising by way of contract. Such a right may be conferred by way of property as, for example, under a trust, but it cannot be conferred on a stranger to a contract as a right to enforce the contract in personam.

Although Viscount Haldane emphasized that it is a fundamental
principle in English Law that no one other than the parties to a contract
can sue on it, the need for such a right motivated the Law Revision
Committee\textsuperscript{49} to make an attempt to introduce it into English Law. The

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\textsuperscript{47}\textcite{Bartholomew} concluded that:
"the only obstacle in recognising the right of a third party to sue in contract made
for his benefit in English Common Law, is the lack of consideration, because the
doctrine of privity is part of the doctrine of consideration and not independent from
it". Professor P.S. Atiyah \textcite{Atiyah} suggested that consideration is any good reason to enforce a promise.

\textsuperscript{48}[1915] A.C. 847 at p.853.

\textsuperscript{49}Sixth Interim Report 1937. (Cmd. 5449). Section D. See Gutteridge and Megrah, \textit{The Law of Bankers' Commercial Credits}, at pp.28-9. The authors of this book who were members of the committee expressed their view that it is uncertain
that a third party has the right to sue the issuing bank under Letter of Credit in the
Committee recommended that:

where a contract by its express terms purports to confer a benefit directly on a third party, it shall be enforceable by the third party in his own name subject to any defences that would have been valid between the contracting parties. Unless the contract otherwise provides, it may be cancelled by the mutual consent of the contracting parties at any time before the third party has adopted it either expressly or by conduct.\(^{50}\)

The basis of the committee’s recommendation of conferring a right to sue on a third person is the intention of the parties. They emphasized in paragraph 28 that where no consideration was given as evidence of the intention of the parties, the intention has to be proved by other means such as writing.

This recommendation met with great support from Lord Justice Denning in three cases, which are Smith & Snipes Hall Farm Ltd. v. River Douglas Catchment Board,\(^ {51} \) Drive Yourself Hire Co. (London) Ltd. v. Strutt,\(^ {52} \) and Adler v. Dickson.\(^ {53} \) In the case of River Douglas his Lordship stated that:

... a man who makes a deliberate promise which is intended to be

\(^{50}\)Ibid. Paragraph 48. This recommendation was adopted in a recent Australian case of Trident General Insurance Co. Ltd. v. McNiece Bros. Pry. Ltd. (1988) 80 A.L.R. 574.

\(^{51}\)(1949) 2 K.B. 500.

\(^{52}\)(1954) 1 K.B. 250.

\(^{53}\)(1955) 1 Q.B. 158.
binding, that is to say, under seal or for good consideration, must keep his promise; and the court will hold him to it, not only at the suit of the party who gave the consideration, but also at the suit of the one who was not a party to the contract, provided that it was made for his benefit and that he has a sufficient interest to entitle him to enforce it, subject always, of course, to any defences which may be open on their merits.54

Explaining, unexhaustively, what constitutes a sufficient interest, but conferring such right specifically to the beneficiary in his relationship with the issuing bank under the irrevocable letter of credit, his Lordship said:

... it does cover the protection of the legitimate property, rights and interests of the third person, although no agency or trust for him can be inferred. It covers, therefore, rights such as the following which can not justly be denied; the right of a seller to enforce a commercial credit issued in his favour by a bank under contract with the buyer ...55

As Dowrick concluded,56 although Lord Justice Denning directed the

54(1914) 2 K.B. 500 at p.514. In support of his view Lord Denning cited section 56 (1) of the Law of Property Act, 1925, which states: "A person may take an immediate or other interest in land or other property, or the benefit of any condition, right of entry, covenant or agreement over or respecting land or other property, although he may not be named as a party to the conveyance or other instrument".

55Ibid. at p. 515. Lord Justice Denning’s view in this case was cited with approval by Devlin J. in Pyrene Co. Ltd. v. Scindia Navigation Co. Ltd. (1954) 2 Q.B. 402. Devlin said: "There is nothing novel about the idea of a third party coming into enforce a contract... as a beneficiary. Denning L.J. in Smith & Snipes Hall Farm Ltd. v. River Douglas Catchment Board..., reviews the main categories into which such third parties commonly fall."

attention to the need in England for *jus quaesitum tertio* by way of contract, it is still not established as part of English Law, the Court of Appeal in the case of *Green v. Russell, McCarthy (third party)*,\(^{57}\) returned to the old view of Viscount Haldane in *Dunlop v. Selfridge*,\(^{58}\) rejecting Lord Justice Denning’s view.

Despite Lord Denning dissenting, the House of Lords in the case of *Midland Silicones v. Scruttons*\(^{59}\) gave effect to the Court of Appeal’s decision in *Green v. Russell, McCarthy*\(^{60}\) affirming that a stranger to a contract cannot sue upon it, even if it is clear from the contract that it was made for his benefit. Viscount Simonds\(^{61}\) stated that:

> ...If the principle of *jus quaesitum tertio* is to be introduced in our Law, it must be done by Parliament after a due consideration of its merits and demerits. I should not be prepared to give it my support without a greater knowledge than at present I possess of its operation in other systems of Law.

Professor Bartholomew suggested that the *jus quaesitum tertio* should be established as an exception to the general rule on the grounds of

\(^{57}\)[1959] 2 Q.B. 226.

\(^{58}\)Supra.

\(^{59}\)[1962] A.C. 446.

\(^{60}\)Supra.

\(^{61}\)[1962] A.C. 446 at p. 468. In *Beswick v. Beswick* [1968] A.C. 58. The House of Lords held, that a widow has no right in her own name to enforce the nephew’s promise which was made to her husband.
mercantile usage.\textsuperscript{62}

However, it seems beyond doubt from the above discussed cases that although it is unjust not to give a third party a right to protect his interest,\textsuperscript{63} English Courts are still unwilling to recognize the doctrine of \textit{jus quaesitum tertio} by way of contract.\textsuperscript{64}

4.2.1.2\textsuperscript{[ii]} United States

Prior to 1859 the American Law had the same attitude as the English Law has now, in rejecting the idea of allowing a third person to sue on a contract in which he is not a party, even if the contract was made for his benefit. Since 1859 this attitude has begun to change. In the case of \textit{Lawrence v. Fox}\textsuperscript{65} the facts were that Holly loaned to Fox a sum of $300, and the latter promised Holly to repay this sum of money to Lawrence the next day as a repayment of a previous loan that Holly owed Lawrence. Fox refused to pay. Lawrence as a third party for whose benefit the contract was made sued him. The New York Court of Appeal gave judgment for Lawrence introducing by a majority\textsuperscript{66} a

\begin{itemize}
\item\textsuperscript{62}Relations between Banker and Seller under Irrevocable Letter of Credit, at pp.95-100.
\item\textsuperscript{63}See Lord Scarman’s judgment in Woodar Invt. Development Ltd. v. Wimpey Const. U.K. Ltd. [1980] 1 All E.R. 571 (H.L.)
\item\textsuperscript{64}English Law is nearly alone among other legal systems which reject such right. See Dowrick, \textit{A Jus Quaesitum Tertio by Way of Contract in English Law} at p.389.
\item\textsuperscript{65}20 N.Y. 268 (1859).
\item\textsuperscript{66}\textit{Ibid}. Comstock, J. was dissenting.
\end{itemize}
new principle that a third person for whose benefit a contract was made, can enforce it and sue for its breach.

Since then all the states\textsuperscript{67} have adopted the doctrine laid down by \textit{Lawrence v. Fox}.\textsuperscript{68} Some states have given effect to the doctrine by statutes. These statutes vary from one state to another as regards the classes that they are applicable to. As an example of these statutes\textsuperscript{69} California Civil Code section 1559 reads as follows:

\begin{quote}
a contract made expressly for the benefit of a third person may be enforced by him at any time before the parties thereto rescind it.
\end{quote}

In other states the doctrine was accepted by the courts, either in simple or under seal contracts.\textsuperscript{70}

As a result of the insistent pressure in addition to Professor Corbin's campaign on behalf of this doctrine\textsuperscript{71} the American Law Institute

\textsuperscript{67}Massachusetts is the only state that still has not adopted this doctrine, although it has been recognized by the court there, in some exceptional cases. See Johnson-Foster Co. v. D'Amore Construction Co. 314 Mass 416, 421, 50 N.E. 2d 89 (1943). See Williston, \textit{Contracts for the Benefit of a Third Person} at pp.778-9; Williston, S., \textit{Williston on Contracts} (3rd ed.)(Vol. 2)(1959) at p.848, 1022; Dowrick, F.E., \textit{A jus quaesitum tertio}, at p.389. See also Kincaid, \textit{Third Parties}, at p.253.

\textsuperscript{68}Supra.

\textsuperscript{69}See also Idaho Code §29-102; Michigan Stats Anno §26; Montana Rev Stats §13-204; North Dakota Rev Code c.9-0204; South Dakota Code §10.0204; For a comprehensive discussion of the point see \textit{Williston on Contract}, at p.885.

\textsuperscript{70}\textit{Williston on Contracts}, at p.848.

\textsuperscript{71}For a lengthy discussion about Professor Arthur L. Corbin's activity regarding the third party rule, see Waters, A.J., \textit{The Property in the Promise}.
included in the Second Restatement of the Law of Contracts,\textsuperscript{72} which seems to be regarded as part of the common law of the United States,\textsuperscript{73} provisions that recognize and regulate the doctrine. Section 304 of the Restatement provides that:

A promise in a contract creates a duty in the promisor to any intended beneficiary to perform the promise, and the intended beneficiary may enforce the duty.

The Restatement put down a criterion to determine who is an intended beneficiary, drawing a distinction between him and an incidental beneficiary,\textsuperscript{74} who acquires no right to enforce the contracts.\textsuperscript{75} Also the parties cannot cancel or modify the contract if it contains a stipulation to this effect, the beneficiary acts in reliance on the promise, brings an action on it or he accepts it as a result of either the promisor’s or promisee’s request.\textsuperscript{76}

This shows that despite the various systems of law which the American Law consists of, these systems generally, permitted a third party beneficiary to maintain an action to enforce a contract made for his benefit.

\textsuperscript{72}American Law Institute. Restatement (Second) of Contracts (1979).

\textsuperscript{73}See Waters, The Property in The Promise, at pp.1111-12; see also Kincaid, Third Parties, at p.253.

\textsuperscript{74}Restatement (Second) of Contracts, §.302.

\textsuperscript{75}Ibid. §315.

\textsuperscript{76}Ibid. §311.
4.2.1.2[iii] Scotland

The doctrine of consideration which deters the English courts from allowing a third party, to whose benefit a contract is made, to maintain an action on it, has no existence in Scottish Law. Gloag in this respect stated77:

The doctrine of consideration, as it has been developed in English Law, has no place in the law of Scotland. There is nothing in our law corresponding to the English distinction between contracts under seal, in which consideration is presumed, and simple contracts which are not binding unless consideration is proved.

The absence of this doctrine from Scottish law makes it unsurprising to find that jus quaesitum tertio78 is well known there. It was accepted by the court as early as 1591 in the case of Wood v. Moncur.79 In this case an action was brought by the plaintiff to remove a tenant. The


79 (1591) Mor. 7719., Dowrick F.E. A Jus Quaesitum Tertio, at p.387. Speaking about the doctrine in the law of Scotland said "It should be profitable to pause and consider the scope of the doctrine in its native system".

court sustained a defence by the tenant that there was an agreement between the original parties that the tenant should not be removed.

Before the end of the seventeenth century the doctrine was stated by Stair; he observed80:

...it quadrates to our customs, that when parties contract, if there be any article in favours of a third party, at any time, est jus quaesitum tertio, which cannot be recalled by both of the contractors, but he may compel either of them to exhibit the contract, and thereupon the obliged may be compelled to perform. So a promise, though gratuitous, made in favour of a third party, that party, albeit not present, nor accepting, was found to have right thereby.81

The third party who has a legitimate interest in the performance of the contract derives his right from the intention of the contracting parties.82 This intention can be either expressed, such as by naming him or indicating him in the contract83 or implied such as that the third party is the only one who would benefit by the performance of the contract.84

80Stair, The Institutions of the Law of Scotland, at p.197, §I.10.5.

81This was restated by the Court of Session in Morton's Trustee v. Aged Friend Society at p.87.

82Hislop v. M'Ritchie's Trs. (1881) 8R. (H.L.) 95. See also Gloag, The Law of Contract at p.236. A person who is not intended by the contracting parties to acquire such right cannot sue upon it even if he would benefit of its performance. See Finnie v. Glasgow & South Western Ry. (1857) 3 Macq 75.

83Greenlees v. Port of Manchester Insurance Co. (1933) S.C. 383.

As to when the promise, to the benefit of a third party becomes irrevocable by the original parties, Stair's statement\(^8\) in this connection seems to imply that the promise becomes irrevocable as soon as the contract between the original parties is concluded,\(^8\) but this view was rejected after considerable examination in *Carmichael v. Carmichael's Exx*,\(^7\) stating that the irrevocability of the contract is "a condition not a consequence of the expression of *jus* in favour of the tertius."\(^8\)

The original parties retain their power to revoke the contract unless the third party was informed by either of them\(^9\) or knew by any means that the contract was made for his benefit\(^9\) or even has a reasonable belief that the contract was made for his benefit, which leads him to act in reliance on it,\(^9\) also the contract becomes irrevocable after registration\(^9\) or delivery.\(^9\)

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\(^7\)(1920) S.C. (H.L.) 195. See Lord Dunedin's judgment.

\(^9\)Ibid. at p.200.


\(^9\)Carmichael v. Carmichael's Exx, supra. at pp.204-7.

\(^9\)Ibid. at p.203.

\(^9\)Ibid. See also Cameron's Trs v. Cameron (1907) S.C. 407.
4.2.1.2[iv] Does This Theory Furnish A Solution?

This theory seems to give a satisfactory explanation to the issuing bank beneficiary’s legal relationship since the beneficiary’s legal right to enforce and sue upon the letter of credit derives from the *jus quaesitum* which is created by the contract entered into, for a valid consideration, by the account party and the issuing bank which embodies an undertaking by the issuing bank, as promisor, to pay the beneficiary the value of the letter of credit, or honour the draft. This undertaking can be irrevocable\(^{94}\) in certain circumstances or by providing in the contract to be so. So if the issuing bank fails to perform his obligation the beneficiary would be entitled under the doctrine of *jus quaesitum tertio* to maintain an action against it in his own name.

The *jus quaesitum tertio*, as we have seen, on the surface, bears a strong resemblance to the letter of credit, but, this theory has received

\(^{93}\)Crosbie’s *Trs. v. Wright* (1880) 7R. 823. As regards irrevocability, see Cameron, J.T., *Jus Quaesitum Tertio True Meaning of Stair*, classification of *jus quaesitum tertio* cases.

\(^{94}\)There is a difference between the letter of credit and the *jus quaesitum tertio* regarding irrevocability; the credit is revocable unless it is indicated in it that it is irrevocable [U.C.P. Art. 7] and sent to the beneficiary by the issuing or intermediary bank [In England see *Dexters Ltd. v. Schenker & Co.* (1923) 14 Ll.L.R. 586. In the United States see *American Bank and Trust Co. v. National City Bank of New York* (1925) 6F. 762; See also U.C.C. §5-106, although there is an English case *Urquhart Lindsay & Co. Ltd. v. Eastern Bank Ltd.* [1922] 1 K.B. 318, discussed *infra* at p.112, which suggested that, it becomes irrevocable once the beneficiary acts in reliance on it] whereas, under the *jus quaesitum tertio* the right becomes irrevocable in various situations. See as regards to this point in United States *supra.* p.52., in Scotland *supra.* p.55. See also Sarna L. *Letters of Credit The Law and Current Practice* (2nd Ed.) pp.35-6.
a great deal of criticism which will be discussed in the following pages.

It is beyond question that this theory would be put forward as a solution to this problem in the English jurisdiction, where a person who is not a party to the contract was denied the right to enforce it, or sue upon it, even if the contract was made for his benefit.\textsuperscript{95}

The objections to this theory in the Scotland and in the United States where the doctrine of \textit{jus quaecitum tertio} was recognised are as follows.

Firstly, under the \textit{jus quaecitum tertio} the beneficiary acquires his right from the contract between the stipulator and the promisor, so his right derives from the mere intention of the parties to benefit him from the contract,\textsuperscript{96} whereas under the letter of credit he does not acquire his right from the contract for the arrangement of the letter of credit between the issuing bank and the account party but from the direct promise by the issuing bank to bind itself to the beneficiary, this promise is to be found in the issuing of documentary credit and sending it to the beneficiary, i.e. the intention of the issuing bank and the account party is not to contract for the benefit of the beneficiary, but they intend that the issuing bank shall undertake to bind itself towards the beneficiary - an arrangement that the customer is not a party to. In other words the beneficiary does not derive his right against the issuing bank from the document which contains the contract between the issuing bank and the

\textsuperscript{95}See \textit{supra} at pp.47 et seq.

\textsuperscript{96}In the United States see Restatement (Second) of Contracts, §302(1); In Scotland see \textit{Hislop v. M'Ritchie's Trs. supra}. 
buyer, but from another document which is sent to him by the issuing bank that includes the issuing bank's promise to the seller i.e. the irrevocable credit, which is separate and independent from the other document.97

So as Professors McCurdy98 and Thayer99 put it, this theory does not appreciate the intention of the parties which is, that the right of the beneficiary is based upon the contract between him and the issuing bank, which is separate and independent from the contract between the issuing bank and the account party.

Secondly, in Scotland the third party beneficiary under the *jus quaesitum tertio*, according to some authors, is not entitled to sue for damages for defective performance. Gloag,100 stated:

That principle, though it may entitle a tertius to sue on nonfeasance of contract will not entitle him to damages for misfeasance, because the real foundation of his title to sue is that the debtor in the contract has agreed to be liable to him, and it is not to be presumed that the debtor in a contract has agreed to be liable to a tertius in respect of his defective performance.

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97U.C.P. Art. 3.

98Commercial Letters of Credit (1922) 35 Harv. L. Rev. 539 at p.573.

99Irrevocable Credits in International Commerce: Their Legal Nature (1936) 36 Colum. L. Rev. 1031 at p.1038 n.33. See also Mead, C.A. Documentary Letter of Credit (1922) 22 Col. L. Rev. 279 at p.203.

100The Law of Contract, at p.239. See also Robertson v. Fleming (1861) 4 Macq. 167, per Lord Chancellor Campbell.
This objection seems to be rather weak,101 but if to be taken as a good law in Scotland, would mean that, by characterizing the credit as *jus quaesitum tertio* the beneficiary in letter of credit transactions would lose his absolute right to sue for damages for the bank’s defective performance.102

The third, and more important objection to this theory is that the third party’s right under the *jus quaesitum tertio* is dependent on the contract between the promisee and the promisor, and this dependency leads to the third party’s right being subject to any defence that would be valid between the contracting parties.103 So the promisor can raise the defence that the original contract is not valid at law, for instance, for lack of consideration, capacity, or other defences such as mistake, failure

101 This view was strongly criticized by Scottish authors. Professor Walker, [Principles of Scottish Private Law Vol. 2 at p.127,] stated that, "some cases have, ..., been interpreted [by Gloag] as laying down that a tertius can not sue for damages for defective performance, but such cases are all instances of a defective performance of contracts collateral of the contract or gift giving rise to the jus quaesitum, and not truly affecting that principle at all. There is no good reason why conferment of a jus quaesitum implies conferment of a title to enforce performance but not, as is said, title to recover damages for defective performance,". Smith T.B. Studies Critical and Comparative, at pp.190 et seq. the learned author rejected this view after a full analysis of the authorities which Gloag relied on in supporting his view. In Scott Lithgow Ltd. v. GEC Electrical Projects Ltd. (1989) G.W.D. 38-1739, Lord Clyde held that under the *jus quaesitum tertio* the tertius, in general, should be allowed to sue for damages for the breach of the contract. See also Woolman, An Introduction to the Scots Law of Contract, at p.145.


103 Restatement (Second) of contract §140. See Williston on Contracts at pp.1063 et seq.; See also Lord Keith Spirit of the Law of Scotland at p.28; Smith, A Short Commentary on the Law of Scotland, at p.784.
of consideration or fraud.

The adoption of this theory would defeat the main object of the irrevocable documentary credit which is, by complying with the credit’s terms, the beneficiary is guaranteed payment even if there was a dispute between the account party and the beneficiary under the underlying contract or under the opening of the credit contract between the issuing bank and the account party, or under any contract connected with the letter of credit operation. 104

The last objection which also shows some weakness in this theory was furnished by Professor Hershey; he argued that it is not acceptable to classify the irrevocable letter of credit, which is mainly used to finance an international transaction and requires worldwide uniform regulation, as a contract made for the benefit of a third party the rules as to which differ considerably from one country to another. 105

In the light of the preceding discussion of the objections to this theory, one could conclude that this theory has fallen short of setting forth a satisfactory explanation to the beneficiary issuing bank legal relationship under the irrevocable letter of credit. 106

104See supra at p.19 Note 2.

105Letters of Credit (1918) 32 Harv. L. Rev. 1, at pp.24-5.

106Similar objections were raised against this theory in Germany and France which has rendered it unacceptable there. See Ellinger, Documentary Letters of Credit, at pp.54-6.
4.2.1.3 The Estoppel And Trust Theory

Another attempt to solve the problem of the validity of the irrevocable letter of credit was suggested only in the common law countries. This attempt is based upon the doctrine of estoppel which is a principle of the law of evidence. This principle in Scotland is clearly explained by the words of the Earl of Birkenhead L.C., in the case of Gatty v. Maclaine,107 his statement reads:

The rule of estoppel or bar, as I have always understood it, is capable of extremely simple statement. Where A has by his word or conduct justified B in believing that a certain state of fact exists and B has acted upon such belief to his prejudice, A is not permitted to affirm against B that a different state of facts existed at the same time.108

Similarly in England the court in the case of Pickard v. Sears109 observed that:

Where one by his words or conduct wilfully causes another to believe the existence of a certain state of things, and induces him to act on that belief, so as to alter his own previous position, the former is concluded from averring against the latter a different state of things as existing at the same time.

1071921 S.C. (H.L.) 1.

108Ibid. at p.7.

109(1837) 6 A. & E. 469.
Hershey,\textsuperscript{110} in an attempt to enhance the estoppel theory suggested that the opening of the irrevocable credit also involves a trust. The argument of this theory therefore, would be that the issuance of the irrevocable credit by the issuing bank amounts to a representation that it has acquired sufficient funds or its equivalent from the buyer for the use of the seller, so the issuing bank would be estopped from denying this representation after the seller has acted in reliance on it.\textsuperscript{111}

It will be appropriate to discuss the two sides of this theory separately.

4.2.1.3\[i\] Estoppel

There are few cases in which little support was given to the argument that the issuance of the letter of credit constitutes a representation of its validity which the issuing bank is estopped from denying. The first case is \textit{Re Agra and Masterman's Bank, Ex Parte Asiatic Banking Corporation},\textsuperscript{112} Turner L.J. in this case observed that:

\ldots this letter was given by the banks with a view to its being shown to persons who were to negotiate the bills, and to make advances upon the faith of the letter.\textsuperscript{113}

He then continued to say:

\textsuperscript{110}\textit{Letters of Credit, at pp.16 et seq.}

\textsuperscript{111}\textit{Ibid.} See also McCurdy, \textit{Commercial Letters of Credit}, at p.584; Davis, \textit{The Law Relating to Commercial Letters of Credit}, at p.68.

\textsuperscript{112}(1867) L.R. 2 Ch.App. 391.

\textsuperscript{113}\textit{Ibid.} at p.395.
The whole effect of the letter is, that the Agra Bank held out to the persons negotiating the bills a promise that it would pay the bills; and it would be impossible, according to my view of the doctrines of Courts of equity, to allow the bank, after having sent that letter into the world, addressed to the persons who were to negotiate the bills, and so held out to them that it would be answerable for their payment, to say that because there was a debt due to it from the persons to whom it had given the letter of credit, therefore it would not pay the bill.114

The above statement could be understood to have implied that the bank is estopped from denying the validity of the letter of credit after it was acted upon.115

*Maitland v. The Chartered Mercantile Bank of India, London and China*116 is another case in which James V.C., following the decision in the case of *Re Agra and Masterman’s Bank*, although not expressly stating that the letter of credit was a representation, indicated that the letter of credit was either a promise or a representation.117

Moreover, in *Johannessen v. Munroe*118 a merchant obtained an open

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115The statement is also capable of being understood to mean that the issuing of the letter of credit is an offer which becomes a contract when it is accepted by conduct.

116(1869) 38 L.J. Ch. 363. It should be noted that this case and Re Agra’s case were concerned with open letter of credit.

117See Ellinger, *Documentary Letters of Credit*, at p.68.

letter of credit from the defendants (bank). The former offered this letter of credit to the plaintiff as a settlement of a debt between them. Before accepting the letter of credit the plaintiff made an inquiry about its genuineness. He was reassured by the issuing bank (defendant) that it was genuine and it would not be cancelled. Relying on the issuing bank’s reassurance he accepted the letter. The defendants later cancelled the letter of credit, and the plaintiff brought an action against it.

The Court of Appeal of New York, affirming the decision of the court below, held that the issuing bank’s representation that the letter of credit was valid precluded them from denying their liability after the plaintiff has acted on the faith of that representation. Bartlett J. in this connection stated:

We are of opinion that this entire transaction, beginning with the issuing of the letter of credit and closing with the settlement referred to, presents all the elements of an estoppel, and defendants are precluded from setting up a defence based upon the alleged invalidity of the letter of credit for any cause… We have here the representation of certain facts by the defendants with knowledge that the plaintiff proposed to act thereon; the fact that he did so act and took the letter of credit and money in payment of his claim, releasing all parties from further liability. This constituted a taking of the letter of credit in good faith and for value. The plaintiff by the representation of defendants was induced to change his position...\textsuperscript{119}

The decision in this case seems to be strongly in support of the

\textsuperscript{119}53 N.E. at p.536.
estoppel theory, however Professor Ellinger\textsuperscript{120} argued that the transaction in this case differs considerably from the situation under the irrevocable letter of credit. He pointed out that in practice neither does the beneficiary inquire about the genuineness of the irrevocable credit nor does the issuing bank make any kind of representation about the validity of the credit. Therefore Professor Ellinger reached the conclusion that the case of Johannessen v. Munroe does not give any support for classifying the irrevocable letter of credit as an estoppel and its decision should be understood to be confined to the case's own circumstances.

In addition to the little support this theory gained from court cases, there are three objections which were raised against it. Firstly, that there must be a misrepresentation as to an existing fact in order to raise an estoppel. Under the irrevocable credit the issuing bank, by issuing and sending the irrevocable credit to the beneficiary, only informs the beneficiary that an irrevocable promise to pay, subject to certain conditions was made in his favour. So the information that the beneficiary receives is not a representation of an existing fact; it has the nature of a promise which cannot be the basis of liability by estoppel.\textsuperscript{121}

Secondly, even if it is assumed that the issuing of the irrevocable

\textsuperscript{120}\textit{Documentary Letters of Credit}, at p.69.

\textsuperscript{121}See Finkelstein, \textit{Legal Aspects of Commercial Letters of Credit}, at p.289; Thayer, \textit{Irrevocable Credits in International Commerce: Their Legal Nature}, at p.1042.
credit amounts to a representation, the estoppel cannot explain the rule of the irrevocable credit that the credit becomes irrevocable from the time of its communication to the beneficiary, because the estoppel does not take effect until the representation was acted on.\footnote{122} So the estoppel is not capable of determining an exact time at which the credit becomes irrevocable but it would leave its determination to vary depending on the facts of each particular case. Also it would inevitably leave a lapse of time between the time when the beneficiary receives the credit and the time when he acted in reliance on it, in which the issuing bank could revoke the credit.

Thirdly, estoppel is merely a rule of evidence, and cannot be the foundation of an action.\footnote{123} Thus, classifying the irrevocable credit as an estoppel would result in leaving the beneficiary with no cause of action against the issuing bank, which he otherwise has.

\section*{4.2.1.3[ii] Trust}

Hershey, in an attempt to avoid the difficulty that estoppel as a general rule cannot be the basis of a cause of action, relied on Bartlett J.'s\footnote{124}
statement in *Johannessen v. Munroe*,\(^{125}\) in arguing that by sending the irrevocable letter of credit to the beneficiary the issuing bank is making a statement to the effect that the applicant has put it in funds and such funds will be paid to the beneficiary if he complied with the terms of the credit. Thus, if the beneficiary acted in reliance on this representation the issuing bank will be estopped from denying that it kept the money for the use of the beneficiary.\(^{126}\)

In other words, Hershey is suggesting that Bartlett J.’s view, in this case, was that the issuing bank holds a sum of money equivalent to the value of the letter of credit, which is given to it by the customer for the use of the beneficiary. So the issuing bank would be treated as a trustee.

Assuming that Hershey’s analysis, according to the facts of that particular case, are correct, it is impossible to apply such analysis to the irrevocable credit, where the issuing bank very rarely receives the value of the credit from the buyer before its issuance. In practice the issuing bank advances its own money,\(^{127}\) and the buyer does not become obliged to reimburse it until the time when the bank tenders the documents of title to him. In some circumstances however, the buyer

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\(^{125}\) *Supra.*

\(^{126}\) *Letters of Credit, at p.18.*

is not obliged to make such reimbursement until he resells the goods.\textsuperscript{128}

Gutteridge and Megrah raised a further objection against the view that the issuing bank holds the money paid by the buyer for the use of the seller; they rightly pointed out that it is true that if the bank received money from a customer for the satisfaction of the customer’s debt the bank will not be allowed to use such money for any other purposes and if this fact is communicated to the creditor the latter will have a right of action against the bank if it did not pay it to him. However, this is not the normal course of business in letter of credit transaction, where the issuing bank does not communicate to the beneficiary whether the buyer has put it in funds before the issuance of the credit or not, and the beneficiary is not interested to know such a fact.\textsuperscript{129}

It must also be noted, that the mere agreement between the buyer and the bank that such money should be held by the bank for the use of the seller, is not sufficient to create a trust; it is essential that the seller accept it.\textsuperscript{130} In practice, however, the seller does not expressly accept the irrevocable letter of credit.

Moreover, Finkelstein\textsuperscript{131} looks at the possibility that the issuing

\textsuperscript{128}See \textit{supra} at pp.23-4.

\textsuperscript{129}\textit{The Law of Bankers’ Commercial Credits}, at p.32.

\textsuperscript{130}See Penn, Shea and Arora \textit{The Law and Practice of International Banking}, Banking Law (Vol.2) at p.301, and authorities cited therein.

\textsuperscript{131}\textit{Legal Aspects of Commercial Letter of Credit}, at p.286.
bank's representation to the beneficiary is not that it was put in funds by the customer but that it has received a promise from the customer that he will pay the bank enough money to cover the value of the credit. Finkelstein, then, pointed out that this view is not sufficient since even if the bank could be estopped from denying that it has been promised by the customer, it would not be estopped from proving that the customer did not perform his promise, i.e., it failed to put the bank in funds.

Finally, in the case of Morgan v. Lariviére\textsuperscript{132} the House of Lords decisively rejected the view that the opening of a letter of credit creates a trust. The main facts of this case are that the respondent entered into a contract with the French Government to supply their ministry of war with some kind of ammunition. A letter of credit was issued by the appellants in favour of the respondent. The letter stated that "We are instructed by ... to advise you that a special credit for the sum of £40,000 has been opened with us in your favour, and that it will be paid to you rateably as the goods are delivered, upon receipt of certificates of reception issued by the French ambassador ...". Claiming that the goods were not supplied within the time stipulated for in the sale contract the French ambassador instructed the appellant to cancel the credit which the latter carried out. Lariviére brought an action against Morgan claiming that the latter held the sum of £40,000 in trust for him. The court below held that this letter of credit created an equitable assignment to the plaintiff of the sum of £40,000 deposited into the defendant bank by the French government, and ordered this sum of money to be paid

\textsuperscript{132}(1875) L.R. 7 H.L. 423.
into court for the satisfaction of the plaintiffs’ debt when it fell due.

The House of Lords, upon appeal by Morgan, reversed this decision. The plaintiff’s counsel’s argument was that:

The declaration that they had opened a credit in favour of the Respondent was a declaration that they had control over a fund of certain specific amount appropriated to a certain specified purpose. Surely that is the declaration of a trust as to that specified fund, and shows that the fund itself was impressed with a trust. The Appellants could not afterwards deny what they had thus written...133

In an answer to this argument Lord Cairns L.C. said:

What is there in this letter which constitutes an equitable assignment, or what is there in it which impresses with a trust any particular sum of money? I can find no expression in this letter which could authorize such a conclusion. It appears to me to be simply a statement by a banker that he has opened a credit under instructions in favour of a particular person. That is an expression well known to bankers, and well known to all persons engaged in commerce... I read this letter as being nothing more than this: a statement by bankers to a tradesman who supplies goods to a customer of the banker that they, the bankers, on behalf of their customers, will act as paymaster to the tradesman up to a certain amount of money; but that, in order to call upon them to act as paymasters, he, the tradesman, must bring with him certain certificates showing that the goods have been delivered to their customer. In a transaction of that kind there is nothing of an equitable assignment, there is nothing of trust; and it appears to me that any banker who had given an undertaking of that kind would be very much surprised to find that it was held that a certain portion of the funds of his customer in his hands had been impressed with a trust, had been equitably assigned, and had, in

133 ibid. at p.428.
fact, ceased to be the moneys of the customer, and had become the moneys of the tradesman who was to supply the goods.\textsuperscript{134}

Lord Chelmsford shared the same opinion; his Lordship stated:

But opening a letter of credit for a particular sum cannot constitute an equitable assignment or specific appropriation of the sum, but is merely an authority to the person in whose favour the credit is opened to draw to the extent of the specified amount. Nor ... can the letter of the Appellants informing the Respondent that the credit had been opened (no sum being set apart or appropriated as a specific fund to be drawn upon) constitute them trustees of the amount for which the Respondent is to be at liberty to draw.\textsuperscript{135}

In conclusion the estoppel and trust theory is not capable of giving a satisfactory solution to the difficulties arising from the issuing bank-beneficiary legal relationship under the irrevocable letter of credit.\textsuperscript{136}

\textit{4.2.1.4 The Assignment Theory}

The Assignment theory was advanced by McCurdy\textsuperscript{137} as one of his several attempts to find a satisfactory solution to the difficulties relating to the issuing bank-beneficiary legal relationship under the irrevocable

\textsuperscript{134}\textit{Ibid.} at p.432.

\textsuperscript{135}\textit{Ibid.} at p.434.

\textsuperscript{136}Professor Ellinger discussed the \textit{Treuhandvertrag} theory in Germany as an equivalent to the estoppel and trust theory in common law countries, which he proved not to be the answer to these difficulties. \textit{Documentary Letters of Credit}, at pp.71-2.

\textsuperscript{137}\textit{Commercial Letters of Credit}, at pp.583 et seq.
letter of credit.

This theory suggests that the right which the buyer obtains from his contract with the issuing bank is assigned by the buyer to the seller, and the sending of the irrevocable credit to the seller constitutes a notice of that assignment.

McCurdy in support of this theory cited some English\textsuperscript{138} and American\textsuperscript{139} cases. One of these cases was \textit{Re Agra and Masterman's Bank Ex Parte Asiatic Banking Corporation}.\textsuperscript{140} In this case an open letter of credit was issued by Agra and Masterman's Bank in favour of their customer Dickson, Tatham & Co., on these terms:

You are hereby authorized to draw upon this bank at six months' sight, to the extent of £15,000 sterling, and such drafts I undertake duly to honour on presentation. This credit will remain in force for twelve months from this date, and parties negotiating bills under it are requested to indorse particulars on the back hereof.

Dickson, Tatham & Co. drew bills for £6,000 under the letter of credit. These bills were later discounted with Asiatic Banking Corporation. Both Agra and Masterman's Bank and Asiatic Banking Corporation


\textsuperscript{140}(1867) L.R. 2 Ch. App. 391.
became bankrupt. While Agra and Masterman’s Bank was in the process of being wound up it stopped payment. The liquidator of the Asiatic Banking Corporation claimed the amount of the bills from the liquidator of Agra and Masterman’s Bank, who refused to pay on the ground that the sum of money designated by the bills should be set off against a debt due to the Agra and Masterman’s Bank from Dickson, Tatham & Co. The argument in this case was that Agra and Masterman’s Bank made no direct undertaking to the Asiatic Banking Corporation, the only undertaking it made was to Dickson, Tatham & Co.

The Court of Appeal rejected this contention and held that the promise made in the letter of credit by Agra and Masterman’s Bank to honour any drafts drawn under the letter of credit when presented by negotiators constituted a binding obligation which was not affected by the claim that Agra and Masterman’s Bank had against Dickson, Tatham & Co., Cairns L.J., during the course of his judgment, stated that:

But assuming the contract to have been at Law a contract with Dickson, Tatham & Co., and with no other, it is clear that the contract was in equity assignable, and that Dickson, Tatham & Co., must be taken to have assigned (if assignment were needed) to the Asiatic Banking Corporation, and to have been by the writers of the letter intended to assign to them, the engagement in the letter providing for the acceptance of the bills.141

The Lord Justice in support of this argument pointed out that the intention of the parties was that the assignment was free from equities

141 ibid. at p.397.
and said:

Generally speaking a chose in action assignable only in equity must be assigned subject to the equities existing between the original parties to the contract, but this is a rule which must yield when it appears from the nature or terms of the contract that it must have been intended to be assignable free from and unaffected by such equities.

However, the nature of the open letter of credit differs considerably from the nature of the modern irrevocable credit which makes the Re Agra case hardly applicable to the irrevocable credit. They differ in the following aspects; Firstly, the open credit in Re Agra case was addressed to the customer and was handed to him directly. So the customer was the first beneficiary. On the contrary, under the modern irrevocable credit, the letter of credit is addressed to the beneficiary and sent by the bank directly to him. So the beneficiary is not the customer who requests its issuance, but someone else. Secondly, the first difference between the two types of letters of credit leads to an interesting observation, that if it is according to the terms of the modern irrevocable credit that the customer is not the beneficiary and has no right to draw drafts under the letter of credit, how could it be said that he assigns such right to the beneficiary. Thirdly, in Re Agra case the open credit had come into existence and became valid as between the issuer and its customer as first beneficiary before it came to the hand of

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142 See supra at pp.7-8.

143 Taggart, Letters of Credit: Current Theories and Usages, at p.591; White and Summers, Uniform Commercial Code, (Vol. 2) Chap.19 at p.11.
the second beneficiary, so the question in this case was not concerned with the letter of credit's validity as between the original parties; it was only concerned with its validity as between the issuer and the second beneficiary. Therefore the situation in this case was that the credit was issued and became valid as between the immediate parties and later was assigned to a third person. Thus this case gives no support to this theory which claims that the irrevocable credit comes into existence and becomes valid as between the original parties as a result of the assignment.\(^{144}\)

The assignment argument in *Re Agra* case was also weakened by the decision of the House of Lords in *Citizens Bank of Louisiana v. First National Bank of New Orleans*\(^ {145}\) where it was held that even if the customer has put the bank in funds, the issuance of the credit does not constitute an assignment of these funds by implication.

It should be noted that as all cases cited by McCurdy in support of this theory were concerned with open letter of credit, they will be regarded as giving no support to this theory on the same grounds that the *Re Agra* case was rejected.

Furthermore, as it is the usual practice of modern irrevocable credit that the issuing bank, in the first place, obtains the documents of title for the goods from the beneficiary and makes payment to him, then tenders

\(^{144}\)Ellinger, *Documentary Letters of Credit*, at p.58.

\(^{145}\)(1873) L.R. 6 H.L. 352. See also *Morgan v. Lariviére* (1875) L.R. 7 H.L. 423 discussed *supra* at p.71.
these documents to its customer in order to be reimbursed, i.e. the customer does not put the issuing bank in funds initially. Thus it is difficult, in this case, to see what constitutes the benefit of the contract between the issuing bank and its customer which the latter assigned to the beneficiary.\textsuperscript{146}

Cairns L.J.'s remarks that the assignee did not take the rights under the assigned contract subject to equities, existing between the original parties, as mentioned above, would place this theory outside the scope of assignment.\textsuperscript{147} Finkelstein commenting on Cairns L.J.'s above statement, argued rightly, that as the main difference between the assignment and negotiable instruments' rules is that the rules of the former allow defences that exist between the original parties to be raised against the new party, Cairns statement which modified the assignment's rules to the degree of disallowing the raising of these defences has created a new legal principle that cannot be called an assignment.\textsuperscript{148} Therefore, the beneficiary's right against the bank, according to this theory, should not be regarded to have been derived from something

\textsuperscript{146}Todd, Bills of Lading and Bankers' Documentary Credits, at p.182.

\textsuperscript{147}Under the true assignment the assignee takes the assigned rights subject to equities. In Scotland see Bell's Principles of the Law of Scotland, at §1468; Stair, The Institutions of the Law of Scotland at I, 10, 16; III, 1, 20; IV, 40, 21; Erskine, Institute, III, 5, 10. In England see Ord v. White (1840) 3 Beav. 357; Mangles v. Dixon (1852) 3 H.L.C. 702 at p.731; Athenaeum Soc. v. Pooley (1853) 3 D. & J. 294. In the U.S.A. Restatement (Second) of Contracts §336 (1981); Williston, Contracts, at §§432, 433; Simpson, L. Handbook of the Law of Contracts (1954) at pp.357-8.

\textsuperscript{148}Legal Aspects of Commercial Letters of Credit, at p.278.
other than an ordinary assignment. This would destroy the independent character of the irrevocable credit, opening the door for the issuing bank to raise against the beneficiary any defences that it may have against its customer. For instance, that the customer opened the credit by fraud.

The assignment theory was also suggested by Oberparleiter¹⁴⁹ in Germany who was of the opinion that the right which the customer has against the issuing bank is transferred by the customer to the beneficiary by way of assignment (which is called Anweisung in Germany). The translation of Para. 783 BGB,¹⁵⁰ which regulates the assignment, reads as follows:

If a person delivers an instrument to a third party in which he directs another to pay or deliver money, negotiable instruments, or other fungible things [fungible things defined by Para 91 BGB as movable things which are customarily determined by number, measure or weight]¹⁵¹ to the third party, the latter is authorized to procure payment or delivery in his own name from the drawee; the drawee is authorized to pay or deliver to the payee of the order on account of the drawer.¹⁵²

This suggestion encountered similar objections to that raised against

¹⁴⁹Das Dokumentaere Akkreditiv, (1922) at pp.4-6. See Ellinger, Documentary Letters of Credit, at p.61. See also Hershey, Letters of Credit, at p.8.

¹⁵⁰The paragraph reads as follows "Händigt jemand eine Urkunde, in der er einen anderen anweist, Geld Wertpapiere oder andere vertretbare Sachen an einen Dritten zu leisten, dem Dritten aus, so ist dieser ermächtigt, die Leistung bei dem Angewiesenen im eigenen Namen zu erheben; der Angewiesene ist ermächtigt, für Rechnung des Anweisenden an den Anweisungsempfänger zu leisten."

¹⁵¹Ellinger, Documentary Letters of Credit, at p.61, Note 86.

¹⁵²Translated by Chung Hui Wang, The German Civil Code, at pp.170-1.
it in the common law countries. Zahn\textsuperscript{153} pointed out that the \textit{Anweisung} allows the issuing bank to raise against the beneficiary defences that it may have against its customer. Krebs\textsuperscript{154} also raised the objection that the \textit{Anweisung} is revocable unless it was proved that the assignee has accepted it or acted in reliance on it, which is not the case under the rules of the irrevocable credit.

The above discussed objections have undoubtedly rendered the assignment theory incapable of giving an acceptable solution to the problem of the validity of the irrevocable letter of credit in Scotland, England, the U.S.A. or in Germany.

\textbf{4.2.1.5 The Novation Theory}

Having noticed the main defect in the assignment theory, namely that the issuing bank would be entitled to raise against the seller defences that it may have against the buyer, McCurdy, in an attempt to maintain the independent character of the irrevocable credit, advanced another argument under the novation theory, he said:

In order to preclude the setting up of these defences it would be necessary to go a step further and find a novation assented to in

\textsuperscript{153}Zahlung und Zahlungssicherung im Aussenhandel, (2nd ed. 1959) at p.18; Wiele, \textit{Das Dokumenter-Akkreditiv und des Anglo-amerikanische, Documentary Letter of Credit}, at pp.33-4; Ellinger, \textit{Documentary Letters of Credit}, at p.62.

\textsuperscript{154}Das Akkreditivgeschaeft, at pp.21-2.
advance by the seller.\textsuperscript{155}

Explaining how this theory would overcome the main objection raised against the assignment theory, he said:

Defences against the buyer-assignor which exist at the time of the novation could not be availed of against the seller-assignee by the obligor-bank even though the obligor-bank were ignorant of them at the time of the novation.\textsuperscript{156}

The application of this theory to the operation of the irrevocable letter of credit would be that, the stipulation in the sale contract that the buyer should arrange for the issuing of an irrevocable letter of credit constitutes an advance consent of the seller, that the buyer would be free from his liability to pay the price of the goods if he procures the irrevocable credit stipulated for. So the issuing of the irrevocable credit would amount to a novation of the buyer’s contractual rights against the bank to the seller.\textsuperscript{157} It is fair to say that this theory takes into

\textsuperscript{155}Commercial Letters of Credit, at p.584.

\textsuperscript{156}Ibid. In support of the novation theory McCurdy cited Re Agra and Masterman’s Bank, Ex Parte Asiatic Banking Corporation (1867) L.R. 2 Ch. App. 391; and Hindley & Co. v. Tothill, Watson & Co., (1894) 13 N.Z.L.R. 13; and Contra, Bell v. Moss, 5 Whart. (Pa.) 189 (1839). However Ellinger argued rightly that these cases do not give support to the theory, Documentary Letters of Credit, at p.63, Note 99.

\textsuperscript{157}Ibid. In interpreting McCurdy’s argument in this theory, Davis went as far as to suggest that there is an implied term in the contract of sale to the effect that the issuing of the irrevocable credit would be deemed as a novation of the sale contract and the stipulation in the sale contract that the buyer would arrange for the issuing of an irrevocable letter of credit constitutes the seller’s acceptance of such novation. So the issuing bank becomes a party to the contract of sale, taking the place of the buyer, who drops out of the whole transaction. It is clear that Davis’s
account the independent nature of the irrevocable credit, nevertheless, it distorts the facts of the transaction, leaving other problems unsolved. According to this theory the buyer would lose all his rights against the issuing bank such as insisting on the bank’s strict compliance with the terms of the credit which he would be otherwise entitled to, because the effect of novation is to extinguish the original contract between the buyer and issuing bank. Moreover, the seller would lose his right of recourse against the buyer because the novation discharges the debt of the assignor. However, the law and the practice of the irrevocable letter of credit does not regard the opening of the credit to be an absolute discharge of the buyer’s obligation to pay. The only effect that the opening of the credit has, is to put the seller under an obligation to claim payment in the first instance from the bank, and if the latter fails to pay, the seller will have the right to claim payment from the buyer.

Yet there is a further difficulty facing this theory which is that for the completion of a novation the creditor’s acceptance must be

understanding of McCurdy’s argument is not limited to the novation of the buyer’s obligation to pay but it suggests that the whole contract of sale is novated. The Law Relating to Commercial Letters of Credit, at p.71.

158McCurdy, Commercial Letters of Credit, at p.584. See also Davis, The Law Relating to Commercial Letters of Credit, at p.71.


160See supra at p.20 Note 4.
communicated to the new debtor.\textsuperscript{161} Under the irrevocable credit the seller (creditor) does not send to the issuing bank (the new debtor) any notice of acceptance. McCurdy’s argument that the stipulation in the sale contract that the buyer is to procure an irrevocable credit amounts to the seller’s acceptance of the novation in advance, cannot be accepted because firstly, there is no indication in that specific term or in the whole contract of sale that the seller intends to free the buyer from his obligation, and secondly, because the contract of sale is between the seller and the buyer, the bank does not need to look at it, thus, it is not usually shown to it.\textsuperscript{162}

In short, the above objections showed that the adoption of the novation theory as an answer to the difficulties arising from the beneficiary-issuing bank legal relationship would create more problems than it would solve.\textsuperscript{163}

\textbf{4.2.1.6 The Delegation Theory}

The delegation theory, which was advanced in a number of civil law

\textsuperscript{161}In England see Wilson v. Lloyd (1873) L.R. 16 Eq. 60, at p.73; Meek v. Port of London Authority [1918] 2 Ch. 96. In Scotland, see Gloag, The Law of Contract, at p.258. In U.S.A. see Corbin on Contracts, at §1299.

\textsuperscript{162}Ellinger, Documentary Letters of Credit, at p.63.

\textsuperscript{163}The novation theory was also rejected for similar objections in Germany and France. See Ellinger, \textit{Ibid}. 
countries, offers a better explanation of the legal relationships involved in the irrevocable credit, than the common-law assignment or novation theories.

The definition of the delegation of a debt in the Roman Law, where it was originated, is that an agreement whereby a debtor is released from his liability to pay by having another person to be responsible to the creditor for payment of such debt.

The French Law refers to the Roman Law delegation, which is described above, as a perfect delegation, distinguishing it from a variety thereof known there as imperfect delegation. The difference between the two types of delegation is that if it can be proved that the creditor has the intention of freeing his original debtor from his liability the delegation will be regarded as perfect, but if it can not be proved the delegation will be considered as imperfect. The effect of such delegation is to bind the new obligant but does not free the original

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164 In France, see Hamel in a note on the decision of the Cour de Cassation, Req. 26.1.1926, Dalloz Per. 1926 1 at p.201. In Italy, see Asquini, "Pagamenti Mediante 'Rimborso di Banco'", 20 Riv. Dir. Comm. 225 et seq. (1922). It is also suggested in other civil-law countries, see Kozolchyk, Commercial Letters of Credit in the Americas, at p.587 Note 55.

165 Kozolchyk, Ibid.

166 Délégation Parfaite.

167 Délégation Imparfaite.
Similarly in Scottish Law the creditor’s mere agreement to be paid by another person does not constitute a delegation that frees the original debtor from his liability to pay the debt, unless it is proven that the creditor intended to release him from his liability. So the effect of the delegation if it cannot be proven that the creditor intended to free the original debtor is that the creditor will acquire two debtors instead of one.\(^{169}\)

The irrevocable letter of credit according to this theory was regarded as imperfect delegation in France or a delegation that does not release the original debtor in Scotland.

The application of this theory to the issuing bank, the customer and the beneficiary legal relationship, proposes that by issuing the irrevocable letter of credit the issuing bank ‘délégué’ would be regarded to have accepted the customer’s ‘déléguant’ request to pay to the beneficiary ‘délégataire’ the sum of money owed by the customer to the

\(^{168}\text{Art. 1275 Code Civil, reads as follows "La délégation par laquelle un débiteur donne au créancier un autre débiteur qui s'oblige envers le créancier, n'opère point de novation, si le créancier, n'a expressément déclaré qu'il entendait décharger son débiteur qui a fait la délégation," this Article was translated by Cachard H. to read as follows "A substitution by which a debtor gives to a creditor another debtor, who binds himself towards the creditor, does not occasion a novation unless the creditor has expressly declared that he intended to release his debtor who has made the substitution."}, \textit{The French Civil Code.} rev. ed. (1986-87) at p.701.

\(^{169}\text{Stair, \textit{The Institutions of the law of Scotland}, at 1. 18, 8; Erskine, \textit{Institute}, iii. 4, 22; Bell’s Principles of the Law of Scotland, at §577; Fraser v. M’Lennan, 1849, 12D. 208; Anderson v. McDowal, 1865, 3 M. 727.}
beneficiary; such acceptance renders the issuing bank legally bound to pay.

This theory overcomes the main defect in the novation theory, namely that, under the novation theory the seller loses his right of recourse against the buyer, whereas, under this theory because the beneficiary does not, by stipulating in the sale contract that payment is to be by letter of credit, intend to discharge the buyer from his liability, he does not lose his right of recourse against the buyer if the issuing bank failed to pay.

Moreover, unlike the assignment theory this theory accounts for the independent character of the irrevocable credit. Under the imperfect delegation of debt, although the cause of the délégué’s obligation towards the déléataire derives from the contract between the délégué and the délégant, the déléataire is a stranger to that relationship and cannot be involved in it. Thus the issuing bank ‘délégué’ cannot raise against the beneficiary ‘déléataire’ defences that it may have against the buyer ‘délégant’.

As the practice of the irrevocable letter of credit is that the issuing bank’s role is merely to effect a loan to its customer payable to the beneficiary, it could be argued that the delegation of debt assumes that

170 Stoufflet, Le Crédit Documentaire (Paris, 1957), at pp.378-9; Ellinger, Documentary Letters of Credit, at p.60; Thayer, Irrevocable Credits in International Commerce: Their Legal Nature, at p.1047. It is not clear according to Scots law in the case of the delegation which does not free the original debtor whether the new debtor could raise against the creditor defences that he has against the original debtor.
the buyer 'délégrant' is the creditor of the issuing bank 'délégué' for the sum designated by the letter of credit. So because the buyer is not a creditor of the issuing bank this theory does not seem to explain his position. In an answer to this argument, it has been pointed out that the obligation of the issuing bank towards its customer, which is to effect a loan, is delegated to the beneficiary, i.e. the customer confers upon the beneficiary the right to claim the amount of the loan contracted for between the customer and the issuing bank.\textsuperscript{171}

Despite the fact that the imperfect delegation of a debt coincides with the irrevocable credit in most of the latter’s features, it is still inadequate to account for all the fundamental requirements of the irrevocable letter of credit. Thus two objections were raised against this theory; in the first place, because the obligation which the délégue (issuing bank) undertakes is based upon the fact that there is a valid contractual relationship between the délégant (customer) and the délégataire (beneficiary), the délégant (customer) would be allowed to raise the defence that the underlying contract between the délégant (customer) and the délégataire (beneficiary) is void.\textsuperscript{172} Such rule is contrary to the practice of the irrevocable credit.

In the second place the theory failed to explain a very important rule of the irrevocable letter of credit which is, that the letter of credit


becomes irrevocable from the moment of its communication to the beneficiary. In order for the delegation to be legally effective, under the imperfect delegation of a debt, the beneficiary ‘déléguataire’ must give his acceptance of the delegation.173

As the case in the irrevocable credit being that the beneficiary does not give any notice of his acceptance of the credit, it was suggested that the beneficiary’s silence or rather not raising any objections against the letter of credit after receiving it, amounts to his acceptance of the delegation.174 Such a suggestion is difficult to accept because on one hand, even if it is assumed that it is easy to determine the moment at which silence could be regarded to amount to an acceptance, the credit would be revocable between the time when it is communicated to the beneficiary, and the time at which his silence is considered to be an acceptance.175 On the other hand, the fact that silence does not begin until sometime after the credit reaches the beneficiary, makes this suggestion inconsistent with the rule of the irrevocable credit, mentioned above, because it places the moment of irrevocability at a different time than the rule places it.

It was suggested, in another attempt to solve this difficulty, that the beneficiary’s stipulation in the underlying contract that payment is to be

173Stoufflet, Le Crédit Documentaire, at pp.382-3; see Ellinger, Documentary Letters of Credit at p.60.

174Hamel, in a note on the decision on the Cour de Cassation Req. 26.1.1926 Dalloz Per at p.203; see Ellinger, Documentary Letters of Credit, Loc.cit.

175Ellinger, Documentary Letters of Credit, at p.61.
by irrevocable credit is an antecedent acceptance of the delegation.\textsuperscript{176} This explanation also failed because in addition to the fact that referring to the underlying contract is contrary to the autonomy principle of the irrevocable credit,\textsuperscript{177} it places the moment of irrevocability at some time before the beneficiary receives it, which is also not in line with the rule that the irrevocability starts at the time the credit is communicated to the beneficiary.

In conclusion this theory at first glance seems to furnish a perfect solution to the difficulties arising from the legal relationship between the beneficiary and the issuing bank under the irrevocable credit, but upon greater reflection it appears not to take into account all aspects of the irrevocable credit and it does not correspond to the intention of the parties of the irrevocable credit who do not intend the issuing of the irrevocable credit to be imperfect delegation of a debt.\textsuperscript{178}

\textbf{4.2.1.7 The Agency Theories}

Two attempts were made to give an explanation to the problem of the beneficiary-issuing bank legal relationship under the irrevocable letter of credit in terms of the notion of agency. One of the attempts was made

\textsuperscript{176}Stoufflet, \textit{Le Crédit Documentaire}, at pp.383-4; see Ellinger, \textit{Documentary Letters of Credit}, Loc.cit.

\textsuperscript{177}Ellinger, \textit{Documentary Letters of Credit}, Loc.cit.

\textsuperscript{178}Thayer, \textit{Irrevocable Credits in International Commerce: Their Legal Nature}, at pp.1047-8.
in the common law system while the other was made in the civil law system. The agency theory in the common-law system suggests that the buyer is the agent of the seller, whereas in the civil law system it classifies the issuing bank as the agent of the buyer. Because the two theories differ considerably from each other it is appropriate to discuss each of them separately.

4.2.1.7[i] The Buyer As An Agent Of The Seller

This theory proposes that when the contract of sale stipulates that payment is to be made by way of an irrevocable letter of credit, the seller impliedly authorises the buyer to act as his agent in contracting with the issuing bank for opening the credit. So when the buyer applies for the credit and the issuing bank accepts the application, a new contract comes into existence in which the issuing bank promises to pay the price of the goods to the seller, in consideration of the seller’s promise to tender the documents of title of the goods to it.

This theory seems to fit naturally to the circumstances of the irrevocable letter of credit; nonetheless, a number of objections were raised against it.

Firstly, this theory ignores the fact that the seller does not promise to submit the documents to the issuing bank; therefore if the seller does not submit such documents, it is hardly true to say that the issuing bank has any right of action against him.179

179Ellinger, Documentary Letters of Credit, at p.64.
Secondly, this theory places the moment of the irrevocability of the credit at an earlier time than the law and practice of the irrevocable credit places it, which is at the time when the beneficiary receives it. Under this theory the credit would be irrevocable at the time when the contract between the issuing bank and the seller comes into existence, i.e. when the issuing bank accepts the buyer’s application and not at the time when it reaches the seller.\(^{180}\)

Thirdly, this theory is not in line with the intention of all parties who regard the buyer in applying for the credit to be acting as a principal. Furthermore, it would be of great surprise to the buyer, who has a substantial interest in the credit contract, to find out that he is being treated merely as an agent of the seller in concluding such a contract with the issuing bank, because if the contract of opening the irrevocable credit is between the issuing bank and the seller they would be entitled to change the terms of the credit and the buyer would have no right to object, because he is only an agent whose task finishes when he completes the contract between his principal (seller) and the issuing bank.\(^{181}\)

Fourthly, this theory does not safeguard a very important character of the irrevocable letter of credit which is its independence from the contracts on account of which it is issued. According to this theory the

\(^{180}\)Ibid. at p.65.

\(^{181}\)As the seller’s name is mentioned in the credit it is not possible to treat the buyer as an agent to an undisclosed principal whose task does not finish by concluding the contract. Ellinger, *Documentary Letters of Credit*, Ibid. at pp.64-5.
issuing and sending of the irrevocable credit to the seller by the issuing bank would not amount to more than a notice that the contract of the opening of the credit is completed. That would render the irrevocable credit as a part of the opening of the credit contract and dependent on it.\textsuperscript{182} However, Gutteridge and Megrah who advanced this theory argued that there are two separate contracts; the opening of the credit contract and the irrevocable letter of credit contract.\textsuperscript{183} Looking for a consideration to support the second contract they argued that the tender of the documents of title to the bank which is the duty of the seller amounts to a sufficient consideration.\textsuperscript{184}

This contention seems far from reality because, as mentioned above, the seller is under no legal obligation whatsoever to submit the documents to the bank.

Lastly, many writers\textsuperscript{185} raised a very crucial objection against this theory regarding the position in which it places the seller. If the seller is to be treated as the principal of the buyer in opening the irrevocable

\textsuperscript{182}Ibid. at p.65. See also Penn, Shea, and Arora, \textit{The Law and Practice of International Banking}, (Vol.2) at p.302.

\textsuperscript{183}Gutteridge and Megrah, \textit{The Law of Bankers’ Commercial Credits}, at pp.33-4.

\textsuperscript{184}Ibid. at p.28.

\textsuperscript{185}McCurdy, \textit{Commercial Letters of Credit}, at p.581; Thayer, \textit{Irrevocable Credits In International Commerce: Their Legal Nature}, at p.1041; Davis, \textit{The Relationship Between Banker and Seller under a Confirmed Credit}, at p.228; Dighe, \textit{Mercantile Specialty: A Theory by which to Enforce Letters of Credit Under Common Law}, at p.222.
credit, the seller would be vicariously liable to the issuing bank for an unlawful act committed by his agent (the buyer) in the course of performing his duty. So if the buyer procures the irrevocable credit by fraud the seller would be liable to the issuing bank for his agent's deceit. This objection shows that the agency theory defeats the main purpose of the irrevocable letter of credit, which is that the seller by complying with its terms will be guaranteed payment regardless of any dispute that may arise either from the sale contract or the opening of the letter of credit contract.

In view of these objections it could be said that Gutteridge and Megrah's theory cannot be accepted as a solution to the difficulties of the seller-issuing bank legal relationship under the irrevocable credit.

4.2.1.7[ii] The Bank As An Agent Of The Buyer

The second possible solution for the problem arising from the irrevocable credit under the law of agency was originally advanced in the civil law countries. The theory suggests that the bank, in acting according to the buyer's instructions, would be considered to be acting as an agent of the buyer. The scope of the bank's agency is limited by the terms of the credit. In general terms it could be defined to be to pay the beneficiary a specified sum of money after receiving certain

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documents and verifying that such documents are in compliance with its principal’s instructions. A further duty to be done by the agent (issuing bank) in order to be entitled for reimbursement, is to send these documents to his principal (buyer). If the issuing bank (agent) exceeds its authority, such as paying before receiving all the documents required by his principal’s instructions or accepting documents not in strict compliance with such instructions, the bank (agent) would not be entitled to reimbursement from the buyer (principal).

In France, the agency theory was said to fit under the scope of mandat which is described in Article 1984 of the Code Civil.187 This Article which is translated by Cachard reads as follows:

A procuration or power of attorney is an instrument by which one person gives to another the power to do something for the principal and in his name.

The contract is concluded by the mere acceptance of the attorney-in-fact.188

Like the agency theory in the common law countries this theory seems to have a strong resemblance to the facts of the irrevocable credit. However, two strong objections were raised against it.

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187The Article reads: "Le mandat ou procuration est un acte par lequel une personne donne à une autre le pouvoir de faire quelque chose pour le mandant et en son nom.
Le contrat ne se forme que par l’acceptation du mandataire."

188The French Civil Code, at pp.370-1. See Ellinger, Documentary Letters of Credit, at p.66.
Firstly, according to the law of agency the third party has no direct right of action against the agent unless the latter acted outside the scope of his agency or he is acting on behalf of an undisclosed principal. Because the buyer’s name is always mentioned in the credit, the bank cannot be said to be acting on behalf of an undisclosed principal. Therefore this theory does not explain the direct right of action that the law of the irrevocable credit grants the beneficiary against the issuing bank, even if the bank is acting according to the terms of the irrevocable credit.189

Secondly, under the agency law the agent contracts in the name of his principal and not in his own name. This is contrary to the practice of the irrevocable credit, where the bank, acting as a principal, contracts in its own name.190

The irrevocable credit was also suggested in Germany to be a contract of agency between the buyer and the bank according to Para. 622 BGB,191 and the suggestion was rejected for similar objections to those raised against the agency theory in France. Additionally, because the German Law entitles the principal to revoke his mandate at any time, it could be said that the contract of agency ignores the main character of the irrevocable credit which is its irrevocability.192


190Ellinger, Documentary Letters of Credit, at p.66.

191Ibid.

192Ibid. at p.67.
Thus, like the theory of agency in the common law countries this theory also failed to give a satisfactory solution to the problem arising from the irrevocable letter of credit in the civil law countries.

4.2.1.8 The Partnership Theory

The partnership theory was advanced in an attempt to overcome the difficulties that were encountered by the agency theories.

This theory proposes that it could be understood from the intention of all parties involved in the irrevocable credit transaction that when the customer applies for the irrevocable credit and the issuing bank accepts the application, the latter becomes a partner to its customer in the sale. Such understanding would, on one hand, render the issuing bank directly liable to the beneficiary for the price of the goods, and on the other, would not release the customer from his liability towards the beneficiary.

This theory, however, does not reflect the intention of the parties since the issuing bank would be amazed to know the fact that it is regarded by law as a partner in a transaction that it knows nothing about. Moreover, most bank's regulations do not allow it to make a partnership arrangement with the customer and the mere fact that it financed a transaction made by its customer does not amount to a partnership agreement.\(^{193}\)

Also it did not escape the author that classifying the relationship

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between the issuing bank and its customer as a partnership would give the issuing bank the right to raise against the beneficiary all defences that the customer is entitled to raise against the beneficiary.\textsuperscript{194}

4.2.1.9 The Sale Theory

A rather superficial analysis was advanced to explain the nature of the irrevocable credit's transaction under this theory. As it is the practice of the irrevocable credit that the bank's payment is given to the beneficiary in exchange for the latter's submission of certain commercial documents, which the bank later tenders to its customer in exchange for reimbursement plus commission, Sarna\textsuperscript{195} explained the relationships between the parties under the irrevocable credit, in view of such practice, to be that the bank buys the commercial documents from the beneficiary and then resells them to its customer.

The sale theory seems, at first glance, to fit the facts of the irrevocable credit, nonetheless, it has left some questions unanswered; firstly, it does not explain why the bank's offer to buy the commercial documents becomes irrevocable from the time it is communicated to the beneficiary, secondly, why is the bank under an obligation to sell the documents to that customer in particular and why does the latter have to buy them. Moreover, it is difficult to see a ground on which the customer could enjoin the bank from making payment to the beneficiary.

\textsuperscript{194}Ibid.

\textsuperscript{195}Letters of Credit, The Law and Current Practice, at p.40.
in the case where the documents tendered are fraudulent or to instruct it not to pay where the documents are not in conformity with the terms of the credit.\textsuperscript{196}

Furthermore, saying that the bank sells the documents to its customer would naturally mean that it sells him the goods which these documents represent, hence, forcing the bank to be involved with the goods which follows that it warrants against any defect in them. This is obviously contrary to the reality of letter of credit transaction where the bank deals with documents and not goods and is entitled to payment from its customer if the documents are in order, even if there were no goods at all or the customer received worthless goods.\textsuperscript{197}

In short this theory is of no assistance in solving the problem raised by the irrevocable letter of credit.

\textbf{4.2.1.10 Letter Of Credit As A Bill Of Exchange}

Turner after discussing the decision in the case of \textit{Second National Bank of Toledo v. M. Samuel & Sons, Inc.}\textsuperscript{198} disagreed with the court’s application of the law of negotiable instruments to the irrevocable letter

\textsuperscript{196}{\textit{Ibid.} at p.41.}

\textsuperscript{197}{\textit{Ibid.} at p.40.}

\textsuperscript{198}{12 F. 2d 963 (1926).}
Nevertheless, he suggested that the law of bill of exchange would be of much assistance in solving the problems raised by the nature of the irrevocable credit.

In justifying his view the author put forward an example in which he is tried to illustrate how similar the irrevocable letter of credit transaction is to the situation where the buyer draws a bill of exchange on the bank in favour of the seller which the bank accepts but added that payment will be made if the seller complied with certain conditions. Applying this situation to the irrevocable letter of credit transaction he suggested that the buyer’s application to the bank constitutes the drawing of the bill and the banks issuance of the credit constitutes his acceptance of it.

However, there are huge dissimilarities between the two instruments to which the author suggesting this theory contributed in calling the attention to. These differences will be discussed seriatim.

Firstly, and above all, the parties of the transaction do not intend that the irrevocable credit is to be negotiable.

199 In applying the law of negotiable instruments in this case the court decided that the bank should have accepted the stipulated documents which were presented by the seller after the expiry date.


201 Ibid. Note 10. See also Mautner, M., Letters-of-Credit Fraud: Total Failure of Consideration, Substantial Performance and the Negotiable Instrument Analogy, at pp.642-3.
Secondly, according to the law of bill of exchange it is essential that a valuable consideration moves from the payee (beneficiary) to the acceptor (bank). However according to the practice of the irrevocable credit the seller does not give any consideration for the bank’s undertaking. Thayer in this regard stated:

... the undertaking of the bank may be treated in the same way as the acceptance of a bill of exchange drawn in favour of the seller. *Quaere*, if such a view were to be followed logically, how the seller, before acting under the credit, would establish that he had taken it for value ...

Thirdly, the law of negotiable instruments makes it necessary, for a bill of exchange in order to be negotiable, to contain an unconditional promise to pay a certain sum of money, but that is not the case in the irrevocable letter of credit transaction where payment under the majority of them is conditional upon the submission of certain documents by the beneficiary. It could, however, be argued that a clean letter of credit, under which payment is not conditional upon the presentation of

\[ \text{Note 51.} \] 202Irrevocable Credits in International Commerce: Their Legal Nature, at p.1042

\[ \text{203In the U.K. see Section 3(1) of the Bills of Exchange Act 1882. In the U.S.A. see Section 3-104(1) of the U.C.C.. In France see Article 126 paras. 3-4 of the Code De Commerce. In Germany see para. 25 of the German Wechselgesetz.} \]

\[ \text{204Turner, R.B., although argued that the irrevocable letter of credit could be classified as a bill of exchange even if it is conditional, pointed out that after the letter of credit is assigned by the seller it is doubtful whether the fulfilment of the letter of credit’s conditions would be acceptable from someone else other than the seller. Letters of Credit - Negotiable Instruments, at pp.248, 250-51.} \]
any documents, could be regarded as a bill of exchange. Although this argument overcomes this objection it failed to account for the lack of intention to regard the clean credit as a bill of exchange and the lack of valuable consideration moving from the beneficiary to the bank. Moreover, it is of little help to classify one and a very rarely used type of documentary letter of credit while ignoring the vast majority of letters of credit which are conditional.205

Fourthly, it is elementary in the law of bill of exchange that the bill is drawn for a 'sum certain in money'; although the irrevocable credits sometimes designate the exact amount of money, that is not always the case; sometimes for instance, the credit may specify the price of the goods but permit the seller to ship them in instalments leaving him the option as to the quantity of each shipment, or specifying the price of each unit or ton giving the seller the option to decide the quantity to be shipped.207

Kozolchyk also objected to this theory on the ground that contrary to the position with regard to negotiable instruments a letter of credit is not always necessarily to be shown to the drawee. It is enough that he has the knowledge of its contents.208


206See *Bills of Exchange Act* provisions cited, *supra* at p.100 Note 203.


208*Commercial Letters of Credit in the Americas*, at p.594.
Furthermore, Sarna pointed out a further distinction between the irrevocable letter of credit and the bill of exchange, which is that under the former the beneficiary, by complying with the terms of the credit will be entitled to payment and the bank cannot prevent making such payment by raising against him defences that are available to it against the buyer. However, under the law of negotiable instruments, although the maker of the bill is not entitled to raise certain defences against a holder in due course he is entitled to raise them against the immediate party.\textsuperscript{209}

Finally, the Court in \textit{United City Merchants (Investments) Ltd. v. Royal Bank of Canada}\textsuperscript{210} dismissed this analogy by stating that despite the similarity between letter of credit and bill of exchange the former is not a negotiable instrument.

In conclusion, the huge differences between the two instruments, discussed above, render it by no means acceptable to classify the irrevocable credit as a bill of exchange.

\textbf{4.2.1.11 The Anticipatory Acceptance Theory}

Similar to the previous theory, this theory suggests that when the bank undertakes to open an irrevocable letter of credit, it is in fact given an anticipatory acceptance of a bill of exchange drawn under the letter of

\begin{footnotes}
\item[209]Letters of Credit, The Law and Current Practice, at p.50.
\item[210](1982) Q.B.D. 208 at p.222.
\end{footnotes}
credit by the beneficiary.

The origin of the anticipatory acceptance theory is case law, in which this theory was advanced in an attempt to find a solution for the problems raised by the open letter of credit and not the modern irrevocable letter of credit. In Pillans v. Van Mierop\textsuperscript{211} and Mason v. Hunt\textsuperscript{212} it was held that the promise in an open letter of credit constitutes an acceptance in advance of drafts to be drawn under it. Such acceptance was also held to be equivalent to an acceptance which is written on the bill of exchange. In Bank of Ireland v. Archer\textsuperscript{213} however, the Court overruled this decision stating that an acceptance of a bill of exchange in order to be binding must be written on the bill itself. This rule was later restated in Section 17 of the Bills of Exchange Act, 1882. For this reason this theory was not acceptable as a solution to the problems of open letter of credit in the United Kingdom, therefore, it was never suggested as a solution to the difficulties arising from the modern irrevocable credit.

The anticipatory acceptance theory has been suggested in France by Dean Rousseau\textsuperscript{214} as an explanation to the modern irrevocable letter of credit, but the suggestion was objected to by some French authors on the

\textsuperscript{211}(1765) 3 Burr. 1663.

\textsuperscript{212}(1779) 1 Doug. 297.

\textsuperscript{213}(1843) 11 M. & W. 383.

\textsuperscript{214}Rousseau's Note on Trib. Com. de La Seine 27.2.1920, S.1922. 2. 17; Note to Banque de Marseilles v. Delamare, S.1926. 1. 353.
following grounds. In the first place, the anticipatory acceptance (une acceptation anticipée) of a bill of exchange would only be applicable to the situations where the irrevocable letter of credit designates that a bill of exchange should be drawn under it, but it would not apply to other irrevocable letters of credit that do not call for a bill of exchange to be drawn,\textsuperscript{215} i.e., where the bank promise in the credit is to pay cash against documents.

Secondly, the anticipatory acceptance which is said to be written in the letter of credit conflicts with article 126 paragraph 1 of the \textit{Code De Commerce} which provides that in order for an acceptance to be valid it must be written on the bill itself. Furthermore, as the issuing bank’s undertaking under the irrevocable credit is invariably conditional upon certain documents to be submitted with the draft, this is undoubtedly, contrary to article 126 paragraphs 3-4 which provides that an acceptance of a bill of exchange must be unconditional.\textsuperscript{216}

In an attempt to overcome these last two objections it was suggested that the promise given by the bank to the seller is not an actual acceptance of a bill of exchange, but merely a promise to accept a bill of exchange.\textsuperscript{217} This suggestion seems convincingly to be capable of

\textsuperscript{215}Stoufflet, \textit{Le Crédit Documentaire}, at pp.388 \textit{et seq.} See also Kozolchyk, \textit{Commercial Letters of Credit in the Americas}, at p.594.

\textsuperscript{216}Also the theory is not applicable in Germany because Para. 25 of the \textit{German Wechselgesetz} contains similar provisions to that of the French Code.

\textsuperscript{217}Chéron, Note, Dalloz Pe’r. 1923. 11. 137; see Thayer, \textit{Irrevocable Credits in International Commerce: Their Legal Nature}, at p.1046.
avoiding the difficulties that an acceptance of a bill of exchange must be unconditional and must be written on the bill, but unfortunately, such suggestion did not take into account that in French Law a promise without cause or which is not accepted by the promisee is not binding.\textsuperscript{218}

In the U.S.A. it has also been held in a number of cases that the promise in an open letter of credit constitutes an anticipatory acceptance of a bill of exchange.\textsuperscript{219} The theory in the U.S.A. encountered similar objections to that raised against it in the other countries discussed above, namely that in order for an acceptance to be valid it must be written on the bill. The \textit{U.C.C.} \S 3-410 (1) provides that:

Acceptance is the drawee's signed engagement to honor the draft as presented. It must be written on the draft...

However, Section 135 of the \textit{Negotiable Instruments Law} provides that:

An unconditional promise in writing to accept a bill before it is drawn is deemed an actual acceptance in favor of every person who upon the faith thereof receives the bill for value.

This section is almost inapplicable in United States in this regard,

\textsuperscript{218}Thayer, \textit{Irrevocable Credits in International Commerce: Their Legal Nature}, \textit{Ibid.} This suggestion is similar to that of the offer and acceptance theory discussed above.

Professor Williston quoting the official comment to the U.C.C. §3-410 stated:

Subsection (1) [of the U.C.C. §3-410] adopts the rule of Section 17 of the English Bills of Exchange Act that the acceptance must be written on the draft. It eliminates the original Sections 134 and 135, providing for "virtual" acceptance by a written promise to accept drafts to be drawn and "collateral" acceptance by a separate writing. Both have been anomalous exceptions to the policy that no person is liable on an instrument unless his signature appears on it. Both are derived from a line of early American cases decided at a time when difficulties of communication, particularly overseas, might leave the holder in doubt for a long period whether the draft was accepted. Such conditions have long since ceased to exist, and the "virtual" or "collateral" acceptance is almost entirely obsolete. Good commercial and banking practice does not sanction acceptance by any separate writing because of the dangers and uncertainties arising when it becomes separated from the draft.220

Even on the assumption that Section 135 is still in force in the U.S.A. it is difficult to accept it as being applicable as a solution to the problem of the irrevocable letter of credit, when it has expressly provided that the acceptance must be unconditional, and in contrast, payment under the irrevocable credit is almost always conditional upon the presentation of certain documents.221

220Williston on Contracts, Vol. 10 §1186 Note 19.

221Ellinger, Documentary Letters of Credit, at p.46. See also Kozolchyk, Commercial Letters of Credit in the Americas, at p.594. However the writer seems later to have abandoned this opinion he stated ‘... it can be argued that despite the inclusion in the text of the letter of credit of terms referred to as a conditions, from a purely legal standpoint such stipulations are not future and uncertain events but formalities required for the payment of the promise. Accordingly, a letter of credit
In view of all of these objections it could be concluded that the anticipatory acceptance theory is not a sufficient answer to the problem raised by the irrevocable credit in all of the jurisdictions discussed above.

4.2.1.12 A New Type Of Mercantile Currency

Professor Kozolchyk suggested that commercial letters of credit should be regarded as a new type of Mercantile Currency.\textsuperscript{222} He pointed out that a commercial letter of credit, to some extent, bears resemblance to money. In the first place there is no direct contract between the issuer and the holder of money, equally there is no direct contract between the issuing bank and the beneficiary under the letter of credit. Secondly, the promise given in both cases has the same nature in that it generates the same effect which is making the promise in both cases reliable upon.\textsuperscript{223}

Kozolchyk after stating that the legal definition of money is ‘a physical
despite its non-transferability could still be regarded as "an unconditional promise to pay a sum certain". This promise binds the issuing bank to accept the beneficiary’s draft prior to the creation of the draft itself.’ \textit{International Encyclopedia of Comparative Law}, (Vol. IX) Chapter 5 (Letters of Credit) at p.140.

\textsuperscript{222}Kozolchyk, B. \textit{Commercial Letters of Credit in the Americas}, at pp.595 \textit{et.seq.}; by the same author, \textit{The Legal Nature of the Irrevocable Commercial Letter of Credit}, at pp.415 \textit{et.seq.}; See also \textit{International Encyclopedia of Comparative Law, Letters of Credit} (Vol. IX) Chapter 5 at pp.139 \textit{et.seq.}

\textsuperscript{223}Kozolchyk, \textit{The Legal Nature of the Irrevocable Commercial Letter of Credit}, at pp.416-7; by the same author, \textit{Commercial Letters of Credit in the Americas}, at pp.598-9.
and fungible object that is given or accepted as a "fraction, equivalent, or multiple of an ideal unit"; admitted that letter of credit is not the fraction, equivalent, or multiple of the ideal unit. Firstly, because letters of credit are made for specified persons and payment under it is generally conditional that makes it not as abstract as money which is not conditional and where any holder of which can be the beneficiary. Secondly, letters of credit are not negotiable they are not as freely circulated as money. Thirdly, in the case of destruction of letter of credit it is easy to obtain a duplicated copy of it, whereas in the case of the destruction of money it is difficult to acquire its replacement.

Finally Kozolchyk pointed out a further difference regarding the level in which the irrevocable letter of credit stands compared with money; he argued that unlike the holder of money the beneficiary of an irrevocable credit cannot convert it into cash until after he has complied with its terms, and even if he complied by tendering facially complying documents the buyer's allegation that the documents are forged may bring about a court injunction which defeats the beneficiary's right to convert the irrevocable credit into money.

Despite these differences between letter of credit and money which renders them legally unequivalent, and in spite of the fact that

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224 Commercial Letter of Credit in the Americas, at p.596.

225 Ibid.

226 Ibid. at p.597.

227 Ibid. at p.598.
establishing the distinction between them is very necessary to determine the different legal consequences flowing from each of them, Professor Kozolchyk is still of the opinion that it should not be an obstacle in the way of recognizing their similarity in the way that they economically operate. He pointed out that there are many objects which possess different degrees of "moneyness", giving the example that if an economist was offered an irrevocable letter of credit issued by a reputable Swiss bank in Swiss Francs or Swiss Francs themselves, he would acknowledge that they are both a form of money, but he would choose the Swiss Francs because they have a higher degree of "moneyness". 228

Professor Kozolchyk concluded that commercial letter of credit is a commercial instrument which embodies a formal monetary promise the degree of "moneyness" of which depends on many factors, such as, the solvency of the issuing bank and the kind of letter of credit etc., and he went on to define it as "a formal and certain promise embodying an abstract obligation to accept a draft or demand for payment upon literal compliance with its terms". 229

However, it appears from the whole argument in this theory that Kozolchyk is trying to put forward the point that a commercial letter of credit should be recognized as a self-sufficient monetary instrument of

228 Ibid. at p.597.

229 Ibid. at p.599. See also by the same author The Legal Nature of the Irrevocable Commercial Letter of Credit, at p.417.
the commercial world, which is the argument discussed in the usage theory.\textsuperscript{230}

\textsuperscript{230}See infra at p.187.
4.2.2 Contractual Theories

In order to overcome the difficulties that encountered the attempts to solve the issuing bank-beneficiary relationship problems by way of classification, several attempts were made in common law countries to establish that there is a simple contract between them.

4.2.2.1 The Offer And Acceptance Theory

The legal nature of the old form of commercial letter of credit (open credit) was considered as a simple contract. The issuance of the letter of credit by the issuing bank, either addressed to a specific beneficiary or to the world at large, constitutes an offer resulting in a valid contract between them from the moment that the beneficiary accepted it by conduct. Davis put forward this explanation as a solution to the difficulty arising from the legal relationship between issuing bank and the beneficiary under the modern irrevocable letter of

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231 Re Agra & Masterman's Bank, Ex Parte Asiatic Banking Corporation, (1867) L.R. 2 Ch. App. 391. See also Hershey, Letters of Credit, at pp.10-1; Williston on Contract §32; Ellinger E.P., Documentary Letters of Credit, A Comparative Study at p.82.

232 The Law Relating to Commercial Letters of Credit (3rd Ed.) p.73. Also by the same author, The Relationship Between Bank and Seller Under a Confirmed Credit (1936) 52. L.Q.R. at p. 225.
credit. Treitel is also in favour of this analysis.\textsuperscript{233}

There is much support to this theory in some English and American cases. In England in the recent case of \textit{United City Merchants (Investments) Ltd. v. Royal Bank of Canada (The American Accord)}\textsuperscript{234} Lord Diplock was of the opinion that, as his Lordship put it "it is trite law" that the relationship between the beneficiary and the confirming bank under a confirmed irrevocable letter of credit is contractual,\textsuperscript{235} ruling out any other solutions. His Lordship said:

If, on their face, the documents presented to the confirming bank by a seller conform with the requirements of the credit... that bank is under a contractual obligation to the seller to honour the credit.\textsuperscript{236}

However, his Lordship did not explain how this contractual relationship comes into existence.

\textit{Urquhart Lindsay & Co. v. Eastern Bank Ltd.},\textsuperscript{237} is another case that may shed some light on to how this contractual relationship comes into existence. The facts of this case are that the plaintiff contracted to sell machinery to Benjamin Jute Mills, and the latter in compliance with the

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\textsuperscript{233}Trietel, \textit{The Law of Contract} at p.139. See also Pennington, Hudson and Mann, \textit{Legal Topics Series, Commercial Banking Law}, at pp.337-8.

\textsuperscript{234}[1983] 1 A.C. 168.

\textsuperscript{235}\textit{Ibid}. 182H-183C.

\textsuperscript{236}\textit{Ibid}. at p.183.

\textsuperscript{237}[1922] 1 K.B. 318.
sale contract, opened a confirmed and irrevocable letter of credit for a sum not exceeding £70,000 in favour of the plaintiff with the defendant bank. The plaintiff tendered the required documents and drafts which were in excess of the contract price but not exceeding the amount of the credit. The drafts for the first two shipments were accepted and were paid under the credit by the defendant’s bank. Having noticed that the sum paid was in excess of the contract price, the buyer instructed the defendant bank not to accept the draft for the third payment, which the latter carried out. The plaintiff considered the defendants’ act as a repudiation of their contractual obligations and brought an action for damages. After the writ was issued the defendant bank paid the amount of the third shipment draft.

Although the issue before the court was not the validity of the letter of credit\textsuperscript{238} there is an \textit{obiter dictum} in this case by Rowlatt J. in support of this theory, he 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 defendant and the plaintiff...\textsuperscript{239}

In \textit{Dexters, Ltd. v. Schenker & Co.}\textsuperscript{240} a contract was entered into

\textsuperscript{238}Ellinger E.P., \textit{Documentary Letters of Credit}, at p.83; see also Todd P.N., \textit{Sellers and Documentary Credits} (1983) J.B.L. 468 at p.476.


\textsuperscript{240}(1923) 14 Lloyd’s L.R. 586.
between the plaintiffs and the *Astra Co.* for the sale of certain goods. The contract provided that payment was to be made by confirmed banker’s credit. Although the credit opened did not conform with the terms of the sale contract and was of unusual form\(^{241}\) it was accepted by the plaintiff who shipped the goods and tendered the documents, but the defendants rejected them and refused to pay. In an action by the plaintiffs the defendants raised the defence of lack of consideration, although this contention was later withdrawn, Greer J. applying Rowlatt’s J.’s dictum in *Urquhart, Lindsay & Co. Ltd. v. Eastern Bank Ltd.*\(^{242}\) said:

Now it is clear that, until they [meaning plaintiffs] got a form of banker’s credit which would comply with the terms of the contract, plaintiffs 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 there was a full and ample consideration for this undertaking.\(^{243}\)

Moreover, this theory is upheld in some American cases. In *Moss*

\(^{241}\)It provides that "... 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." Greer J. interpreted this statement to mean that payment will be made after the buyer received the goods.

\(^{242}\)Supra.

\(^{243}\)Supra at p.588. See also *Scott v. Barclays bank* [1923] 2 K.B. 1., this case was decided on the belief that there is a valid contract between the beneficiary and the bank.
v. Old Colony Trust Company\textsuperscript{244} the bank (defendant) issued an irrevocable credit in favour of the seller (plaintiff) who upon receipt of the credit noticed that the terms of the credit were not in compliance with the sale contract's terms and subsequently rejected it. The bank, therefore, sent another letter which contained the amendments required by the seller but also contained some modifications which he was not satisfied with but made no reply. After shipping the goods the seller tendered the documents to the bank who rejected them contending that although they were in compliance with the original credit, they did not comply with the modifications in the second letter. The seller brought an action contending that the original credit was still valid between him and the bank. The court rejected this contention deciding that the original credit was a mere offer which did not become a contract binding on the part of the bank because it was not accepted by the seller. Rugg J. regarding this issue stated:

...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.\textsuperscript{245}

Also in Banco Nacional Ultramarino v. First National Bank of Boston\textsuperscript{246} support to this theory could be taken from Peters J.'s

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{244}246 Mass. 139, 140 N.E. 803 (1923). See also Lafargue v. Harrison 70 Cal. 380, affirmed 11 Pac. 636 (1886); American Steel Co. v. Irving National Bank 266 F. 41 (1920), per Rogers, J. at p.43; Second National Bank of Hoboken v. Columbia Trust Co. 288 F.17 (1923).
\item \textsuperscript{245}Ibid. at p.808.
\item \textsuperscript{246}289 F. 169, D.Mass. (1923).
\end{itemize}
\end{footnotesize}
judgment; his view was that the bank's promise in the irrevocable letter of credit becomes a contract from the time at which the bill of exchange is negotiated.247

Relying on the above discussed cases this theory could be said to have adequately fitted the complicated relationship between the beneficiary and the issuing bank, under the irrevocable letter of credit, into a simple contract. Nevertheless, there are objections to which Davis248 who is in favour of this theory, strongly made counter arguments. Some of these objections are directed to the consideration moving from the beneficiary to the issuing bank; the others are directed to the beneficiary's acceptance of the issuing bank's offer; therefore, it will be appropriate to discuss each category separately.249

4.2.2. Il[i] Consideration

As mentioned above, the doctrine of consideration does not exist in the Law of Scotland,250 also in the United States of America the Uniform Commercial Code251 stated that:

247 Ibid. at p.174.

248 The Law Relating to Commercial Letters of Credit, at pp.73 et seq; see also by the same author, The Relationship Between Banker and Seller Under a Confirmed Credit, at pp.229 et seq.

249 It has been argued that the acceptance and the consideration are inseparable. See Hamson C.J., The Reform of Consideration (1938) 54 L.Q.R. 233.

250 See supra at p.55.

251 The U.C.C. has been adopted in all the States. See supra at p.10.
No consideration is necessary to establish a credit or to enlarge or otherwise modify its terms.252

However the question of consideration still arises in English Law which regards it as a fundamental element for the validity of a contract.253

Looking for a consideration moving from the beneficiary to the issuing bank, McCurdy254 and Finkelstein255 argued rightly, that the making of the sale contract between the buyer and the seller cannot be regarded as a consideration moving from the seller to the issuing bank, because it is past consideration, since the sale contract is usually made before the issuing of the credit.

Davis256 and Treitel257 suggested that the seller's performance of


253See supra at p.47. The U.C.P. made no mention of consideration, and even if it provides that consideration is not needed, these rules are not law in England but only applicable if stated to be so in the credit.

254Commercial Letters of Credit, at p.569.

255Legal Aspects of Commercial Letters of Credit, p.282. See also Ellinger, Documentary Letters of Credit, at p.88; Jack, R. Documentary Credits: The Law and Practice of Documentary Credits, Standby Credits and Performance Bonds, at p.75.

256The Relationship Between Banker and Seller under a Confirmed Credit, at p.229; Also The Law Relating to Commercial Letters of Credit, at p.73.
his contract with the buyer constituted a consideration moving from him to the issuing bank.

McCurdy\textsuperscript{258} contended that the seller’s performance cannot be regarded as a consideration for the bank undertaking because the issuing bank is not bargaining for the seller’s performance of his contract with the buyer to be made, Davis\textsuperscript{259} relying on Rowlatt J.’s judgment in \textit{Urquhart Lindsay & Co. Ltd. v. Eastern Bank Ltd.}\textsuperscript{260} said, in reply to this objection:

But it is submitted that, in appropriate cases, this is what the bank is bargaining for. It seeks, by undertaking payment, to implement a contract already entered into between the buyer and the seller. If one of the terms of that contract is that the seller shall manufacture the goods, then it would seem clear that the bank does bargain for (\textit{inter alia}) the manufacture of the goods.

It appears that Davis’s argument is not persuasive, since it cannot be said that the issuing bank is bargaining for the seller’s performance of the sale contract, when it is entitled to commission from the buyer whether the seller performs his duty under the sale contract and subsequently tenders the documents or not.\textsuperscript{261}

\textsuperscript{257}The Law of Contract, at p.139.

\textsuperscript{258}Commercial Letters of Credit, at p.569.

\textsuperscript{259}The Relationship Between Banker and Seller under a Confirmed Credit, at p.233.

\textsuperscript{260}Quoted \textit{supra} at p.112.

\textsuperscript{261}Baring v. Lyman 2 Fed. Cas. 794 (1841) the decision in this case is concerned with an open letter of credit but it is adoptable to commercial letters of credit, so in
Another objection to the seller’s performance of the sale contract being regarded as a consideration moving from him to the issuing bank is that the seller is already legally obliged to perform under the contract of sale. This performance cannot be given as a consideration for a new contract (the letter of credit) to the issuing bank. That is to say, A’s promise to B to perform his duty under a contract cannot be a good consideration moving from A to C in return for a promise by C. This argument seems to be weak since it is now submitted that pre-existing contractual duty can be furnished as a consideration for new contract with a third person.

On the other hand, Ellinger, looking at this objection from a

the irrevocable credit the issuing bank will be entitled to commission at the time the credit becomes irrevocable, i.e. when the credit is communicated to the seller. See Ellinger, *Documentary Letters of Credit* at p.160; *Benjamin’s Sale of Goods* (3rd Ed.) at p.1410, §2222.


264 *Documentary letters of Credit*, at pp.88-9.
different angle, argued convincingly, that the duty of the seller to perform under the sale contract does not exist before the issuance of the irrevocable credit. Although the contract of sale was made before the opening of the irrevocable credit, it contains a condition precedent to the performance on the part of the seller, a duty on the part of the buyer to furnish a letter of credit. Thus, the seller is under no legal obligation to start performing under the contract of sale until the letter of credit stipulated for therein is communicated to him.\textsuperscript{265}

In Trans Trust S.P.R.L. v. Danubian Trading Co. Ltd.,\textsuperscript{266} Denning L.J. said:

...the stipulation for a credit is a condition which is an essential term of the contract. In those cases the provision of the credit is a condition precedent... to the obligation of the seller to deliver the goods. If the buyer fails to provide credit, the seller can treat himself as discharged from any further performance of the contract...\textsuperscript{267}

At the moment that the irrevocable credit is communicated to the seller, he becomes under an obligation to perform his duty under the contract of sale and the issuing bank becomes bound \textit{vis-à-vis} the seller under the irrevocable letter of credit. So at that moment the obligation to perform the sale contract, as a consideration, moved from the seller

\textsuperscript{265}See \textit{supra} at p.18.

\textsuperscript{266}[1952] 2 Q.B. 297.

\textsuperscript{267}\textit{Ibid.} at p.304.
to both the buyer and the issuing bank. Such consideration is valid.268

English courts, however, have assumed that there is a good consideration moving from the seller for the bank's undertaking. Regarding this point Davis stated that:

...it is thought that any argument submitted to an English Court that there was no legal obligation between the banker and the seller would receive little sympathy.269

4.2.2. [iii] Acceptance

Before deciding what constitutes the seller's acceptance, the nature of the seller-issuing bank contract should first be determined. The seller has no intention of binding himself vis-à-vis the issuing bank to perform under the sale contract and in practice neither the bank nor the seller have the understanding that the seller owes the issuing bank any duty whatsoever before presenting the documents to the bank. Moreover, it cannot be argued that the parties are looking for the formation of a bilateral contract because the seller does not in practice give either

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268 Shadwell v. Shadwell, (1860) 9 C.B. (N.S.) 159. This explanation, appears to be, what Greer J. was implying in his statement in Dexters, Ltd. v. Schenker & Co., discussed supra at p.113. In contrast Clarke M., after a lengthy discussion regarding this point, concluded that there are duties on the part of the seller under the contract of sale before the opening of the credit by the buyer. Bankers Commercial Credits Among The High Trees (1974) 33 (2) C.L.J. 260. See also Cheng, "Irrevocable" Credits and the Law, (1980) M.L.J. lxii, at p.lxiv.

269 The Law Relating to Commercial Letters of Credit, at p.77. Also Atiyah P.S., said "Yet in practice it is unthinkable that a court could declare such promise to be unenforceable in modern times..." Essays on Contract at p.222.
expressly or by implication\textsuperscript{270} any promise to the issuing bank to perform any of his obligations under his contract with the buyer. For these reasons the contract under this theory cannot be regarded as other than a unilateral contract.\textsuperscript{271} In this contract the promise of one person is given in exchange for an act by the other; the latter is not bound to act and even if he did commence performance and later stopped the promisor cannot bring an action against him.

An example would be useful to illustrate the nature of this contract, suppose A promises B to pay him £1,000 if he passes a degree. A is not asking for a promise from B to start the degree in exchange for his promise, and B is not legally bound to start the degree, and if he did and later stopped before he finished the degree, A cannot bring an action against B to force him to continue.

Todd strongly in favour of this analysis\textsuperscript{272} regarded it to be in line with Lord Diplock’s view in United City Merchants v. Royal Bank of Canada (\textit{The American Accord}).\textsuperscript{273}

In the Law of Scotland the promise under the unilateral contract does

\textsuperscript{270}Davis, \textit{The Relationship Between Banker and Seller under a Confirmed Credit}, at p.239.

\textsuperscript{271}The difference between the unilateral and bilateral contract is that in the bilateral contract the offerer is requesting an acceptance for his offer. So there will be a legal obligation under the contract on both sides as from the time the acceptance is received by the offerer.

\textsuperscript{272}\textit{Bills of Lading and Bankers’ Documentary Credits} at p.190.

\textsuperscript{273}[1983] 1 A.C. 168 at 182H-183C.
not require acceptance on the part of the promisee and it becomes irrevocable from the moment it is communicated to the promisee.\textsuperscript{275} Also in the United States the problem of lack of acceptance of the bank’s offer by the beneficiary was solved by the Uniform Commercial Code, Section 5-106 (2)\textsuperscript{276} which provides, that the irrevocable letter of credit becomes established from the time that the beneficiary receives it removing the need for his acceptance.

Unlike Scottish and American law, English Law regards the unilateral promise as revocable by the promisor until the promisee accepts it by performance. Therefore by regarding the irrevocable credit as a unilateral contract the question which will obviously raise itself in these jurisdictions, is what constitutes the seller’s acceptance of the issuing bank’s unilateral offer, made by the opening of the irrevocable credit? Gutteridge and Megrah\textsuperscript{277} are of the opinion that the presentation of the

\begin{footnotesize}
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\item \textsuperscript{275}Duguid v. Caddall’s Trs. (1831) 9 s. 844; Smeaton v. St. Andrews Police Commrs., (1871) supra; Shaw v. Muir’s Exrx. (1892) 19 R. 997.
\item \textsuperscript{276}Supra.
\item \textsuperscript{277}The Law of Banker’s Commercial Credits, at p.31; Finkelstein, Legal Aspects of Commercial Letters of Credit, at pp.280-1; McCurdy, Commercial Letters of Credit, at p.569. See also Donaldson J.’s judgement in Elder Dempster Lines Ltd. v. Ionic Shipping Agency Inc; Midland Bank; and Marine Midland Grace Trust Co. of New York, [1968] 1 Lloyd’s Rep. 529 (Col.2). In his view the letter of credit is an offer which becomes binding from the time the seller accepts it by tendering the documents. Although this view was expressed in a case concerning standby credit it is still applicable to a documentary letter of credit. See Jack, R.,
\end{itemize}
\end{footnotesize}
documents is the only act which can be regarded as the seller’s acceptance of the bank’s offer, hence, there would be a period of time between the issuing of the irrevocable letter of credit and the presentation of the documents during which the bank would be able to revoke the unaccepted offer. This would destroy the purpose of the irrevocable credit, which is to guard the seller during this period, in which he is manufacturing or making preparations for the goods, against the bank’s revocation of the credit, which the bank may do in certain circumstances, such as if the buyer becomes insolvent or if he fraudulently opened the credit. Moreover, it will wipe out any difference between the revocable and the irrevocable letters of credit. 278

Davis disagreed with Gutteridge and Megrah on this point; he is of the opinion that the seller’s acceptance takes place at some time prior to the presentation of the documents; he said 279:

But such authority as there is on this point would seem to suggest that the acceptance takes place at some time anterior to the tender

Documentary Credits: The Law and Practice of Documentary Credits, Standby Credits and Performance Bonds, at pp. 74, 76.

278This theory under this understanding could be said to fit squarely the nature of the revocable credit because the intention of the parties, under this kind of letter of credit, is that the issuing bank is under no legal obligation towards the seller until the former accepts the tendered documents, but before that time the issuing bank can cancel the revocable credit without even giving notice to the seller. U.C.P. Art. 9(a); U.C.C. §5-106 (3); See also Cape Asbesto Co. Ltd. v. Lloyd’s Bank Ltd. [1921] W.N. 274.

279The Relationship Between Banker and Seller under a Confirmed Credit, at p. 229.
of the documents - at the latest when the goods are shipped... the contract was concluded by the plaintiffs' [seller] acting upon the undertaking and that their so acting was a sufficient acceptance of the defendant's [the bank] offer.

In support of his argument Davis cited Rowlatt, J.'s *dictum* in *Urquhart Lindsay & Co. Ltd. v. Eastern Bank Ltd.* But the issue before the Court in that case was not to determine at what stage, before the tender of the documents, the letter of credit becomes irrevocable, because the bank revoked the letter of credit after the tender of the documents. Also Rowlatt, J. was not talking, in his statement, about acceptance but about consideration, nevertheless he was clear that the letter of credit becomes irrevocable when the seller acts upon it, but he did not go further to say whether it is the beginning of the performance or the completion of it. Davis understood it to mean the beginning of the performance.

McCurdy, argued that if the bank’s offer is made for the formation of a unilateral contract, there would be no binding contract upon the banker until the required performance had been completed, which is to say when the seller presents the documents to the bank. Support for this view can be found in the case of *Carlill v. Carbolic*

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280 Quoted *supra* at p.112.

281 *The Relation Between Banker and Seller Under a Confirmed Credit Loc.cit.* See also Treitel, *The Law of Contracts*, at p.139.

282 *Commercial Letters of Credit*, at p.569.
Smoke Ball Co.\textsuperscript{283} where it was held that the offeree before full performance has no right against the offeror. Also in *Luxor [Eastbourne] Ltd. v. Cooper*\textsuperscript{284} the House of Lords held that the owner of the land can revoke his promise to pay commission to the agent for the sale of the land at any time before the sale is completed. Moreover, Todd\textsuperscript{285} raised the possibility that if the *dictum* of Rowlatt, J. ‘acting upon the undertaking’ can be understood to mean the beginning of the performance, it could be also, understood to mean the completion of it.

Looking at McCurdy’s objection one would admit that the unilateral contract cannot be regarded as binding on the promisor until the stage of full performance, for the simple reason that if the promisee under such contract is not bound to start the performance and if he started and later stopped the promisor cannot maintain an action against him, it would be logical to say the promisor is also not bound by the contract before full performance. But this logic, on the other hand, could make it unfair to allow the promisor to revoke his promise, for instance, in the situation, when the promisee has completed three-quarters of the performance required in exchange for the promise.

Pollock\textsuperscript{286} was of the opinion that the completion of the performance


\textsuperscript{284}[1941] A.C. 108.

\textsuperscript{285}Sellers and Documentary Credits, at p.478.

is the consideration for the unilateral promise, so before this stage the promisor is not bound to pay any money, but the promisee’s acceptance of the offer which completes the formation of the contract, could be assumed at the time the promisee began the performance by doing an act unequivocally referable to the requirement of the offer.\textsuperscript{287}

This view can be supported in the American case of \textit{America I. & I. Holding Corp. v. Gainsburg},\textsuperscript{288} the facts of this case were that A, promised to pay a sum of money to a hospital, and in reliance on the promise the hospital incurred mandatory liabilities. It was held that the hospital’s act was an acceptance, therefore A’s promise became irrevocable.\textsuperscript{289}

The Restatement (Second) of Contracts stated this principle in these terms:

\begin{quote}
Where an offer invites an offeree to accept by rendering a performance and does not invite a promissory acceptance, an
\end{quote}

\textsuperscript{287}Ellinger, \textit{Documentary Letters of Credit}, at p.86, agreeing with this view he supported it by showing the strong resemblance between the acceptance in the unilateral contract and in the surety contract.

\textsuperscript{288}276 N.Y. 427, 12 N.E. 2d. 532 (1938); see also \textit{Wentworth v. Day} 44 Mas. (3 Met.) 352, 37 Am. Dec. 145 (1841).

\textsuperscript{289}Similarly the tender of part performance renders the offer irrevocable. See \textit{Hollidge v. Gussan, Khan & Co. Inc.} 67 F.2d 459 (1933).
option contract is created where the offeree tenders or begins the invited performance or tenders a beginning of it.290

In the English case of *Errington v. Errington and Woods*,291 A, bought a house, he paid some of its price in cash and borrowed the rest of the price on a mortgage from a building society. He said to his son and daughter-in-law that if they paid the whole mortgage instalments the house would be theirs. They lived in the house and started paying the instalments, although they did not bind themselves to continue paying the mortgage. The Court of Appeal’s decision was that the father’s promise became irrevocable from the time the couple acted in reliance on it by starting to pay the instalments. Denning L.J. observed that:

The father’s promise was a unilateral contract - a promise of the house in return for their act of paying the instalments. It could not be revoked by him once the couple entered on performance of the act, but it would cease to bind him if they left it incomplete and unperformed, which they have not done.292

Moreover, about the decision of the House of Lords in *Luxor (Eastbourne) Ltd. v. Cooper*,293 Cheshire and Fifoot and Furmston294

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290Restatement (Second) of Contracts, §45 (1).

291[1952] 1 K.B. 290; Thompson M.P., suggested that the father’s promise in this case was irrevocable on the grounds of estoppel rather than contractual. *Licences: Questioning the Basics* [1983] Conv. 50, 51; see also Erle C.J. discussion in *Offord v. Davies* (1862) 12 C.B. (N.S.) 748 at p.753.

292Ibid. at p.295.


294*Cheshire, Fifoot and Furmston’s Law of Contract*, at p.60.
stated that:

At first sight this might appear to support the view that offers of unilateral contracts are freely revocable until performance. But the House of Lords did not rely on any such principle which would have provided a complete and simple answer to the plaintiff’s claim. Instead they held that, in the circumstances of the case, it would not be proper to imply an undertaking by the owner not to revoke his promise once performance had begun. Clearly this argument assumed that if such an undertaking could be implied, it would be binding.

Ellinger\textsuperscript{295} distinguished the unilateral offer in the case of \textit{Carlill}\textsuperscript{296} which was made to the world at large, from the unilateral offer in the documentary credit which is to a specified person. He argued that in the former case the reasons for allowing the offer to be revocable before full performance are; firstly the offerer cannot be said to be able to know when the performance of each member of the public starts. Secondly, the offerer by making his offer to the world at large, intended not to be bound to anyone except the person who performs in full; assuming otherwise would lead to unreasonable results, which is that the offerer would be bound not to revoke his offer to so many people that have accepted the offer by starting to perform, which means that he would be bound to accept more than one full performance.

However, these reasons are not applicable to the offer in the case of irrevocable letter of credit. By making the offer to a specified person,

\textsuperscript{295}Documentary Letters of Credit, at p.87.\\[296]Supra.
the offerer has the intention to bind himself towards the offeree from the time the performance starts, if his intention is not to be bound until after the completion of the performance he would have made his offer to the world at large and accepted the first completed performance. Also by being bound to one person, he would not meet the possibility that more than one full performance is tendered. Moreover, the law of the irrevocable letter of credit gives the offerer the right to reject an unsatisfactory performance, so being bound from the time the performance begins would not put him at risk, this right does not exist in the case of the offer to the world at large. So these differences between the offer to the world at large and the offer to a specified person under the irrevocable letter of credit prove that there is every reason for the former offer not to be binding before full performance, whereas, there is no reason for the latter offer not to be binding from the time it is accepted by the beginning of the performance.

The preceding discussion indicates that the offer in the irrevocable credit, even if it is considered as a unilateral offer can be regarded as irrevocable before presentation of the documents. Therefore this objection to the offer and acceptance theory fails.

4.2.2.1[iii] Does This Theory Furnish A Solution?

This theory, so far, seems to give a satisfactory explanation of the nature of the irrevocable credit, but, there are some difficulties that this

297U.C.P. Art. 15; U.C.C. §5-114 (1).
theory falls short of overcoming, these difficulties are:

Firstly, regarding the seller’s act upon the bank’s undertaking as the acceptance of the bank’s offer, would mean that the seller’s act, which constitutes acceptance and subsequently the credit become irrevocable, can be easily defined\(^2\) but that is not the case in practice. As letters of credit are usually opened for the finance of different kinds of transactions: service, sale of goods, manufacturing them, etc., there are no criteria to decide which of the seller’s acts is in reliance on the bank’s undertaking and then constitutes an acceptance. Davis gave a rather impractical solution to this difficulty by suggesting that the seller should make sure that the underlying contract is very clear, so as to make it easy to determine which act the seller has done in reliance on the bank’s undertaking.\(^3\) But even if the seller knows when he acted in reliance on the bank’s undertaking, the latter cannot be said to be able to know when such an act took place, and as a result the bank would not know from what moment his offer is accepted and the letter of credit becomes irrevocable. Unless this theory suggests that the bank should always assume that the seller accepts its offer by acting upon it as soon as the offer is communicated to him, the bank will always be in a dilemma, if it for some reason wishes to revoke the credit, as to whether this revocation is a mere withdrawal of the offer or a repudiation of the


\(^3\)The Relationship Between Banker and Seller, at pp.233-4.
contract with the seller. This sound objection shows that this theory makes the moment in which the letter of credit becomes irrevocable uncertain, which is undesirable by banks and also by businessmen.

Secondly, as the seller is not bound to perform the contract of sale until he receives the credit,\textsuperscript{300} he will naturally commence performance at some time after the credit has been communicated to him, that would lead to the result that the bank would be allowed to withdraw its offer at any time after the advising of the letter of credit and before the seller's act which constitutes the beginning of the performance.\textsuperscript{301} Davis contended that there is no necessity for the letter of credit to be irrevocable from the time it reaches the hand of the seller, because the seller would not suffer any loss if the bank revoked the credit before the seller commenced to perform the contract of sale. So there would be no need to give him the protection of the irrevocability before he commenced performance.\textsuperscript{302}

Ellinger strongly rejected this weak contention, pointing out that there would be a financial loss on the part of the seller if the bank revoked the credit before the former commenced performance.\textsuperscript{303} For instance,

\textsuperscript{300}See \textit{supra} at p.18.


\textsuperscript{302}\textit{The Relationship Between Banker and Seller}, p.233.

\textsuperscript{303}\textit{Documentary Letters of Credit}, at p.90.
if the contract with the buyer was for manufacturing, the seller relying on the buyer’s order, may have rejected some other orders, and he may suffer financial loss by losing time waiting for a new order.

Finally, placing the moment of irrevocability at some time after the credit has been advised to the seller is inconsistent with the understanding of the irrevocable letter of credit practice and with its law. It is well established that the letter of credit becomes irrevocable at the time when it is communicated to the seller, with no requirement for any acceptance on his side. The only case which suggested such requirement was the American case of Moss v. Old Colony Trust Company,304 but the majority305 of the decided cases on this point suggested that the letter of credit becomes irrevocable as soon as it is advised to the beneficiary.

In the United States of America, Hough, J. in Pan-American Bank & Trust Co. v. National City Bank of New York306 stated this principle in these terms:

304 Discussed supra at pp.114-5. Disagreeing with the Massachusetts Supreme Judicial Court decision in this case, McCurdy gave a sound analysis of it, concluding that the seller acceptance is not needed in order to render the bank undertaking irrevocable. The Right of the Beneficiary under a Commercial Letter of Credit, at pp.328-31. See also Lamborn v. Nat. Park Bank 240 N.Y. 520 (1925); In England see Midland Bank Ltd. v. Seymour (1955) 2 Lloyd’s Rep. 147 at p.166.

305 In Urquhart Lindsay & Co. Ltd. v. Eastern Bank Ltd., it was held, as mentioned supra at p.112, that the letter of credit becomes irrevocable at the time the beneficiary acts upon it.

306 6 F. 2d. 762 (1925). See also American Steel Co. v. Irving National Bank, (1920) 266 F. 41 at p.43; U.C.C. §5-106(1)(b) quoted supra at p.33.
...by express agreement it became irrevocable as soon as the Rio Branch [the bank] communicated its terms to Barcellos [the beneficiary]; from that moment Barcellos had contractual rights against City bank.\textsuperscript{307}

Also in Bril v. Suomen Pankki Finlands Bank,\textsuperscript{308} Halpern J. observed that:

The obligation arises only when a letter of credit is actually issued by one of the banks and is delivered to the beneficiary. The contract between the opening bank and the beneficiary comes into existence at the time of the delivery of the letter of credit to the beneficiary and not earlier.\textsuperscript{309}

In the U.K. as mentioned above Greer, J. in the case of Dexters, Ltd. v. Schenker & Co.,\textsuperscript{310} was also of the view that the irrevocable letter of credit becomes binding on the issuing bank when it is advised to the seller.\textsuperscript{311} Moreover, Jenkins L.J. in Hamzeh Mallas v. British Imex

\textsuperscript{307}Ibid. at p.769.

\textsuperscript{308}97 N.Y.S. 2d. 22 (1950), aff'd 101 N.Y.S. 2d 256 (1950).

\textsuperscript{309}Ibid. at p.32. As regard this point, see also First Wisconsin National Bank of Milwaukee v. Forsyth Leather Co. 189 Wisc. 9. 206 N.W. 843 (1926). Where it was held per Crownhart J., at p.845., that the letter of credit becomes irrevocable when it is communicated to the beneficiary and not only an offer becomes, irrevocable when it is acted upon. See also Distribuidora Del Pacofico S.A. v. Gonzales, 88 F. Supp. 538 (1950); see Dolan, J.F., The Law of Letters of Credit, Commercial and Standby Credits at §5. 01.

\textsuperscript{310}Supra.

\textsuperscript{311}Quoted supra at p.113; This principle has been adopted in both France, see Stoufflet J., Le Crédit Documentaire, at pp.229-302., and Germany, see Staub, Kommentar zum Handelsgesetzbuch (14th Ed.) (1933) Vol. III p.358.
Industries\textsuperscript{312} seems to hold the same opinion, he said "... it seems to me plain enough that the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods which impose on the banker an absolute obligation to pay..." 

In short, the time in which this theory places the irrevocability of the credit, which is at some time after the credit reaches the beneficiary, prevented it from being applicable to the relationship between the bank and the beneficiary in the world of practice.

\textit{4.2.2.2 The Forbearance Theory}

In an attempt to overcome the defects in the offer and acceptance theory, Ellinger\textsuperscript{313} advanced this theory under which he is endeavouring to prove that the irrevocability of the irrevocable letter of credit can be placed at the time the beneficiary received it, by proving that the beneficiary accepts the letter of credit and consideration moves from him to the issuing bank at that time.

So there are three questions which will be respectively discussed. Firstly, what is the consideration which moves from the beneficiary to the issuing bank, at the time when the irrevocable letter of credit is communicated to him? Secondly, at that time, how does the beneficiary

\textsuperscript{312}[1958] 1 All E.R. 262.

accept the irrevocable letter of credit? Finally, could this theory be the answer to the problem of the beneficiary, issuing bank’s legal relationship?

4.2.2.2[i][f] Consideration

The change of the beneficiary’s position at the time the irrevocable letter of credit is communicated to him, in Professor Ellinger’s view constitutes forbearance, which is good consideration moving from the beneficiary to the issuing bank at that time. His explanation was that, before receiving the irrevocable letter of credit the seller is not bound to the buyer to perform under the sale contract, but he is bound to do so from the moment the irrevocable letter of credit is communicated to him. So the seller forbears from trying to find another buyer for the contracted goods. Moreover, before receiving the irrevocable letter of credit the seller has the right to demand payment from the buyer, but from the moment the credit is communicated to him, he has to demand payment from the banker in the first instance; he is only entitled to demand payment from the buyer in the situation, for example, when the banker becomes bankrupt or declines to pay. So the seller forbears from demanding payment from the buyer.

Professor Ellinger’s first argument which is, that after receiving the

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314 "Documentary Letters of Credit," at p.100.

315 See supra at p.18

316 See supra at pp.20-1.
credit the seller becomes bound to perform the contract of sale and subsequently forbears from trying to find a different buyer for the goods is unpersuasive. It is true that the seller is not bound to begin the performance of the contract of sale until he receives the irrevocable letter of credit, but that does not mean that before receiving the credit he is at liberty to sell the goods to a different buyer and only after receiving it he forbears from doing so. The seller would be in breach of the contract of sale if he did so, either before the designated time in which the credit should be opened, or after the issuance of the credit at that time. The seller is only entitled to sell the goods to a different buyer if the original buyer fails to open the credit before the date agreed upon in the sale contract, which will be regarded as a breach of the contract of sale.317

Looking at it from a different angle, the seller’s forbearance is said to be inferred from his loss of right to negotiate the termination of the sale contract with the buyer,318 that is to say that the seller is forborne from negotiating the discharge of the contract of sale with the buyer in exchange for the issuing bank’s promise to pay, embodied in the issuing of the irrevocable letter of credit. Such forbearance constitutes good consideration, nevertheless, it is clear that when the seller accepts the irrevocable credit he does not lose his right to negotiate with the buyer

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the termination of the sale contract. The issuing bank has no interest whatsoever in whether the seller and the buyer perform the sale contract or agree to terminate it, because it is entitled to its commission from the buyer in either case.

Ellinger's second argument is, that when the seller receives the irrevocable credit he forbears from claiming payment from the buyer. This forbearance, in his view is a consideration moving from the seller to the issuing bank. He puts forward a possible objection against this theory, which is that as it is established that forbearance is not consideration unless the forbearing person has a valid claim or at least he believes that he has a valid claim, the seller under the irrevocable credit has no right to claim payment before he tenders the document to the issuing bank, subsequently there is no valid claim over the price of the goods at that time, so there is no forbearance. Relying on this objection Clarke rejected this theory; he stated:

... it is doubtful whether the seller has any right to claim the price of the goods from the buyer unless and until the bank, the primary obligor, defaults.

Professor Ellinger, however, overcame this objection by examining the

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320 *Bankers' Commercial Credits Among The High Trees*, at p.263.
whole international transaction. He put forward the following convincing illustration.321

Under this transaction the seller would not part with the goods by shipping them unless he has been paid in cash; the buyer, on the other hand, would not part with the money unless he is certain that the goods have been shipped and their documents are in compliance with the terms of the sale contract. Appreciating the buyer’s caution the seller gives up his right to demand payment in cash at the beginning of the shipment period, and accepts a stipulation in the underlying contract to the effect that payment is to be by an irrevocable letter of credit, which should be opened by the buyer at that time.322 So the seller would not be paid at the time when he commenced shipping the goods, which he should be, but he will be paid after he completes the shipment and tenders the documents. This illustration shows that the seller gives the buyer time to pay. That is to say, if the credit is not opened before the shipment period starts the seller would insist on his right to be paid in cash before he ships the goods, but if the credit was communicated to him at that time, he would start shipping the goods and would forbear from claiming payment from the buyer. This forbearance constitutes a good consideration.323

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322 The contract of sale usually provides that the irrevocable letter of credit should be opened before the shipping period commences.

323 Giving the debtor more time to pay constitutes a consideration. In England see *Crowther v. Farrer* (1850) 15 Q.B. 677. In the U.S.A. see *Goodman v. Simonds* 61 U.S. 343; 15 L.Ed. 934; 20 How. Pr. 343 (1857); *Hoffman v. Seth* 207
It is worth adding that even though the seller does not expressly promise to forbear, his actual forbearance would be evidence of an implied promise to forbear.\(^{324}\) Also in cases where an implied promise cannot be inferred, it was held that the actual forbearance constitutes a good consideration.\(^{325}\)

Clarke also rejected this theory on a different ground, which is that the actual forbearance, so as to constitute a consideration, must be induced by the express or implied request of the promisor.\(^{326}\) Here there is no express request from the bank, also looking at the bank’s position there is no reason to believe that the bank has any benefit from the seller’s forbearance to imply such a promise, when it is entitled to its commission from the buyer anyway.\(^{327}\)

This objection, in my view, is not sustainable since it is clear that by sending the irrevocable credit to the seller, the issuing bank induced him


\(^{325}\)In England see Alliance Bank Ltd. v. Broom (1864) 2 Dr. & Sm. 289; Brikom Investments Ltd. v. Carr [1979] Q.B. 467; In the U.S.A. see Mickshaw v. Coca Cola Bottling Co. Inc. of Sharon 166 Pa. Super 148; 70 A. 2d 467; 17 Lab. Cas. (CCH) P65, 557 (1950).

\(^{326}\)In England see Crears v. Hunter (1887) 19 Q.B.D. 341; Alliance Bank v. Broom, supra.; In the U.S.A. see First Nat. Bk. v. Nakdimen 111 Ark. 223, 163 SW 785; Union Trust Co. of Pittsburgh v. Long 309 Pa. 470; 164 A. 346 (1932); Kirkpatrick v. Muirhead 16 Pa. 126.

\(^{327}\)Clarke, Bankers' Commercial Credits Among The High Trees’, at p.263.
not to claim payment from the buyer at the beginning of the shipment period, but to wait until the shipment is completed. So if it was not for the letter of credit that the seller receives, he would not ship the goods unless he gets paid in cash at that time.\(^{328}\) That is to say he would not give the buyer time to pay.

As regards the objection that the bank has no benefit from the seller’s forbearance, it is established that there would be sufficient consideration if the promisee suffers detriment at the promisor’s request to confer a benefit on a third party.\(^{329}\) Applying it to the letter of credit, the seller suffers detriment by forbearing from claiming payment from the buyer in exchange for the issuing bank’s implied request, inferred from the sending of the irrevocable letter of credit to benefit a third party which is the buyer.

4.2.2.2[iii] Acceptance

In the usual practice of commercial letter of credit, as mentioned, there is no express acceptance of it, given by the seller to the issuing bank. What usually happens when the seller receives the credit is either he keeps silent, and in reliance on it, forbears from claiming payment from the buyer, and starts performing the contract of sale, if he is

\(^{328}\)This understanding is inconsistent with Greer J.’s observation in Dexters, Ltd. v. Schenker & Co. quoted supra at p.113.

satisfied with it, or protests against it to either the buyer or the issuing
bank if he is not. This fact seems to render the contract between the
seller and the issuing bank to be unilateral, for which the former’s
forbearance is given as consideration.

In an attempt to place the moment in which the credit becomes
irrevocable as near as it can be to the time when the seller receives it,
Professor Ellinger, having in mind that the contract between the issuing
bank and the seller is a bilateral one, suggested that the seller’s silence
is his acceptance of the issuing bank’s offer.

This suggestion faces the objection that as a general rule the offeree’s
silence does not amount to an acceptance of an offer. Nevertheless,
Professor Ellinger found an escape route in the major exception to
this principle, namely, that silence can amount to an acceptance if the

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330 As regards the problem of the time when the offer under a unilateral contract
is accepted and subsequently becomes irrevocable see supra at pp.121 et. seq.

331 Documentary Letters of Credit, at p.92.

332 In England see Felthouse v. Bindley (1862) 11 C.B. (N.S.) 869. In the
U.S.A. see Beach v. United States 226 U.S. 343; 57 L.Ed 205, 33 S. Ct. 20 (1912);
Bank of Buchanan County v. Continental Nat. Bk. 277 F 385 (8 Cir. 1921); De
Cecchis v. Evers 54 Del. 99, 174 A. 2d 463 (1921). In Scotland see Gloag W.M.
The Law of Contract, at pp.28-29; Walker D.M. Principles of Scottish Private Law,
Vol. 2 at p.18.

333 There are other exceptions such as in the case of actual forbearance, see above
at p.140. Also in the unilateral contract the communication of the acceptance is
usually waived.
circumstances of the case demonstrated it to be so.334

In the case of irrevocable credit, the circumstances which justify regarding the seller’s silence as acceptance, are that, according to the trade usage prevailing in international trade, the seller is not expected to accept the irrevocable credit expressly, also his silence and making no objection is an indication that he intended to demand payment initially from the issuing bank.

The question would be whether a silence can be understood, according to a trade usage, to amount to an acceptance and hence create a contract? To answer this question, it is important to make a brief discussion of the authorities on this point in English, Scottish and American Law.

In England the case of North v. Bassett335 is an important authority on this point. In this case an architect hired a quantity surveyor, who brought an action to recover his fees from the builder. Although there was no direct contact between them, the quantity surveyor relied on the fact that by the trade usage the quantity surveyor was entitled to his fees from the builder. Approving of this usage the Court of Appeal held that there was a contract under which the builder was liable to the quantity surveyor for his fees. A.L. Smith stated that:

334E.g. In England see Roberts v. Hayward (1828) 3 Car. and P. 432; Felthouse v. Bindley, supra. In the U.S.A. see Cole-McIntyre-Norfleet Co. v. Holloway 141 Tenn. 679; 214 S.W. 87 (1919); Hendrickson v. International Harvester Co. 100 Vt. 169, 135 A. 702, 705 (1927); See also Restatement of Contracts (Second) §69. In Scotland see Ballantine v. Stevenson (1881) 8 R. 959; M'Farlane v. Mitchell (1900) 2F. 901.

335[1892] 1 Q.B. 333.
Over and over again have I seen this notorious usage proved, that the builder pays the quantity surveyor and puts the amount of his fees upon the amount of his tender. First of all, the building owner agrees to hand over the money for the quantity surveyor’s fees to the builder, and the builder agrees to hold it for the quantity surveyor, and the latter agrees that he shall hold it. This kind of tripartite agreement is a sensible and convenient one. In my opinion, ... in a case like the present the quantity surveyor can maintain an action for his fees against the builder.336

Also in the case of Helps v. Clayton337 the bride’s father engaged solicitors on her behalf. In the action by the solicitors to recover their fees from the bridegroom, they relied on a usage by which the bridegroom was liable to pay the bride’s solicitors fees; Willes J. observed:

... that usage makes the husband liable to indemnify whosoever on the part of the wife has properly incurred expense by retaining the solicitor to prepare a settlement in the property of which the latter has so large an interest.338

Moreover, according to a trade usage the courts held an agent acting on behalf of an undisclosed principal to be liable as a principal,339 i.e.,

336Ibid at p.336.

337(1864) 17 C.B. (N.S.) 553.


there will be a privity of contract between the agent and whoever the agent is dealing with on behalf of his principal which enables the latter to maintain an action directly against him.

In Scotland, in the case of *Sharrat v. Turnbull*\(^{340}\) goods were sent to a merchant, who alleged that they were ordered by another person. But he did not notify the manufacturer that they had sent him the goods as a purchaser by mistake. In an action by the manufacturer the Court of Session held that the defender's silence amounted to an acceptance of the goods. Lord President Hope said:

> The defender, however, appears to be a person in considerable business for the district or country in which he resides, and must be in the daily habit of receiving goods, and at all events could not fail to see that the invoice was addressed to him, and therefore that he was charged with the contents. Indeed I know that manufacturers often send goods without any order, merely stating that they are such as may be serviceable to the retail dealer and the understanding distinctly is, that if they are not immediately rejected, and notice given to that effect, the party to whom they are sent is held to be the purchaser.\(^{341}\)

Moreover, the same view is to be found in the case of *Thomas Lombe v. Thomas Scott*,\(^{342}\) in this case goods were ordered by a merchant who specified a commission for the sender, which the sender accepted. For certain circumstances the sender had to increase the commission. He sent a letter notifying the merchant of this increase to which the latter

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\(^{340}\)1827 5 S. 361.

\(^{341}\)Ibid. at pp.363-4.

\(^{342}\)1779 M. 5627. See also *Serruys & Co. v. Watt* 12 February 1817 F.C.
made no reply. When the goods arrived the merchant rejected them.

In an action by the sender the Court held:

The decision of this case must depend, ... on the general practice and understanding of merchants in transactions of this sort. When a merchant studying the interests of his correspondent, transmits goods to him without any orders, or contrarily to the precise tenor of his commission, the risk attending this falls upon the sender. If, however, he gives immediate information of his proceedings, it is the duty of the correspondent immediately to notify his dissatisfaction, should the adventure be disagreeable to him. His silence on such an occasion is construed into an approbation of the measures adopted by the sender, which no after contingency will entitle him to retract. A contrary idea would be attended with fatal consequences to trade, by relaxing that punctuality of correspondence which is so necessary among merchants.343

In the United States, in the case of C.M.I. Clothesmakers, Inc. v. A.S.K. Knits, Inc.,344 the plaintiff gave evidence that there was a custom in the textile industry to include arbitration provisions in all their sale contracts and it is the duty of the buyer to make objection to the provisions if he is not satisfied with them. Recognizing this custom the court held that the defendants’ silence amounted to an acceptance of the arbitration provisions.

Also in City Mortgage & Discount Company v. Palatine Insurance

343Ibid. at 5628.

Company the court recognised a local custom according to which fire policies were to be automatically renewed unless cancelled by either party.

This principle is now provided for in the Restatement (Second) of Contracts §222 (3) which reads as follows:

Unless otherwise agreed, a usage of trade in the vocation or trade in which the parties are engaged or a usage of trade of which they know or have reason to know gives meaning to or supplements or qualifies their agreement.

Similar provision is adopted in the Uniform Commercial Code §1-205 (3) which provides:

A course of dealing between parties and any usage of trade in the vocation or trade in which they are engaged or which they are or should be aware give particular meaning to and supplement or qualify terms of an agreement.

Moreover, the Restatement (Second) of Contracts §69 provides

345226 Ala. 179, 145 So. 490 (1933). See also Rose Inn Corp. v. National Union Fire Insurance Co. 258 N.Y. 51; 179 N.E. 256; 83 A.L.R. 293 (1932); T.C. May Co. v. Menzies Shoe Co. 184 NC. 150, 113 S.E. 593 (1922); Wood & Brooks Co. v. Hewitt Lumber Co. 89 W. Va. 254, 109 S.E. 242, 19 A.L.R. 467 (1921); Miller v. Stults 143 Cal. App. 2d. 592, 300 P.2d 312 (1956); Roberts v. Buske 12 Ill. App. 3d 630, 298 N.E. 2d 795 (1973) in this case because there was no previous course of dealing between the parties and there was no evidence of a trade usage the court held that silence does not amount to an acceptance. See also Williston on Contracts, §6:49; Corbin, When Silence gives Consent 29 Yale L.J. 441 (1920); Kessler F. and Gilmore G., Contracts, Cases and Materials (2nd Ed.) at pp.172 et seq.; Jackson J.H. and Bollinger L.C., Contract Law In Modern Society, Cases and Materials (2nd Ed.) at pp.320 et seq.; Fuller L.L. and Elsenberg M.A., Basic Contract Law (4th Ed.) at pp.456 et seq.
1- Where an offeree fails to reply to an offer, his silence and inaction operate as an acceptance in the following cases only:

... (c) where because of previous dealings or otherwise, [otherwise here could be understood to mean a usage of trade] it is reasonable that the offeree should notify the offeror if he does not intend to accept.

The preceding discussion put it beyond doubt that in all of these Law systems where there is a usage of trade according to which there is no need for communication of acceptance, the offeree’s silence would be regarded as an acceptance of the offer.

Finally, it should be noted that the reason for the general rule that silence is not acceptance is mainly for the protection of the offeree from the danger of being bound by a contract unless he makes the effort to reject the offer. Another reason is not to leave the offeror in doubt as to whether his offer has been accepted or not. These reasons do not exist in the case of irrevocable letter of credit because on one hand, when the offeree [seller] agreed with the buyer to be paid by irrevocable letter of credit, this agreement means that he is going to forbear from demanding payment from the buyer. So by regarding the seller’s silence as an acceptance of the offeror’s [issuing bank] offer, the seller would not be bound under this contract [letter of credit] to do more than he intended. Therefore he would not need to be protected. On the other hand, the offeror [issuing bank] would not be in doubt as to whether his offer has been accepted or not, because it knows from the offeree’s [seller] silence, after receiving the irrevocable letter of credit, that he has accepted the offer.
4.2.2.2[iii] Does This Theory Furnish A Solution?

The preceding discussion shows that the forbearance theory makes it possible to put the seller-issuing bank legal relationship in the form of a simple contract. The offer embodied in the issuing of the irrevocable letter of credit is accepted, according to the trade usage, by the seller’s silence, and the seller gives a valid consideration in exchange for the issuing bank’s offer which is the forbearance from demanding payment from the buyer. However, this theory faces two criticisms which render it unsuitable as an answer to this problem.

These criticisms are: firstly, it makes the time in which the seller accepted the issuing bank’s offer dependent upon the facts of each case,\(^{346}\) i.e. in some cases the seller receives the irrevocable letter of credit as soon as it reaches his address. So his silence could be taken as an acceptance and he could be said to have started forbearance, but in other cases it could reach his office after the working hours or he is out of the office during the working hours, or even in the office but does not notice it. In such cases, where the seller does not know about the credit, how could it be said that his silence is acceptance and he has commenced forbearance. Therefore a theory which makes the validity of the irrevocable letter of credit dependent upon the circumstances of each individual case would not be acceptable either in law or in the world of business practice as a solution to the problem. Professor Kozolchyk put his dissatisfaction with this suggestion in these words:

\(^{346}\)Ellinger, *Documentary Letters of Credit*, at p.103.
... the irrevocable credit could only be deemed as established from the moment the silence actually commenced, at best a most uncertain rule.\textsuperscript{347}

Secondly, this theory makes the commencement of the irrevocability of the letter of credit nearer to the time of its communication to the seller, than the offer and acceptance theory does. Under this theory if the seller does not protest against the credit within a short time after receiving it, his silence would be deemed as an acceptance and the credit would be irrevocable. Nevertheless, it shares the same criticism put forward against the offer and acceptance theory, namely, that it places the moment of irrevocability at some time after the credit has been communicated to the seller which is contrary to the law and practice of the irrevocable letter of credit, which determines the moment of the irrevocability to be at the time when the credit reaches the hand of the seller.\textsuperscript{348}

\textbf{4.2.2.3 The Breach Of The Underlying Contract Theory}

In an attempt to place the moment of irrevocability at the time when the irrevocable credit is communicated to the seller, Todd,\textsuperscript{349} suggested that the issuing bank’s revocation of the irrevocable credit at any time after the credit is communicated to the seller could put the buyer in

\textsuperscript{347}\textit{International Encyclopedia of Comparative Law, Letters of Credit} (Vol IX) Chap. 5 at p.137.

\textsuperscript{348}\textit{See supra} at p.33.

\textsuperscript{349}\textit{Sellers and Documentary Credits}, at p.480-1.
breach of his contract with the seller.

It is, however, fair to say that it did not escape the above mentioned author that the seller does not seek a direct action against the buyer, what he seeks is a direct action against the bank. Therefore, he suggested that if the credit is revoked the seller could have a tort action against the bank for inducing breach of the contract of sale which provides for the opening of the irrevocable credit.

Although this suggestion is capable of placing the moment of irrevocability at the time when the seller receives the credit, it creates two other problems namely that the measure of damages in contract would not be the same as in tort. The second problem is that this suggestion does not account for the independent character of the irrevocable credit, because the bank’s liability would depend on the terms of the contract of sale.

4.2.2.4 The Buyer’s Consideration Theory

Mead advanced this theory\(^{350}\) in an attempt to overcome the main obstacle that prevents the seller and the issuing bank from being legally bound under the irrevocable letter of credit by a simple contract in the common law countries, which is the non-existence of a consideration moving from the seller to the issuing bank in exchange for the latter’s undertaking to pay the former under the credit.

\(^{350}\)Mead C.A. Documentary Letters of Credit, at p.302. This theory named ‘Mead’s Theory’ by Professor Ellinger, Documentary Letters of Credit, at p.79.
He suggested that there is a contractual relationship between the seller and the issuing bank with consideration moving to the latter from the buyer, i.e. the promise that the buyer makes to the issuing bank, at the time when applying for the irrevocable credit, which is to reimburse it and pay the commission, is the consideration for the issuing bank’s direct promise to the seller. So according to this theory, the contractual relationship under the irrevocable credit is between the issuing bank as promisor and the seller as promisee with consideration moving from someone other than the promisee which is the buyer.

It should be noted that there is a difference between this situation and the contract for the benefit of a third party. In the latter contract the consideration moves from the promisee but the question is whether the beneficiary who is not the promisee, i.e. he is not a party to the contract, would be able to enforce it. Whereas in the former contract the question is whether the promisee is allowed to enforce a contract where the consideration moves to the promisor not from him but from a third person. So the promisee in this case is a party to the contract unlike in the contract for the benefit of a third party where the beneficiary’s right derives from the contract made for his benefit.

This theory met with approval by some American authors; McCurdy in his conclusion stated:

By the better and more recent view - and the trend of American decision is in this direction - the irrevocable forms of the letter of credit are contracts between the seller as promisee and the bank as promisor with the consideration moving to the promisor from one other than the promisee. These letters of credit confer upon
the seller legal rights against the bank from the moment of issue. 351

This theory is not applicable in England since English courts still follow the settled principle that in order to regard an agreement as a valid contract consideration must move from the promisee. 352 In the case of Dunlop Pneumatic Tyre Co., Ltd. v. Selfridge & Co., 353 Lord Haldane in his judgment stated:

... if a person with whom a contract not under seal has been made is to be able to enforce it consideration must have been given by him to the promisor or to some other person at the promisor's request. 354

The difficulties which English courts face in accepting this theory has no existence in the law of Scotland, since there is no requirement consideration for the validity of a contract. 355 Moreover, the law of

351 Commercial Letters of Credit, at pp.591-2. Finkelstein [Legal Aspects of Commercial Letters of Credit at p.284] holds the same view in support of this theory; he said "The most acceptable view hitherto advanced has been that the letter of credit is a promise by the bank to the seller with consideration moving from the buyer. This approaches the actual intention of the parties more closely than any of the other theories thus far suggested."


354 Ibid. at p.853.

355 See supra at p.55.
the U.S.A. does not make it necessary for the validity of a contract that consideration moves from the promisee,\textsuperscript{356} therefore, this theory could be acceptable in Scotland and in the U.S.A.

Mead and McCurdy cited several cases in support of the argument that the consideration for the issuing bank undertaking, to pay the seller under the irrevocable credit, is the buyer's promise to reimburse the issuing bank and pay the commission.

In the Canadian case of \textit{Sovereign Bank of Canada v. Bellhouse, Dillon & Co. Ltd.}\textsuperscript{357} after an irrevocable letter of credit was received by the seller, the buyer instructed the bank to cancel it. The seller brought an action against the bank. The Court held that the instruction of the buyer to the bank to cancel the irrevocable credit does not justify its cancellation, since the irrevocable credit is a contract only between the bank and the seller, so the buyer as a stranger to the contract cannot lawfully compel the bank to revoke its undertaking. Recognizing the irrevocable letter of credit's contract to be between the seller as promisee and the bank as promisor with consideration moving from the

\textsuperscript{356}Hamilton \textit{v. Hamilton}, 127 App. Div. 871, 112 N.Y. Supp. 10 (1908); Williamson \textit{v. Yager} 91 Ky. 282, 15 S.W. 660 (1891); Bell \textit{v. Sappington}, 111 Ga. 391, 36 S.E. 780 (1900); \textit{Palmer Savings Bank v. Insurance Co. of North America}, 166 Mass. 189, 44 N.E. 211 (1896); \textit{Rector of St. Mark's Church v. Teed}, 120 N.Y. 583, 24 N.E. 1014 (1890); \textit{Van Eman v. Stanchfield}, 10 Minn. 255 (1865); \textit{Cabot v. Haskins}, 3 Pick. (Mass.) 83 (1825). See Williston S., \textit{Contracts for the Benefit of a Third Person}, at p.771; Williston on Contracts, §7:20. Section 71(4) of \textit{The Restatement (second) of Contracts} provides "The performance or return promise may be given to the promisor or to some other person. It may be given by the promisee or by some other person."

\textsuperscript{357}(1911) 23 Q.R. (K.B.) 413.
buyer to the bank, in exchange for its promise to the seller, the court held that no rule of law prevents a person from furnishing consideration in favour of another in order to bind the latter to a third.358

Moreover, in the case of Gelpcke v. Quentell359 the seller received an irrevocable credit issued in his favour by the plaintiff (bank) at the request of the buyer. Subsequently, an instruction was made by the buyer to the bank to revoke the credit which the latter refused to follow. After the bank honoured drafts drawn under the credit, they sought to recover their amount from the buyer. The buyer declined to indemnify the bank who brought an action for payment in which they succeeded. The Court said:

The defendant could not, by his revocation of the credit, escape liability to indemnify the plaintiffs against responsibilities which they had incurred or required them to violate contracts which they had made in pursuance of a letter of credit before notice of the revocation... By the terms of the plaintiff's agreement [the irrevocable credit], which they made on the faith of the defendant's implied promise to indemnify, they were bound to accept the drafts... and look to the defendant for indemnity.360

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358 Professor Ellinger of the view that the judge in this case was referring to the law of the U.S.A. not to the law of Canada, Documentary Letters of Credit at p. 80, Note 22.

359 74 N.Y. 599 (1878). Other cases were discussed by Mead and McCurdy to support this theory such as American Steel Co. v. Irving National Bank 266 Fed. 41 (1920); Frey & Son v. Sherbourne Co. and National City Bank Ltd., (1920) 193 App. Div. 849, 184 N.Y. Supp. 661. However there is no indication in these cases that the consideration for the bank undertaking moves from the buyer, they only said that the irrevocable credit is a contract between the issuing bank and the seller.

360 Ibid.
It is clear from this statement that the court regards the buyer’s promise to reimburse the issuing bank as the consideration for the latter’s promise to pay the seller under the irrevocable credit.

4.2.2.4.1 Does This Theory Furnish A Solution?

Although this theory seems to solve the problem of lack of consideration for the bank undertaking in some common law countries, failed to escape many text writers’ criticisms.

The first objection is that in order to secure the seller’s payment, one of the main purposes of the autonomy principle of the irrevocable credit361 is to make it independent of the opening of the credit contract between the buyer and the issuing bank, so that disputes which may arise between them do not effect the seller-issuing bank relationship under the credit. This theory, by regarding the consideration for the bank’s undertaking to pay the seller, to be the buyer’s promise to the bank to reimburse it and pay commission, has made the link between the two contracts inevitable. In other words, basing the bank’s undertaking towards the seller upon the buyer’s consideration would make it possible for the issuing bank to revoke the credit on the grounds that the consideration given by the buyer had failed, for instance, in the situation, where the buyer becomes insolvent, opens the credit by a fraud362 or

361See supra at p.19 Note 2.

362Thayer, Irrevocable Credits In International Commerce, at p.1040; Finkelstein, Legal Aspects of Commercial Letters of Credit, at p.284; Kozolchyk, Commercial Letters of Credit in the Americas, at p.581; Ellinger, Documentary
where he repudiates his agreement to reimburse the issuing bank.\textsuperscript{363}

McCurdy, in defending the theory, contended that the issuing bank could not raise such a defence against the seller. He referred in supporting the argument to two cases,\textsuperscript{364} but they are irrelevant since neither of them were dealing with the question of failure of consideration.\textsuperscript{365} As a last resort McCurdy justified his contention by placing the risk of the failure of the buyer's consideration onto the issuing bank in exchange for the commission received by it from the buyer; he said:

In order to make the letter irrevocable for all purposes from the moment of issue a better explanation perhaps is that the commission covers the risks of fraud and insolvency of the buyer, and that as a matter of business expediency the risk should be borne legally by the bank. The parties contemplate this result. There is no reason why legal effect should not be given to their intention.\textsuperscript{366}

\textit{Letters of Credit}, at p.80.

\textsuperscript{363}Finkelstein, \textit{Legal Aspects of Commercial Letters of Credit} at p.284.


\textsuperscript{365}See Thayer, \textit{Irrevocable Credits in International Commerce}, at p.1040, Note 41; Ellinger, \textit{Documentary letters of credit}, at pp.80-1.

\textsuperscript{366}\textit{Commercial Letters of Credit}, at pp.580-1. This explanation does not cover Finkelstein's very remote possibility that where the bank mistakenly issued a credit without being requested by the buyer. In this situation there is no consideration at all, subsequently there would not be any commission to cover the bank's risk against failure of consideration. \textit{Legal Aspects of Commercial Letters of Credit}, at p.284.
McCurdy’s argument, that the issuing bank would not be able to repudiate its contract with the seller under the irrevocable credit, for total failure of the consideration given to it by the buyer, is not supported by direct authority. Also the explanation as he gave it, would not make the contract under the irrevocable credit, where the buyer’s promise is to be regarded as the consideration for the bank’s undertaking, an exception to the general rule in the United States, which is that total failure of the consideration given by one party, whether the promisee or a third person, is sufficient ground to discharge the other from his duty under the contracts. Similarly the same rules apply in the law of Scotland. So by concluding that the issuing bank, under this theory, could raise the defences of lack or failure of consideration, which is supposed to have been supplied to it by the buyer, against the seller, would make it inconsistent with the irrevocable letter of credit autonomy principle.

The second obligation is that, as mentioned previously, in England and some American States, which follow the English law as regards to consideration, the promisee is not entitled to enforce a contract if the


368See Thayer, Irrevocable Credits in International Commerce, at p.1040 Note 41.

369Adopting otherwise would mean, as Thayer put it, "to penalize the bank for having accepted consideration from the buyer" Ibid.

consideration moves to the promisor not from the promisee but from a third person. Therefore, explaining the validity of an international trade instrument like the irrevocable letter of credit by a theory which is not acceptable in all of the law jurisdictions is sufficient grounds to reject it.\textsuperscript{371}

The third objection is directed to the time at which this theory determines the irrevocability of the credit. Mead is of the opinion that the irrevocability starts from the time when the credit is issued;\textsuperscript{372} this is, as discussed previously, contrary to the irrevocable credit law, whereby the issuing bank is entitled to revoke the credit at any time before it is received by the seller.\textsuperscript{373} McCurdy on the other hand has the view that the irrevocability begins at the time when the bank mails it to the seller,\textsuperscript{374} this view would put this theory open to the same objection raised against the seller’s offer theory.\textsuperscript{375}

A further objection could be raised against this theory which is that in order for a contract to be binding the promisor’s offer must be accepted

\textsuperscript{371}Thayer, \textit{Irrevocable Credits in International Commerce}, at pp.1039-40; Ellinger, \textit{Documentary Letters of Credit}, at p.81.

\textsuperscript{372}\textit{Documentary Letters of Credit}, at p.303.

\textsuperscript{373}See \textit{supra} at p.33.

\textsuperscript{374}\textit{Commercial Letters of Credit}, at p.575. He said: "If the sales contract is made before the letter of credit is issued, then, if the irrevocable direct or indirect import letter is sent by the bank to the seller the contract is complete with the seller on mailing."

\textsuperscript{375}See \textit{infra} at pp.167-68.
by the promisee. Here there is no acceptance by the seller of the issuing bank's offer, embodied in the issuance of the irrevocable credit. McCurdy contended that the seller accepted the credit in advance, in other words, he accepted it at the time when he agreed with the buyer to be paid by an irrevocable credit.\textsuperscript{376} This contention is not sustainable, since referring to the underlying agreement between the buyer and the seller is contrary to the irrevocable credit autonomy principle.

Lastly, there is a court decision which disagrees with this theory. the Supreme Court of New York in the case of \textit{Lamborn v. National Park Bank of New York}\textsuperscript{377} held that the irrevocable letter of credit is a valid contract between the seller and the issuing bank with consideration moving to the bank from the buyer, Proskauer J.'s explanation was that:

While no consideration flowed to the bank directly from plaintiffs, this letter was issued pursuant to request from, and implied promise of reimbursement and compensation by plaintiff's vendee.\textsuperscript{378}

The Appellate Division, although it upheld the decision of the Supreme Court, disagreed with Proskauer J.'s explanation. Burr J., held that there is a consideration moving directly from the seller to the issuing

\textsuperscript{376}Commercial Letters of Credit, at p.575.

\textsuperscript{377}123 Misc. 211, 204 N.Y.S. 557 (1924), \textit{affirmed} 212 App. Div. 25, 208 N.Y.S. 428 (1925), \textit{affirmed} 240 N.Y. 520, 148 N.E. 664 (1925).

\textsuperscript{378}\textit{Ibid.} at p.559.
bank, which was in this case, his acceptance of a letter of credit of one bank instead of that of two.379

The above discussed objections have, convincingly, rendered the buyer’s consideration theory an unsuitable explanation of the validity of the irrevocable letter of credit.

4.2.2.5 The Seller’s Offer Theory380

Under this theory Thayer381 advanced a radically different approach to solve the problem of the seller’s - issuing bank legal relationship contractually. This theory is unlike the other contractual theories discussed above where the issuing bank is the promisor and the seller is the promisee, Thayer in this theory suggested that under the irrevocable letter of credit contract it is the other way around, the seller is the promisor and the issuing bank is the promisee.

Thayer, by looking at the difference between an international sale where payment is to be in cash and other international sales where payment is to be by irrevocable letter of credit, noticed that under the

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379208 N.Y.S. at p.432. The Court of Appeals of New York affirmed the decision that the irrevocable credit is a contract between the seller and the issuing bank, but made no indication as to what was the consideration for the bank undertaking. See Ellinger, Documentary Letters of Credit, at p.82.

380This name was given to the theory by Davis A.G., The Law Relating to Commercial Letters of Credit. at p.72.

381Irrevocable Credits in International Commerce: Their legal Nature, at pp.1055 et seq.
former sale the seller hands the document of title and other documents concerning the goods, which are the subject of the sale contract, directly to the buyer, while under the latter sale the seller hands the documents to the bank instead of the buyer.

This observation led to the understanding that where there is a stipulation in an international sales contract that payment is to be made by irrevocable letter of credit, the buyer will request a bank to open an irrevocable credit which the bank is very unlikely to undertake to do only in exchange for the buyer's promise to reimburse it and pay a commission, but also it would demand some form of security. It is well understood in practice that the security under the irrevocable credit is not given to the bank by the buyer, but by the seller. This security is the documents which represent the goods and gives full control over them which is given by the seller to the bank to secure its reimbursement and the commission from the buyer.

This analysis shows that the bank undertakes to issue an irrevocable credit in exchange for a promise to be reimbursed, paid a commission and to be given a security. This in Thayer's view means the existence of two separate contracts; the first contract is between the buyer and the issuing bank, who issues the credit in consideration of the buyer's promise to reimburse it and pay its commission; the second contract is between the seller and the issuing bank, the latter's undertaking to pay or honour the seller's drafts is made in consideration of the seller's promise to submit the documents which give the issuing bank control over the goods as security.
So according to this theory, the stipulation in the contract of sale that payment is to be made by irrevocable letter of credit means that the seller has made an offer to submit the documents representing the goods to the bank in exchange for the bank’s undertaking to pay or honour his drafts. Considering that there is no communication between the seller and the issuing bank before the credit is opened, it must be assumed that the seller’s offer is communicated to the bank by the buyer at the time of the arrangement for the opening of the credit. As to the question of at what time the contract between the seller and the issuing bank becomes binding, Thayer is of the opinion that it becomes binding when the bank accepts the seller’s offer, in other words when it issues an

382 Usually there is a condition in the application form to open a documentary credit to the effect that these documents are to be given to the issuing bank as a security for any payment it advances in connection with the credit. This is one of the conditions recommended in the standard forms for documentary credit work, by the International Chamber of Commerce in brochure No. 323, 1978. As an example of this condition in the Request Form to Open a Documentary Credit used by Midland Bank Limited, the condition reads as follows "All documents received by you [the issuing bank] or your agents under any such credit and the goods represented thereby shall be held by you as security for the due payment by us of all moneys due to you by us in respect of credits opened and of the moneys herein before mentioned and all our indebtedness or liability to you from time to time on any account. We agree to assign to you our rights as unpaid sellers to transfer the goods into your control and that until payment by us of such moneys due to you the proceeds of the sales of the goods are to be held as available to you and if received by us shall be paid to you forthwith and until so paid shall be held by us on your behalf."

See also condition No.8 in the Application For Commercial Letter of Credit used by First National City Bank.

This agreement although it is between the buyer and the bank, indicates that there is understanding between the seller and the buyer that the seller is to submit the documents to the bank.
irrevocable credit in favour of the seller.\textsuperscript{383}

\subsection*{4.2.2.5.1 Does This Theory Furnish A Solution?}

This theory overcomes a major objection put forward against the other contractual theories, namely that under this theory there would not be a lapse of time between the issuing of the credit and the acceptance of the offer in which the issuing bank could revoke the credit. Nevertheless, there are other objections raised against this theory.

The first objection is that this theory cannot be applied to ‘\textit{clean credits}’\textsuperscript{384} where there is no requirement for documents to be tendered to the bank by the seller.\textsuperscript{385} In such cases there is no offer made by the seller which the bank accepts by issuing the credit. This objection sounds convincing, nonetheless, it does not seem to have the strength to weaken this theory because it is very rare in practice that an irrevocable letter of credit is issued without the requirement for the documents to be tendered to the bank by the seller.

The second objection was raised against this theory by Davis. The

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{383}Thayer, \textit{Irrevocable Credits in International Commerce}, at p.1057.
\item \textsuperscript{384}Davis, \textit{The Law Relating to Commercial Letters of Credit}, at p.73; Ellinger, \textit{Documentary Letters of Credit}, at p.78. As to the definition of ‘\textit{clean credits}’ see Wunnicke B. and D.B., \textit{Standby Letters of Credit}, at p.86; Dolan J.F., \textit{The Law of Letters of Credit, Commercial and Standby Credit}, at A-33.
\item \textsuperscript{385}Banks may issue such a credit in situations where the documents of title are not needed as a security, for instance where the applicant has put the bank in funds before issuing the irrevocable credit or in the case where the bank trust that the applicant is financially reliable.
\end{itemize}
\end{footnotesize}
objection is that when the seller stipulates in the contract of sale, to be paid by an irrevocable letter of credit, his main concern at the time is to be sure that the price of his goods is going to be paid to him, regardless of who pays it. So normally the seller does not specify the issuing bank; the only requirement that he would insist on is that the irrevocable credit which the buyer is going to procure must be issued by a bank of good repute and integrity. In addition to this fact, under this theory the contract between the bank and the seller is concluded at the moment when the bank accepts the seller’s offer by issuing the credit, accordingly the result would be that as Davis put it "... he [the seller] may be in a legal relationship with a person of whose existence even he may be unaware."386

Thirdly, Thayer did not clarify the way in which the seller’s offer is communicated to the issuing bank. As it is known that there is no direct communication between the seller and the bank before the seller receives the credit, the only possibility would be that the buyer does so on behalf of the seller. It is not clear what the legal position of the buyer is when he acts on behalf of the seller. To assume that Thayer understood the stipulation in the contract of sale, that payment is to be by an irrevocable credit, to mean an authorization by the seller to the buyer to act as his agent in concluding the irrevocable credit contract with the issuing bank387 would render this theory open to the criticism

386Davis, The Law Relating to Commercial Letters of Credit, at p.73.

387See Ellinger Documentary Letters of Credit, at p.77 Note 10.
that was raised against the agency theory.\textsuperscript{388}

Fourthly, by considering the seller as the offeror, Thayer, in his theory, is seeking to avoid the difficulties arising from the seller’s acceptance of the bank’s offer, but it creates a different problem. This theory reads into the contract of sale that there is a promise by the seller to surrender the documents in exchange for the bank’s undertaking to issue an irrevocable credit in his favour. Such a promise would be binding on the part of the seller from the time it is accepted by the bank. The result, however, would be that this theory puts the seller under a contractual obligation to submit the documents to the bank and failing to do so would put him in breach of the contract and subsequently would give the bank the right to bring an action against him for such a breach.\textsuperscript{389} That is not so, because in reality the seller does not give such a promise either expressly or by implication with the intention to be legally bound by it. Moreover, under documentary credit law, the seller’s failure to submit the documents is not a breach of a contract with the bank nor has the bank any right to maintain an action against him for such failure.

Fifthly, Thayer in an attempt to justify his suggestion that the irrevocable letter of credit becomes irrevocable from the moment of its issuance, so from that moment a contract comes into existence between the seller and the issuing bank, said:

\textsuperscript{388}See supra at pp.89 et.seq.

\textsuperscript{389}Ellinger, \textit{Documentary Letters of Credit}, at p.78.
In view of the prior stipulation for the credit by the seller in the contract of sale, it seems fair to say that its communication is completed when it is entrusted by the bank to the post or to the telegraph office, as the case may be.\footnote{Thayer, \textit{Irrevocable Credits in International Commerce: Their legal Nature}, at p.1027, Note 129.}

This argument seems tenable since according to the technical rules of offer and acceptance, where there is an agreement that notice of acceptance is to be made by post, the acceptance will take effect and the contract is completed from the moment the letter of acceptance is posted.\footnote{In England see \textit{Adams v. Linsdell} (1881) 1 B. & Ald. 681; \textit{Potter & Sanders} (1846) 6 Hare, 1; \textit{Dunlop v. Higgens} (1848) 1 H.L.C. 381; \textit{Harris's Case, Re.}, \textit{Imperial Land Co., Marseilles} (1872) L.R. 7 Ch.App. 587; \textit{Household Fire and Carriage Accident Insurance Ltd v. Grant} (1879) 4 Ex.D. 216; \textit{Henthorn v. Fraser} [1892] 2.Ch. 27 at p.33; \textit{Port Sudan Cotton Co. v. Govindasmay Chettiar & Sons} [1977] 2 Lloyd’s L. Rep. 5; see on this point Jacobs E., \textit{Communication of Acceptance} (1983) L.M.C.L.Q. p.663. In the United States see \textit{Tayloe v. Merchants’ Fire Insurance Co. of Baltimore}, 9 How. [50 U.S.] 390, 13 L.Ed. 187 (1850); \textit{Burton v. United States} 202 U.S. 344; 50 L.Ed. 1054; 26 S.Ct 688 (1906); \textit{Shubert Theatrical Co. v. Rath}, 271 F. 827, 20 A.L.R. 846 (C.C.A.N.Y. 1921); See also \textit{United States v. Continental Casualty Co.} 245 F.Supp 871, 873 (1965); \textit{Restatement (Second) of Contracts} §41 (3). In Scotland see Bell, \textit{Commentaries on the law of Scotland} 1, 344.} Nevertheless, the purpose of the irrevocable letter of credit is to guarantee the seller’s payment after parting with the goods, so he naturally would not be expected to ship the goods before receiving the credit. Accepting such a suggestion would lead firstly, to disregarding this fact, putting the seller contractually bound well before receiving the credit and secondly, to some inconvenience to all parties and frustration to the main transaction in the situation where after the letter of credit is put under the control of the post office it is delayed or even fails to
reach the seller.

Professor Ellinger\textsuperscript{392} raised another objection against this theory which is that this theory regards the time when the bank issues the credit as the time when it becomes irrevocable. However that is not in line with the decided cases on this point; they determined the moment of the irrevocability of the credit at the time when the seller receives it.\textsuperscript{393}

The last but not the least important objection against this theory is also raised by Ellinger; he argued rightly, that if the sale contract constitutes the seller’s offer and the letter of credit is deemed to be the bank’s acceptance, the terms of the sale contract will have to be regarded as part of the irrevocable letter of credit, a result that is inconsistent with the autonomy principle of the irrevocable letter of credit.\textsuperscript{394}

The seller’s offer theory was put forward in an attempt to overcome the difficulties that faced the other contractual theories as regards consideration and acceptance; however it is open to so many criticisms that render it far from being suitable to explain the legal relationship between the beneficiary and the issuing bank under the irrevocable letter of credit.

\textsuperscript{392}Documentary Letters of Credit, at p.78.

\textsuperscript{393}Discussed \textit{supra} at p.33.

\textsuperscript{394}Documentary Letters of Credit, at pp.78-9.
4.2.3 Unilateral Promise Theories

In order to avoid the consideration and the acceptance difficulties that faced the contractual theories two attempts were made to establish that the issuing bank binds itself unilaterally to the beneficiary.

4.2.3.1 The Firm Offer Theory

The issuing bank’s irrevocable undertaking was explained\(^{395}\) under this theory to be that, by issuing the irrevocable credit, the issuing bank makes an offer to pay a certain sum of money to the seller when he accepts the offer by tendering the stipulated documents. The issuing bank also promises to keep this offer irrevocable for a stated period of time.

Regarding the irrevocable credit as a firm offer seems to avoid all the artificial technicalities giving a rather simple and straight-forward explanation to the nature of the irrevocable credit which coincides with the intention of all parties.

The existence of the firm offer and examining its suitability as an answer to the legal nature of the irrevocable credit in Scotland, the United States and England will be discussed respectively.

4.2.3.1[1] Scotland

The nature of this offer in Scotland is best explained in the following example. If a person offered to do something and promises to keep this offer open for a period of time, he will be considered, according to Scots law, to have made two unilateral juristic acts; the first is an offer to do something which does not become binding on him until it is accepted by the offeree. The other which is to keep the offer open is a unilateral declaration of will which is binding on the offeror from the time it is communicated to the offeree with no need for the latter’s acceptance.

This obligatory offer is well established in the law of Scotland, in the case of Marshall v. Blackwood\(^{396}\) an offer was promised to be kept open for two weeks. Before the expiry of that period the offeree accepted the offer. The offeror declined the acceptance claiming that he had contracted with another person. On the ground that a promise to keep an offer open for a period of time is a binding obligation, the offeror was held liable for damages.

Moreover, in the case of Littlejohn v. Hadwen\(^{397}\) Lord Fraser stated that:

The defendant is not entitled to withdraw his offer before the expiry of the ten days; that it was an obligation no doubt

\(^{396}\)(1747) Elchies, voce Sale, No.6.

\(^{397}\)(1882) 20 S.L.R. 5.
unilateral, but still binding upon the offeror during the appointed period.

This decision was approved by Viscount Dunedin in *Paterson v. Highland Railway Co.* he said:

I am prepared to say that the opinion of Lord Ordinary Fraser, expressed in the now old case of *Littlejohn v. Hadwen* in which I was counsel many years ago, is right, i.e. If I offer my property to a certain person at a certain price, and go on to say: ‘this offer is to be open up to a certain date’, I cannot withdraw that offer before that date, if the person to whom I made the offer chooses to accept it.

Also Bell explained the principle in these terms:

If a time be limited for acceptance, the offer is held to subsist, and not to be revocable during that time, and to be withdrawn by the expiration of that time without acceptance.

Keeping the offer open for a period of time is a binding promise on the promisor with no requirement for the promisee’s acceptance. It becomes irrevocable from the time it is communicated to the promisee by the promisor. Unlike other law systems the law of Scotland

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398 1927 S.C. (H.L.) 32.


402 *Duguid v. Caddall’s Trs.* (1831) 9 S. 844; *Smeaton v. St.Andrews Police Commrs.*, *supra*; *Shaw v. Muir’s Exrx.* (1892) 19 R. 997; *Denny’s Trs. v.*
requires no consideration or cause for concluding an obligation; thus this promise is independent and obligatory by itself.

The interpretation of the irrevocable letter of credit in Scots law as an offer held open seems to be able to overcome satisfactorily the difficulties concerning the seller-issuing bank legal relationship. The issuance of the irrevocable credit constitutes an absolute promise by the issuing bank to keep the offer to pay open for a definite period of time, and to pay the seller when he accepts the offer by tendering the stipulated documents within that time. Such a promise is entirely independent of any underlying agreements. It confers on the seller a direct right against the bank from the time he receives the credit. The issuing bank is not entitled to revoke the credit from the time it is communicated to the seller until its expiry date, with no need for an acceptance on the part of the seller.

It is clear from the discussion above that this theory gave the most convincing explanation to the seller-issuing bank legal relationship, nonetheless, there are a few difficulties to be taken into consideration.

There is a slight difference between the rules of the irrevocable credit and the offer held open, namely, that Professor Kozolchyk interpreted the U.C.P. Art. 10(a) "An irrevocable credit constitutes a definite undertaking of the issuing bank, provided that... the terms and conditions

\[^{403}\text{Smith T., A Short Commentary on the Law of Scotland, at p.742. See supra at p.55.}\]
of the credit are complied with" to mean that even if the beneficiary rejected the irrevocable credit, but later presented to the bank documents in compliance with its terms and conditions, he will be entitled to payment.\textsuperscript{404} However, the rejection of the offer held open terminates its irrevocability.\textsuperscript{405} Corbin, disagreeing with this rule, put forward an interesting argument; he said:

This effect should not be given to a rejection, if it is contrary to the offeror's own expressed intention and desire. In making an offer, the offeror has control of its terms and the time and mode of acceptance; he can create such a power of acceptance as he pleases. The rule that a rejection terminates power is solely for the protection of the offeror; and there seems to be no sufficient reason for terminating the power of acceptance against his will.\textsuperscript{406}

The main difficulty, which could render this theory an unsuitable explanation to the nature of the irrevocable credit in Scotland is that, as mentioned previously, Scots law requires no cause or consideration for a promise to be binding on the promisor, nevertheless, if the promise is based upon consideration and this consideration subsequently failed, the promisor would be discharged of his obligation and money paid under the promise is recoverable by the promisor. Gloag, in this respect,

\textsuperscript{404}International Encyclopedia of Comparative Law, Letters of Credit, Vol. IX. Chap. 5, at p.136, Note 792.


\textsuperscript{406}Corbin on Contracts, at §94. The option contract in the United States does not become revocable if it is rejected by the offeree. See Restatement (Second) of Contracts §37. See also E.A. Farnsworth, Contracts, at pp.174-5.
said:

...it is the rule of the Law of Scotland that consideration is not essential to contractual obligation, yet if the original intent of the contract was that a gift or payment was made in view of something which was to be given or done in return for it, and that consideration fails, money which has been paid may be recovered...407

Similarly Smith stated:

Scots Law does not require "consideration" as a badge of concluded obligation. Nor again, as in certain other systems, is there now in Scotland any doctrine of "cause" in the sense of causa civlis or causa praeter conventionem by which the actionability of agreements must first be tested. On the other hand "consideration" or causa is used in Scots Law to designate causa naturalis i.e. the cause or reason for granting an obligation. Simulated causa or some illegality of causa or consideration may thus be resolutive of an obligation ... Again when the contemplated object has failed, the resulting situation of unjustified enrichment is redressed...408

Of course the issuing bank makes his promise to the seller in the view that it will be reimbursed and paid commission by the buyer. If that is the case, in the situation where the buyer becomes bankrupt or his contract with the bank becomes frustrated or the buyer opened the credit by fraud, the issuing bank would be entitled to revoke the credit, and if it had paid the seller under the credit it would be entitled to recover the money. That would be very unsatisfactory and defeating the main


408A Short Commentary on the Law of Scotland, at pp.742-3.
object of the irrevocable letter of credit.

4.2.3. [ii] The U.S.A

As a common law country the U.S.A. law generally considers any offer to be revocable by the offeror, even if he promised not to revoke it, unless it was under seal or supported by consideration.\(^{409}\) However, *The Restatement Second of Contracts* made it possible for an offer to be made irrevocable in certain circumstances even if there was no consideration,\(^{410}\) but the Uniform Commercial Code went further to give a merchant the right to make an irrevocable offer, omitting the necessity of consideration, provided that the promise to keep the offer open is in a written statement which is signed by the promisor. \(\S\ 2-205\) reads as follows:

An offer by a merchant to buy or sell goods in a signed writing which by its terms give assurance that it will be held open is not revocable, for lack of consideration, during the time stated or if no time is stated for a reasonable time, but in no event may such period of irrevocability exceed three months; but any such term of assurance on a form supplied by the offeree must be separately signed by the offeror.

Although this provision permits a person to be unilaterally bound by

\(^{409}\)*Hill v. Corbett*, 33 Wash. 2d. 219, 204, P. 2d 845 (1949); *Moffett, Hodgkins & Clarke Co. v. Rochester*, 178 US 373; 44 L.Ed. 1108; 20 S.Ct. 957 (1900); *Collins v. Morgan Grain Co*, 16 F 2d 253 (CCA 9).

\(^{410}\)§87 (2) provides that: "An offer which the offeror should reasonably expect to induce action or forbearance of a substantial character on the part of the offeree before acceptance and which does induce such action or forbearance is binding as an option contract to the extent necessary to avoid injustice."
his promise to keep the offer open, explaining the irrevocability of the issuing bank’s promise according to this provision would encounter two conceivable objections; firstly the provision made the maximum period of time in which the offer can be irrevocable to be three months; thus the offeror will be entitled to revoke his offer after such period expired even if the offeror’s written promise expressly stated that the offer will be held open for a longer period. So the question is, what would the seller’s position be if the credit period exceeded the three months limit and the issuing bank revoked it after the three month period had expired?

The second and major objection is that according to this provision a firm offer can only be made to sell or buy goods. As the purpose of the issuing bank’s irrevocable offer to the seller is not to buy or to sell, it is doubtful whether this provision is entirely applicable to the issuing bank’s promise under the irrevocable credit.

4.2.3.1[iii] England

This theory is not applicable in England because the firm offer has no place in that jurisdiction. The general rule there, is that an offer which is not supported by consideration or not made under seal can be revoked by the offeror at any time before it has been accepted even if he promised to keep it open for a period of time. In Routledge v. Grant411 the defendant offered to buy the plaintiff’s house. The former gave the latter six weeks to accept the offer. It was held that the

411(1828) 4 Bing. 653. See also Cooke v. Oxley (1790) 3 T.R. 653.
defendant was entitled to revoke his offer at any time before it is accepted even if the six weeks period had not expired.

Moreover, in the case of *Dickinson v. Dodds*\(^{412}\) the defendant offered to sell his house to the plaintiff. The defendant promised to keep this offer open until Friday. The Court held that the defendant was free to withdraw his offer before Friday. James L.J., in this case said:

> It is clear settled law, on one of the clearest principles of law, that the promise being a mere *nudum pactum*, was not binding, and that at any moment before a complete acceptance by Dickinson of the offer Dodds was as free as Dickinson himself.

The Law Revision Committee criticising this general rule recommended that the present law on this point should be reformed.\(^{413}\)

### 4.2.3.2 The Abstract Promise Theory

Under this theory a rather straight-forward and realistic approach was put forward to explain the nature of the issuing bank's irrevocable undertaking. This theory regards the sending of the irrevocable credit by the issuing bank to the seller as being a unilateral promise binding only on the issuing bank. This promise, according to this theory, becomes irrevocable from the moment it is communicated to the seller.

\(^{412}\) (1876) 2 Ch. D. 463.

\(^{413}\) 6th Interim Report, Cmd 5449 (1937) para. 38. See also Law Commission Working Paper, No. 60 (1975).
with no requirement for the seller’s acceptance. It also secures the autonomy of the irrevocable credit because such promise is independent of its cause.

This simple explanation does not only reflect exactly the intention of all parties of the irrevocable credit but it is also consistent with its legal consequences.

In the following pages there will be a brief discussion of the availability of such a promise and to what extent would it be suitable to explain the nature of the irrevocable credit in Germany, France and Scotland.414

4.2.3.2[if] Germany

The wider acceptable explanation of the nature of the irrevocable credit in Germany takes into account the two sides of the transaction; the relationship between the issuing bank and the buyer on one hand and the relationship between the issuing bank and the seller on the other; according to this theory the former relationship constitutes a contract for performance and reimbursement plus commission.415 This contract is permitted to be cancelled unless the right of cancellation is

414In England and the United States a promise without consideration is not enforceable.

415Werkvertrag plus a Geschäftsbesorgung. See BGB, para. 675; Thayer, Irrevocable Credits in International Commerce, at p.1051 Note 106.
renounced.\textsuperscript{416} In as far as the relationship between the buyer and the issuing bank is concerned the buyer's application to open an irrevocable credit is deemed to amount to a renunciation of such right,\textsuperscript{417} and subsequently the buyer would not be entitled to instruct the issuing bank to revoke the credit.

As regards the relationship between the issuing bank and the seller, this theory considered the issuance of the irrevocable credit by the issuing bank to be an \textit{abstraktes schuldversprecher}, i.e., an abstract promise.\textsuperscript{418} The theory derives support for such a promise to be binding on the promisor from BGB, paragraph 780.\textsuperscript{419} Chung Hui

\textsuperscript{416}BGB para. 649; 1 Warneyer, \textit{Kommentar zum Buergerliches Gesetzbuch, Fur Das Deutsche Reich} (2d ed.) (1930) at p.1166.


Wang’s translation of this paragraph reads as follows:

For the validity of a contract whereby an act of performance is promised in such manner that the promise itself is to create the obligation (i.e., a promise of debt), a written statement of the promise is necessary unless some other form is prescribed.421

This promise is binding on the promisor from the moment of its communication to the promisee.422 The promisee’s acceptance is not required for the validity of the promise.423 The promise is obligatory by itself, independently of the underlying cause.424 Like the offer held open in Scotland the rule of the abstract promise in Germany seems to coincide with the rules of the irrevocable letter of credit.425

This theory encounters a similar difficulty that faced the offer held open theory, namely, that in German law the non-existence or the failure of the cause renders the acquired performance under the promise to be

420The German Civil Code, at p.170; see also Ellinger, Documentary Letters of Credit at p.72 Note 146. For a similar translation see Forrester, I.S., Goren, S.I., and Iligen, H., The German Civil Code at p.127.

421The issuance of the irrevocable letter of credit is always in writing. See Wolff, Das Akkreditiv, Juristische Wochenschrift, at p.773.

422BGB-RGRK, Vol. II part 4 §780 IV-2; Krebs, Das Akkreditivgeschaeft, at pp.33-4.

423BGB-RGRK, §781,3,a; Krebs, Das Akkreditivgeschaeft, at p.33; Ellinger, Documentary Letters of Credit at p.72.

424BGB para. 780; BGB-RGRK, §780; Staudinger J.V., Kommentar zum Büergerlichem Gesetzbuch, (11th ed.)(1960) at pp.2592 et seq.

425The German courts support the theory in the following cases, RGZ 106 304 at p.307; RGZ 107 7 at p.9; RGZ 144 133 at pp.134-5; BGHZ 28 129.
unjust enrichment. Paragraph 812 of the BGB\textsuperscript{426} which is translated by Chung Hui Wang\textsuperscript{427} reads as follows:

(1) A person who, through an act performed by another, or in any other manner, acquires something at the expense of the latter without ground, is bound to return it to him. He is so bound even if a legal ground originally existing disappears subsequently, or a result originally intended to be produced by an act of performance done by virtue of a juristic act is not produced.

(2) Recognition of the existence or non-existence of a debt, if made under a contract, is also deemed to be an act of performance.

This paragraph would enable the issuing bank to avoid liability under the irrevocable letter of credit.\textsuperscript{428} It is worth mentioning what constitutes the legal ground or the cause for the issuing bank’s undertaking, failure of which could be used as a defence by the issuing bank against the seller to avoid liability under the irrevocable credit. The German text writers are not in agreement in this regard; in Sieckmann’s view the contract of sale between the buyer and the seller

\textsuperscript{426}The paragraph stated "Wer durch die Leistung eines anderen oder in sonstiger Weise auf dessen Kosten etwas ohne rechtlichen Grund erlangt, ist ihm zur Herausgabe verpflichtet. Diese Verpflichtung besteht auch dann, wenn der rechtliche Grund später wegfällt oder der mit einer Leistung nach dem Inhalte des Rechtsgeschäfts bezweckte Erfolg nicht eintritt. Als Leistung gilt auch die durch Vertrag erfolgte Anerkennung des Bestehens oder des Nichtbestehens eines Schuldverhältnisses."

\textsuperscript{427}\textit{The German Civil Code}, at pp.177-8. For a similar translation see Forrester, I.S., Goren, S.L., and Ilgen, H., \textit{The German Civil Code} at pp.132-3.

\textsuperscript{428}Sieckmann, \textit{Das Akkreditiv}, at p.38; Wiele, \textit{Das Dokumenter-Akkreditiv und des Anglo-Amerikanische Documentary Letter of Credit}, at p.58.
is the cause, whereas Reichardt regards the cause for the bank undertaking to be both the credit contract between the issuing bank and the buyer and the contract of sale between the buyer and the seller. However, whatever the cause maybe, it is questionable whether the theory is satisfactory if the issuing bank could use this paragraph to revoke its abstract promise, contained in the irrevocable credit, in the situation where the cause for the undertaking has failed i.e., the buyer becomes insolvent or declines to reimburse the issuing bank or the contract of sale becomes frustrated.

However, paragraph 812 of the BGB, in Zahn’s opinion is of no assistance to the issuing bank to revoke the credit. He pointed out that only a party to the underlying cause is allowed, if it failed, to rely on the paragraph to revoke his abstract promise. So if the abstract promise is made by a third person who is a stranger to the underlying cause, which is the case in the irrevocable letter of credit, he would not be entitled, if the cause failed, to rely upon the paragraph to revoke his abstract promise. Zahn explains:

It has therefore been decided by the Reichsgericht that an

\[429\] Das Akkreditiv, at p.38. See also Frost, Das Dokumentenakkreditiv Und der Letter of Credit, unpublished dissertation, Cologne, (1948) at pp.45-8.


\[431\] Zahlung und Zahlungssicherung im Aussenhandel, at p.57.

\[432\] Zahn cited RGZ 119 332 and RGZ 163 34. Although neither case was concerned with documentary credit they both supported his view. See Ellinger,
abstract promise which has been given by a third party (say, a banker) to one party to a contract (say, a seller) in pursuance of an order of the other party to the underlying transaction (say, a buyer), cannot be revoked by the third party (say, a banker) upon the failure of the underlying contract. The party to the contract who gave the order (the buyer) [would have to raise the plea of para. 812 BGB against the other party to the underlying contract i.e. the seller.]

Although Zahn did not put into consideration that the underlying cause could be the contract to open the irrevocable credit between the bank and the buyer, his explanation seems to be perfectly in line with the intention of all parties of the irrevocable credit. Moreover, in the view of the German law permitting the promisor, in the case of an abstract promise given to a third party, to waive defences arising from the underlying cause, Ellinger, supporting Zahn’s view, argued that there is no reason not to give effect to the intention of all the parties to the irrevocable credit which is that the issuing bank is not entitled to raise against the seller any defences derived from its contract with the buyer or the contract of sale.

In conclusion it can be said that if the above argument was accepted the abstract promise theory would furnish an adequate solution to the

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Documentary Letters of Credit, at p.74, note 158.

433Translated by Ellinger, Documentary Letters of Credit, at p.74.

434Staudinger, Kommentar zum Bürgerlichen Gesetzbuch, at p.2603 Ann 33-34; RGZ 71 187.

435Loc. cit.
problem of the irrevocable letter of credit in Germany.

4.2.3.2[iii] France

The theory was introduced in France by Chevalier,436 who suggested that the issuing bank’s undertaking can be classified as an abstract promise. This view derives support from a principle in French law which gives a person the right to bind himself unilaterally by an abstract promise437 which is independent of its cause.438

Nevertheless, the French law does not dispense with the necessity for a cause for any agreement to be legally valid. The translation439 of article 1131 of the Civil Code reads as follows "An obligation without cause, or with a wrongful or illicit cause can have no effect."440

So the effect of the abstract promise in France is only to presume that there is adequate cause for the undertaking,441 but the issuing bank can

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437Article 1132 of the Code Civil stated "La convention n'est pas moins valuable, quoique la cause n'en soit pas exprimée" which means that the agreement is not made less valid by the fact that the cause is not expressed.

438Thayer, Irrevocable Credits in International Commerce, at p.1048.


440The article stated "L'obligation sans cause, ou sur une fausse cause, ou sur une cause illicite, ne peut avoir aucun effet."

441See Thayer, Irrevocable Credits in International Commerce, at p.1048, note 92.
rely on this article to revoke the credit by proving that there is no cause for its undertaking or the cause has failed. That would certainly render the theory an unacceptable explanation to the irrevocable credit in France.

4.2.3.2[iii] Scotland

The absence of the doctrine of consideration from the law of Scotland has led to the establishment of a general rule that the intention of a person to bind himself by an enforceable obligation and expressing such intention clearly, is the only requirement for such undertaking to be lawfully enforceable by whomsoever such an undertaking is promised,442 regardless of whether the promisee gave anything in exchange or not.

This broad principle of obligation made it possible for the development of what is known in Scots Law as the unilateral voluntary obligation,443 under which a person would be bound unilaterally by his promise. According to Bell:

Unilateral obligation may be either gratuitous or for valuable

442 Morton's Trs. v. Aged Christian Friend Society, (1899) 2F. 82, Per Lord Kinnear at p.85; M'Gibbon v. M'Gibbon, (1852) 14 D. 605; Law v. Humphrey, (1876) 3 R. 1192; Paterson v. Paterson (1893) 20 R. 484; See also Stair, The Institutions of the Law of Scotland, i. 10, 7; Bell's Principles of the Law of Scotland, §§8, 64.

443 It should be noted that there is a distinction between a unilateral contract and a unilateral promise, while the former is an offer which becomes later a mutual agreement the latter is unilaterally obligatory by itself.
consideration. It is not necessary that an obligation shall proceed upon a valuable consideration, adequate or inadequate. It is effectual if an engagement be proved by such evidence as law requires in the special case.\textsuperscript{444}

The above discussion shows that the abstract promise is well established in the law of Scotland, but, as the obligation to keep the offer open itself is a unilateral voluntary obligation (\textit{pollicitatio}) the same rules which govern the former, and which were mentioned previously, apply to the latter,\textsuperscript{445} so interpreting the irrevocable credit as a \textit{pollicitatio} would mean that the same objection directed against the offer held open theory would be directed against this theory.\textsuperscript{446}

\textsuperscript{444}Bell's Principles of the Law of Scotland, at §63. See also Gloag and Henderson, Introduction to the Law of Scotland, at p.55.

\textsuperscript{445}The only distinction is that under the offer held open a bilateral contract would emerge when the offeree (the seller) accepts the offer by tendering the documents. So the acceptance of the offeree is a necessary condition of the constitution of the obligation to pay. Whereas under the \textit{pollicitatio} the acceptance of the offeree if it is demanded (e.g. tendering certain documents) would only be a necessary condition for the enforcement of the obligation. That is to say, the fulfilment of that condition does not change the juristic act from being an obligatory unilateral promise to a bilateral contract.

\textsuperscript{446}See infra at pp.173-4.
4.2.4 Mercantile Speciality Theory

The last theory is an attempt to solve the issuing bank-beneficiary legal relationship by avoiding the main defect in all the previous theories, namely, the distortion of the nature of the relationship by trying to fit it within a well established principle of the law. This theory advocates the acceptance of the nature of the relationship between the two parties as it is, basing its legal validity on a general mercantile usage.

4.2.4.1 The Mercantile Usage Theory

The importance of the exact determination of the moment of irrevocability, the feature of being binding without cause or consideration, or for the beneficiary acceptance, the abstract character of the issuing bank’s obligation to the beneficiary, the formality and the literal interpretation of the credit’s terms; these features confer on the irrevocable letter of credit a unique nature, which is peculiar to itself; thus although it is similar to the *jus quae situm tertio*, agency, suretyship and the firm offer, and despite of its partaking some of its features from the contractual relationship it is impossible to fit it under these categories without either distortion of the irrevocable credit’s nature or modifying the existing institutions. In this regard Bankes L.J., in *Donald H. Scott & Co. Ltd. v. Barclay’s Bank Ltd.*447 said:

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The large and important part which letters of credit play in modern commerce restrains me from expressing my opinion on many of the points argued. The system should be kept as free as possible from technicalities, and from unnecessary judicial dicta which may embarrass business dealing in future.\textsuperscript{448}

Also in \textit{New Zealand Shipping Co. Ltd. v. A. M. Satterthwaite & Co. Ltd.}, \textit{(The Eurymedon)}\textsuperscript{449} although the case is not concerned with documentary credit, there is a \textit{dictum} supporting the argument that irrevocable letters of credit should be recognized as a mercantile speciality, Lord Wilberforce said:

The whole contract is of a commercial character, involving service on one side, rates of payment on the other, and qualifying stipulations as to both. The relations of all parties to each other are commercial relations entered into for business reasons of ultimate profit... It is only the precise analysis of this complex of relations into the classical offer and acceptance, with identifiable consideration, that seems to present difficulty, but this same difficulty exists in many situations of daily life, e.g. ...bankers' commercial credits. These are all examples which show that English law, having committed itself to a rather technical and schematic doctrine of contract, in application takes a practical approach, often at the cost of forcing the facts to fit uneasily into the marked slots of offer, acceptance and consideration.\textsuperscript{450}

Many authors also believe that the legal nature of the irrevocable letter of credit should be recognized by the courts as a mercantile speciality which has been established by trade usage all over the world. In

\textsuperscript{448}Ibid. at p.10.


\textsuperscript{450}Ibid. at p.167.
practice the understanding of the issuing banks is that, by issuing the irrevocable credit they create on themselves a binding obligation towards the beneficiary, and the latter, sharing the same understanding, relies on the bank’s undertaking. So there seems to be no reason why effect should not be given to such understanding.

Hershey is one of the earliest authors who is in favour of this theory, he said:

...all the requirements of the situation are met, and on the whole are better met, by treating the letter of credit as a self-sufficing instrument of the law merchant. In the end nothing will do so well as a frank and full recognition by law of the universal understanding of the commercial world.451

Finkelstein, who also shares the same opinion came to the conclusion that452:

To view the irrevocable commercial letter of credit as a mercantile speciality of a new type, most clearly, simply, and satisfactorily explains the rights of the parties, harmonizes the decisions of the past, and makes more dependable the future development of the law, thus enabling both banker and merchant to proceed with their activities with confidence and assurance. The theory that the irrevocable letter of credit is a mercantile speciality has now for some time been acted upon and has been functionally adopted. The ability of the law to develop with the needs of commerce has not yet disappeared, and with the growing consciousness on the part of the courts of the true status of the commercial credit, its formal recognition as a mercantile speciality cannot long be

451Letters of Credit, at p.38.

452Legal Aspects of Commercial Letters of Credit, at pp.294-5. Ellinger also favours this theory, Documentary Letters of Credit, at p.122.
Trimble\textsuperscript{454} disagrees with these writers’; his view is that there is no need now for the recognition of the irrevocable credit as a mercantile speciality because letters of credit have been known for centuries and have been governed throughout their history by the law merchant. He explained his view in these terms:

The argument for regarding the irrevocable credit as a mercantile speciality is that the promise of the bank to the seller is binding because it is so considered by the business world and because it is couched in a form recognized by the customs of merchants,\textsuperscript{455} presumably, their present customs. It is submitted that such grounds for disregarding common law rules of contract in enforcing mercantile letters of credit are two centuries too late, and that a letter of credit is a "mercantile specialty" ...because it is governed, and throughout its history has always been governed by the law of merchant and has always been enforced by the common law courts in accordance with the basic principles of the law merchant. Hence, the problems of consideration and irrevocability that still bother our text writers and some of our courts would seem to be, in reality, nonexistent in the law.\textsuperscript{456}

From the letter of credit’s definition that Trimble used, he seems to be describing the open letter of credit and not the modern documentary

\textsuperscript{453}Footnotes of the quoted text omitted. This theory is also favoured by Dighe, \textit{Mercantile Specialty: A Theory by which to Enforce Letters of Credit under the Commercial Law}, at p.225; Cheang, \textit{"Irrevocable" Credits and the Law}, at p.lxiv.

\textsuperscript{454}\textit{The Law Merchant and the Letter of Credit}, (1948) 61 Harv. L.R. 981.

\textsuperscript{455}Discussing Thayer’s analysis.

\textsuperscript{456}\textit{Ibid}, at p.1002.
credit. The definition he used was that:

A legally enforceable letter of credit might be defined as a written document... whereby the writer (issuer), expressly or impliedly, requests some other person or persons to pay money, or to establish a credit available to a third person (beneficiary) ...and whereby the issuer, expressly or impliedly, promises to repay to the payer the amount paid by him to the beneficiary... 457

Trimble adopted Story's definition of open letter of credit. 458 In this transaction the bank at the request of the customer issues a letter of credit in favour of the customer himself. The promise contained in this letter is that the bank will reimburse people who pay money to the customer. So the customer who is the beneficiary has a direct contractual right against the bank. 459 However, in the modern documentary credit the bank at the request of the buyer issues a letter of credit in favour of the seller, who is a third person. The bank promises in it to pay or accept drafts drawn under it by the seller if he tenders certain documents. So this documentary credit cannot be fitted within the definition that Trimble adopted. He also, talking about the modern documentary credit, said "The term is also used loosely to mean a written communication by a bank to a person that a credit has been


459 Ellinger, Documentary Letters of Credit, at p.107.
established with the bank against which he may draw.\textsuperscript{460} In short his argument does not cover [as he put it] what is bothering the text writers and the courts, i.e., the modern irrevocable documentary credit.

However, two objections were put forward in an attempt to invalidate this theory: that the form of the irrevocable credit has not reached a sufficient degree of uniformity to be considered as a mercantile specialty and the problem of lack of consideration. As regards the first objection McCurdy in 1922, contrasting letter of credit with bills of exchange, argued:

\ldots these letters have not reached that point of uniformity that bills of exchange and promissory notes have attained. There are many types, some of which are considered in the business world as creating binding obligations upon issue, and others of which are looked upon as revocable at will. If business ideas on the subject are not uniform, judicial ideas are chaotic. Moreover, letters of credit vary in formality from telegraphic communication and simple memoranda to letters written in ordinary epistolary form. There is considerable variation in the forms and in the transaction which gives rise to the letter. For an instrument to be a specialty it must have reached a high degree of formality.\textsuperscript{461}

In the wake of the large increase of the use of irrevocable credit since McCurdy wrote his article Finkelstein, in 1930, argued that although letters of credit would never be as uniform as bills of exchange, there is no need for the irrevocable credit to reach such uniformity, the only

\textsuperscript{460}Trimble, The Law Merchant and the Letter of Credit, at p.1005.

requirement is that letters of credit should contain similar conditions which confer on them the characteristics of the irrevocable credit and make them easily recognized as such. This degree of uniformity, at that time, in Finkelstein’s opinion had been reached.462

As a result of the issuance of the first edition of the *Uniform Customs and Practice for Documentary Credit* by the Chamber of Commerce in 1933 Thayer, writing in 1936, referring to this objection, stated "This difficulty does not appear to be insuperable. Its (the irrevocable letter of credit) basic characteristics remain unchanged and are well understood commercially."463 After the U.C.P. revision was issued in 1951,464 Bartholomew, writing in 1959, shared the same opinion with Thayer; he argued that the irrevocable credit in its form today was known to the courts as early as 1871.465 In an answer to McCurdy’s argument, quoted above, Bartholomew stated rightly, that the common law courts recognized the commercial customs as regards cheques and bills of exchange in the seventeenth century which is a long time before they

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462 *Legal Aspects of Commercial Letters of Credit*, at pp.293-4.

463 *Irrevocable Credits in International Commerce: Their Legal Nature*, at p.1041, Note 46.

464 The U.C.P. has been revised since then in 1962, 1974 and 1983. See *supra* at p.10.

became as uniform as they are today.466

It is appropriate therefore to say, that after banks adopted the International Chamber of Commerce recommended standard form for documentary credit which was published in 1978 in brochure No.323 and revised in 1986 in brochure No.416, that this objection is not valid in the 1990's.

It should finally be noted that although at the present time, the forms and conditions of the irrevocable credit are uniform there is lack of uniformity in the interpretation of the description of the documents which the beneficiary should present when he demands payment. Efforts were made to make such interpretation as unified as possible in practice.

Lord Sumner in Equitable Trust Co. of New York v. Dawson Partners Ltd.467 said "there is no room for documents which are almost the same or which will do just as well."468 Also in English, Scottish and Australian Bank Ltd. v. Bank of South Africa,469 Bailhache J. stated:

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

466Ibid. at p.104. In support of the argument he cited Holden, History of Negotiable Instruments in English Law (1955).

467(1927) 27 Li.L.Rep. 49 (H.L.).

468Ibid. at p.52.

469(1922) 13 Li.L.Rep. 21.
entitled to honour drafts presented to it under a letter of credit unless those drafts with the accompanying documents are in strict accord with the credit as opened.\(^470\)

The problem, however, appears to remain unsolved because it is very difficult to determine to what degree the strict compliance with the terms of the irrevocable credit should be. Nevertheless, the variation of business practice on this point is not sufficient ground to suggest that the irrevocable credit has not reached the degree of uniformity required to recognize it as self-sufficing instruments of the law merchant.\(^471\)

The second objection which is that the recognition of the irrevocable credit as a mercantile speciality would mean the abolition of the common law principle that consideration is necessary for a promise to be binding, constitutes the major objection to this theory. McCurdy, in this regard, stated: "...even if a letter of credit be recognized as a mercantile specialty it does not follow that consideration is unnecessary."\(^472\)

Thayer, while in agreement with McCurdy, argued that even if the recognition of the irrevocable credit as a mercantile speciality implies that consideration for the bank undertaking is presumed, such presumption is not conclusive, its effect is only to shift the burden of proving the non-existence of consideration for the promise contained in

\(^{470}\)Ibid. at p.24.

\(^{471}\)Bartholomew, Relations Between Banker and Seller Under Irrevocable Letters of Credit, at p.105.

\(^{472}\)Commercial Letters of Credit, at p.565.
the credit onto the bank. So that would allow the issuing bank to avoid liability, if it so wishes, by proving that there is no consideration for its promise. This result is inconsistent with the nature of the irrevocable credit.

Hershey and Finkelstein on the other hand, think that the rigidity of common law principles of consideration should not be put as an obstacle in the way of recognizing the irrevocable credit as a mercantile speciality. Finkelstein, in counter argument against McCurdy's objection, said:

Even if no such theory has previously been in existence, [Meaning a theory which makes a promise binding without consideration] that alone is no reason why one should not now be adopted if the necessities of commerce so require, particularly if it is the only basis upon which a multitude of actual and wise decisions can be put in order and upon which the point of view underlying the results reached can be adequately expressed.

McCurdy, while admitting that the courts should recognize the customs of merchants, objected to this theory, contending that such customs should not be recognized by the courts because they were contrary to the positive law; he explained:

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474Letters of Credit, at p.38.

475Legal Aspects of Commercial Letters of Credit, at pp.290-3.

476Ibid. at p.291.
It may be urged with force from a business point of view that commercial letters of credit should be legally recognized as mercantile specialties which require no consideration. Bankers, it may be argued, regard certain types of these letters as creating binding obligations; sellers on whose behalf they are issued rely upon them; the law should give its sanction to the business principle that a man's deliberate promise made in the course of business should be as good as his bond. To this it may be answered that customs of merchants should be given effect wherever possible, but wherever possible the effect should be given according to the principles of existing law.

In response to this objection a brief discussion about whether the recognition of this theory would be contrary to the law of England, Scotland and the United States, will be made in the following pages.

4.2.4.1[i] The Usage Theory In England

4.2.4.1[i][A] The Irrevocable Credit And Contrary To Positive Law.

The commercial usage of the irrevocable letter of credit which is defined in article 10(a) of the U.C.P. to "constitute a definite undertaking of the issuing bank, provided that the stipulated documents are presented and that the terms and conditions of the credit are complied with" was said to be contrary to the positive law of England which necessitates for the validity of a promise consideration moving from the promisee. This objection against the recognition of the irrevocable letter of credit on the

477 Commercial Letters of Credit, at p.564.
basis of its commercial usage derives support from the well established principle that no "mercantile usage, however extensive, should be allowed to prevail if contrary to positive law..."478 In an attempt to show that the usage of the irrevocable credit is not contrary to the positive law Professor Ellinger argued that this phrase can be interpreted in two different ways.479 The two interpretations and cases supporting this argument will be discussed respectively.

4.2.4.1[i][A](i) The Literal Interpretation Of Contrary To Positive Law.

The literal interpretation is that the common law rules should be strictly adhered to. So a usage which is not in line with the common law principles should not be recognized. This interpretation would lead to the result that the commercial usage which established the irrevocable letters of credit cannot be recognized. The same result would naturally apply to any other commercial usages which are not strictly in line with the common law principles. This interpretation, as Professor Ellinger pointed out, is incorrect because if accepted it would leave no room for the commercial usage that is not in strict compliance with the common law principles to form part of the law of England, which is not the case. The recognition by English courts of the commercial usages establishing negotiable instruments, which was later drafted into the Bill of Exchange Act 1882, is a clear example that a general usage is recognizable by


479 Ellinger, Documentary Letters of Credit, at p.109.
courts even if it deviates from the principles of the common law.

The usage establishing negotiable instruments deviates from the established rules of common law in the following aspects. Firstly, negotiable instruments are recognized to be an exception to the common law principle that choses in action are not assignable,\footnote{Ryall v. Rowles (1750) 1 Ves. Sen. 348. See also Cheshire, Fifoot and Furmston’s Law of Contract (12th ed.) at p.506; Treitel, G.H. The Law of Contract, (8th ed.) at p.576.} i.e. the assignment gives the assignee only the right against the assignor personally, but does not give him a right of action for recovery from the debtor which the negotiable instrument does. Secondly, contrary to the law of assignment that the assignor cannot pass to the assignee a better title than he himself possesses,\footnote{Mangles v. Dixon (1852) 2 H.L.C. 702, at pp.731-5. See also Cheshire, Fifoot and Furmston’s, Law of Contract, at p.519; Treitel, The Law of Contract, at p.592.} negotiable instruments’ recognized usage is that a person who obtains a negotiable instrument in good faith and for a valid consideration, the bill being complete on its face, he acquires a good title against the person who directly transfers it to him and all the previous parties to the instrument even if the person who transferred it to him has a defective title, for instance, if he stole it or found it.\footnote{Bills of Exchange Act 1882, §29. This was the position long before the introduction of the Act, see Miller v. Race (1758) 1 Burr 452, discussed infra at p.200.} Thirdly, in negotiable instruments there is no necessity for notice of the transfer to be given to whoever is liable on the
This rule goes against the assignment law which makes it necessary that a notice of the assignment is to be given to the debtor. Furthermore, the assignee of a contractual right, according to the law of assignment, takes it subject to any defects or claims whether he knew about them at the time of assignment or not. However, the transferee of a negotiable instrument does not take it subject to equities, provided that he acted in good faith and the bill is complete on its face. In *Miller v. Race*, a bank note which had been posted to the creditor by his debtor was stolen from the mail coach. This bank note was transferred to the plaintiff who took it in good faith, having no knowledge of its theft. The plaintiff was held to be entitled for payment from the Bank of England.

The concept of negotiability also conflicts with the doctrine of consideration in the following aspects. Firstly, in negotiable instruments an antecedent debt or liability is a sufficient consideration. This constitutes an exception to the common law rule that past consideration is invalid. Secondly, as a general rule of common law the burden

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486 (1758) 1 Burr 452. See also *Bills of Exchange Act 1882*, §38(2).


488 See *supra* at p.117.
of proving the non-existence of consideration is on the plaintiff, but in negotiable instruments law the consideration is presumed to have been given.\textsuperscript{489} So the defendant has to prove that no consideration has been given. Thirdly, the holder of a negotiable instrument can bring an action for payment with no need for proving that he has given consideration; the only requirement is that consideration should have been given at any time in the period between the time the bill was accepted until it comes to the hand of the last holder. Section 27(2) of the Bills of Exchange Act provides that:

Where value has at any time been given for a bill the holder is deemed to be a holder for value as regards the acceptor and all parties to the bill who became parties prior to such time, i.e. prior to the time at which value was given.

An example may be helpful to explain this provision. Suppose that A, accepts a bill of exchange drawn on him by B, who gave no consideration. A, can avoid liability by proving that no consideration was given, but if B transfers it to C, and the latter gave a valid consideration for it, he would be entitled to enforce it against A, and B. Furthermore, if C, transferred the bill to D, gratuitously, D, would have the right to enforce it against A, and B. This rule is directly inconsistent with the common law rule that consideration must move from the promisee.\textsuperscript{490}

Because of this conflict with the common law rules an attempt was

\textsuperscript{489}Mills v. Barber (1836)1 M. & W. 425.

\textsuperscript{490}See supra at p.153.
made by Holt C.J. to stop the recognition of a commercial usage which creates a new negotiable instrument. In *Potter v. Pearson*\(^{491}\) he refused to recognize a promissory note that was contended to be negotiable by a mercantile usage of the trade in London, on the ground that this promissory note would bind a person to pay money without consideration. Also in *Clerke v. Martin*\(^{492}\) Holt C.J., declined to recognize the negotiability of a new promissory note which was created by a trade usage in Lombard-Street on the grounds that it was unknown to the common law before.

The introduction of the *Promissory Notes Act, 1704*\(^{493}\) overruled the decision in *Potter v. Pearson* and *Clerke v. Martin*. Moreover, Holt C.J.'s decisions were not applied in later cases; on the contrary the courts were willing to recognize the negotiability of new instruments if a general commercial usage regard them to be so. Thus in *Glyn v. Baker*\(^{494}\) the court refused to recognize the usage because it was not proved, but in *Gorgier v. Mieville*,\(^{495}\) when it was proved that bearer bonds which were issued by a Prussian government were negotiable by commercial usage Abbott C.J. recognized them as being lawfully

\(^{491}(1702)\) 2 Ld. Raym. 759.

\(^{492}(1702)\) 2 Ld. Raym. 757. See also *Buller v. Crips* (1703) 6 Mod. 29.

\(^{493}\) & 4 Ann., C.9.

\(^{494}(1811)\) 13 East 509.

\(^{495}(1824)\) 3 B. & C. 45.
negotiable. Moreover, in *Partridge v. The Bank of England* the court declined to recognize the negotiability of dividend warrants because the usage which was alleged to have established it, was proved to be only prevailing in London. So if the usage was proved to be general the court would have enforced it. Likewise, in the case of *Dixon v. Bovill* iron script was alleged to be negotiable by commercial usage. Lord Cranworth L.C. was willing to recognize its negotiability if the usage was proved. His Lordship refused to acknowledge the usage on the grounds that "no evidence was given to show any general mercantile usage affecting such instrument as that now in question..."  

In *Crouch v. The Crédit Foncier of England Ltd.*, however, the court showed a similar attitude to that of Holt C.J. towards the acknowledgment of a new negotiable instruments established by mercantile usages. In this case a debenture which contained a promise to pay the bearer 100 guineas was stolen from the person who bought it from the issuing company [the defendant]. The defendant company having known of the debenture theft refused to pay the plaintiff who acquired the debenture for valuable consideration and in good faith. The plaintiff brought an action arguing that the instrument was negotiable by a recent commercial usage. Blackburn J. delivering the court

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496(1846) 9 Q.B. 396.

497(1856) 3 Macq. H.L. 1.

498 ibid. at p.13.

499(1873) L.R. 8 Q.B. 374.
judgment refused to recognize the usage on the ground that a person cannot assign more than he himself possesses either at common law or in equity.\footnote{Ibid. at p.380.} He said:

...where the incident is of such a nature that the parties are not themselves competent to introduce it by express stipulation, no such incident can be annexed by the tacit stipulation arising from usage, It may be so annexed by the ancient law merchant, which forms part of the law, and of which the courts take notice. Nor, if the ancient law merchant annexes the incident, can any modern usage take it away.\footnote{Ibid. at p.386.}

The view in this case was not followed in the case of Goodwin v. Robarts.\footnote{\citeyear{l.R.10.Ex.337}} The question before the Court of Exchequer Chamber in this case was whether scrip issued by a foreign government which was considered by a recent trade usage to be negotiable, should be recognized to be negotiable at law. Cockburn L.C.J. delivering the court judgment rejected the argument that no instruments other than those known to the ancient law merchant can become negotiable by a mercantile usage, he said:

Having given the fullest consideration to this argument, We are of the opinion that it cannot prevail. It is founded on the view that the law merchant thus referred to is fixed and stereotyped, and incapable of being expanded and enlarged so as to meet the wants and requirements of trade in the varying circumstances of commerce. It is true that the law merchant is sometimes spoken
of as a fixed body of law, forming part of the common law, and as it were coeval with it. But as a matter of legal history, this view is altogether incorrect. The law merchant thus spoken of with reference to bills of exchange and other negotiable securities, though forming part of the general body of the lex mercatoria, is of comparatively recent origin. It is neither more nor less than the usages of merchants and traders in the different departments of trade, ratified by the decisions of Courts of Law, which, upon such usages being proved before them, have adopted them as settled law with a view to the interests of trade and the public convenience, of Court proceeding herein on the well-known principle of law that, with reference to transactions in different departments of trade, Courts of Law, in giving effect to the contracts and dealings of the parties, will assume that the latter have dealt with one another on the footing of any custom or usage prevailing generally in the particular department. By this process, what before was usage only, unsanctioned by legal decision, has become engrafted upon, or incorporated into, the common law, and may thus be said to form part of it.503

Cockburn L.C.J. continued to emphasize, that recent commercial usage is capable of creating a new negotiable instruments, he observed that:

Usage, adopted by the Courts, having been thus the origin of the whole of the so-called law merchant as to negotiable securities, what is there to prevent our acting upon the principle acted upon by our predecessors... Why is it to be said that a new usage which has sprung up under altered circumstances, is to be less admissible than the usage of past times.504

The learned Judge then pointed out that the recognition of a mercantile

503 Ibid. at p.346.

504 Ibid. at p.352.
usage should be limited to the fact that it is not contrary to positive law, he said:

We must by no means be understood as saying that mercantile usage, however extensive, should be allowed to prevail if contrary to positive law, including in the latter such usage as, having been the subject of legal decision, and having been sanctioned and adopted by Courts, have become, by such adoption, part of the common law. To give effect to such a usage which involved a defiance or disregard of the law would obviously be contrary to a fundamental principle.505

The negotiability, as mentioned above, conflicts with some aspects of consideration and with the law of assignment, nevertheless, the court in this case enforced the usage. The following quoted words of Cockburn L.C.J. indicate that commercial usage introducing a new negotiable instrument is not necessarily contrary to the positive law:

If we could see our way to the conclusion that, in holding the scrip in question to pass by delivery, and to be available to bearer, we were giving effect to a usage incompatible either with the common law or with the law merchant as incorporated into and embodied in it, our decision would be a very different one from that which we are about to pronounce. But so far from this being the case, we are, on the contrary, in our opinion, only acting on an established principle of that law in giving legal effect to a usage, now become universal, to treat this form of security... as assignable by delivery.506

505 Ibid. at p.357.

506 Ibid. at pp.357-8. Lord Chorley said about Cockburn L.C.J’s judgment in this case that it "should be inscribed in letters of gold in every court handling commercial litigation", The Conflict of Law and Commerce (1932) 48 L.Q.R. 55.
The decision in this case was affirmed by the House of Lords\textsuperscript{507} and adopted by it in the case of *London Joint Stock Bank v. Simmons*.\textsuperscript{508} Moreover, it was followed in *Rumball v. The Metropolitan Bank*,\textsuperscript{509} *Venables v. Baring Bros. & Co.*\textsuperscript{510} and *Bechuanaland Exploration Co. v. London Trading Bank, Ltd.*\textsuperscript{511}

The recognition of the negotiable instruments by English Courts, despite the fact that they are not strictly in line with the common law principles, has put it beyond doubt that the literal interpretation of the meaning of "contrary to the positive law" is not acceptable. Thus, it seems rather illogical to recognize the usage establishing negotiable instruments and then turn to say that the usage establishing the irrevocable letter of credit is contrary to the positive law, while both of them deviate from the common law principles in the same way.

Although the recognition of mercantile usage introducing negotiable instruments was restricted to instruments that, as Bowen L.J. put it, "actually rising to the level of documents which the commercial world in general treated as negotiable..."\textsuperscript{512} this restriction would not prevent

\textsuperscript{507}(1876) 1 App. Cas. 476.

\textsuperscript{508}[1892] A.C. 201.

\textsuperscript{509}(1877) 2 Q.B.D. 194.

\textsuperscript{510}[1892] 3 Ch. 527.

\textsuperscript{511}[1898] 2 Q.B. 658; See also *Edelstein v. Schuler & Co.* [1902] 2 K.B. 144.

\textsuperscript{512}Easton v. *London Joint Stock Bank* (1886) 34 Ch.D. 95 at p.113.
the recognition of the usage relating to the irrevocable letter of credit, which the whole commercial world considers as a binding obligation on the issuing bank towards the beneficiary.

In as much as the above discussion showed that the literal interpretation is not correct it also showed that the liberal interpretation, which will be discussed next, is more acceptable.

4.2.4. [i][ii] (ii) The Liberal Interpretation Of Contrary To Positive Law.

The other possible interpretation of "contrary to positive law" is that a commercial usage should not be recognized by the courts if the usage conflicts with a particular decision.\textsuperscript{513} This interpretation would lead to the result that if a commercial usage is not in line with a common law principle, but does not override a specific decision, it would be allowed as an exception to that common law principle, as has been shown in the last discussion to be the case with regard to negotiable instruments.\textsuperscript{514}

It could be argued that it cannot be possible even under this interpretation, to recognise usage establishing the validity of the irrevocable letter of credit because the issuance of the irrevocable credit constitutes a mere offer by the issuing bank which is not supported by consideration from the seller. Professor Ellinger rightly argued that the irrevocable letter of credit is not a promise or an offer, he stated:

\textsuperscript{513}Ellinger \textit{Documentary Letters of Credit}, at p.109.

\textsuperscript{514}\textit{Supra}.
...the usage only classifies irrevocable credit as something different from mere offers or promises. It distinguishes irrevocable credits from both offers and promises by saying that they are special instruments of the law merchant. Taking into account the circumstances surrounding irrevocable credits, i.e. the remuneration which the banker receives for opening them and the fact that the seller becomes bound to perform the contract of sale once he receives the letter of credit, it is not difficult to argue that an irrevocable credit is something very different from a mere offer.\textsuperscript{515}

Support for this interpretation can be derived from decided cases on the issue of whether a usage is contrary to positive law. In \textit{Edie v. East-India Co.},\textsuperscript{516} where a bill of exchange was indorsed to a named person but without adding the words ‘or order’ it was alleged that a commercial usage restricted the negotiability of such instrument. Lord Mansfield did not acknowledge the usage because it was not in line with specific decision in earlier cases.\textsuperscript{517} Also in \textit{Oppenheim v. Russell}\textsuperscript{518} the plaintiffs [carriers] contended that according to a commercial usage they had a lien over the goods for money owed to them by the consignees, and such usage abolished the consignor’s right of stoppage \textit{in transitu}. The court held that the usage was not enforceable. Roake

\textsuperscript{515}Ellinger, \textit{Documentary Letters of Credit}, at p.110.

\textsuperscript{516}(1761) 2 Burr. 1216.

\textsuperscript{517}\textit{More v. Manning} (1718) 1 Comyns 311; \textit{Acheson v. Fountain} (1722) 1 Str.557.

\textsuperscript{518}(1802) 3 Bos. & P. 42.
J. saw that the usage was not general but only an agreement,\(^{519}\) he said "If indeed it was a claim founded upon general principles of universal justice ..."\(^{520}\) However, allowing such usage would mean abolishing a right given to the consignor by common law and would override a specific decision on the point.\(^{521}\)

In *Meyer v. Dresser*\(^{522}\) a commercial usage was alleged to give the consignee of a bill of lading the right to deduct from the freight a sum of money equivalent to the value of the missing goods. The court refused to enforce the usage. In Erle C.J.'s view, enforcing such usage would result in overriding the current binding decisions; he also pointed out that the existence of such decisions showed undoubtedly that there cannot be a general usage to that effect, he said:

> It is a self-evident contradiction to my mind, to say that the general law does not allow the deduction, and that there is a universally established usage to allow it.\(^{523}\)

In *Atwood v. Seller & Co.*\(^{524}\) it was contented that the expenses of discharging a damaged ship was considered, by a trade usage established by British average adjusters, to be general average. The court held that

\(^{519}\)Ibid. at p.51.

\(^{520}\)Ibid. at p.50.

\(^{521}\)Ellinger, *Documentary Letters of Credit*, at p.111.

\(^{522}\)(1864) 16 C.B. (N.S.) 646.

\(^{523}\)Ibid. at p.660.

\(^{524}\)(1879) 4 Q.B.D. 342; (1880) 5 Q.B.D. 286 (C.A.).
the costs of discharging a damaged ship according to common law were not general average. Cockburn C.J. who delivered the majority judgement seems to suggest that if a general usage was proven the court would have recognized it even if it was not in line with common law principles, he said:

The practice in question is not a usage of trade by which the terms of a contract may be interpreted or modified. It is not a custom which may be presumed to have had a legal origin. It is not the inveterata praxis of a court or courts having judicial authority, and which must therefore be taken to be the law though inconsistent with general principles. The authority of average adjusters may be said to be of an anomalous character.

he then continued to say:

When a practice of this kind is brought to the test of legal decision and is found to be erroneous and inconsistent with law, it cannot be permitted to override the law and acquire the force of law.

However, the usage establishing the irrevocable letter of credit does not conflict with decided cases. On the contrary there are many cases where courts expressly stated that they are valid.

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525 The recognition of the usage would override the established rule in Hall v. Janson (1855) 4 E. & B. 500; 24 L.J.Q.B. 97.

526 Ibid. at p.363.

527 Ibid. at p.364.

528 See cases discussed in the Offer and Acceptance Theory.
4.2.4.1[i][B] Cases Supporting The Expansion Of The Law Merchant To Meet The Commercial Needs.

In addition to Cockburn L.C.J’s statement\(^{529}\) in which he stressed that when a new usage comes into existence to meet a new commercial needs courts should take judicial notice of it, there are other cases in which the courts held a similar view to that of Cockburn. In *Brandao v. Barnett\(^{530}\)* Lord Campbell said:

> When a general usage has been judicially ascertained and established, it becomes a part of the law-merchant, which courts of justice are bound to know and recognize.\(^{531}\)

In *Edelstein v. Schuler & Co.*\(^{532}\) Bingham J. stated that:

> It is also to be remembered that the law merchant is not fixed or stereotyped; it has not yet been arrested in its growth, by being moulded into a code; it is, to use the words of Cockburn C.J. in *Goodwin v. Robarts*, capable of being extended and enlarged so as to meet the wants and requirements of trade in the varying circumstances of commerce.\(^{533}\)

Finally in *Bank of Baroda Ltd. v. Punjab National Bank Ltd.*\(^{534}\) Lord

\(^{529}\)Quoted *supra* at p.205.

\(^{530}\)(1846) 12 Cl. & F. 787.

\(^{531}\)*Ibid.* at p.805.

\(^{532}\)[1902] 2 K.B. 144.

\(^{533}\)*Ibid.* at p.154.

\(^{534}\)[1944] A.C. 176.
Wright observed that:

But the law merchant is not a closed book, nor is it fixed or stereotyped ... Practices of business men change, and courts of law in giving effect to the dealings of parties will assume that they have dealt with one another on the footing of any relevant custom or usage prevailing at the time in the particular trade of class of transaction.535

If the usage establishing the irrevocable credit is general and not contrary to positive law, as has been shown, and the law merchant is not fixed but capable of growing, it is difficult to see the need for classifying the irrevocable credit as one of the pre-existing institutions of law which are incapable of accommodating it in its present form and even if any of them did the future developments of the irrevocable credit will be restricted by such institution’s rules and not recognizing its validity as being established by usage and allowing such usage to develop.536

4.2.4.1[i][C] Cases In Support Of The Mercantile Usage Theory.

There are some authorities, which, although not conclusively recognizing the commercial usage to be the source of the validity of the irrevocable letter of credit, give some support to this submission. In *International Banking Corporation v. Barclay’s Bank Ltd.* 537 Atkin L.J.

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discussing the instrument in this case which was a negotiable credit cabled by an English bank to a Japanese seller, said:

I think it may be said that the law relating to such transactions is not at the present moment so crystallized that it is not dependent upon proof of custom. In any case it is plain that it is emphatically the kind of transaction where commercial usage when proved will eventually determine the legal rights between the parties, and in this case there is quite definite evidence of commercial usage when letters of credit such as were issued in the present case are to be used in the commercial market in the East.538

From the quoted passage Atkin L.J. seems to suggest that the recognition of the instrument depends on the proof of the usage. He doubted, at that time (1925), that the usage establishing this negotiable credit had reached the stage in which it could be regarded as a general usage in England. Had the case been otherwise he seems to see no legal reason why such usage should not have been recognized.

Support for this argument can be found in the later decision of the Court of Appeal in the case of Hamzeh Malas & Sons v. British Imex Industries Ltd.539 Jenkins L.J. in this case removed the doubt that Atkins L.J. had about the certainty of the irrevocable credit’s usage.540

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540 The usage should be certain to be recognized by courts, See *Sewell v. Corp* (1824) 1 Car. & P. 392 per Best C.J. at p.393; *Devonald v. Rosser & Sons* [1906] 2 K.B. 728 per Farwell L.J. at p.743.
In that case, Jenkins L.J. observed that:

It seems to be plain that the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods which imposes on the banker an absolute obligation to pay, irrespective of any dispute which there may be between the parties on the question of whether the goods are up to contract or not. An elaborate commercial system has been built up on the footing that bankers’ confirmed credits are of that character, and, in my judgement it would be wrong for this court in the present case to interfere with that established practice.\textsuperscript{541}

The last words of Jenkins L.J.’s quoted statement which is that "... it would be wrong for this court in the present case to interfere with that established practice" seems undoubtedly to imply; firstly that the court is willing to recognize the commercial usage of the irrevocable credit as the source of its validity and secondly that this usage is not contrary to positive law; if it was Jenkins L.J. would have not made such a statement.\textsuperscript{542}

The more recent case of Harbottle (R.D.)\textit{(Mercantile) Ltd. v. National Westminster Bank Ltd.}\textsuperscript{543} also supports the view that the irrevocable credit derives its validity from the commercial usage. Kerr J. in this case stated that:

It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They

\textsuperscript{541}\textit{Ibid.} at p.129.

\textsuperscript{542}Ellinger, \textit{Documentary Letters of Credit}, at p.121.

\textsuperscript{543}[1978] 1 Q.B. 146.
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are the life-blood of international commerce. Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain ... The machinery and commitments of banks are on a different level. They must be allowed to be honoured, free from interference by the courts. Otherwise, trust in international commerce could be irreparably damaged.\textsuperscript{544}

However, it might be noted that Lord Diplock in \textit{United City Merchants (Investments) Ltd. v. Royal Bank of Canada (The American Accord)}\textsuperscript{545} by emphasizing that there is a direct contractual relationship between the beneficiary and the confirming bank,\textsuperscript{546} appeared to have given a contrary view to this analysis which regards the commercial usage to be the base for the bank’s obligation towards the beneficiary.\textsuperscript{547}

\textbf{4.2.4.1(ii) The Usage Theory In The U.S.A}

The same objection raised against the theory in England, namely that a usage which makes a promise binding without consideration is contrary to positive law, could be raised in the U.S.A. However, the view in the U.S.A is that the contention that a usage is contrary to the common law rules is not sufficient ground to reject it, if it was so important that all

\textsuperscript{544}Ibid. at pp.155-6.

\textsuperscript{545}[1983] A.C. 168.

\textsuperscript{546}Ibid. 182H-183C. See \textit{supra} at p.112.

\textsuperscript{547}See Todd, P., Bills of Lading and Documentary Credits, at p.190; Also by the same author, \textit{Sellers and Documentary Credits [1983] J.B.L.} 468 at p.479.
people engaged in a certain business have worked according to it.548

There are cases in which the American courts expressly stated that documentary letters of credit are commercial instruments established by usage. In Moss v. Old Colony Trust Co.,549 Rugg J. stated that:

A letter of credit is a well-known instrumentality of commerce. No particular form is prescribed for it... Moreover, letters of credit are extensively used in commerce.550

Also in Kingdom of Sweden v. New York Trust Co.,551 Wasserfogel J. observed that "Commercial letters of credit have a long mercantile history and the principles which govern them are well established".552

Although both cases considered documentary letters of credit to be established by a commercial usage, neither of them gave an expressed decision that the usage is the source of their validity. Hershey expected in 1918 that "... the courts should give effect to it [the irrevocable credit] for what it is intended to be. Perhaps the timid, not to say false, conservatism of the courts may compel business men to turn to the Commissioners on Uniform State Laws and invoke the aid of the

548Bourne v. Ashley, 3 Fed. Cas. 1002 (Case No. 1698)(1863); Swift v. Gifford, 23 Fed. Cas. 558 at pp.559-60 (1872).

549246 Mass. 139, 140 N.E. 803 (1923). In this case it was also argued that documentary credit was a written contract.

550Ibid. at p.807.


552Ibid. at p.787.
This expectation has become true. Today the practice of documentary credit is codified in Article 5 of the Uniform Commercial Code. This recognition of the usage by the legislature has made the American courts' recognition of the usage to be the source of the validity of the irrevocable credit immaterial.

The legislative solution has removed the two difficulties concerning the irrevocable letter of credit; Firstly, Section 5-105 removed the necessity of consideration, it reads as follows "No consideration is necessary to establish a credit or to enlarge or otherwise modify its terms." Secondly, Section 5-106 (2) removed the need for the beneficiary acceptance of the bank's offer.

4.2.4.1[iii] The Usage Theory In Scotland

No doubt trade usage constitutes a source of law in Scotland. Despite the fact that the law of Scotland adopts the same principle which exists in English Law, namely, that no commercial usage should be recognised if it is contrary to the general rule of the country, the

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553Letters of Credit, at p.38. He then continued to say "But legislation cannot come in time to take care of the litigation that is almost certain to flow presently from the enormous volume of business done under these letters in the last four years".

554See supra at p.123.


556Anderson v. M'Call, 1866, 4 M. 765; Dobell, Beckett & Co. v. Neilson, (1904) 7 F. 281.
lack of consideration objection which was raised against the theory in England cannot be raised against the theory in Scotland because the general rule of this country is that a promise is binding even if there is no consideration to support it.

The irrevocable credit has been known for more than a century and its usage is general, prevailing in the whole world. However, it should be noted that the usage need not be universal to be enforced by courts in Scotland. Although there is no specific authority in Scotland recognizing the commercial usage to be the source of the irrevocable credit's validity, the legal system of Scotland is wide enough to accommodate this commercial usage. Bell, speaking of the law merchant, said:

The Law-merchant is universal. It is a part of the law of nations, grounded upon the principles of natural equity, as regulating the transactions of men who reside in different countries, and carry on the intercourse of nations, independently of the local customs and municipal laws of particular states. For the illustration of this law, the decisions of courts, and the writings of lawyers in different countries, are as the recorded evidence of the application of the general principle; not making the law, but handing it down; not to be quoted as precedents, or as authorities to be implicitly followed, but to be taken as guides towards the establishment of the pure principles of general jurisprudence.

The only difficulty facing the theory in Scotland is that the adoption

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558 Commentaries on the Law of Scotland, at p.XI.
of the theory in Scotland alone is not enough. The irrevocable credit is an international instrument, so the source of its validity should be the same in all countries.\footnote{This theory has not been suggested in France but Professor Ellinger saw no legal reason preventing French courts from recognizing the commercial usage to be the source of the validity of the irrevocable credit. \textit{Documentary Letters of Credit}, at p.125. See also Sarna, L., \textit{Letters of Credit, The Law and Current Practice}, at pp.52-3.}
PART TWO

THE RELATIONSHIPS BETWEEN THE MAIN PARTIES OF LETTER OF CREDIT AND OTHER PARTIES

1. The Intermediary Banks

2. The Holders Of The Beneficiary’s Draft
 CHAPTER FIVE
The Intermediary Bank

5.1 The Intermediary Bank’s Roles In The Credit Operation

Because a letter of credit is a means of financing international transactions it usually involves in addition to the three parties which are the seller, the buyer and the buyer’s bank [whether issuing or requesting bank], a further party known as the intermediary or the correspondent bank. The involvement of such a bank derives from two factors; firstly the seller’s desire to deal with a bank situated in his own country, which he knows well and on which undertaking he is more likely to rely on than that of a foreign bank. Also it would be easier for the seller to contact and deliver the documents to such a bank. Therefore he will demand from the buyer that the credit is to be opened in his country. Secondly, the buyer would not be keen on opening the credit in a foreign country, because he may encounter some difficulties in dealing with a remote bank. Also, being unknown to that remote bank, the buyer may find it very difficult to convince such a bank to open a letter of credit. In compromise between these two conflicting views the buyer will employ a bank in his country and instruct it, to use, in arranging the opening of the required credit the services of a bank in the seller’s country.
There are three common methods in which a letter of credit involves an intermediary bank in the seller's country. Firstly, if the seller in his arrangement with the buyer demands that the credit is to be opened in his own country, the buyer will instruct his bank to request a bank in the seller's country to issue a letter of credit in favour of the seller. In this case the buyer's bank is known as an \textit{instructing bank} and the seller's bank is known as an \textit{intermediary issuer} who alone, by issuing the credit, becomes liable to the seller.\textsuperscript{1} Such liability will vary according to whether the letter of credit issued is revocable or irrevocable.

Secondly, the seller may not demand that the credit is to be opened in his own country, but in order to enhance the foreign issuer undertaking he may insist on acquiring an additional undertaking by a local bank. In this method the buyer's bank will open a letter of credit and will then instruct an intermediary bank in the seller's country to inform the seller of its issuance and that they are liable to him to the extent that the issuing bank is liable.\textsuperscript{2} The letter of credit in this case is known as an \textit{irrevocable confirmed credit} and the intermediary bank as the \textit{confirming bank}.\textsuperscript{3}

Thirdly, in some cases the seller does not demand an undertaking of

\textsuperscript{1}Such arrangement was made in \textit{Bank Melli Iran v. Barclay's Bank D.C.O. [1951]} 2 Lloyd's L.Rep. 367.

\textsuperscript{2}See \textit{infra} at p.261.

\textsuperscript{3}The U.C.C. \textsection 5-103(1)(f) defined a confirming bank as being "... a bank which engages either that it will itself honor a credit already issued by another bank or that such a credit will be honored by the issuer or a third bank."
a bank in his own country, but he may agree with the buyer that a bank in his country should be employed only for the purpose of advising the credit. The reason for employing such a bank is that the issuing bank is unknown to the seller and the latter has no means of making sure that the foreign issuing bank exists or that the letter of credit is not forged. Therefore, the seller will be more inclined to rely on a letter of credit which is advised by a local bank, who has the experience of international banking and advanced communication technology which will enable it to determine whether the letter of credit is genuine.

More often the seller would not be satisfied only with the advising of the credit by a local bank but in order to make it easy for himself to tender the documents and receive payment from a local bank in his local currency he may demand that such bank should also be employed to take up the documents and pay against them in his own currency. In this method the buyer's bank, after issuing the credit, will engage an intermediary bank in the seller's country instructing it either to notify the seller that a letter of credit is being issued in his favour (advising only) or in addition to the notification, inform him that he can tender the documents and receive payment from such bank (advising and paying). The intermediary bank will also expressly emphasize that the advising of the credit in his part does not put it under any liability to the seller. In this

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4An advising bank may on occasion act as a negotiating bank.

method the intermediary bank is known as an advising bank.\(^6\)

The participation of an intermediary bank in the credit operation necessitates that it has some form of relationship with the other parties. The nature of such relationships with each other will be discussed separately.

### 5.2 The Relationship Between The Intermediary Bank And The Buyer

#### 5.2.1 Is There A Contractual Relationship?

As the intermediary bank is always employed by the buyer’s bank and not by the buyer, there is no direct negotiation between the latter and the intermediary bank and consequently no privity of contract whether such bank was issuing, confirming or advising bank even if it was nominated by the buyer. This view is generally accepted by many authors\(^7\) and has been expressly stated by courts about the buyer relationship with all three kinds of intermediary bank.

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\(^6\)The U.C.C. §5-103(1)(e) defined an advising bank as being "... a bank which gives notification of the issuance of a credit by another bank."

5.2.1.1 The Intermediary-Issuer

In *Kunglig Jarnvagsstyrelsen v. National City Bank of New York*\(^8\) a shipment of coal was sold by *Messrs, Dexter & Carpenter, Inc.*, to *G & L. Benjer Import & Export Aktiebolag*, a Swedish Corporation. The latter after reselling the coal to the plaintiff requested a Swedish bank to instruct a bank in New York to open an irrevocable credit in favour of the seller. The funds for the opening of the credit were raised by the plaintiff. The New York bank opened the requested credit, but it did not comply strictly with its terms; it accepted a broker’s insurance certificate despite the fact that the letter of credit provided that the seller should render along with other documents an insurance policy. After the coal was lost in a marine accident, it appeared that no insurance was effected at all. The second buyer brought an action against the original seller (*Messrs. Dexter & Carpenter*) and the New York bank (the intermediary issuers). The latter’s contention that there was no privity of contract between them and the plaintiff (the second buyer) was accepted by the court. It was held that:

The relation between the Swedish Bank and the defendant bank arose by instructions to open a special letter of credit and the carrying out of this instruction. The defendant bank was paid a commission. There was no expressed contract between the plaintiff and the defendant bank. The bank’s contract was to open a letter of credit for another bank, which made it its correspondent bank, and it was from it alone that it took instructions. The defendant bank never communicated with the

\(^8\)20 F.2d 307 (1927).
customer of the foreign bank, who was the buyer of the goods, and indeed did not investigate the credit of such foreign buyer. It looked to the correspondent foreign bank for reimbursement.9

Although in this case the plaintiff was not the buyer who applied for the credit it is clear from the above statement that the contract was only between the Swedish Bank and the New York Bank. Therefore, this rule would have been equally applied had the first buyer (Beijer) who applied for the credit brought the action.

In the more recent case of United Trading Corporation S.A. v. Allied Arab Bank Ltd.10 the Court of Appeal rejected the argument that there is a contractual relationship between the account party and the correspondent issuing bank.11

5.2.1.2 The Confirming Bank

The rule applied to the relationship between the buyer and the intermediary-issuer also applied in the case of the relationship between the buyer and the confirming bank. In Distribuidora Del Pacifico S.A. v. Gonzales,12 the defendant Gonzales sold a quantity of barbed wire to

9Ibid. at p.309.

10[1985] 2 Lloyd’s L.Rep. 554n, CA. It should be noted that the case is concerned with a performance bond, but the same rules are applicable to letter of credit.

11Ibid. at pp.559-60.

1288 F. Supp. 538 (1950). See also United States v. Foster Wheeler Corp. 639 F. Supp. 1266 (S.D.N.Y. 1986) in which it was held that the confirming bank’s contractual relationship is only with the issuing bank and the beneficiary, and has no
a Mexican firm who requested a Mexican bank to open an irrevocable
credit in favour of Gonzales and to confirm it by the Citizens Trust &
Savings Bank which the Mexican bank carried out. The Citizens Trust
&Savings Bank after accepting the documents which were tendered to
it and honouring the draft accompanying them, sent the documents to the
Mexican bank and received reimbursement.

When the Mexican firm received the goods they noticed that they were
not of the quality agreed on. They brought an action against the seller
(Gonzales) and the confirming bank (The Citizens Trust & Savings
Bank). The bank’s argument that there was no privity between it and
the plaintiffs was accepted by the court, which held that:

It is equally clear that no recovery can be had against the
defendant Bank. There was no direct contractual relation
between the Bank and the plaintiff. The Bank, through its
Mexican banking representative, received the irrevocable letter of
credit payable to the defendant Gonzales. Upon its receipt,  
Gonzales was notified. ...This notification bound the bank to
honor the letter of credit upon surrender of certain instruments,
which the forwarding Bank made a condition.13

Also in Dulien Steel Products, Inc., of Washington v. Bankers Trust
Co.,14 the same opinion was adopted. In this case the buyer sued the

13Ibid. at p.541. See also Linden v. National City Bank of New York 12 App.

14189 F. Supp. 922 (1960). For the facts of this case see infra at p.255.
confirming bank for wrongful honour of the beneficiary’s draft. The
court held that there was no contract between the buyer and the
confirming bank. Marshall J. said:

There was no contract between the plaintiff [the buyer] and the
defendant [the confirming bank]. All of Dulien’s negotiations
were with Seattle Bank [the issuing bank].

5.2.1.3 The Advising Bank

This rule was also equally applied to the relationship between the
buyer and the advising bank. In Samuel Kronman & Co. Inc. v. Public
National Bank of New York, a quantity of onions was sold to the
plaintiff by a Spanish seller. The former requested the Public National
Bank to open an irrevocable credit in favour of the seller and instructed
it to arrange for the credit to be advised to the beneficiary by Crédit
Lyonnais. The credit was advised to the seller by Crédit Lyonnais,
but its terms were different from that of the sale contract. In the credit
there was a stipulation to the effect that the seller should tender among
other documents a set of bills of lading made to the order of Public

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15Ibid. at p.841. The English case of Equitable Trust Co., of New York v.
Dawson Partners Ltd. [(1926) 25 L.I.L.R. 90 (C.A.), (1927) 27 L.I.L.R. 49 (H.L.)]
did not affirm that there is no relationship between the buyer and the confirming
bank; it only determined that there was no relationship of principal and agent
between them.

16218 A.D. 624, 218 N.Y.S. 616 (1926).

17The bank was not instructed to confirm the credit. See the letter of credit
opened in this case, ibid. at pp.618-9.
National Bank, but there was no term in the contract of sale to such effect. The seller submitted the documents to Crédit Lyonnais but they were rejected because they did not include bills of lading made to the order of Public National Bank. The seller therefore refused to deliver the goods and the plaintiff brought an action against both banks. In an answer to the argument that the issuing of the letter of credit created a contract between the buyer and the advising bank, Burr J. said:

No promise by defendant Crédit Lyonnais to the plaintiff can be based upon the letter of credit to which the plaintiff by his bill of particulars has limited his claim of privity.\(^{18}\)

By stressing in the above statement that the letter of credit itself is not a ground on which a privity of contract between the buyer and the advising bank can be based, and as mentioned earlier, there is no direct communication at all between them, it can be said therefore that there is no relationship between them.

5.2.2 The Exemption Clauses

In addition to the lack of privity of contract between the buyer and the intermediary bank, the U.C.P. and the U.C.C. contain provisions freeing the issuing bank from any liability to the buyer for acts or omissions of the intermediary bank.\(^{19}\) Article 20(a) and (b) of the U.C.P. reads as

\(^{18}\)Ibid. at p.622.

\(^{19}\)Even if there were no exemption clauses the issuing bank would not be held vicariously liable for the intermediary bank's acts or omissions. See Ellinger, Documentary Letters of Credit, at p.232.
follows:

20(a) Banks utilizing the services of another bank or other banks for the purpose of giving effect to the instructions of the applicant for the credit do so for the account and at the risk of such applicant.

(b) Banks assume no liability or responsibility should the instructions they transmit not be carried out, even if they have themselves taken the initiative in the choice of such other bank(s). 20

A provision to the same effect is also to be found in the U.C.C. Section 5-109(1)(b) which provides:

(1) An issuer’s obligation to its customer includes good faith and observance of any general banking usage but unless otherwise agreed does not include liability or responsibility

... (b) for any acts or omission of any person other than itself or its own branch or for loss or destruction of a draft, demand or document in transit or in the possession of others... 21

20 It was suggested that this provision should be construed to mean that the issuing bank is entitled to pass to the applicant only the liabilities which do not rest with the banks. For example, if the intermediary bank accepted documents which are not in compliance with the terms of the credit, the issuing bank should not be allowed to compile the applicant to accept them on the ground that the utilisation of the services of the intermediary bank was at his risk. See Jack, R., Documentary Credits, at p.68.

21 These provisions undoubtedly make it easy for the intermediary bank to deviate from following the buyer’s instructions strictly, lessening the value of the strict compliance principle. Sassoon suggested as a solution to this problem that these provisions should not be applicable except in situations beyond the banks’ control. Documentary Credits: The Applicant and the Advising Bank, [1986] J.B.L. 33, at p.35.
Similar exemption clauses are also contained in the application form.

5.2.3 The Consequences

The combined effect of lack of privity and the exemption clauses could cause the buyer hardship. There are many situations in which the act or the omission of the intermediary bank causes the buyer financial loss, as for example, if, contrary to the buyer’s instruction, the intermediary bank opens a revocable credit instead of an irrevocable one, requires the seller to tender documents that are not required by the buyer’s instructions or does not inform the seller about the opening of the credit until after the time in which the credit should be opened or fails to inform him at all.22 In these situations the seller has the right to repudiate the contract of sale23 and resell the goods. The buyer may lose profits because the transaction was not completed also he may have to pay the seller damages if the price at which the goods were resold was lower than the price agreed between the buyer and the seller in the

22Dolan argued that in these situations the buyer should bear the loss because he alone knows the degree of how serious the errors are, and he knows what measures should be taken to prevent such errors. On the other hand, the intermediary bank who makes the error has no knowledge of the facts of the underlying agreement; thus it has no means to determine which aspect of its performance should be double checked to avoid making an error that could be fatal to such agreement. Therefore it is not reasonable to hold it responsible. The Correspondent Bank in Letter of Credit Transactions, at pp.425-6. Cf. Integrated Measurement Sys., Inc. v. International Commercial Bank of China, 757 F. Supp. 938 (N.D.III. 1991); U.C.C. §5-107(1) which provides that "... it (the advising bank) does assumed obligation for the accuracy of its own statement." The provision is silent as to whom this duty is owed. For more detail as regards this point see infra, at p.265.

23See the relationship between the buyer and the seller supra at p.18.
contract of sale. The buyer may also incur the same loss if the intermediary bank wrongfully rejected documents in compliance with the terms of the credit and the seller elected to repudiate the sale contract.

In both examples the buyer cannot sue the intermediary bank because there is no privity of contract between them. Equally he cannot sue the issuing bank for the breach committed by the intermediary bank because of the exemption clauses. Therefore, it could be said that the buyer is being virtually left with no remedy. It is true that the intermediary bank, in these examples, has committed a breach of its contract with the issuing bank, but the latter would not bring an action against the former because it did not incur any loss and would gain no benefit from bringing such action.

Moreover, the current rules could be unjust to the buyer when the intermediary bank negligently accepted forged documents. In this case because the documents are appearing on their face to be in compliance with the credit terms, the issuing bank is under a duty to accept them and reimburse the intermediary bank. Equally the buyer would have to accept them and reimburse the issuing bank who has committed no breach of his duty towards the buyer. In this situation the only possible action that is left to the buyer is to sue the seller on the

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24 In theory the intermediary bank is neutral but in practice such bank is usually located in the beneficiary's country and in many cases has other dealings with him. Therefore it is possible that the intermediary bank has an interest of his own in seeing the beneficiary satisfied. See Furman Dann, Confirming Bank Liability in Letter of Credit Transactions: Whose Bank Is It Anyway? at p. 1241.

25 U.C.P. Art 16(a), U.C.C. 5-114.
sale contract, but that defeats the main objective that the buyer intended to achieve by agreeing to pay by a letter of credit which is to avoid such risks. A further example showing how the effect of such rule could be unfair to the buyer, is that if the buyer put the issuing bank in funds and the issuing bank forwarded these funds to the intermediary bank to meet the seller’s draft. If this fund is not allocated to meet such a draft\textsuperscript{26} the buyer cannot claim a refund from the intermediary bank if the latter failed to honour the draft. He could only claim such fund from the issuing bank, but if the latter becomes insolvent the buyer will be treated as an ordinary creditor of the issuing bank.\textsuperscript{27}

Equally these rules could cause the intermediary bank hardship in the situation where it has paid the beneficiary [or has not, but is under an obligation to pay, as is the case in confirmed credit] and before it has been reimbursed, the issuing bank becomes insolvent. Because of the lack of privity of contract between the customer and the intermediary bank the latter cannot turn to the former for reimbursement.\textsuperscript{28} It will

\textsuperscript{26}If the fund is appropriated to meet such a draft the intermediary bank will be deemed to be holding the fund in trust for the buyer. See Davis, \textit{The Law Relating to Commercial Letters of Credit}, at p.101.

\textsuperscript{27}Davis, \textit{ibid}; Gutteridge and Megrah, \textit{The Law of Banker’s Commercial Credits}, at p.57.

\textsuperscript{28}It was suggested that the intermediary bank is entitled to obtain reimbursement directly from the buyer on the ground that the buyer, who received goods without paying for them, is unjustly enriched. Alternatively because the issuing bank, when it employs the service of the confirming bank, is acting upon the buyer’s instruction, the latter should be treated as the intermediary bank’s disclosed principal. See Kozolchyk, \textit{International Encyclopedia of Comparative Law, Letters of Credit}, Vol.IX. Ch.5, at pp.46-7 and authorities cited therein. It was also suggested that
only be treated as a general creditor of the insolvent issuing bank unless the buyer had put the issuing bank in funds and such funds were appropriated to the performance of the credit; in this case the intermediary bank will be paid in preference over the general creditors of the insolvent issuing bank.29

5.2.4 Possible Solutions

There have been a few attempts to establish a legal ground on which the buyer could sue the intermediary bank in both the United States and

29See supra at p.20 Note 7.
the United Kingdom.  

5.2.4.1 Under The Codes

Article 15 of the U.C.P. which defines the banks' duties does not mention to whom such duties are owed. Similarly the U.C.C. does not provide that the intermediary bank owes a duty of care to the buyer. Section 5-109 provides that the issuer owes a duty of care to its

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30 As a solution in France it was suggested by Stoufflet (Le Crédit Documentaire, Paris, 1957, at p.290) that the buyer employs the issuing bank as his agent in making the contract between him and a confirming bank or an intermediary-issuer [he excluded the advising bank who he regarded as the issuing bank's agent]. This no doubt gave a solution to the buyer problem but it is contrary to the intention of the parties. The intermediary bank does not intend to enter into a contractual relationship with foreign person that it does not know. See Ellinger, Documentary Letters of Credit, at p.233; Kozolchyk, International Encyclopedia of Comparative Law, Letters of Credit, Vol.IX. Ch.5, at p.45.

31 The Article 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. Documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to be in accordance with the terms and conditions of the credit."

32 In Instituto Nacional De Comercializacion Agricola (Indeca) v. Continental Illinois National Bank & Trust Co. [530 F. Supp. 279 (N.D. Ill. 1982) at p.282] the court construed Section 5-107(2) of the U.C.C. which reads "A confirming bank by confirming a credit becomes directly obligated on the credit to the extent of its confirmation as though it were its issuer and acquires the rights of an issuer." not to mean more than that the confirming bank has the right to be reimbursed by its customer which is the issuing bank. See Furman Dann, Confirming Bank Liability in Letter of Credit Transactions: Whose Bank Is It Anyway? at p.1235.

33 The Section reads "An issuer’s obligation to its customer includes good faith and observance of any general banking usage..."

34 Section 5-107(2) classified the confirming bank as an issuer. See Note 32.
customer, but that does not mean that the buyer is the intermediary bank’s customer. Section 5-103(g)\textsuperscript{35} includes within the definition of a customer an issuing bank who instructed another bank to issue or confirm the credit. So the issuing bank accordingly owes a duty of care to its customer which is the buyer and the intermediary bank owes a duty of care to its customer which is the issuing bank.\textsuperscript{36}

Although there is no express provision either in the U.C.P. or in the U.C.C. to the effect that the buyer has a cause of action against the intermediary bank, it is worth discussing whether such cause of action could be found within the Codes.

5.2.4.1[i] The U.C.P.

Article 20(a)\textsuperscript{37} by stating that the intermediary bank does the service at the risk of the buyer implies that there are obligations running between the buyer and the intermediary bank.\textsuperscript{38} Moreover, Article 20(c) states:

The applicant for the credit shall be bound by and liable to

\textsuperscript{35}The Section reads "A ‘customer’ is a buyer or other person who causes an issuer to issue a credit. The term also includes a bank which procures issuance or confirmation on behalf of that bank’s customer."


\textsuperscript{37}Quoted \textit{supra} at p.231.

indemnify the banks against all obligations and responsibilities...

Furman Dann, construed this Article to be implying that the intermediary bank has the right to claim reimbursement directly from the buyer. As a consequence of such understanding the author suggested that the buyer should equally have rights against the confirming bank.39

This interpretation of the Article is not correct, since the last sentence of it, which reads "... imposed by foreign laws and usages." limited the application of this Article to cases in which the intermediary bank incurs a loss as a result of a foreign law or usage.40

5.2.4.1[ii] The U.C.C.

Although Article 5 does not expressly provide that the account party has the right to bring an action against the intermediary bank it also does not provide that he cannot. Section 5-102(3) expressly stated that the Article does not cover all the problems arising out of dealing in letter of credit, the section reads as follows:

This Article deals with some but not all of the rules and concepts of letters of credit as such rules or concepts have developed prior to this act or may hereafter develop. The fact that this Article states a rule does not by itself require, imply or negate application of the same or a converse rule to a situation not provided for or to a person not specified by this Article.

39Ibid.

40See Gutteridge and Megrah, The Law of Bankers’ Credits, at p.80.
This Section was explained by the official comment to have given the courts the power to apply by way of analogy other rules to letters of credit problems which are not covered by the Article,\textsuperscript{41} and the courts have done so in several cases. In \textit{Barclays Bank D.C.O. v. Mercantile National Bank}\textsuperscript{42} the court asked the question that "... whether the policies underlying Article 5 would be furthered by applying a rule which is not specifically articulated there, but which is nonetheless developed by analogy to specifically codified rules"\textsuperscript{43} and stated that Section 5-102(3) gives an affirmative answer.\textsuperscript{44}

Also in \textit{AMF Head Sports Wear, Inc. v. Ray Scotts All-American Sport Club, Inc.},\textsuperscript{45} despite the fact that the Code provides that the issuing bank owes a duty of good faith only to its customer the court extended it to be owed also to the beneficiary.\textsuperscript{46}

\textsuperscript{41}U.C.C. §5-102 Official Comment 2 (1977).

\textsuperscript{42}481 F.2d 1224 (5th Cir. 1973).

\textsuperscript{43}\textit{Ibid.} at p.1231.

\textsuperscript{44}In this case the Fifth Circuit Court disagreed with the defendant who in reliance on the U.C.C. Section 5-103(f) which reads "A ‘confirming bank’ is a bank which engages either that it will itself honor a credit already issued by another bank …" argued that Article 5 does not apply to a letter of credit issued by a firm of mortgage consultants and confirmed by a bank. The court here extended the Code definition to include a confirming bank who confirmed a nonbank credit. \textit{Ibid.} at pp.1230-32.


\textsuperscript{46}\textit{Ibid.} at p.224.
5.2.4.1 ii A Analogy To U.C.C. Section 4-207

Based upon the flexibility of Article 5 it was suggested\(^\text{47}\) that Section 4-207 should be applied by analogy to be the basis of the confirming bank's direct liability to the buyer. The section gave the payer of a cheque the right to sue any customer or collecting bank for breach of warranty. The official comment on this Section states that "... the warranties and engagements run with the item with the result that a collecting bank may sue a remote prior collecting bank or a remote customer and thus avoid multiplicity of suits."\(^\text{48}\)

Extending the application of this Section by analogy to the letter of credit transaction, will clearly give the buyer the right to sue the confirming bank directly, avoiding having to sue the issuing bank and subsequently being faced with the exemption clauses.

However attractive this solution seems, it has its shortcoming; it imposes upon the confirming bank a greater responsibility than that imposed upon it by letters of credit law. Section 4-207(2)(a) provides that the collecting bank warrants that it has a good title to the instrument; however, under letter of credit law the confirming bank's duty is only


\(^{48}\)A further purpose of this Section is that the person who dealt with the fraudulent person is in the best position to discourage such a fraud therefore he should be held accountable for the loss. See Furman Dann, D., *Confirming Bank Liability in Letter of Credit Transactions: Whose Bank is it Anyway?* at p.1242.
to ensure that the documents appear regular on their face,\textsuperscript{49} regardless of whether they are of any value.

The author suggesting this solution has noticed this shortcoming but argued that:

\[ \ldots \text{allowing a direct action would not impose a greater standard of care on the confirming bank than already exist in its dealings with the issuer. Extending the express provisions of the Code by analogy would simply fill a gap left by the drafters, thereby providing the ultimate customer with a remedy when the confirming bank alone has breached code-imposed duty in honoring the beneficiary's draft.}\textsuperscript{50} \]

In short this solution seems to suggest that Section 5-107(2) of the U.C.C. which reads "A confirming bank by confirming a credit becomes directly obligated on the credit to the extent of its confirmation as though it were its issuer and acquires the rights of an issuer." is clearly stating that the confirming bank has the same rights and under the same duties towards its customer\textsuperscript{51} (the issuing bank) as that of the issuing bank towards its customer (the buyer). So applying Section 4-207 by way of analogy would impose upon the confirming bank the same duties towards the ultimate customer (the buyer) as that owed to its customer (the issuing bank).

\textsuperscript{49}See U.C.C. §5-109; U.C.P. Art. 15.

\textsuperscript{50}Confirming Bank Liability in Letter of Credit Transactions: Whose Bank is it Anyway? at p.1243. (Footnote of the quoted text omitted.)

\textsuperscript{51}and towards the beneficiary.
This solution, however, provides only an answer to the confirming bank-buyer relationship leaving out his relationship with other intermediary banks.

5.2.4.1[ii][B] A breach Of Warranty Under Section 5-111(2)

The same author who suggested the above solution advanced a further argument in an attempt to find a legal basis for the confirming bank's liability towards the buyer. The solution suggests that the confirming bank could be held liable to the buyer for breach of warranty under Section 5-111(2). The Section provides:

Unless otherwise agreed a negotiating, advising, confirming, collecting or issuing bank presenting or transferring a draft or demand for payment under a credit warrants only the matters warranted by a collecting bank under Article 4 and any such bank transferring a document warrants only the matter warranted by an intermediary under Articles 7 and 8.

As there is no indication in the provisions as to whom these warranties are made, the author who advanced this solution, suggested that there can not be more than two possible interpretations. The first is that the warranties are only made to the intermediate transferee. This interpretation derives support from a close reading of Section 5-111. In sub-section (1), which is concerned with warranties given by the beneficiary, it was expressly stated that those warranties are made "to all

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53 Ibid.
interested parties." So if the bank's warranties are meant to run to the buyer these words "to all interested parties" would have been included in sub-section (2). 54

The second, and more desirable interpretation, is that the warranties run with the documents, in which case the confirming bank's warranties run to the buyer. The author, in support of this interpretation, thought; firstly, that the reference by Section 5-111(2) to the warranties in Section 4-207, which runs with the documents, is a strong indication that the warranties under Section 5-111(2) also run with the documents. 55 Secondly the code should not be interpreted in a way that benefits an intermediary bank who is acting in bad faith. 56

Even if the second interpretation was accepted the intermediary bank would not be liable under Section 5-111(2) for any breach committed by it in good faith. 57 Articles 4, 7 and 8 referred to by Section 5-111(2) say that the bank only warrants its own good faith and authority and does not go beyond that to include a duty of due care.

54 In Pubali Bank v. City National Bank [676 F. 2d 1326 (9th Cir. 1982)] the confirming bank was held to be liable to the account party under Section 5-111(1) not as a confirming bank but as a person who has an interest of its own in the credit.


56 Ibid. at p.1252.

57 The author who advanced this solution only intended it to cover breaches that are committed in bad faith such as the intermediary bank's acceptance of documents that it knows have been forged.
5.2.4.2 Liability For Negligent Misrepresentation

It was suggested both in the U.S.A. and the U.K. that the intermediary bank could be held liable to the buyer for negligent misrepresentation.

5.2.4.2[i] In The U.K.

Professor Ellinger,58 in an attempt to find a cause of action, examined the possibility of holding the intermediary bank liable for negligent misrepresentation if in reliance on this misrepresentation the buyer suffers a pecuniary loss.59 For instance if the intermediary bank negligently accepted forged documents would it be held accountable to the buyer for negligently stating that the documents conform with the terms of the credit?

58Documentary Letters of Credit, at pp.236-8, also by the same author Letters of Credit: Buyer Action against the Confirming Banker, (1963) 26 M.L.R. 713 et.seq. See also Sassoon, Documentary Credits: The Applicant and the Advising Bank [1986] J.B.L. 33 at p.36; Penn, Shea and Arora, The Law and Practice of International Banking, (Vol. 2) at pp.344-5.

59Ellinger illustrates this point [Ibid. at pp.234-5] by the example that a full set of bills of lading and an all risks insurance policy were required by the credit but the beneficiary tendered only one bill of lading and an insurance policy covering total loss only. The confirming bank, in an inquiry as to whether to accept the documents, informed the issuing bank that only one bill of lading was tendered but made no mention that the insurance policy did not cover all risks. After being informed by the issuing bank the buyer waived this discrepancy and the issuing bank instructed the confirming bank to accept the document. The goods were later damaged but not totally lost. In this example it seems that the buyer does not need to sue the confirming bank because if after receiving the documents the buyer found a further discrepancy other than that he had waived he still has the right to reject the documents.
To give an answer to the above question it is essential to discuss the rules of negligent misrepresentation causing financial loss that were made by the House of Lords in *Hedley, Byrne & Co., Ltd. v. Heller & Partners Ltd.* The facts of this case were that the respondent (bank) was asked by the appellant’s bank to give a reference about the financial position of one of the respondent’s customers (*Easipower Ltd.*). The reference, which was given without responsibility on the part of the respondent, was satisfactory. Relying on which the appellant (advising agents) entered into a transaction with *Easipower* who later went into liquidation causing the appellant a loss of over £17,000. The appellant brought an action for damages against the respondent alleging, *inter alia*, that the reference was given negligently by the respondent. The latter was proved to be negligent at the trial but the House of Lords held that the appellants’ action failed because the respondent gave the reference subject to their disclaimer of liability.

However, in this case the House of Lords expressed the opinion that damages for financial loss resulting from negligent misrepresentation would be awarded if the plaintiff proved that the defendant owed him a duty of care. The House further pointed out that such a duty of care would arise whenever there is a contractual, fiduciary or other special

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relationships.61 No definite description was given by the House as to
the nature of these special relationships but there were attempts to show
how such a relationship could come into existence. Lord Morris stated
that:

it should now be regarded as settled that if someone possessed of
a special skill undertakes, quite irrespective of contract, to apply
that skill for the assistance of another person who relies upon such
skill, a duty of care will arise. The fact that the service is to be
given by means of or by the instrumentality of words can make no
difference. Furthermore, if in a sphere in which a person is so
placed that others could reasonably rely upon his judgment or his
skill or upon his ability to make careful inquiry, a person takes it
upon himself to give information or advice to, or allows his
information or advice to be passed on to, another person who, as
he knows or should know, will place reliance upon it, then a duty
of care will arise.62

Lord Reid also expressed the opinion that:

I can see no logical stopping place short of all those relationships
where it is plain that the party seeking information or advice was
trusting the other to exercise such a degree of care as the
circumstances required, where it was reasonable for him to do
that, and where the other gave the information or advice when he
knew or ought to have known that the inquirer was relying on
him. I say ‘ought to have known’ because in questions of
negligence we now apply the objective standard of what the

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61Ibid. at pp.486, 496-7, 502-3, 514, 523, 528-9, 539. Before this case it was
doubted that a negligent misrepresentation which causes a pecuniary damage could
constitute a cause of action, see for example, Derry v. Peek (1889) 14 App. Cas.
[1951] 2 K.B. 164.

62Ibid. at pp.502-3.
reasonable man would have done.\textsuperscript{63}

In the words of Lord Pearce:

To import such a duty the representation must normally, I think, concern a business or professional transaction whose nature makes clear the gravity of the inquiry and the importance and influence attached to the answer.\textsuperscript{64}

Lord Devlin also said:

... relationships which ... are 'equivalent to contract', that is, where there is an assumption of responsibility in circumstances in which, but for the absence of consideration, there would be a contract.\textsuperscript{65}

It could be understood from the above statements that in order for a duty of care to exist outside the contractual or fiduciary relationship a number of factors must be established. Firstly, that the statement must be made in the course of business or profession and the person making it must have a special knowledge or skill in the subject matter. Secondly, the person who makes the statement must know or ought to know the importance of his statement and that the other person may rely on it. In other words he must assume responsibility. Thirdly, the recipient of the statement must prove that he relied on the statement and it was reasonable to do so.

\textsuperscript{63}\textit{Ibid.} at p.486.

\textsuperscript{64}\textit{Ibid.} at p.539.

\textsuperscript{65}\textit{Ibid.} at p.529.
The examination as to whether these rules are applicable to the situation where the intermediary bank makes a negligent statement and the buyer by relying on this statement sustained a financial loss is as follows. Firstly, the statement made by the intermediary bank is connected to its profession and it has the knowledge of what is happening at its end. Secondly, the intermediary bank is aware of the importance of its statement and knows or ought to know that the issuing bank will pass it to the buyer, and the latter will be influenced by it in making his decision. So it should be held to have assumed liability. Thirdly, it is clear that the buyer will act on reliance on the intermediary bank’s statement and he is justified in doing so.

It seems from the preceding discussion that the intermediary bank could be held liable to the buyer for its negligent mis-statement. However, although the point of holding the intermediary bank liable to the buyer in negligence has been raised in court cases in the U.K. it has not been fully argued. In United Trading Corpn S.A. v. Allied Arab Bank Ltd the submission, which was made on behalf of the plaintiff,

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66Professor Ellinger argued rightly that because there is no direct communication between the intermediary bank and the customer it is difficult to lay down a general rule that the intermediary bank is always aware that the information it gives will be passed to the customer and the latter may rely on it. Letters of Credit: Buyer’s Action Against the Confirming Banker, at p.715.

67It should be noted that the Hedley case was concerned with a situation where information was requested, but it is not essential that the information is given as a result of a request. See Percy, R.A., Charlesworth & Percy on Negligence, (18th ed.)

68[1985] 2 Lloyd’s L. Rep. 554n, CA. The case was concerned with a performance bond.
was that the issuing bank and all other banks in the chain would arguably be liable to the plaintiff in the tort of negligence if they complied with the beneficiary's demand which they know to be fraudulent at the time of payment. This submission was accepted on behalf of the respondent as being arguable and on this basis the case proceeded. In *GKN Contractors Ltd. v. Lloyds Bank Plc.* this point was also raised. Following the view of *United Trading* it was accepted by the Court of Appeal as being arguable. Parker L.J. in this case stated:

That cause of action [tort of negligence] is one which I find some difficulty in appreciating, but, in view of the fact that in this court in a case not yet reported [*United Trading* case] ..., the existence of such a cause of action was considered arguable, for the purposes of the present appeal I take it that it is also arguable.

Parker L.J. in the above statement seems to suggest that if the point was fully considered no duty of care would be found. Jack, citing *I E Contractors Ltd v. Lloyds Bank Plc and Rafidian Bank* also suggested that if the argument was to be decided, the intermediary bank would not be held to owe a duty of care to the account party because

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70 (1985) 30 Build. L.R. 48, CA. This case was also concerned with a performance bond.


72 *Documentary Credits,* at p.267.

73 [1989] 2 Lloyd's Rep. 205, Court of Appeal (1990) Financial Times, 17 July, CA. It is difficult to see how this case could be supportive to the author's view since this point was not discussed at the trial.
there is no relationship between the two parties that could allow imposing such a duty.

5.2.4.2[ii] In The U.S.A.

The permission given by Section 1-103 of the U.C.C. which provides that "unless displaced by the particular provisions of this Act, the principles of law and equity ... shall supplement its provisions" has led courts and law commentators to question the possibility of applying the common law principle of negligent misrepresentation as the basis of a cause of action by the account party against the intermediary bank.

The Task Force did not suggest that there should be a specific provision in the next revision of the U.C.C. Article 5 that deals with the problem of the lack of privity between the confirming bank and the applicant for the credit, but they emphasized that such lack of privity should not be construed as giving the confirming bank a permission to act with gross negligence. In such case they are of the opinion that the applicant should be allowed to sue the confirming bank for negligence.75

74 In many cases courts have applied common law principle to letters of credit; for instance, the principle of equitable estoppel has been applied in Bank of Cochin v. Manufacturers Hanover Trust Co., 808 F.2d 209 (2d Cir. 1986); Marino Industries Inc., v. Chase Manhattan Bank, N.A., 686 F.2d 112 (2d Cir. 1982). The principle of waiver has been applied in Barclays Bank D.C.O. v. Mercantile National Bank, 481 F.2d 1224 (5th Cir. 1973). Bank of Canton Ltd. v. Republic National Bank, 509 F. Supp. 1310, 1317 (S.D.N.Y.), affirmed, 636 F.2d 30 (2d Cir. 1980).

75 Towards the Revision of U.C.C. Article 5 (Letters of Credit) A Report of the Task Force on the Study of U.C.C. Article 5, 1989 [This revision is not final] at
It has long been recognized by American Courts that where a negligent mis-statement made by a person resulted in pecuniary loss to another an action will lie, even if there was no privity between them.76 One of the early cases in which this point was decided is Glanzer v. Shepard.77 In this case a firm of public weighers (the defendant) were requested by the seller to make a certificate of the weight of the goods and send a copy of it to the plaintiff. Relying on the weight certificate, that was sent to him by the defendant, the plaintiff purchased the goods. He later discovered that the weight of the goods was less than what the certificate stated it to be. In an action by the plaintiff to recover the money overpaid to the seller from the defendant (the firm of public weighers) the Court of Appeals of New York held that the defendant was liable to the plaintiff. In this case Cardozo J. stated:

... assumption of the task of weighing was the assumption of a duty to weigh carefully for the benefit of all whose conduct was to be governed. We do not need to state the duty in terms of contract or of privity. Growing out of a contract, it has none the less an origin not exclusively contractual. Given the contract and

p.41.


77233 N.Y. 236, 135 N.E. 275 (1922).
the relation, the duty is imposed by law.\textsuperscript{78}

It was also stated:

The defendants, acting, not casually nor as mere servants, but in the pursuit of an independent calling weighed and certified at the order of one with the very end and aim of shaping the conduct of another. Diligence was owing, not only to him who ordered, but to him also who relied.\textsuperscript{79}

In order to succeed in an action for negligent misrepresentation the plaintiff must prove that the defendant owed him a duty of care. The mere reasonable expectation that the information may be passed to third parties is not sufficient to create a duty of care between the maker of the statement and these third parties.\textsuperscript{80} In \textit{Ultramares Corporation v. Touche, Niven & Co.},\textsuperscript{81} a firm of accountants (defendant) were requested to prepare a balance sheet of a company. The defendant knew that the balance sheet would be shown to third parties for the purpose of making some financial transactions, but they did not know specifically to whom or what kind of transaction. The defendant negligently prepared the balance sheet to show falsely that the company was in good financial status. The plaintiffs, in reliance on the balance sheet, made several deals with the company. The company later failed and the plaintiffs sustained financial loss. In an action by the plaintiffs

\textsuperscript{78}135 N.E. at p.276.

\textsuperscript{79}Ibid. at p.277.


\textsuperscript{81}255 N.Y. 170, 174 N.E. 441 (1931).
to recover their loss from the defendant, the court held that although the accountants firm were negligent in preparing the balance sheet, they did not owe any duty of care to the plaintiffs. Cardozo C.J., in giving his reasons for the dismissal of the action stated:

If liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class. The hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences. 82

Cardozo C.J.'s fear of imposing unlimited liability upon the person who makes a negligent misrepresentation was recognized by The Restatement of Torts (Second). Section 552(2) restricted the liability to loss suffered:

(a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it: and (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

The rules of negligent misrepresentation discussed, appear to be applicable to the situation in which the intermediary bank makes a negligent misstatement and the buyer, as a result of relying on it, suffered financial loss. However, a contrary conclusion was reached by courts in cases where this point was raised. In Courteen Seed Co. v.

82Ibid. at 179, 174 N.E. at 444.
Hong Kong & Shanghai Banking Corp., upon an agreement to purchase a shipment of alfalfa seeds, the plaintiffs (the buyers) requested the Union Trust Co. of Chicago to open an irrevocable letter of credit in favour of the Russian seller. The Union Trust Co. requested the defendants to negotiate the draft drawn by the seller on the Union Trust Co. The defendants’ branch in Vladivostock [a Russian seaport] negotiated the seller’s draft despite the fact that it was presented after the expiration of the credit and the bill of lading stated that the goods were shipped after the expiration of the shipping period. The defendants’ branch in Vladivostock later received a telegram directing them to amend the letter of credit by reducing its amount and extending its expiry date for an extra nine days. The defendants’ branch replied that it had already negotiated the seller’s draft. Because the goods arrived before the documents, the plaintiffs accepted them and sold them at a loss. After receiving the documents the plaintiffs discovered that the terms of the credit were not complied with. So they brought an action against the defendants for damages, contending that the loss they suffered resulted from the defendants’ negligent misrepresentation that the beneficiary complied with the terms of the credit. The court held that the defendant did not owe any duty of care to the plaintiffs. In the

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83245 N.Y. 377, 157 N.E. 272 (1927) affirmed 159 N.E. 641 (1927). It should be noted that the defendant in this case was a negotiating bank.

84 Ibid. at 380, 157 N.E. at 273.

85 Ibid.

86 Ibid.
course of his judgment Pound J. stated:

The Court has had to deal recently with cases involving liability for information negligently given. They all rest on the principle that negligent words are not actionable unless they are uttered directly, with knowledge or notice that they will be acted on, to one to whom the speaker is bound by some relation of duty, arising out of public calling, contract or otherwise, to act with care if he acts at all.\(^87\)

He then continued to say:

Here respondent owed no duty of diligence to appellant. Appellant made no inquiry of respondent as to the exact date on which the draft had been purchased and shipment made. The information that respondent gave the Union Trust Company was that the letter of credit had been drawn upon. It ran all the risk of its negligent act in buying the draft after the expiry date. It might anticipate that if it so bought the draft the Union Trust Company would refuse to honor it. It could scarcely anticipate that appellant would, without verifying the date of shipment, accept the alfalfa seed merely on the strength of the telegram. Respondent did not have knowledge or its equivalent that such would be the result of the misinformation, or that the seed would arrive before the draft and accompanying documents. It did not deal with appellant, had no relations with it, and was under no duty of care to it.\(^88\)

In Dulien Steel Products, Inc. of Washington v. Bankers Trust Co.\(^89\) Messrs. Marco Polo Group Projects, Ltd. were entitled to a commission from the plaintiffs for having arranged some kind of transaction between

\(^87\)Ibid. 157 N.E. at p.273.

\(^88\)Ibid. at p.274.

\(^89\)298 F.2d 836 (2d Cir. 1962) affirming 189 F. Supp. 922 (1960).
the plaintiffs and some other person. For the payment of this commission the plaintiffs instructed *Seattle First National Bank* to open an irrevocable letter of credit in favour of *Sica* (a person nominated by *Marco Polo* to be the beneficiary of the credit). The irrevocable credit was confirmed by the defendants. Later the price of the goods under the main transaction was reduced and consequently the commission should have been reduced also. The defendants were informed of this change by the issuing bank and were asked not to pay the full amount of the credit. However, *Sica* demanded the full amount of the credit and the defendants complied. The plaintiffs (the account party) brought an action against the defendants (confirming bank) for the recovery of the money overpaid to *Sica*. Because no contract exists between the two parties, the plaintiffs tried to establish the claim on negligence. They contended that the confirming bank "failed to exercise that degree of care and prudence exercised by banks in comparable circumstances and to which plaintiff was entitled in conformity with established custom and

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^90 As an alternative ground the plaintiffs alleged that the communication between the issuing bank and the defendant about the change in the underlying transaction gave rise to an estoppel. Marshall J. rejected this argument, he said "There were no communications between *Bankers Trust* and *Dulien* and therefore no representation by *Bankers Trust* to *Dulien." he then said "There is no estoppel here. There was no promise and it is therefore impossible to spell out promissory estoppel. There is no equitable estoppel because there could be no valid reliance on the assumption that Bankers Trust would breach an enforceable obligation to pay Sica." *Ibid.* at p.842. It should be noted that in English and Scottish Law estoppel is merely a rule of evidence, it is not a foundation of an action. In England see *Low v. Bouverie* [1891] 3 Ch. 82 Per Bowen, L.J. at pp.101,105; *Combe v. Combe* [1951] 2 K.B. 215. In Scotland see Gloag, *The Law of Contracts*, at p.167.
usage in banks generally.\textsuperscript{91} Marshall J. held that the defendants were not negligent, but did not exclude the possibility of them being sued for negligence if they were.

The point was finally decided in \textit{Instituto Nacional De Comercialization Agricola (Indeca) v. Continental Illinois National Bank \\& Trust Co. of Chicago}.\textsuperscript{92} In this case the plaintiffs, \textit{Indeca} agreed to purchase 6,000 metric tons of black beans for $5 million from the seller, \textit{RuMex}. They requested \textit{Banco de Guatemala} to open an irrevocable credit in favour of the seller. \textit{Banco} issued the credit and engaged the defendant as the confirming bank. \textit{RuMex} tendered the documents to the confirming bank but they were rejected because the certificate of origin was not 'legalized' by the Guatemalan Consul as the credit required. Despite the fact that the confirming bank was located in Chicago and the office of the Guatemalan Consul was in Miami, the beneficiary, three hours after the documents were rejected, returned with the certificate of origin signed and stamped with the Guatemalan Consul’s Miami address. The confirming bank accepted the documents and honoured \textit{RuMex}'s draft. The documents were forwarded to the issuing bank who passed them to \textit{Indeca}. The latter confirmed that they were in compliance with the terms of the credit and authorized payment. The goods never arrived in Guatemala. In an action by the plaintiffs, the federal district court held that the defendant confirming bank was

\textsuperscript{91}\textit{Ibid.} at p.840.

\textsuperscript{92}530 F. Supp. 279 (N.D.Ill. 1982)
liable to the plaintiffs for negligent misrepresentation. The court stated that "Continental [the confirming bank] represented to all who might foreseeably rely on such information that RuMex [the beneficiary] was honest in its revisions."93

In an appeal94 by the defendant a special jury hearing was held. The jury was asked among other questions "Do you find by a preponderance of the evidence that, in carrying out its duties as a confirming bank, Continental [the confirming bank] made a misrepresentation to Indeca [the buyer] and, if so, that Continental was negligent in determining the truth or falsity of the misrepresentation?"95 Although the jury response was affirmative, the court held that the confirming bank acted reasonably, and therefore was not negligent.

Indeca made an appeal96 in which the Seventh Circuit held that no action would lie by the account party against the confirming bank for negligent misrepresentation, on the ground that the confirming bank is not required, by the letter of credit law, to look beyond the face of the presented documents.97 Thus holding it liable for negligent misrepresentation would impose on it a greater duty.

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93Ibid. at p.284.

94675 F. Supp 1515 (N.D.I11. 1987)

95Ibid. at p.1518.

96858 F.2d 1264 (7th Cir. 1988)

97U.C.C. §5-109(2).
Regarding whether the flexibility of the code would allow the application of the negligent misrepresentation rules to letter of credit transaction, the Appeal Court stated:

The flexibility accorded by the Code, however, should not be mistaken for approval to range far and wide over the legal landscape in search of legal theories to invoke against the parties to a letter of credit transaction. The flexibility accorded is limited by the underlying policies of letter of credit law and Article 5.98

Also with approval the court quoted these words from *Auto Servicio San Ignacio S.R.L. v. Compania Anonima Venezolana de Navegacion*99:

The exchange function of the letter of credit rests upon objective predictable standards with defined expectations and risks. Injecting the uncertainty of the tort principles contended for is inconsistent with these necessities and is not supported by the Code, which implicitly rejects them.100

The court here does recognize that imposing on the confirming bank a liability for negligent misrepresentation will be contrary to the independent principle of letter of credit, i.e., would force the confirming bank to ensure the genuine performance of the underlying transaction.101

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98 858 F. 2d 1264 at p.1268.

99 765 F. 2d 1306 (5th Cir. 1985).

100 *Ibid.* at p.1308.

101 *U.C.C. §5-114(1).*
Furthermore, the Appeal Court's decision seems in line with Professor J. Dolan's criticism of the lower court decision. He described it as being "a significant departure from the rule of Section 5-111(2)." Referring to Section 1-103, he argued that common law principle supplements the Code but does not apply if displaced by a specific provision of the Code. Therefore Section 5-111(2) displaces any common law rule which adds warranties other than those provided for in the section, which is the confirming bank's good faith and authority.

Finally, the lower court decision is also contrary to Section 5-114(2)(b) which provides that:

... an issuer acting in good faith [acting negligently is not a bad faith] may honor the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents...

In short, there is no room for negligent misrepresentation to be fitted within letter of credit law.

102 The Law of Letters of Credit, Commercial and Standby Credits, at p.6-40.


104 It also applies to the confirming bank. See §5-107(2).

5.3 The Relationship Between The Intermediary Bank And The Beneficiary

The role assumed by the intermediary bank determines the nature of its relationship with the beneficiary. In the situation where the intermediary bank issues the credit in its name (intermediary-issuer) it will have with the beneficiary the same contractual relationship that the latter has with the issuing bank. Similarly, when the intermediary bank confirms a credit opened by the issuing bank, it stands in the same position as the latter vis-à-vis the beneficiary. The fact that both the issuing bank and the confirming bank, in this situation, make the same promise to the beneficiary does not change the nature of his relationship with either of them.\(^{106}\) McAvoy J. in this regard observed "Each of these undertakings is a separate and distinct contract between the bank issuing the new commitment and the beneficiary of such new undertaking."\(^{107}\) This view has now been codified by both the U.C.P. and the U.C.C. Article 10(b) of the U.C.P. sets out the undertaking of the confirming bank towards the beneficiary in the same way it sets out the irrevocable undertaking of the issuing bank in Article 10(a). The same effect is also given by Section 5-107(2) of the U.C.C. which reads:

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\(^{106}\)See Benjamin’s *Sale of Goods*, at §23-141.

(2) A confirming bank by confirming a credit becomes directly obligated on the credit to the extent of its confirmation as though it were its issuer and acquires the rights of an issuer.

It can, therefore, be said that the principles applicable to the beneficiary's relationship with the issuing bank are equally applicable to his relationship with both the intermediary-issuer and the confirming bank.

It is, however, different when the correspondent bank assumes the role of advising bank. In this situation the advising bank does not make any promise to the beneficiary and often includes in the advice a statement, the effect of which is to negate the possibility of it being under a contractual relationship with the beneficiary, such as "without engagement on our part".

Both codes expressly provide that the advising of the credit does not constitute an undertaking by the advising bank to the beneficiary. Article 8 of the U.C.P. states:

A credit may be advised to a beneficiary through another (the advising bank) without engagement on the part of the advising bank,...

Similarly Section 5-107(1) of the U.C.C. reads:

Unless otherwise specified an advising bank by advising a credit issued by another bank does not assume any obligation to honor drafts drawn or demands for payment made under the credit...

108See supra at pp.32 et seq.
It is, therefore, clear that the beneficiary has no right against the advising bank, but such lack of contractual relationship will give rise to two difficulties.

5.3.1 The First Difficulty

What is the position of the beneficiary if he suffered a financial loss as a result of the advising bank's failure to do its duty? Such loss could be incurred as a result of failing to advise the credit at all, advising the credit but too late to allow the beneficiary enough time to assemble the required documents before the expiry date of the credit, or as a result of calling for documents other than those required by the credit\textsuperscript{109} which when tendered by the beneficiary will be rightly rejected by the issuing bank.\textsuperscript{110}

As regards the last situation the U.C.P. Article 8 in its latter part states "...but that bank shall take reasonable care to check the apparent authenticity of the credit which it advises." This Article clearly imposes on the advising bank a duty of care towards the beneficiary to ensure

\textsuperscript{109}It should be noted that the occurrence of these errors is very rare due to the fact that issuing banks usually when instructing an advising bank by teletransmission state in it that a mail confirmation will follow which constitutes the operative instrument (U.C.P. Art. 12) and even if there was no mail confirmation the advanced communication technology at the present time provides very accurate transmission. See infra. at p.264 Note 109. See generally on this point Kozolchyk, Is Present Letter of Credit Law Up To Its Task? (1986) GMU L.Rev. 285 at pp.288 et seq.

\textsuperscript{110}As to whether the issuing bank is under an obligation to accept these documents on the basis of being bound by the act of its agent-the advising bank, see infra at pp.281-2.
that the credit is genuine but it does not include liability for its error in transmitting the terms of the credit to the beneficiary. It is, however, apparent that the words "without engagement on our part" only mean that the advising bank is not under an obligation to pay the beneficiary under the credit, and are not capable of being understood to have the effect of excluding the advising bank's liability for its error in advising the credit to the beneficiary.

On the theory that the advising bank is the agent of the issuing bank,\textsuperscript{111} it was suggested\textsuperscript{112} that according to the law in the United Kingdom an agent when dealing with a third party impliedly warrants that he has the authority of his principal, and if he acts without authority he will be liable to the person to whom the warranty is given for its breach.\textsuperscript{113} Thus, as the advising bank is not authorized by the issuing bank to advise the credit wrongly, it will be liable to the beneficiary for breach of the implied warranty of authority if it does.

Alternatively it was argued\textsuperscript{114} that the advising bank knows that its information will be relied upon by the beneficiary and therefore it owes him a duty of care, the breach of which will render the advising bank

\textsuperscript{111}See infra, The Relationship Between the Issuing Bank and the Advising Bank at p.279.

\textsuperscript{112}Jack, R., Documentary Credits, at p.112.

\textsuperscript{113}See Collen v. Wright (1857) 8 E. & B. 647; Firbank's Executors v. Humphreys (1886) 18 Q.B.D. 54.

\textsuperscript{114}Benjamin's Sale of Goods, at §23-142.
liable to the beneficiary for negligent misrepresentation within the rule of *Hedley, Byrne & Co. Ltd. v. Heller & Partners Ltd.*\(^{115}\)

In the U.S.A. the latter part of Section 5-107(1) of the U.C.C. expressly provides "...but it (the advising bank) does assume obligation for the accuracy of its own statement." This provision makes it clear that the advising bank is responsible for the accuracy of its advice but it does not clarify whether the advising bank is liable to the issuing bank with which it has a contractual relationship or to the beneficiary. This point, however, has been settled by a number of cases; in *Merchants Bank of New York v. Credit Suisse Bank*\(^{116}\) the court held that:

An advising bank ... assumes no, or very limited responsibilities under the letter of credit arrangement. It is considered a neutral party, important in forging some connection between the issuing bank and the beneficiary, parties which generally have no prior link. The advising bank is confined to transmitting information and authenticating the information transmitted, and therefore assumes no liability to the party addressed, except liability for accurate transmission.\(^{117}\) (Emphasis added.)

In *Sound of Market Street v. Continental Bank International*\(^{118}\) the

\(^{115}\)[1964] A.C. 465. As to the rule of this case and negligent misrepresentation in general see *supra* at pp.244 *et seq.*


\(^{118}\)819 F. 2d 384, 4 U.C.C. Rep. Serv. 2d (Callaghan) 175 (3d Cir. 1987).
Once the letter of credit is established, however, the seller acquires the additional right to rely upon the letter of credit. He acquires the right to insist upon payment from the issuing bank upon presentation of the required documents and the right to collect damages from the advising bank if the purpose of the letter of credit is frustrated by the giving of an inaccurate advice.\textsuperscript{119}(Emphasis added)

A contrary view has been advocated by Professor Dolan\textsuperscript{120} who suggested that the advising bank should not be held liable for its error in advising the credit on the following grounds; firstly, not imposing liability on the advising bank will encourage the beneficiary to enquire and put the situation right before any loss is incurred. Secondly, being familiar with the terms of the sale contract, the beneficiary usually knows if the credit advised is not correct and, even if he does not know, his experience of the industry practices puts him in a better position to detect if there is any error and guard against it than the advising bank. Thirdly, the beneficiary should not be allowed to recover in an action against the advising bank for breach of duty of care because on one hand the beneficiary by not enquiring is contributorily negligent and, on the other, the law of tort does not impose a duty of care on a person if he

\textsuperscript{119}819 F. 2d 384 at p.394. It was further stated (at p.395) "Once the letter of credit is advised, and thereby established, the beneficiary has a right to rely upon accuracy of the advice given and the advising bank is liable if a loss is occasioned by its failure to accurately advise."

\textsuperscript{120}The Correspondent Bank in the Letter-of-Credit Transaction, at pp.423-8.
has no way to know how much care he should take.\textsuperscript{121} Fourthly, making the advising bank liable may require it, in some cases, to pay the whole amount of the credit to the beneficiary; it is true that the beneficiary will submit the documents to the advising bank and may assign to it his right against the buyer, which will enable the advising bank to recover its loss by reselling the goods or suing the buyer, but that is unsatisfactory, since unlike the beneficiary who is a commercial party well equipped to deal with the goods and has elected to deal with the buyer, the advising bank is a financial party who is not equipped to deal with the goods and never chose to deal with the buyer. Lastly, disallowing the beneficiary a cause of action against the advising bank will not create a number of litigations at the end of which the advising bank will be the party who bears the loss (i.e. the beneficiary will sue the buyer for breach of the contract of sale and the buyer will sue the issuing bank for breach of their agreement in the application form, and the issuing bank will sue the advising bank for not carrying out its instructions properly) since even if the beneficiary can sue the buyer for breach of the underlying contract the buyer would not be able to sue the issuing bank because the issuing bank is exempt from liability for the advising bank’s act or omission.\textsuperscript{122}

Dolan’s above argument as a whole is convincing, but it does not appear to account for the fact that freeing the advising banks from

\textsuperscript{121}See Dolan, \textit{The Correspondent Bank in the Letter-of-Credit Transaction}, at p.427 Note 68 and authority cited therein.

\textsuperscript{122}See exemption clauses \textit{supra} at pp.230-1.
liability for their error in advising the credit, is very likely to reduce the beneficiaries’ inclination to rely on their advice which may lead to the dispensation with their services and consequently diminishing the importance of the role they assume in letter of credit transactions.

However, for the same above reasons Dolan suggested that the advising bank should not be responsible to the beneficiary in the two other situations, i.e. when it does not advise the credit or advises it but too late. This view is in line with the decision in Sound of Market Street, Inc. v. Continental Bank International.\(^\text{123}\)

In this case the advising bank’s (Continental Bank) late advising of the letter of credit resulted in the beneficiaries’ (Sound of Market) inability to ship the goods before the shipping date, designated by the letter of credit. Because the account party refused to make an amendment of the credit in order to allow late shipment the beneficiary (Sound of Market) brought an action against the advising bank (Continental Bank) contending that the advising bank’s failure to advise the credit on time was a breach of a duty owed to it. After examining the possible grounds on which the advising bank could be held liable to the beneficiary, namely, statutory duty, negligence and third party beneficiary of the contract between the issuing bank and the advising bank, the Third Circuit Court rejected them all and reversed the lower

\(^{123}\)819 F. 2d 384, 4 U.C.C. Rep. Serv. 2d (Callaghan) 175 (3d Cir. 1987).
court’s decision by holding that the advising bank is not under any obligation to the beneficiary to advise the letter of credit in a timely fashion. In the conclusion of the judgment the Third Circuit Court stated:

Until the letter of credit is advised, the only party owing a duty to the future beneficiary is the account party and that duty derives from the underlying contract between the account party as buyer and the future beneficiary as seller. (Emphasis added)

The above statement clearly establishes that before the letter of credit is advised the advising bank is not under any obligation to the beneficiary; that statement is wide enough to deny the beneficiary a right of action against the advising bank if it fails to advise the credit at all.

In the United Kingdom the same effect can be derived from the decision in Lindsay (A.E.) & Co., Ltd. v. Cook. In this case the letter of credit reached the seller too late as a result of a delay in the inter-bank communication, and not as a result of the buyer’s failure, nonetheless, the court held him liable to the seller. Making the buyer’s obligation to open the credit in time absolute, in this case, is a clear indication that the beneficiary’s right when the credit is not opened


127 Ibid. at p.335.
or not opened in time is against the buyer and not against the advising bank.

5.3.2 The Second Difficulty

When the advising bank’s role is not limited to advising the credit but includes accepting the beneficiary’s documents and making payment against them, would it be allowed to recover the money paid to the beneficiary if it has accepted documents that are not in compliance with the terms of the credit if the issuing bank rejected them?

In answering this question a distinction should be drawn between the situation where payment was made by utilizing a bill of exchange and the situation where no bill of exchange is involved.

In the first situation if the bill is not honoured by payment or acceptance, as the case may be, the advising bank as a holder of the bill has under the law of negotiable instruments, the ordinary right of recourse against the beneficiary who is the drawer and endorser of the bill.128

In Ng Chee Chong, Ng Weng Ching, Ng Cheng and Ng Yew (Maran Road Saw Mill) v. Austin Taylor & Co. Ltd.129 Ackner J. approving of Gutteridge and Megrah’s130 opinion in this connection stated:

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128See infra at p.307 Note 35.
130The Law of Bankers’ Commercial Credits, at p.87.
This article makes it clear that a confirming bank may not have recourse. It is otherwise in the case of a non-confirming bank. The reason is that whereas the latter is the agent of the issuing bank for the purpose of advising the credit, it acts as principal vis-à-vis the beneficiary. He is under no duty to negotiate and if it does so, it may make whatever conditions it likes as to a pre-requisite to doing so. It follows that if the credit is available by "time" draft, the negotiating bank may have recourse on the draft if this is ultimately unpaid. The fact of advising places no responsibility on the negotiating bank, no greater responsibility than if it were not the advising bank; and it makes no difference that negotiations may be restricted to that bank.\textsuperscript{132}

It is, however, doubtful if the advising bank will be entitled to recover the money in the second situation, where payment is made against documents that do not include a bill of exchange. Even if the rules of waiver and estoppel, which can be raised by the beneficiary against the issuing bank,\textsuperscript{133} cannot be raised by the former against the advising bank, because of lack of contractual relationship between them, it is uncertain if the advising bank can recover such money as being paid under a mistake of fact, since it is under no obligation to the beneficiary to accept the documents and its acceptance of them would not be considered as being made on the belief that they are in compliance with

\textsuperscript{131}Referring to Art. 3 of the U.C.P. 1962 Revision (Art. 10 1983 Revision).


\textsuperscript{133}See supra at p.36.
the terms of the credit. Even if it is assumed that the advising bank has an action for money paid under a mistake of fact, in most cases such action would not succeed because during the period between accepting the documents and seeking recourse by the advising bank, which is not short, the beneficiary would very likely to have altered his position. Disallowing the advising bank a right of recourse against the beneficiary is consistent with Article 16 of the U.C.P. which indicates that, as regards the beneficiary, the acceptance of the documents is the final stage; thus, the Article could be relied upon to preclude the advising bank from claiming that the documents are not facially in compliance with the credit's terms after accepting them.

In the U.S.A. Section 5-111(1) of the U.C.C. provides in part that the beneficiary "Warrants to all interested parties that the necessary conditions of the credit have been complied with."

The advising bank is undoubtedly one of the interested parties to whom this warranty runs but the question is whether the beneficiary warrants in addition to any hidden defects, discrepancies that could reasonably be discovered by examining the face of the documents? The

\[134\] See Benjamins' Sale of Goods at §23-142.

\[135\] Gutteridge and Megrah, [The Law of Bankers' Commercial Credits, at p.86] are of the view that the bank is entitled to recover the money paid as money paid under a mistake of fact if the recourse was claimed before the beneficiary changed its position in good faith, but cf. Goode, Reflections on Letters of Credit-III, [1980] J.B.L. 443 at pp.444-5; by the same author, Commercial Law, at pp.678-9.

members of Article 5 Task Force\textsuperscript{137} did not give a conclusive answer to the question. Some of them were of the view that the beneficiary warrants both defects arguing that beneficiaries could raise the defence of waiver and estoppel against the issuer who accepted facially defective documents. However, this argument does not seem to account for the fact that the beneficiary cannot raise these defences against the advising bank because of the lack of contractual relationship between them. The more acceptable opinion is given by the other members who were of the view that the warranty is limited to hidden defects because extending it to facial defects would, firstly, encourage issuers and payers to weaken the standard of the examination of documents. Secondly, it would not be consistent with the commercial credit function which promotes the finality of payment.

Dolan\textsuperscript{138} sharing the same opinion, argued that the purpose of this section is to protect the account party if there were any hidden defects, which does not excuse him from reimbursing the issuing bank, i.e., the issuing bank is under a duty only to examine the documents to determine their facial compliance with the terms of the credit and will be entitled to reimbursement from the account party even if there was a hidden defect. Thus, imposing this warranty on the beneficiary guarantees the


account party a remedy in this situation.\textsuperscript{139}

It could, therefore be said in conclusion, that the advising bank, in this situation, is not entitled to recover the money paid to the beneficiary. Advising banks, however, could avoid this difficulty by making payment "under reserve".\textsuperscript{140} The effect of making payment in this way was explained by Kerr L.J. in Banque de L'Indochine et de Suez S.A. v. J.H. Rayner (Mincing Lane) Ltd.\textsuperscript{141} in these terms:

Payment was to be made under reserve in the sense that the beneficiary would be bound to repay the money on demand if the issuing bank should reject the documents, whether on its own initiative or on the buyer's instruction.\textsuperscript{142}

To leave no room for dispute the advising bank should make it clear in the payment under reserve agreement with the beneficiary that it is entitled to repayment whatever the reason behind the rejection of the documents.

\textsuperscript{139}Cf. Philadelphia Gear Corp. v. Central Bank, 717 F.2d 230 (5th Cir, 1983) (where it was held that the beneficiary warrants the facial compliance under section 5-111(1)).

\textsuperscript{140}Payment under reserve is recognized by the U.C.P. See Art. 16(f).


\textsuperscript{142}Ibid. at p.234.
5.4 The Relationship Between The Issuing Or Instructing Banks And The Intermediary Banks

Upon the buyer’s request to issue, confirm or advise the credit by an intermediary bank, the issuing bank, the buyer’s bank, is the party who always instructs the intermediary bank directly to do so. Hence, there is a contractual relationship between them. This contractual relationship is independent of the other relationships involved in the documentary letter of credit’s operation. Consequently the buyer’s bank’s communication with the intermediary bank does not put either of them under any obligation to the beneficiary. In *Bril v. Suomen Pankki Finlands Bank* the Supreme Court of New York dismissed the action in which the plaintiffs (seller) relying on the defendants’ (issuing bank) correspondence with the intermediary bank alleged that the defendant had opened the letter of credit but later repudiated it. Halpern J. said:

The opening of the credit by the inter-bank communication does not of itself create any obligation on the part of either bank enforceable by the proposed beneficiary. That obligation arises only when a letter of credit is actually issued by one of the banks and is delivered to the beneficiary.

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The U.C.P. now contains a provision to the same effect. Article 6 reads:

A beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the applicant for the credit and the issuing bank.

Also Article 16(f) indicates that the contract between the beneficiary and the advising bank is independent of the contract between the beneficiary and the issuing bank.

The same can be said about the applicant for the credit. He is neither a party to the contract between the issuing bank and the intermediary bank nor can he rely on their communication.146

This principle applies regardless of the banks' role, i.e. it applies whether the applicant's bank was an issuing or requesting bank and whether the intermediary bank was an issuing, advising or confirming bank. So the intermediary bank takes his instructions from the applicant's bank alone and not from any other person. The intermediary bank, regardless of its role, must adhere strictly to these instructions with the same degree of strictness as that exercised by the applicant's bank in observing the applicant's instructions. Failing to do so may put its right of reimbursement in danger. However, if the deviation from the applicant's bank's instructions resulted from an error

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146Kunglig Jarnvagsstyrelsen v. National City Bank of New York, 20 F.2d 307 at p.309 (1927). In Dulien Steel Products, Inc., of Washington v. Bankers Trust Co. [298 F.2d 836 (2d Cir. 1962) at p.842] It was held that the communication between the banks does not create an estoppel for the benefit of the buyer. See supra at p.256 Note 90.
in translating or decoding such instructions the intermediary bank will not be responsible.\footnote{See U.C.P. Art. 18; U.C.C. §5-107 (4). It is worth noting that there is hardly any error in translating or decoding the issuing bank instructions at the present time; the reason is that most banks nowadays have abandoned their traditional method of communication (by telex) and adopted more advanced technology. In this new method the issuing bank transmits its messages via Society for Worldwide Interbank Financial Telecommunications (SWIFT) a company that uses electronic data interchange (EDI). This technology allows the issuing bank to transmit the information into the SWIFT system which relays them to the correspondent bank, fast, cheap and error free. For detailed information about the use of SWIFT in letters of credit, see Kozolchyk, The Paperless Letter of Credit and Related Documents of Title 55 Law & Contemp. Probs. 39-101 (1992). The author was of the opinion that the U.C.C §5-107 (4) and the U.C.P. Art. 18 should be interpreted to mean that banks are not released from their liability unless the errors are committed by an independent party who was employed to transmit the instructions, such as SWIFT. \textit{Is Present Letter of Credit Law up to its Task?} GMU law Review Vol.8, No 2, (1986) 285 at pp.291-2.}

However, although the mutual obligations between the buyer’s bank and the other intermediary banks to some extent are similar, there are differences in the nature of the contractual relationship between them. These differences are brought about by the different roles assumed by the banks.

\section*{5.4.1 The Intermediary-Issuer}

The nature of the contractual relationship between the requesting bank (the buyer’s bank) and the intermediary-issuer is similar to that between the buyer and the issuing bank.\footnote{Discussed supra at p.26. Stoufflet in France was of the opinion that the requesting bank, in giving the instructions to the intermediary-issuer, acts as an agent of the buyer but this view is not acceptable, see supra at p.29, \textit{Le Crédit}} This analogy was accepted by the
Uniform Commercial Code, Section 5-103(1)(g) which includes in its definition of a ‘customer’ a bank ‘which procures issuance or confirmation on behalf of that bank’s customer.”

The principles applying to the relationship between the buyer and the issuing bank, should be, therefore, applicable to the relationship between the requesting bank and the intermediary-issuer. That is to say that the intermediary-issuer is under a duty to pay the beneficiary after accepting conforming documents and is entitled to a commission and reimbursement from the applicant bank.

The court in Pan-American Bank & Trust Co. v. National City Bank of New York considered the nature of the relationship between these two banks. In this case the Pan-American Bank, acting under a request from an American firm (the buyers), cabled the National City Bank asking it to open an irrevocable letter of credit in favour of the seller in Brazil. The Pan-American Bank signed the City Bank’s application form. Upon a dispute between the seller and the buyer the Pan-American Bank instructed the City Bank to cancel the letter of credit. Disregarding this instruction City Bank honoured the seller’s draft and asked for reimbursement from Pan-American Bank who refused. In an action it was argued, inter alia, that the contract between the banks was

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149 The U.C.P. Art.(2) also indicates that any person who requests the issuance of the credit is regarded as a customer.

150 6 F. 2d 762 (1925).
one of guarantee and not a letter of credit, therefore it was *ultra vires* the powers of *National Banks*.\textsuperscript{151} This argument was rejected by the Court of Appeals. Hough J. stated 'A plainer reimbursement contract ... it is hard to imagine.'\textsuperscript{152}

As the contract between the buyer and the issuing bank is a contract of reimbursement this statement confirms that the contract between the requesting bank and the intermediary-issuer is of the same nature.

\textbf{5.4.2 The Advising Bank}

There seems to be an agreement among most law commentators\textsuperscript{153} that the relationship between the advising bank and the issuing bank is that of an agent and principal. This view is supported by authorities. In the U.S.A. the court held in *Bamberger Polymers International Corp. v. Citibank, N.A.*,\textsuperscript{154} that "Citibank [defendant advising bank] had no

\textsuperscript{151}Conferred on them by the *Federal Reserve Act* of 1913.

\textsuperscript{152}6 F. 2d 762 at p.766.


independent obligation under the Letter of Credit as advising bank and paying bank, it was functioning not as the account debtor, but as the agent of the account debtor, [the issuing bank]. In the U.K., Lord Diplock in *Gian Singh & Co. Ltd. v. Banque de l'Indochine*, stated "... the customer did not succeed in making out any case of negligence against the issuing bank or the notifying bank which acted as its agent, in failing to detect the forgery." (emphasise added)

The agency nature of the relationship between the issuing bank and the advising bank was clearly explained by Lambert J. in the Canadian case of *Michael Doyle & Associates v. Bank of Montreal* he said:

At the first and most fundamental level, it is possible for the intermediary bank, as an advising bank but not a confirming bank, to be merely a conduit for information about the credit, and, also, but not necessarily, a conduit for the transmission of the documents from the beneficiary to the issuing bank. In such a case, the advising bank would be primarily the agent of the issuing bank and the terms of its agency would be very limited.

At the second level, it is possible for an intermediary bank, as an advising bank but not a confirming bank, to take on obligations, owed exclusively to the issuing bank, with respect to examination of the documents for compliance with the credit and with respect

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155 N.Y.S. 2d at p.932.


to the method selected by the issuing bank for discharging its undertaking with respect to payment. Here again, the intermediary bank would be primarily the agent of the issuing bank, but the terms of its agency would be less limited than at the first level.\footnote{Ibid. at p.507.}

Classifying the contract between the issuing bank and the advising bank as being one of agency is rather simple and attractive, but on one hand, neither the issuing bank nor the advising bank intended their relationship to be one of agency,\footnote{See Byrne, \textit{Letters of Credit},(1988) 43 Bus. Lawyer, 1353 at p.1366.} and on the other, applying the rules of agency strictly to this contract may, in some circumstances, cause an unacceptable effect to either bank.

Firstly, under the law of agency the agent [the advising bank] is bound to account to its principal [the issuing bank] for any profit it makes from the transaction beyond the agreed fee between the agent and its principal.\footnote{\textit{Andrews v. Ramsey & Co.} [1903] 2 K.B. 635. See generally \textit{Chitty on Contracts}, (26th ed.) Vol. 2. §2599; Gloag and Henderson’s \textit{Introduction to the Law of Scotland}, at p.319.} So although the advising bank’s extra profit is acceptable in practice, applying the rule strictly would put it in breach of its duty to the issuing bank, for example, if it gains a profit by discounting the beneficiary’s draft in respect of which it is not authorized, or it obtains a confirmation fee from the beneficiary for making a "silent confirmation".

In order to allow the advising bank to make extra profit despite the
fact of being an agent, it was argued that the agency contract is at an end when the advising bank notifies the beneficiary of the opening of the credit. But how about the situation where the advising bank has additional tasks, such as accepting the documents on behalf of the issuing bank? Professor Ellinger suggested the possibility of employing a commercial usage to justify the implication of a term in the contract between the issuing bank and the advising bank which permits the latter to make extra profit from the transaction.

Secondly, the agent when acting within his ostensible authority binds his principal. Thus, if the advising bank deviated from the issuing bank’s instructions, say it did not include in its advice to the beneficiary a document that the issuing bank instructed it to call for, this advice is within the advising bank’s ostensible authority and consequently it will bind the issuing bank as against the beneficiary. In the situation where the advising bank is also the paying bank, the agency theory is perfect. If the advising bank accepted the documents and paid against them it would have exceeded its authority and the issuing bank will be entitled to reject them on the ground that they are not in compliance with the

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162 Courteen Seed Co. v. Hong Kong and Shanghai Banking Corporation, 157 N.E. 272 (1927) aff’d. 159 N.E. 641 (1927).

163 Chitty on Contracts, Specific Contracts, §3018; Benjamin’s Sale of Goods, §23-139.

164 See Bowstead on Agency (15th ed.) at pp.299-302.
terms of the credit, hence the party who is at fault will bear the loss, but the difficulty arises in the situation where the advising bank’s authority is limited to advising the credit to the beneficiary; in this case the issuing bank is bound by the incorrectly advised credit and under an obligation to pay the beneficiary against such documents.

In an attempt to justify this result Professor Ellinger argued that it is the intention of the issuing bank that the beneficiary should rely on the advising bank’s notification of the credit. Additionally, if the error of not including a specific document in the notification of the credit to the beneficiary was made by the issuing bank, the beneficiary will be entitled to payment against the tender of the specified documents, so why should the issuing bank be in a better position simply because the notification was made by its agent. Dolan, on the other hand, does not accept such result; he suggested that the advising bank, which is employed only to notify the beneficiary of the opening of the credit, should be considered as an independent contractor who does not bind the issuing bank.

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165 Assuming that the U.C.P. or the U.C.C. exemption clauses do not apply, see as to the exemption clauses, supra at p.230.

166 A similar situation may also arise when the advising bank, who is authorized to accept the documents but not to pay against them, although advised the credit correctly, it accepted defected documents in this case the issuing bank will also be bound by its agent act and the beneficiary will be entitled to payment. On the assumption that the issuing bank cannot compile the buyer to accept such documents [see supra at p.231 Note 20] the issuing bank will be left with the documents and its only remedy would be to sue the advising bank for breach of their agency contract.

167 Documentary Letters of Credit, at p.247.
bank except to the terms that the latter intended to be bound by.\textsuperscript{168}
This characterization protects the issuing bank not only from having to pay the beneficiary against non confirming documents, but also from going through the trouble of recovering its loss from the advising bank.\textsuperscript{169}

5.4.3 The Confirming Bank\textsuperscript{170}

The relationship between the issuing bank and the confirming bank is also viewed as being one of principal and agent.\textsuperscript{171} The main support to this view is derived from the case of Bank Melli Iran v. Barclays

\textsuperscript{168}The Correspondent Bank in the Letter of Credit Transaction, at p.422. The same opinion is also held by Byrne, Letters of Credit, (1988) 43 Bus. Lawyer, 1353 at p.1366.

\textsuperscript{169}It may also protect the issuing bank from being liable to the applicant or the beneficiary for the advising bank’s negligence in the absence of express exemption clauses in the application form.

\textsuperscript{170}It happens, although very rarely, that upon the beneficiary’s request the advising bank may confirm the credit without being instructed by the issuing bank to do so (the confirmation in this method is called "silent confirmation"). The reason behind such confirmation is the issuing bank’s refusal of the buyer’s request to confirm the credit either because it considers its financial standing as being strong and therefore its undertaking alone is sufficient or because of a national policy directing banks not to request a foreign bank to confirm their credits. The confirming bank in this case has no relationship with the issuing bank and acquires no right against it in as far as the confirmation is concerned. See Jack, R., Documentary Credits, at pp.116-7; Byrne, Letters of Credit, (1988) 43 Business Lawyer, 1353 at p.1365. See also Towards the Revision of U.C.C. Article 5 (Letter of Credit) A Report by the Task Force on the Study of the U.C.C. Article 5, [this revision is not final] (1989) at pp.22-3.

In this case a Persian buyer, who contracted with an English seller to purchase 100 Chevrolet trucks, instructed Bank Melli to open an irrevocable credit in favour of the English seller. Bank Melli requested Barclays Bank to open the letter of credit which the latter carried out. Upon presentation Barclays Bank honoured the beneficiary’s draft and debited Bank Melli’s account with its amount. Bank Melli brought an action claiming a declaration that Barclays Bank was not entitled to debit their account with that amount, on the ground that the documents presented by the beneficiary were not in compliance with the terms of the credit. It was argued on behalf of Barclays Bank that Bank Melli’s inaction was a ratification of their act. In a counter argument it was claimed that the relationship between Barclays Bank and Bank Melli was not one of principal and agent but that of a banker and a customer, where ratification is not applicable. McNair J. accepted the former argument and in justifying the rejection of the second one said:

In my judgment, both on the construction of the documents under which the credit was established and in principle, the relationship between Bank Melli, the instructing bank, and Barclays Bank, the confirming bank, was that of principal and agent. This relationship was held to exist in substantially similar circumstances in Equitable Trust Co of New York v Dawson Partners Ltd (1926) 27 Ll L Rep 49 (see Viscount Cave L.C., at p 52, Lord Sumner at p 53, and Lord Shaw of Dunfermline at p 57), and the existence of this relationship is implicit in the judgments of the Court of

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173From the facts of the case it appears that Barclays Bank alone opened the credit in its own name therefore it is an intermediary-issuer and not a confirming bank.
Apartment in *J H Rayner & Co Ltd v Hambro’s Bank Ltd* [1943] K.B. 37. I accept as accurate the statement of Professor Gutteridge K.C., in his book on *Bankers’ Commercial Credits*, at p 51, that "as between the issuing banker" (in this case Bank Melli) "and the correspondent" (in this case Barclays Bank) "the relationship is, unless otherwise agreed, that of principal and agent..." On the facts of this case I find no agreement to the contrary.\(^{174}\)

Professor Ellinger,\(^{175}\) who does not accept the characterization of the relationship between the issuing bank and the confirming bank to be one of agency, put forward some points which undermined the weight of the support given by this authority.

In the first place, this case does not involve a confirming bank. It is clear from the reported facts of the case that *Bank Melli* did not open the credit itself, it only requested *Barclays Bank* to open it. So the true roles of these two banks are that *Bank Melli* was a requesting bank and *Barclays Bank* was an intermediary-issuer. As explained above, the contract between these parties is not one of agency.\(^{176}\)

Secondly, the case of *Rayner (J.H.) & Co., Ltd. v. Hambro’s Bank, Ltd.*\(^{177}\) which his Lordship quoted in support of his view is not entitled to much weight. Although MacKinnon L.J. mentioned the agency


\(^{175}\)Documentary Letters of Credit, at pp.221-2.

\(^{176}\)See *supra* at p.277.

\(^{177}\)[1943] 1 K.B. at p.37.
relationship between the two banks, the nature of the relationship between the issuing bank and the intermediary bank was not in issue. The issue in the case was whether the documents tendered were in compliance with the terms of the credit.

Thirdly, there was no need for McNair J. in Bank Melli’s case to determine whether the relationship between the two banks was of a customer and bank or of agent and principal in order to apply to that relationship the agency rule of ratification. There are similarities between the agency relationship and some other relationships under the letter of credit transaction which allows some of these former rules to be applicable to these relationships without having to classify them as being one of agency. It has been, for instance, decided in Midland Bank, Ltd. v. Seymour that the agency rule of ratification is applicable to the relationship between the applicant and the issuing bank, although, as explained above, their contract is not an agency contract. It is therefore, possible to say that McNair J.’s view in

178 Ibid. at p.40.

179 See for instance the relationship between the applicant and the issuing bank.

180 Also the relationship between a bank and a customer under a current account is of a debtor and a creditor, but has the principal and agent relationship superimposed on it. London Joint Stock Bank v. Macmillan [1918] A.C. 777; Westminster Bank, Ltd. v. Hilton (1926) 43 T.L.R. 124.


182 See supra at pp.26 et.seq. The court in this case has hinted that the relationship between the issuing bank and the applicant was, to some extent, similar to a contract of agency.
Melli Bank's case about the relationship between the two banks was obiter.

Fourthly, Professor Ellinger further pointed out that *Equitable Trust Co. of New York v. Dawson Partners, Ltd.*\(^\text{183}\) which is the main authority relied on by McNair J. does not lend him the support that he places on it. In this case upon an agreement between the respondents and *Rogge & Co. of Batavia* to purchase a quantity of vanilla beans, the respondents requested the appellants to open in favour of the seller an irrevocable letter of credit. This letter of credit was confirmed by *The Hong Kong & Shanghai Bank* which was chosen by the buyer. The letter of credit was later amended to stipulate among other documents a certificate of quality which should be signed by "experts". *Hong Kong & Shanghai Bank*’s branch in Batavia was notified of this amendment by their office in London. As a result of an error in transmitting the amendment, the former advised the seller (*Rogge & Co.*) that a certificate of quality of "an expert" was required. The seller tendered with other stipulated documents a certificate signed by only one expert, these documents were accepted and the draft which accompanied them was honoured by the Batavia branch. The appellants accepted the documents and the draft but the respondent (the buyer) rejected the documents on the ground that the certificate of quality was not in compliance with the terms of the credit. The appellants brought an action arguing *inter alia* that the respondents (the buyers) had chosen the intermediary bank and therefore it should be considered as their agent.

\(^\text{183}\)(1926) 25 LLR 90 (C.A.), (1927) 27 LLR 49 (H.L.).
Although this argument was not raised in the House of Lords it was discussed and was unanimously rejected.\textsuperscript{184}

Only Lord Shaw\textsuperscript{185} and Viscount Cave L.C.\textsuperscript{186} went further to say that the appellants (the issuing bank) were the principals of the confirming bank. The latter judge put forward his view in these words:

The effect of the correspondence is that at the request of the respondents the Hong Kong & Shanghai Bank in Batavia was substituted as the bank through which the credit should be communicated to Rogge, and so became the correspondents for that purpose of the appellants: and I think that the effect was to make them the agents for this purpose, not of the respondents, but of the appellants.

The support given by this authority could be weakened not only by saying that this view was not unanimous, but also that the relationship between the issuing bank and the confirming bank was not in issue, and therefore, these remarks were \textit{obiter}.

In American law there are also authorities rejecting the view that the confirming bank is the agent of the issuer. In \textit{Kingdom of Sweden v. New York Trust Co.},\textsuperscript{187} upon the request of one of its customers a Swedish Bank opened a letter of credit in favour of an American firm

\textsuperscript{184}\textit{See Ibid.} Viscount Cave L.C., at p.52; Lord Sumner, at p.53; Lord Atkinson at p.56; Lord Shaw, at p.57; Lord Carson dissenting, at pp.58-9.

\textsuperscript{185}\textit{Ibid} at p.57.

\textsuperscript{186}\textit{Ibid} at p.52.

\textsuperscript{187}197 Misc. 431, 96 N.Y.S. 2d 779 (1949).
and requested the defendant bank to confirm it, which it did. A draft drawn under the credit was presented "before the presentation of the documents" which were, however, presented before the expiry of the credit. The defendant honoured the draft and debited the Swedish Bank account with its amount. The American government confiscated the goods but later compensated the Swedish Bank. Because the compensation paid was less than the amount of the credit the Swedish government, on behalf of the Swedish Bank, brought an action against the defendant bank to recover the difference. The court dismissed the action on the ground that as long as the documents were presented before the expiry date of the credit the defendant bank committed no breach of its duty and hence is not liable for the difference. As regards the nature of the relationship between the two banks Wasserogel J. in this case stated "the relationship of the defendant New York Trust Company to the Swedish Bank was one of independent contractor rather than one of agency." 188

Furthermore, considering the confirming bank as being merely an agent of the issuing bank would not assist in explaining the legal basis upon which the confirming bank can be held as being under a direct obligation toward the beneficiary, i.e. to pay or to honour his draft. This objection was explained by Hand J. in Pan-American Bank & Trust Co. v. National City Bank of New York189 in these words:

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18896 N.Y.S. 779 at p.791.

1896F. 2d 762 (1925). For the facts of this case see supra at p.278.
Finally, the plaintiff [the City bank] argues that it was the defendant’s [Pan-American’s] agent to write the letter, and that the defendant had power to do by an agent what it might do directly... The letter was not the defendant’s, but the plaintiff’s, and engaged its credit alone, as was essential to the success of the enterprise. When a man acts through an agent, he must mean the resulting rights or duties to be his own, and the agent must intend to commit, not himself, but his principal, to the person with whom he deals.190

It should, however, be noted that the intermediary bank in this case was an intermediary-issuer and not a confirming bank, but the objection could be equally raised in the case of a confirming bank because it is also under a direct obligation to the beneficiary.

The above discussion shows that the contract between the issuing bank and the confirming bank cannot be classified as being a simple contract of agency. Jack,191 in an attempt to solve this difficulty, suggested that the confirming bank acts in a dual capacity, i.e., as far as its obligation towards the beneficiary to accept the documents and pay against them is concerned it acts as a principal, but at the same time it acts as an agent of the issuing bank with regard to carrying out the latter’s instructions and fulfilling its obligations. It is, however, doubtful whether the agency part of this solution is acceptable since it would be open to the

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190Ibid. at p.771.

191Documentary Credits, at p.116. Stoufflet, [Le Crédit Documentaire, at pp.206-7] in France put forward a different view, he suggested that the issuing bank has no contract with the confirming bank because it engages the latter to confirm the credit not as a principal but as an agent of the buyer, his view, however, is not correct. See supra at p.29.
same objections raised against classifying the advising bank as an agent of the issuing bank.\textsuperscript{192}

\textsuperscript{192}See \textit{supra} at pp.279 \textit{et.seq.}
CHAPTER SIX

The Holder Of The Beneficiary’s Draft

In the preceding discussion in this thesis it was assumed that an immediate cash payment is given to the beneficiary by the paying bank in return for the documents, without involvement of an additional party, but that is not always the case. It may happen that the intermediary bank is not in the beneficiary’s locality or because of the additional costs of engaging such bank the buyer declines to employ it. In these circumstances the beneficiary may agree with the buyer that a bill of exchange is to be drawn under the letter of credit, in order to make it convenient for the former to tender it together with the documents to a local bank for negotiation, discounting or for collection. The introduction of a bill of exchange into the letter of credit transaction gives rise not only to an additional group of rights and obligations between the parties but also, in some cases, to the involvement of additional parties, which are usually banks.

Before discussing the legal relationships between these parties and the other parties of letter of credit two closely related points should first be explained.
6.1 The Bill Of Exchange

Upon the agreement between the buyer and the seller the credit may call for a sight "on demand" or time "usance" bill of exchange which is often called a draft. The way in which the draft is drawn is also a matter of their agreement. However it is usually drawn by the seller in his favour as a payee on the issuing bank, some other bank designated by the issuer to be a paying bank or on the buyer as drawee.¹

6.1.1 Sight draft

If the draft is drawn at sight the beneficiary will present it with the other required documents to the paying bank [whether the issuer or some other bank designated by it] who will examine the documents and honour the draft by payment within three banking days according to the U.C.C.² or within a reasonable time according to the U.C.P.³

As the draft is payable on demand there seems to be no necessity to negotiate it. It would save the beneficiary time and expense to present it himself to the paying bank.⁴ It is submitted, however, that the

¹It could also be drawn in favour of the buyer on the paying bank and then indorsed by the buyer to the seller.

²U.C.C. §5-112(1)(a).

³U.C.P. Art. 16(c).

⁴The beneficiary may negotiate the draft if the paying bank is not in his city.
inclusion of a sight draft with the documents is of no legal significance,\(^5\) since it does not make any important distinction between this method and the method in which cash payment is made against documents without sight draft. Therefore, it may happen that banks accept the documents which are not accompanied by a sight draft even if the credit called for it.\(^6\)

However, a sight draft seems only to serve the purpose of providing the bank with a written demand for payment from the beneficiary. Also it could be kept by the bank as a record for payment which shows the number of the credit under which it was drawn.\(^7\)

Under this method of payment, if the buyer was able to reimburse the issuing bank as soon as the documents arrive, he will lose interest on


\(^6\)It should be noted that although the absence of a sight draft is a mere technical deficiency, strictly speaking, it constitutes a breach by the issuing bank which may put it in a doubtful situation as to whether the buyer could refuse to take the documents on the ground of noncompliance. In Titanium Metals Corp. of America v. Space Metals, Inc., [529 P. 2d 431 (Utah 1974)] it was held that a course of dealing made it unnecessary for the beneficiary to submit the draft called for by the credit. Also in Travis Bank & Trust v. State, [660 S.W. 2d 851 (1983 Tex. C.A.)] where on the basis of substantial compliance it was held that it may be sufficient to tender a letter instead of a draft. In Chase Manhattan Bank v. Equibank [394 F. Supp. 352 (W.D. Pa. 1975)] the court held that the words "please remit" [at p.355. Note 4] contained in a telex satisfied the requirement of a sight draft. But cf. Bounty Trading Corp. v. S.E.K. Sportswear, Ltd., 48 A.D. 2d 811, 370 N.Y.S. 2d 4 (1975); International Leather Distribs., Inc., v. Chase Manhattan Bank, N.A., 464 F. Supp. 1197 (S.D.N.Y.) aff’d mem., 607 F. 2d 996 (2d Cir. 1979).

\(^7\)Goode, Commercial Law, at p.652 Note 32.
that money during the period between the arrival of the documents on one hand and the arrival of the goods and reselling them on the other. Equally, if he was unable to reimburse the issuing bank until he resells the goods the bank will charge him interest over that period.

6.1.2 Time draft

If the buyer is in a better bargaining position than the seller, he may try to acquire credit from the latter by insisting in his agreement with the seller that the letter of credit should call for a time draft. In this method the seller does not receive an immediate payment as in the case for sight draft, but he will receive payment at some time after tendering the required documents for instance, at 90 or 180 days after sight or

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8Deferred payment credit is a relatively new method of payment which also provides the buyer with credit but without involvement of a bill of exchange. This method of payment which is recognized by the U.C.P. [See Art, 9(b)(ii), 11(a), 10(a)(ii), 10(b)(ii) and 16(a). It is not yet recognised by the U.C.C.] was developed during the 1950's in the Far East. It has been thought that the heavy stamp duty imposed on bills of exchange in some countries is one of the reasons behind such development. See generally, Eberth R. and Ellinger E., Deferred Payment Credits: A Comparative Analysis of Their Special Problems, (1983) 14 J of Mar. L. & Com. 387; Kozolchyk, B., International Encyclopedia of Comparative Law, Letters of Credit, Vol.IX. Chapter 5 by the same author The 1983 U.C.P. Revision, Trade Practices and Court Decisions: A Plea for a Closer Relationship, (1984) 12 Can. Bus. L.J. 214 at pp.230-2; McLaughlin G., Should Deferred Payment Letters of Credit Be Specifically Treated In A Revision of Article 5?, (1990) 56 Brooklyn L.R. 149; Watson, A., Finance of International Trade, at p.161. As to the recognition of deferred payment credit in the U.C.P. see Wheble, B., Documentary Credits, U.C.P. 1974/1983 Revisions Compared and Explained, (I.C.C. Publication No. 411, 1984) at p.23.
after the date of the bill of lading. This interval of time between the presentation of the documents and the maturity date of the draft will give the buyer time to sell the goods and enable him to reimburse the issuing bank from the sale proceeds.

The beneficiary, on the other hand, may wait until the draft becomes

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9Payment could also be made in instalments, thus more than one draft should be drawn, for example the credit may call for a draft to be drawn for 50% of the amount on the credit payable at 30 days after sight and a second one drawn for the rest payable 90 days after that date.

10For reason of deferred payment credit being a means of providing the buyer with a credit Eberth and Ellinger [Deferred Payment Credit: A Comparative Analysis of their Special Problems.] and McLaughlin [Should Deferred Payment Letters of Credit be Specifically Treated in a Revision of Article 5? see also by the same author, Structuring Commercial Letter-of-Credit Transactions to Safeguard the Interests of the Buyer (1989) 21 U.C.C.L.J. 318 at p.330.] suggested that it should be treated equally as the payment under acceptance credit as regards being available for discounting and the issuing bank obligation to pay after accepting the documents should be absolute even if it discovered that the documents were forged by the beneficiary. Contrary to this view deferred payment credit should be used not only for the aim of giving the buyer credit but also as a type of letter of credit that enables him, in the situation where he is dealing with a seller of suspicious integrity, to avoid the latter’s fraud. Thus, it should be regulated in a way that does not allow the issuing bank or any other paying bank to pay the beneficiary before the date of payment designated by the credit, giving the buyer the opportunity, not to inspect the goods and give his permission to pay, but in the situation where the seller fraudulently shipped a worthless material or completely non-conforming goods, to discover it and seek an injunction. This suggestion, however, is not novel, the Federal Supreme Court of West Germany has held that the buyer can obtain an injunction in the period between the presentation of the documents and the time in which the deferred payment becomes due, if he can prove that the seller has fraudulently sent a completely non-conforming goods. See McLaughlin, Should Deferred Payment Letters of Credit be Specifically Treated in a Revision of Article 5? at p.161, Note 35.

11In the application agreement with the issuer, the buyer is not usually required to reimburse the bank until one day prior to the maturity of the draft. See U.C.C. §5-114(3).
due or may elect to obtain cash before the maturity date of the draft by selling it to a third party at a discount, i.e., the face value of the draft less interest,\textsuperscript{12} which is calculated according to the interest rates prevailing at the time and the length of time between selling the draft and the time in which it becomes due for payment.\textsuperscript{13}

It is, therefore, obvious that the difference between these two methods of payment is who is going to pay the interest. Devlin J. in \textit{Midland Bank Ltd. v. Seymour}\textsuperscript{14} explained this difference in these words:

Well, of course, basically the confirmed credit is designed to give the seller the security he wants before he ships the goods. He can arrange to ship the goods in the confident knowledge that as soon as he tenders documents that are in order he is bound to be paid. If the letter of credit provides for a cash payment, or a sight bill, he will get paid at once. That will mean, of course, that the buyer, unless he sells the documents for cash, will be out of his money during the period of the voyage and until he disposes of the goods on arrival. But the buyer, of course, may not like that, and then the letter of credit he furnishes will not provide for a cash payment, but, as in this case, for a bill after sight - 90 days’ bill. Then the seller, unless he sells the bill for cash, will be out of his money for 90 days. If the buyer does pay cash, he will probably do so by advance from his bank on the security of

\textsuperscript{12}Upon agreement between the applicant and the beneficiary the letter of credit may provide that the latter is entitled to the full amount of the time draft before the maturity date from the issuing or confirming bank and the interest will be paid by the applicant.

\textsuperscript{13}Harfield pointed out that it is not true to regard the difference between the price paid for a draft and its face value as being an interest. The true situation is that the reduced price given for the draft reflects its value at the time of sale. \textit{Bank Credits and Acceptances}, at p.123 Note 7.

\textsuperscript{14}[1955] 2 Lloyd’s L.Rep. 147.
the goods. If the seller sells the bill to his bank it is only another way of getting an advance on the security of the bill. The only point of difference is, which of the two, buyer or seller, has to pay in the form of interest or discount for financing the goods during what one might call the barren period of transportation or delivery?\textsuperscript{15}

6.2 The Letter Of Credit

The legal consequences arising from the involvement of a bill of exchange in the letter of credit transaction differs according to whether the letter of credit is straight or negotiable.

6.2.1 Straight Credit

In straight credit the promise of the issuing bank (and the confirming bank if the credit is confirmed,) to honour the draft drawn under it is made to the seller alone. Thus he will be expected to present the draft and the documents directly to the issuing bank or the intermediary bank. However, under this type of credit the seller is at liberty to negotiate the draft but the person who purchases it can not, in his own right, enforce the issuing or confirming bank’s promise contained in the credit, simply because it is not directed to him.

In order to avoid this problem and consequently to make the seller’s draft easier to negotiate, the negotiation credit was invented.

\textsuperscript{15}\textit{Ibid.} at p.165.
6.2.2 Negotiation Credit

In negotiation credit the issuing bank’s (and confirming bank’s if the credit is confirmed) promise is not limited to the seller-beneficiary but extended to include an invitation to a bank or banks to negotiate the seller’s draft and the documents. This invitation may either be restricted or general.

Under a restricted negotiation credit the issuing bank invites (authorizes) a specific bank to negotiate the seller’s draft and the accompanying documents and undertake directly to such bank that it will honour the draft if presented with documents which are in compliance with the terms of the credit. Article 11(b) of the U.C.P. made it clear that unless the credit is intended to be general, it must nominate the bank which is authorized to negotiate the seller’s draft. This restriction, however, does not prevent the seller from negotiating the draft to another bank, but such bank will not be entitled to sue the issuing bank on the letter of credit if the draft was dishonoured.

Under a general negotiation credit the issuing bank makes an open

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16It should be noted that negotiation credit does not mean that the letter of credit itself is a negotiable instrument.

17These two kinds of negotiation credit are known in the U.S.A. as domiciled negotiation credit and circular negotiation credit.

18U.C.P. Art. 11(d); U.C.C. §5-114(2)(a).
invitation (authorization) to anyone who is willing to accept it, a typical example of this invitation clause reads as follows:

We hereby agree with the drawers, endorsers, and bona fide holders of drafts drawn under and in compliance with the terms of this letter of credit that such drafts should be duly honoured on presentation and delivery of documents as specified.

Thus the seller can negotiate the draft and the documents to any bank and such bank will have a right of its own to enforce the issuing bank's promise contained in the letter of credit.

In order to consider the legal relationship between the parties of the letter of credit and the additional bank, whose involvement comes about as a result of utilising a bill of exchange, it is essential to differentiate between four situations. The first is where the bank takes the seller's draft for collection. This bank will be called the collecting bank. The

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19 This type of credit is useful to the beneficiary, in the situation where the credit is payable in a foreign currency, to negotiate his draft at whichever bank offers him the best exchange rate.

20 The credit may only say that payment is available by negotiation of the draft.

21 As to a similar clause see Banco Nacional Ultramarino v. First National Bank of Boston 289 F. 169 at p.171 (1923). The U.C.P. Art. 11(a) provides that it must be indicated in the letter of credit whether it is available by negotiation. However, it is not always clear from the words of the letter of credit as to whether it is a negotiation or straight credit but courts tend, in this situation, to consider the credit as being a straight credit. In the U.K. see Sassoon (M.A.) & Sons Ltd. v. International Banking Corporation [1927] A.C. 711, at p.722. In the U.S.A. see Banco Nacional Ultramarino v. First National Bank of Boston, supra, at pp.173-4. As to the ambiguity being about whether the letter of credit is a general or restricted negotiation credit see European Asian Bank A.G. v. Punjab and Sind Bank [1983] 1 W.L.R. 642, [1983] 1 Lloyd's L.Rep. 611.
second is where the bank negotiates the seller’s draft before acceptance and the draft is either drawn under a straight credit or under a restricted negotiation credit and this bank is other than the bank or banks permitted to negotiate it. This bank will be called the \textit{unauthorized negotiating bank}. The third is where the bank negotiates the seller’s draft before acceptance and the draft is either drawn under a general negotiation credit or under a restricted one which permits this bank to negotiate it. This bank will be called the \textit{authorized negotiating bank}. The fourth is where the bank discounts the seller’s draft after acceptance. This bank will be called a \textit{discounting bank}.

6.3 Collecting Bank

In situations where the beneficiary finds it difficult to sell (negotiate) the documents and the draft drawn under straight credit for reasons such as the weakness in either his financial standing or in the issuing bank’s undertaking,\textsuperscript{22} he may request a local bank to take the documents accompanied by the draft and present them to the paying bank on his behalf.

The beneficiary may employ such bank not only because, in international sales, it is more convenient to engage a bank in his locality to deal with the paying bank abroad, but also it may be useful to use the local bank’s experience in checking whether the documents are in

\textsuperscript{22}It could also be because the draft is payable at sight and the seller is not willing to negotiate it.
compliance with the terms of the credit; hence, any discrepancies could be rectified before forwarding them to the remote paying or accepting bank.

It is, however, apparent that this bank has no relationship with any of the parties participating in the letter of credit transaction other than the beneficiary. This relationship is one of agent and principal\(^{23}\) i.e., the collecting bank acts as an agent of the beneficiary as regards presenting the documents accompanied by the draft, for payment in the case of sight draft or acceptance and later payment in the case of a time draft, to the paying or accepting bank. Thus the collecting bank takes its instructions\(^ {24}\) from the seller and is liable to him if it did not carry them out strictly,\(^ {25}\) but it has no right of its own against the paying or accepting bank.

It is to be further noted that in cases where the collecting bank employs another bank for the purpose of collecting the beneficiary’s draft, the beneficiary has no contractual right against such bank.\(^ {26}\)

\(^{23}\)In international sales this relationship is often governed by the I.C.C. Uniform Rules for Collections [Brochure No. 322, 1979] as well as by the principles of the law of agency. Domestic collections in the U.S.A. are governed by Article 4 of the U.C.C.

\(^{24}\)Usually set out in a “collection order”.


\(^{26}\)Applying the principle that there is no privity of contract between a principal and his agent’s subagent. See Calico Printers Association v. Barclays Bank (1931) 145 L.T. 51 at p.56; Valibhoy & Sons A.A. v. Habib Bank Ltd., [1984] 3 I.B.L. 85
6.4 The Unauthorized Negotiating Bank

In some cases the seller may not find it difficult to negotiate (sell) the documents and the draft, which is drawn under a straight credit, to a local bank for several reasons; Firstly, the seller's financial standing may be strong, thus the local bank will be confident that in the event that the paying or accepting bank dishonours the draft it will have a right of recourse against the seller who is the drawer and the indorser of the draft. Secondly, because the local bank has acquired the draft for value, the law gives it a security interest in the accompanying documents. Thirdly, the strength of the issuing bank's irrevocable undertaking to honour the draft if accompanied by confirming documents is also an important factor in enhancing the value of the draft.

The local bank does not always give the beneficiary the whole face value of the draft; it may, in some cases, advance only a percentage of the face value; in this situation the local bank will be considered as a holder for value of the draft to the extent of the sum that it advances.


27 See infra at p.307 Note 35.


29 In the U.K. §27(3) of the Bills of Exchange Act 1882 provides "Where the holder of a bill has a lien on it arising either from contract or by implication of law, he is deemed to be a holder for value to the extent of the sum for which he has a lien." In the U.S.A. a provision to the same effect is to be found in the Uniform Negotiable Instruments Law §27. See also U.C.C. §3-303(a).
It may also happen that because the local bank has effected a loan to the beneficiary to finance the underlying transaction, it requires from him that the documents and the draft should be presented to the paying bank through it, so as to be in control of the documents as a security for the loan. Such a bank will also be considered as a holder for value to the extent of the loan effected.\(^3^0\)

It should be noted that in these last situations the unauthorized negotiating bank although a holder for value, takes the draft from the beneficiary for collection; thus it is difficult to say that by giving such value it ceased to be the agent of the beneficiary.\(^3^1\) The same could be said about the situation where the negotiating bank has purchased the draft but required the beneficiary to sign a collection order.\(^3^2\) Consequently in these situations it is difficult to determine whether such a bank is a collecting bank or a negotiating bank, but for simplicity it will be presumed that such bank assumes one role or the other.

The relationship between each of the parties of the letter of credit

\(^3^0\)In the U.K. §27 of the Bills of Exchange Act, 1882 while listing what constitutes a valuable consideration provides in subsection (1)(b) that "An antecedent debt or liability, such a debt or liability is deemed valuable consideration whether the bill is payable on demand or at a future time." In the U.S.A. see Uniform Negotiable Instruments Law §25. See also U.C.C. §3-303(b).

\(^3^1\)See Barclays Bank Ltd. v. Astley Industrial Trust Ltd [1970] 2 Q.B. 527 at p.538, per Milmo, J.

\(^3^2\)The result is that such bank, in order to recover the money paid to the beneficiary, must firstly, as a negotiating bank, adhere to the negotiable instruments law procedure and secondly as a collecting bank it must adhere to the beneficiary’s instructions laid down in the collection order. See Benjamin’s Sale of Goods at §22-080.
transaction and the unauthorized negotiating bank, will be discussed separately.

6.4.1 The Relationship With The Beneficiary

The unauthorized negotiating bank has a contractual relationship with the beneficiary, i.e. when the negotiating bank purchases the beneficiary's draft it becomes a holder of the draft\(^{33}\) who has a contractual relationship with the drawer and the endorser (the beneficiary). This relationship is governed by the law of negotiable instruments.\(^{34}\)

The unauthorized negotiating bank, as mentioned above, relies mainly on the credit of the beneficiary (the drawer and indorser of the draft) because the law gives it a right of recourse against him if the issuing

\(^{33}\)Such bank could be a holder in due course, i.e. a person who takes the draft for value, in good faith and without notice of irregularities. [In the U.S.A. U.C.C. §3-302(1). In the U.K. §29 of The Bills of Exchange Act, 1882.] It should, however, be noted that the negotiating bank is not often a holder in due course, because they usually take the beneficiary’s draft under reserve [i.e. put the funds into the beneficiary’s account but restrict his right to draw on it for a certain period of time]. Thus a bank who takes the draft under reserve does not give value. In the U.S.A. see U.C.C. §410. See Dolan, The Correspondent Bank in the Letter of Credit Transaction, at p.413 Note 36. In the U.K. see Re Furrow’s Bank Ltd., [1923] 1 Ch. 41 at p.48; Underwood (A.L.) Ltd. v. Barclays Bank [1924] 1 K.B. 775 at p.805; Westminster Bank v. Zang [1966] A.C. 182. See Ryder, F., and Bueno, Byles on Bills of Exchange, The Law of Bills of Exchange, Promissory Notes, Bank Notes and Cheques (26th ed.) 1988 at pp.317-9.

\(^{34}\)In the U.K. by the Bills of Exchange Act, 1882; In the U.S.A. The Uniform Negotiable Instruments Law and Art. 3 of the U.C.C.
bank dishonours the draft by non-payment or non-acceptance.\(^{35}\) Such right of recourse is not, however, free from conditions; i.e., the unauthorized negotiating bank, as a holder of the draft, must present it for payment in the case of a sight draft, or for acceptance and then later for payment in the case of a time draft;\(^{36}\) failing to do so on the date when the draft is due will result in losing its right of recourse.\(^{37}\)

The unauthorized negotiating bank will also lose its right of recourse if the draft was dishonoured but it did not send a notice of dishonour to the drawer and endorsers within a reasonable time.\(^{38}\)

\(^{35}\)In the U.K. §43(2) and 47(2) of the Bills of Exchange Act, 1882. In the U.S.A. §3-507(2) of the U.C.C.; §§84 and 151 of the Uniform Negotiable Instruments Law.

\(^{36}\)There is however, the problem of to whom should the unauthorized negotiating bank present the draft for payment and acceptance or for negotiation in the situation where the issuing bank promises in the credit to negotiate (without recourse) a draft drawn on the buyer. It is apparent that if the draft is presented directly to the buyer the security afforded by the letter of credit will be wasted. Professor Ellinger [Documentary Letters of Credit, at pp.272-3] relying on the rule in Polak v. Everett [(1876) 1 Q.B.D. 669 at pp.675-6.] in the U.K. and §3-606(1) of the U.C.C. in the U.S.A. concluded that the unauthorized negotiating bank should present the draft to the issuing bank for negotiation but if it elected to present it to the buyer, the beneficiary should be discharged from its obligations towards the unauthorized negotiating bank to the extent that such bank ought to have made out of this security. In Sassoon (M.A.) & Sons, Ltd. v. International Banking Corporation [(1927) A.C. 711 at p.730.] the unauthorized negotiating bank was excused for wasting the letter of credit security by presenting the draft for acceptance to the buyer because it was instructed by the drawer to do so.


\(^{38}\)In the U.K. §48 of the Bills of Exchange Act 1882; In the U.S.A. §89 of the Uniform Negotiable Instruments Law; Cf. U.C.C.§3-502.
The question which may arise is whether a notice of dishonour is necessary when the issuing bank dishonours the draft because the documents attached to it are not in compliance with the terms of the credit. In the U.S.A. Section 3-511(2)(b) of the Uniform Commercial Code provides:

2) Presentment or notice or protest as the case may be is entirely excused when...

b) Such party [the drawer]... has no reason to expect or right to require that the instrument be accepted or paid...39

Similarly in the U.K. section 50(2)(c) of the Bills of Exchange Act, 1882 provides that:

2) Notice of dishonour is dispensed with...

c) As regards the drawer in the following cases, namely...(4) where the drawee or acceptor is as between himself and the drawer under no obligation to accept or pay the bill...

As the issuing bank is not under an obligation to honour a draft accompanied by non-conforming documents, nor does the beneficiary expect it to do so, the unauthorized negotiating bank, could be said, in such a situation, not to lose its right of recourse if it did not send the beneficiary a notice of dishonour.40

39See also §114(4) of the Uniform Negotiable Instruments Law.

40See Ellinger, Documentary Letters of Credit, at p.275.
6.4.2 The Relationship With The Issuing Bank

The unauthorized negotiating bank has no contractual relationship with the issuing bank. The promise in a straight credit\(^{41}\) is directed only to the beneficiary; thus, the unauthorized negotiating bank has no right against the issuing bank on the credit.\(^{42}\) Equally the unauthorized negotiating bank is a holder of an unaccepted draft to whom the law of negotiable instruments does not give any right against the drawee (the issuing bank). In the U.K. Section 53(1) of the Bills of Exchange Act, 1882 reads in part "... the drawee of a bill who does not accept as required by this Act is not liable on the instrument..."\(^{43}\)

Due to this lack of contractual relationship, the unauthorized negotiating bank is not under any duty to the issuing bank to present documents which are on their face in compliance with the terms of the credit, but if it did present non-complying documents the issuing bank has the right to reject them, just as it will do if the non-conforming

\(^{41}\) Or in a negotiation credit where the promise is not directed to such bank.


\(^{43}\) In the U.S.A. see U.C.C. §3-409(1); §127 of the Uniform Negotiable Instruments Law. The law in this regard is different in Scotland, Section 53(2) of the Bills of Exchange Act, 1882 reads "In Scotland, where the drawee of a bill has in his hands funds available for the payment thereof, the bill operates as an assignment of the sum for which it is drawn in favour of the holder, from the time when the bill is presented to the drawee." Thus in Scotland if the buyer has put the issuing bank in funds to meet the seller's draft the bill will be regarded at the time of presentation as an assignation of that fund to the holder.
documents and the draft are presented directly by the beneficiary.

Moreover, as the unauthorized negotiating bank has no right of its own to enforce the credit, it is submitted\(^4^4\) that if such bank presented a draft accompanied by forged documents, though facially in compliance with the terms of the credit, the issuing bank has the right to reject them. In support of this argument it is doubtful that such a bank would benefit from Article 16(a) of the U.C.P. since the Article stresses that it is only applicable in the case of authorized negotiating bank\(^4^5\) as referred to in the U.C.P. Article 10(b)(iv).

However, in *Discount Records Ltd. v. Barclays Bank Ltd. and Another*\(^4^6\) Megarry J. seems to suggest that where the fraud is committed by the beneficiary and the presenting bank is not a mere agent of the beneficiary for collection, but a holder in due course, it will be entitled to payment regardless of whether the draft is drawn under a *straight credit* or *negotiation credit*.

In the U.S.A. the U.C.C. is not as clear as the U.C.P. in this regard. Section 5-114(2)(a) unlike Article 16(a) does not stress that in order to be entitled to reimbursement against facially conforming documents the


\(^{4^5}\)See *infra* at p.327.

negotiating bank must have been authorized by the issuing bank to take the beneficiary's draft; it only indicates that the issuing bank is under a duty to reimburse a negotiating bank or a holder of the draft despite the fraud if such a draft is taken "under the credit".

Also courts did not clarify the point; they ruled in favour of the holder in due course where there was a documentary fraud but did not indicate whether the draft was drawn under a straight or negotiation credit.

Dolan, taking into account the practical expectations of both the issuer and the negotiating bank, suggested that the words "under the credit" in Section 5-114(2)(a) meant under a negotiation letter of credit in which the issuer authorizes a bank to take the beneficiary's draft, thus a negotiating bank who takes a draft drawn under a straight letter of credit does not take it "under the credit" as the section provides. So it can not benefit from the fraud exception provided for by Section 5-114(2)(a). Such a bank, in the author's view, is only an agent of the beneficiary for collection, whose qualification of being a holder in due course is immaterial. White and Summers, however, doubted that the

47The U.C.C. uses the term negotiating bank authorized by the issuing bank to take the seller's draft in §5-106(4).


drafters of section 5-114(2) intended such distinction.

A further question that is to be discussed is whether after making payment the issuing bank can claim recourse on the bill of exchange against the unauthorized negotiating bank, in the situations where the issuing bank accepted a set of documents which were not on their face complying with the terms of the credit and which were later rejected by the buyer or where the issuing bank accepted documents which were facially in compliance with the terms of the credit but turned out to be forged.\footnote{The issuing bank has the right of reimbursement by the buyer despite the fraud [U.C.P. Art. 17; U.C.C. §5-109(2)] but to keep a good repute may prefer to recover the money paid from the negotiating bank.} In answering the question a distinction should be drawn between the situation where a bill of exchange is drawn by the seller on the issuing bank, and the situation where the bill is drawn by the seller on the buyer and the issuing bank promises to negotiate it.

In the first situation: i.e., where the issuing bank promises to honour a bill of exchange drawn on itself, if the issuing bank (the drawee) accepted the documents and paid against the draft the law of negotiable instruments regards such payment as having the effect of extinguishing all rights based on the draft.\footnote{See §59(1) of the Bills of Exchange Act, 1882. See in the U.S.A. U.C.C. §3-601(3); U.N.I.L. §51.} It follows that an acceptor of the bill

\footnote{Uniform Commercial Code (3rd ed.) (Vol. 2) Chap. 19 at p.74.}
has no right of recourse on it after payment.

Where the draft is drawn by the seller on the buyer and the issuing bank promises to negotiate it, the issuing bank after accepting the documents and making payment will become a holder of the draft which is endorsed to it by the unauthorized negotiating bank and the latter will become an endorser. Such a holder is entitled by the law of negotiable instruments to a right of recourse against the endorser if the drawee (the buyer) dishonoured the draft\(^{53}\) whether because the documents do not comply with the terms of the credit, the bankruptcy of the buyer or that the documents were fraudulent.

It should be noted, however, that the holder in due course does not warrant that the documents attached to the draft are genuine;\(^{54}\) thus the mere fact that they are forged does not give the subsequent holder a right of recourse. If this principle applies to the relationship between the issuing bank and the buyer,\(^{55}\) it is more likely to be applicable to the relationship between the issuing bank and the unauthorized negotiating bank, because, unlike the issuing bank which owes the buyer a duty to ensure that the documents are regular on their face, the unauthorized negotiating bank, due to the lack of contractual relationship, does not

\(^{53}\)See *supra* at p.307 Note 35 and the accompanying text.


owe the issuing bank any duty to ensure the regularity of the documents let alone the genuineness. But it is important to note that the issuing bank’s right of recourse comes into existence as a result of the buyer’s dishonour of the draft, not as a result of the document being fraudulent.

It is unjust to allow the issuing bank a right of recourse against the unauthorized negotiating bank whatever the reason behind the buyer’s dishonour of the draft, not only because it is very likely that the latter has changed its position after receiving payment, but also, despite the fact that it has a right of recourse against the seller, it would not always be able to recover such money.

Professor Ellinger argued that the issuing bank should not be entitled to such a right on the following grounds; firstly, in many cases the issuing bank’s undertaking in a letter of credit is to pay against the documents alone and the involvement of a bill of exchange from the practical point of view is only intended to be a convenient method of making payment. Thus, the bill of exchange is incidental to the letter of credit transaction, and the rules of the former were not intended to regulate the rights of the parties of the latter. Secondly, the main concern of the issuing bank when negotiating the draft is not directed to the draft itself but to whether the attached documents satisfy its

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56See Ellinger, *The Tender of Fraudulent Documents Under Documentary Letters of Credit* at p.49.

57If the documents were fraudulent the seller is unlikely to be solvent.

58*The Tender of Fraudulent Documents Under Documentary Letters of Credit*, at p.51.
agreement with the buyer, thus, by accepting them it makes a representation to the unauthorized negotiating bank to that effect. Thirdly, the acceptance of the documents by the issuing bank would lead the unauthorized negotiating bank to believe that they are in compliance with the terms of the credit and subsequently giving it a sense of security from having recourse taken against it.

Moreover, the issuing bank is in a different position from an ordinary holder of an unaccepted draft, who takes it mainly on reliance on the credit of the drawer and endorsers. The issuing bank negotiates a draft drawn under irrevocable letter of credit not in reliance on the credit of the drawer and endorsers but relying on the buyer’s promise in their agreement in the application form to accept the draft.

Support to the view of denying the issuing bank a right of recourse is found in the American case of Bank of East Asia, Ltd., v. Pang.59 In this case the plaintiffs (issuing bank) opened an irrevocable negotiation letter of credit in favour of the defendant (seller), who drew under it a draft on the buyers. The issuing bank negotiated the draft and presented it to the buyers for acceptance which the latter did. When the buyers failed before the maturity of the draft the issuing bank (plaintiffs) brought an action against the seller (defendant) to recover the money paid against the draft. In an answer to the plaintiffs’ argument, that as a holder of the draft they have a right of recourse against the defendant, Main, J. said:

59 140 Wash. 603, 249 P.1060 (1926).
The general provision of that statute which permits the holder or any subsequent indorser of a negotiable instrument dishonoured to maintain an action thereon against the drawer is not applicable in the present case because the drafts here involved specifically state that they are drawn under the irrevocable letter of credit, and by that the bank was required to pay when a draft and other documents specified were presented.\(^6^0\)

Denying the issuing bank a right of recourse on the draft against the beneficiary in this case shows that it is more likely to be denied as against the unauthorized negotiating bank.\(^6^1\)

Support to this result is now given by the U.C.C. Section 5-111(2) which reads:

Unless otherwise agreed a negotiating, advising, confirming, collecting or issuing bank presenting or transferring a draft or demand for payment under a credit warrants only the matters warranted by a collecting bank under Article 4 and any such bank transferring a document warrants only the matters warranted by an intermediary under Articles 7 and 8.

It is clear from the reading of the provision that even a collecting bank, who is not a holder of the draft for value, only warrants its good faith and authority;\(^6^2\) thus it does not warrant either that the documents are facially in compliance with the terms of the credit or that they are

\(^{60}\)Ibid, at p.1063.

\(^{61}\)The dishonour was as a result of the failure of the buyer but there is no reason not to make it applicable as regard to the relationship between the issuing bank and the unauthorized negotiating bank whatever the reason was.

\(^{62}\)See U.C.C. §5-111 official comment. See also §§4-207, 7-508 and 8-306.
genuine. It follows that the unauthorized negotiating bank as a holder for value or could be a holder in due course, is more likely to be entitled to rely on this section. So if the issuing bank paid against fraudulent or non-conforming documents it will not be entitled to recover such payment from the unauthorized negotiating bank.

The next question to be discussed is whether the issuing bank is entitled to recover the sum from the unauthorized negotiating bank as money paid under a mistake of fact. In answering this question it is, however, appropriate to discuss separately the situations where the issuing bank seeks to recover the money paid because it accepted by mistake documents that were not regular on their face and the situation where the documents were fraudulent.

In the first situation, if the issuing bank was not entitled to recover the money paid from the seller, it naturally follows for the same reasons that the issuing bank cannot recover such money from the unauthorized negotiating bank.

In the second situation where the issuing bank paid against documents that are facially in compliance with the terms of the credit, but turned out to be forged, it is doubtful that it could recover such money paid under a mistake of fact. Firstly, because the acceptance of the documents will induce the unauthorized negotiating bank to believe that they are in compliance with the terms of the credit, hence, on such belief it is very likely to change its position, for example by paying the

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63 See supra at p.36.
beneficiary the unpaid amount of the draft’s value. Secondly, as the issuing bank’s duty to the buyer is limited to the examination of the documents to ensure that they are regular on their face and does not warrant their genuineness, its concern will be directed to the regularity of the documents and it will accept them relying on that fact and not the fact that they are genuine, thus it is doubtful that it has relied on a mistake of fact.

6.4.3 The Relationship With The Buyer

Due to the fact that there is no relationship between the unauthorized negotiating bank and the issuing bank, the buyer’s relationship to the unauthorized negotiating bank is even more remote than the former relationship to the authorized negotiating bank.

6.5 The Authorized Negotiating Bank

When the issuing bank opens a negotiation letter of credit the beneficiary will not find it difficult to negotiate (sell) the documents and the draft, since under this type of letter of credit a bank negotiating the

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64U.C.P. Arts. 15 and 17; U.C.C. §5-109(2).

65See Ellinger, The Tender of Fraudulent Documents Under Documentary Letters of Credit, at p.50.

66See infra. at p.329.
draft will be in a better position than the unauthorized negotiating bank. On one hand, it will be in a similar position to the latter bank as regards the right of recourse against the drawer (beneficiary). On the other hand, unlike the unauthorized negotiating bank it has a right of its own to enforce the issuing bank’s promise in the credit.68

McAvoy, J., in Courteen Seed Co. v. Hong Kong & Shanghai Banking Corporation,69 explained the unique position of such bank in these words:

When a bank buys a draft relating to a letter of credit, it acts solely for itself and at its own risk; its transaction is with the drawer, not with the drawee, except so far as it seeks to benefit from the drawee’s commitment in its letter of credit; it owes no duty to the drawee, or to the drawee’s customer. It is engaged in quite a distant kind of transaction from selling its credit. It is buying commercial paper, relying upon the credit of the drawer and any other security the drawer at the time may offer.70

Under the negotiation credit the authorized negotiating bank, unless it

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67In fact such bank is in a better position than the issuing, confirming or advising bank who can only claim reimbursement from one person, i.e. the buyer or the issuing bank as the case may be unless there is a recourse against the beneficiary in the case of fraud.

68And the confirming bank if the credit is confirmed.


70Ibid. at p.529. See also Scanlon v. First National Bank of Mexico, N.Y. 249 N.Y. 9, 162 N.E. 567 at p.568 (1928).
has confirmed the credit,\textsuperscript{71} is under no obligation to negotiate the draft,\textsuperscript{72} but such refusal will render the issuing bank liable to the beneficiary for breach of their agreement.

It will be appropriate to discuss the relationships of the authorized negotiating bank with the letter of credit parties separately.

\textbf{6.5.1 The Relationship With The Beneficiary}

The authorized negotiating bank, as mentioned above, is under no obligation to the beneficiary to negotiate its draft, but after negotiation there is a contractual relationship which is governed by the same rules that have been discussed in regard to the relationship between the unauthorized negotiating bank and the beneficiary.\textsuperscript{73}

It should be noted that the mere fact that a draft is drawn under a negotiation credit will not exclude the authorized negotiating bank’s right of recourse against the beneficiary. To avoid recourse the beneficiary should, before negotiating the draft, insert in it the words that exclude his liability such as marking it "without recourse".\textsuperscript{74} It is, however, difficult to find a bank who will agree to negotiate a draft without

\textsuperscript{71}See U.C.C. §5-107(2); U.C.P. Art.10(b)(iv).

\textsuperscript{72}See U.C.P. Art. 11(c).

\textsuperscript{73}See \textit{supra} at pp.306 \textit{et seq.}

\textsuperscript{74}The Bills of Exchange Act, 1882, §16(1). In the U.S.A. see §61 of the U.N.I.L.; U.C.C. §3-413(2).
6.5.2 The Relationship With The Issuing Bank

The issuance of a negotiation credit constitutes an offer which becomes a contract when it is accepted by the authorized negotiating bank\(^{75}\) by acting on it.\(^{76}\) This relationship was clearly explained in the American case of \textit{Banco Nacional Ultramarino v. National Bank of Boston}\(^{77}\) in these words:

If the letter shows that it was written for the purpose of being shown in order to obtain credit, and the purchaser is within the

\(^{75}\)Gutteridge and Megrah, \textit{[The Law of Bankers’ Commercial Credits} at p.93\] are of the view that if the negotiation is restricted to a specific bank such bank will be deemed as acting as the issuing bank’s agent. It was, however, held in \textit{Maran Road Saw Mill v. Austin Taylor & Co. Ltd.}, [\cite{Maran} p.161\] that the authorized negotiating bank is neither the agent of the beneficiary nor of the issuing bank. Dolan [\textit{The Correspondent Bank in the Letter-of-Credit Transaction} (1992) B.L.J. 396 at p.414\] put forward an interesting description of the position of the authorized negotiating bank, he said "...the negotiating bank acting under a negotiation credit, properly understood, functions midway between the issuer and the seller as a quasi-issuer and as a quasi-beneficiary. To the extent that the negotiating bank takes the seller’s draft and gives value, it is a surrogate for the issuer and satisfies the issuer’s undertaking pursuant to the issuer’s authorization. To the extent that the negotiating bank then seeks payment from the issuer, it is a surrogate for the seller but presents documents to the issuer in its own right as a recipient of the issuer’s undertaking." Footnote of quoted text omitted.


\(^{77}\)289 F. 169 D.Mass.(1923).
terms of the letter, it amounts to an offer that, if he purchases the draft, it will be honored. That offer or promise becomes a contract when the draft is negotiated.\textsuperscript{78}

However, in order for a contract to come into being between the issuing bank and the authorized negotiating bank, the latter has to negotiate the seller’s draft in reliance on the negotiation credit;\textsuperscript{79} this was the decision in the \textit{Ultramarino} case. The facts of this case were that, white sugar was agreed to be sold by a Brazilian seller to an American firm. Upon the latter’s request the defendant (issuing bank) opened an irrevocable negotiation credit. The seller drew a draft on the defendant (issuing bank) and presented it without attaching any documents to it\textsuperscript{80} to the plaintiff who negotiated it. The fact that the plaintiff negotiated the draft one day before receiving the documents was an indication that the plaintiff did not negotiate the draft in reliance on the credit and hence was not allowed to enforce it. The court stated:

\textsuperscript{78}\textit{Ibid.} at pp.173-4. Whether the issuing bank’s promise can be revoked as against the beneficiary is immaterial to the authorized negotiating bank, that is because the negotiation credit contains a separate offer to such bank to negotiate the seller’s draft so if this offer is accepted the issuing bank is liable to pay the authorized negotiating bank. See Second National Bank of Toledo v. M Samuel \& Sons, Inc., 12 F. 2d 963 at pp.965,967 (1926). It is, however, unlikely to negotiate the seller’s draft if it was informed by the issuing bank that the credit has been revoked.

\textsuperscript{79}It seems more appropriate to apply "the offer and acceptance theory" [see \textit{supra} at p.111] to the relationship between the issuing bank and the authorized negotiating bank than to apply it to the relationship between the issuing bank and the beneficiary since unlike the beneficiary the authorized negotiating bank is unlikely to incur any loss before the time of negotiation.

\textsuperscript{80}289 F. 169 at p.175 (1923).
...consequently [plaintiff-negotiating bank] must have taken the draft on the credit of the drawer, and not on the strength of the obligation of the drawee to accept it. [Plaintiff-negotiating bank] did not rely on the offer of the defendant contained in any letter of credit, but rather on the personal responsibility of the drawer.

Under these circumstances the plaintiff can stand in no better position than the drawer, who knew that his contract called for Brazil white crystal sugar, to be shipped from Rio.81

Jack,82 however, argued that since it is difficult for the issuing bank to determine whether the authorized negotiating bank has acquired the documents and negotiated the draft in reliance on the credit and hence is bound to accept them, it would be more practical in the situation where the authorized negotiating bank took the draft and the documents initially with no intention to utilise the credit, to allow a contract to come into existence later if the negotiating bank changes its intention at any time up to the moment it presents the documents.

As there is no contractual or fiduciary relationship between the two banks during the period before negotiation83 the question which may arise is, would the issuing bank be allowed an action for damages, if during such period the authorized negotiating bank conveyed misleading

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82Documentary Credits, at p.130.

information and as a result of relying on that, the issuing bank suffered pecuniary loss for example, if the issuing bank relying on the information accepted non conforming documents which remained in its hands as a result of being rejected rightly by the buyer. Here the authorized negotiating bank knows that its statement will be relied upon by the issuing bank, thus, there is more proximity, which would give rise to a duty of care, between the issuing bank and the authorized negotiating bank than between the latter and the buyer. The issuing bank, therefore, is likely to succeed in an action for negligent misrepresentation in both the United Kingdom and the United States.84

In order to be entitled to reimbursement from the issuing bank under the credit the authorized negotiating bank must comply strictly with its terms. McAvoy J. in Courteen Seed Co. v. Hong Kong & Shanghai Banking Corporation85 stated:

Upon a letter of credit being established, the negotiating bank has for its security the documents ... the responsibility of the drawer, and the guaranty of the bank which has issued the letter of credit. If the negotiating bank relies upon the letter of credit, it must see that the documents accompanying the draft and the time of its purchase correspond with the terms of the credit; otherwise, the issuing bank is not liable. If the draft is negotiated under conditions which differ from the terms of the letter of credit, the negotiating bank loses the security offered by the issuing bank’s

84 As to the liability of the intermediary bank to the buyer for negligent misrepresentation in both systems, see supra at pp.245 et seq.

85 216 App.Div. 495, 215 N.Y.S. 525 (1926); aff’d. 245 N.Y. 377, 157 N.E. 272 (1927); aff’d. 159 N.E. 641 (1927).
guaranty to pay the draft.\textsuperscript{86}

Thus, if the authorized negotiating bank presented documents that are not facially in compliance with the terms of the credit, the issuing bank is entitled to reject them. However, the position of the authorized negotiating bank is clearer than the position of the unauthorized negotiating bank as regards the situation where it tendered documents that are facially in compliance with the credit but they are to the knowledge of the issuing bank fraudulent. Here the authorized negotiating bank acts at the request of the issuing bank and since the issuing bank is entitled to be reimbursed by the buyer despite the fraud it is just to treat both banks equally in this regard. In Sztejn v. J. Henry Schroder Banking Corporation\textsuperscript{87} Shientag J.’s statement gives support to this analogy, he said:

On this motion only the complaint is before me and I am bound by its allegation that the Chartered Bank [presenting bank] is not a holder in due course but is a mere agent for collection for the account of the seller charged with fraud. Therefore the Chartered Bank’s motion to dismiss the complaint must be denied. If it had appeared from the face of the complaint that the bank presenting the draft for payment was a holder in due course, its claim against the bank issuing the letter of credit would not be defeated even though the primary transaction was tainted with fraud.\textsuperscript{88}

\textsuperscript{86}215 N.Y.S. 525 at p.529. See also Second National Bank of Toledo v. M. Samuel & Sons, Inc., 12 F. 2d 963 at p.965 (1926).

\textsuperscript{87}177 Misc. 719, 31 N.Y.S. 2d 631 (1941).

\textsuperscript{88}Ibid. at p.635.
Furthermore, Ackner, L.J. in *European Asian Bank A.G. v. Punjab & Sind Bank*\(^{89}\) held that:

It would be a novel position that such fraud would entitle an issuing bank to repudiate liability against a *bona fide* negotiating bank, especially in cases where the letters of credit incorporated the Uniform Customs.\(^{90}\)

Professor Ellinger\(^{91}\) rejected this analogy on two grounds; firstly, because the authorized negotiating bank takes the documents directly from the seller, or his agent, it would therefore stand a better chance of ensuring the genuineness of the documents than the issuing bank. Secondly, unlike the issuing bank the authorized negotiating bank negotiates the seller’s draft relying not only on the issuing bank promise in the credit but also on the credit of the seller. Thus, he saw no reason to give the authorized negotiating bank the same protection given to the issuing bank in the situation where the documents are fraudulent.\(^{92}\) However, this view does not seem to account for the expected practical effect of issuing a negotiation credit\(^{93}\) which distinguishes it from a straight credit. Under the former type the

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\(^{90}\)Ibid. at p.368.


\(^{92}\)In previous work [The Tender of Fraudulent Documents Under Documentary Letters of Credit (1965) Malaya Law Review 24 at pp.46-7.] the author was of the view that the issuing bank should accept the documents despite the fraud. He also holds the same view in a recent work, see Benjamin's Sale of Goods, at §23-149.

\(^{93}\)Dolan, The Law of Letters of Credit, at pp.8-12, 8-13, Note 40.
issuing bank authorizes the other bank to negotiate the seller’s draft and expects to reimburse it when it has done its duty by presenting facially complying documents. Likewise, the authorized negotiating bank as acting under such authority expects to be reimbursed when it has done its duty, which does not include its involvement in verifying the genuineness of the documents.

It can be said, however, that this question has now been settled under both the U.C.P. and the U.C.C. Article 16(a) of the U.C.P. reads:

If a bank so authorized effects payment, or incurs a deferred payment undertaking, or accepts, or negotiates against documents which appear on their face to be in accordance with the terms and conditions of a credit, the party giving such authority shall be bound to reimburse the bank which has effected payment, or incurred a deferred payment undertaking, or has accepted, or negotiated, and to take up the documents.

Similarly Section 5-114(2)(a) of the U.C.C. provides:

(2) Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document ... is forged or fraudulent or there is fraud in the transaction

(a) the issuer must honor the draft or demand for payment if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course...

94If the buyer and the issuing bank discovered the beneficiary’s fraud before negotiation they usually inform the negotiating bank of such fraud, in order to prevent it from being a holder in due course and subsequently from benefiting from this section. See Shaffer v. Brooklyn Park Garden Apartments, [311 Minn. 452,
Regarding the question of whether the issuing bank can recover the money paid to the authorized negotiating bank against documents which were later discovered to be forged or because the buyer rejected them on the ground that they are not facially in compliance with the terms of the credit,\textsuperscript{95} it could be said that the same reasons which were put forward to disallow the issuing bank a right of recourse against the unauthorized negotiating bank\textsuperscript{96} should more forcibly apply in the case of the authorized negotiating bank. Moreover, Article 10(a)(iv) clearly provides that:

(a) An irrevocable credit constitutes a definite undertaking of the issuing bank, provided that the stipulated documents are presented and that the terms and conditions of the credit are complied with:\ldots

(iv) if the credit provides for negotiation - to pay without recourse to drawers and/or bona fide holders, drafts(s) drawn by the beneficiary, at sight or at a tenor, on the applicant for the credit or on any other drawee stipulated in the credit other than the issuing bank itself, or to provide for negotiation by another bank and to pay, as above, if such negotiation is not effected.\textsuperscript{97}

The emphasise on denying the issuing bank, in this Article, a right of recourse in the situation where the right of recourse will arise, indicates

\textsuperscript{250 N.W. 2d 172 (1977)}.  

\textsuperscript{95}Art. 16(e) precludes the issuing bank from claiming that they are not in compliance with the credit if it did not give a notice of rejection on time.

\textsuperscript{96}See \textit{supra} at pp.312 \textit{et seq}.

\textsuperscript{97}The same is applicable if the draft is negotiated by a confirming bank. See Art. 10(b)(iv).
clearly that it is denied in the situations where the issuing bank’s obligations are not to negotiate, but to pay or accept.98

In the U.S.A. section 5-111(2) of the U.C.C. is in line with the U.C.P.; it clearly indicates that the authorized negotiating bank does not warrant that the credit’s conditions are complied with.

6.5.3 The Relationship With The Buyer

The authorized negotiating bank is in the same position as the intermediary bank in as far as its relationship with the buyer is concerned. Thus, it has no contractual relationship with him and does not owe him any duty of care. This was decided in Courteen Seed Co., v. Hong Kong & Shanghai Banking Corporation.99

6.6 The Discounting Bank

In order to enhance the value of the time draft which is drawn under an irrevocable letter of credit the seller may elect to obtain the drawee [the issuing bank or some other bank designated by it as acceptor] before selling the draft. The seller in this situation will, either himself or via


99245 N.Y. 377, 157 N.E. 272 at p.274 (1927). This case is discussed supra, at pp.253-4. In Second National Bank of Toledo v. M Samuel & Sons, Inc. [12 F. 2d 963 (1926)] the negotiating bank was allowed a quasi-contractual action against the buyer. This decision was criticized by Davis [The Law Relating to Commercial Letters of Credit, at pp.109-10]. See also Ellinger, Documentary Letters of Credit, at pp.264-6.
a local bank, send the draft together with the documents to the accepting bank (the drawee) who, after ensuring that the documents are regular will stamp the draft accepted and return it to the seller and pass the documents to the buyer.\textsuperscript{100} The draft at this stage is separate from the documents and its acceptance will enable the seller to discount it in the market. The desirability of discounting such draft although partly depends on the financial standing of the drawer (seller) it mainly depends on the financial strength of the acceptor, who becomes after accepting it the primary obligor.

The seller will endorse the draft to the bank who offers him the best value and such bank (the discounting bank) will become a holder in due course. The discounting bank may retain the draft until maturity then present it for payment or may negotiate it to another bank.

The discounting bank has under the bill of exchange a clear relationship with both the seller and the acceptor (issuing bank). Thus, if the draft is dishonoured by non-payment on maturity the discounting bank has a right of recourse against the drawer (seller) and endorsers.\textsuperscript{101} It also has a right of action against the acceptor (issuing bank).\textsuperscript{102}

\textsuperscript{100}Or the issuing bank then to the buyer if the acceptor was not the issuing bank.

\textsuperscript{101}$\S 47(2)$ of the Bills of Exchange Act, 1882. In the U.S.A. see U.N.I.L. $\S 84$; U.C.C. $\S 3\text{-}507(2)$.

\textsuperscript{102}$\S 54$ of the Bills of Exchange Act, 1882. In the U.S.A. see $\S 3\text{-}410$ of the U.C.C.; U.N.I.L. $\S 132$. 
Using this method, i.e., acceptance credit, enables the issuing bank to ensure that the terms of the credit have been fulfilled before accepting the bill, thus, it appears that the intention of the parties of the letter of credit is to separate the bill from the letter of credit under which it was drawn. It follows that the discounting bank’s rights and obligations stem only from the accepted bill of exchange and it is not concerned with the letter of credit.

The acceptance of the bill by the issuing bank (or other designated bank) does not, however, discharge its liability on the letter of credit. It follows that if the bill was dishonoured the seller or a bank who is authorized by the issuing bank to discount it could also bring an action to enforce the issuing banks promise in the letter of credit.

The issuing bank’s acceptance also does not discharge the buyer from

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103 The reference in the draft that it is drawn under a specific letter of credit does not condition the right of the holder of the draft on the fulfilment of the credit’s terms. Suggesting otherwise would prevent such draft from being a negotiable instrument. See Gutteridge and Megrah, *The Law of Banker’s Commercial Credits*, at pp.96-7; Sarna, *Letters of Credit*, at p.105.


105 See Dolan, *Letters of Credit*, at p.2-19 Note 68.

106 *Ibid*, at p.2-17 Note 61.
its liability to pay the seller under the underlying contract. So if the issuing bank dishonours the draft by non-payment the seller has the right to recover the price of the goods directly from the buyer.\textsuperscript{107}

SUMMARY AND CONCLUSION

Although the documentary letter of credit is of recent origin, its rules have been developed rapidly and have reached a very high degree of uniformity worldwide. However, the position of each party in relation to the others is still not always certain. In summing up such positions the irrevocable letter of credit transaction will be followed from the time it is initiated.

The irrevocable letter of credit usually comes into existence as a result of a term in the underlying contract between the applicant for the credit and its beneficiary which is usually a contract of international sale. The effect of this term is that payment is to be by irrevocable letter of credit. The fulfilment of this term by the buyer is a condition precedent to the seller’s duty to perform his obligations under the sale contract. However, such fulfilment does not discharge the buyer from paying the price of the goods if it was not paid to the seller.

In fulfilment of this stipulation the buyer will fill in an application form in which it requests a bank to open an irrevocable letter of credit in favour of the seller. This application form contains the applicant’s instructions which the issuing bank has to adhere strictly to, if it accepts the applicant’s request either expressly or by implication. Such acceptance brings into existence a contract between the applicant and the issuing bank, the terms of which are contained in the application form.
The nature of this contract was regarded as a contract for employment to which some of the principles of agency are applicable.

Despite the fact that this contract resembles the contract of agency in that the applicant pays the issuing bank a commission as is the case in the agency contract and the applicant’s instructions resemble the principal’s mandate, the contract of agency does not explain the fact that the issuing bank by issuing the credit does not create a contract between the applicant and the beneficiary, but engages itself directly to the beneficiary. Moreover, the agent is not liable to a third party unless he exceeds his authority, but that is not the case as regards the issuing bank who will be liable for any breach of its undertaking to the beneficiary even if such breach is committed as a result of carrying out the applicant’s instructions.

It could be concluded, therefore, that such a contract should be considered as a unique commercial contract to which the principles of contract and agency that do not interfere with its nature should be made applicable.

When the issuing bank accepts the applicant’s request it will draft the letter of credit according to the buyer’s instructions, adding its undertaking to pay the beneficiary upon the latter’s compliance with its terms.

The letter of credit becomes irrevocable at the moment the beneficiary receives it, that is according to the U.C.C. §5-106(1)(b) and court decisions in the U.S.A. In the U.K. although court decisions are not in
agreement on this point, Art. 10(a) seems to imply that it becomes binding on the issuing bank at the time it is communicated to the beneficiary.

The issuing bank is under a duty to the applicant to examine the documents tendered by the beneficiary to determine that they are facially in compliance with the terms of the credit. Accepting documents that are not strictly in compliance with the terms of the credit will result in the loss of the right of reimbursement. Equally, rejecting facially complying documents will make it liable to the beneficiary unless these complying documents were actually forged with the beneficiary’s knowledge.

Courts in the U.S.A. however, have adopted a less strict approach by permitting substantial compliance, i.e., allowing the issuing bank to accept documents that contain minor discrepancies.

If the issuing bank accepted facially non-conforming documents the beneficiary will be entitled to raise the defence of waiver and estoppel in the situation where the issuing bank seeks a recourse against him. Moreover, the beneficiary could rely on the automatic preclusion provided for by Art. 16(e) of the U.C.P. It is however, doubted that the beneficiary warrants under §5-111(1) of the U.C.C. that the documents are facially in compliance with the terms of the credit.

However, in the situation where the facially conforming documents that were accepted by the issuing bank turned out to be forged, the issuing bank will recover the money paid to the beneficiary in an action
for deceit.

Due to the lack of communication between the issuing bank and the beneficiary, which in the conventional sense is the basis of creating a binding contract, a number of theoretical attempts were made during this century in both common and civil law countries in order to establish a legal ground for the validity of the beneficiary-issuing bank’s relationship. They tried to fit it within the scope of an existing legal institution; arguing that:

-the issuing bank is a guarantor of the buyer,

-the buyer-issuing bank contract is made for the benefit of the beneficiary,

-by issuing the credit the issuing bank makes a representation of its validity which it will be estopped from denying,

-the issuing bank holds the money given to it by the buyer as a trustee,

-the rights that the buyer obtains from his contract with the issuing bank is assigned or novated by the buyer to the seller,

-under the imperfect delegation of debt the issuing bank agrees to pay the debt owed by the buyer to the seller,

-the buyer procures the credit as an agent of the seller,

-the bank deals with the seller as an agent of the buyer,

-the issuing bank deals with the seller as a partner of the buyer,
- the issuing bank buys the documents from the seller and resells them to the buyer,

- classifying the issuing bank and the beneficiary as an acceptor and payee of a bill of exchange,

- the issuance of the irrevocable credit constitutes an anticipatory acceptance of a bill of exchange

- and that the irrevocable credit is a kind of mercantile currency.

In other attempts they have tried to establish that a simple contract exists between the issuing bank and the beneficiary. They argued that the issuing of the credit constitutes an offer that the beneficiary accepted by conduct or by silence and the beneficiary’s consideration is his performance of his contract with the buyer, his forbearance from demanding payment from the buyer, or that the promise to reimburse the issuing bank and pay the commission is the consideration moving to it not from the seller but from the buyer. It was also argued that the revocation of the credit by the issuing bank puts the buyer in breach of his contract with the seller, hence, dispensing with the need for the establishment of a contract between the seller and the issuing bank. They also argued that the stipulation in the sale contract that payment is to be made by an irrevocable letter of credit constitutes the seller’s offer to submit the documents representing the goods to the bank which the latter accepts by issuing an irrevocable letter of credit.

To avoid the acceptance and consideration difficulties in the above
attempts they have tried to establish that the issuing bank binds itself unilaterally to the beneficiary. They argued that the issuing and sending of the irrevocable letter of credit to the seller, as being an offer to pay a sum of money to the seller which he accepts by tendering the stipulated documents at the same time the issuing bank promises to keep this offer irrevocable for a stated period of time or that the issuing bank’s undertaking to pay the seller is a unilateral declaration of will which is binding only on the issuing bank.

None of the above proposed theories has set forth an acceptable explanation that accounts for all of the irrevocable letter of credit’s features, i.e., that it is irrevocable from the time the beneficiary receives it, with no need for a cause or consideration and no need for his acceptance, the autonomous character of the credit and the literal interpretation of its terms. Also because the irrevocable letter of credit is an international instrument, it is important to find a solution that is acceptable worldwide; thus, even if any of the theories discussed above have accounted for all of the irrevocable credit’s features in one country, it has been shown that it is not acceptable in other countries.

Furthermore, classifying the irrevocable letter of credit under one of the pre-existing institutions of the law, would mean that the future development of it will be restricted by such institution’s rules.

The usage theory is the last and more acceptable theory. It proposes that the validity of the legal relationship between the issuing bank and the beneficiary under the irrevocable letter of credit should be recognized as
being based upon its own commercial usage which has been developed by merchants and bankers all over the world for about a century. This usage, as has been explained, is not contrary to the law of any of the countries discussed.

Unlike the other theories which necessitate the distortion of the nature of the irrevocable credit or the modification of the existing legal institution in order to fit it under one of them, this theory advocates the acceptance of the irrevocable letter of credit as it is. In conclusion this theory proposes the ideal solution\(^1\) which firstly, treats it as a unique commercial contract\(^2\) to which its own rules apply. Yet in situations that are not covered by its law it allows the application of other principles of the law provided that they are not contrary to its nature. Secondly, as the irrevocable letter of credit usage was developed by bankers and merchants all over the world there seem to be no obstacles in the way of its recognition in each individual country. Thirdly, the recognition of the irrevocable letter of credit’s usage as it is today would mean that any future developments in such usage will be equally recognized.

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\(^1\)A contrary conclusion was reached by Penn, Shea and Arora, [The Law and Practice of International Banking, Vol. 2 at p.303.] They said "While the development of the commercial credits has been due to a large extent to mercantile custom, the letter of credit is these days more the creature of contract than custom, and the courts readily hold it to be the subject of the rules of contract law."

\(^2\)The Court in East Girard Savings Association v. Citizens National Bank & Trust Co. [593 F.2d 598 (5th Cir. 1979)] said that "a letter of credit simply is not an ordinary contract." at p.603.
This theory seems to be taken into account by the drafters of the U.C.C. in the United States. They firstly freed the irrevocable letter of credit from the common law contract’s requirements by dispensing with the need for the beneficiary’s acceptance; Section 5-106(1) provided that the credit is irrevocable from the time that it is communicated to him. Also Section 5-105 abolished the requirement of consideration in order for the credit to be binding on the issuing bank. Secondly, they freed the letter of credit to develop by providing that, "This Article deals with some but not all of the rules and concepts of letters of credit as such rules or concepts have developed prior to this Act or may hereafter develop". It also allowed other principles of the law to be applicable to the letter of credit provided that they are not contrary to its rules.

In addition to the main parties, there is a further bank which may be involved in the letter of credit transaction, which is known as an intermediary bank. Such bank is usually located in the seller’s country and may assume the role of issuing the credit, confirming it or advising it.

The intermediary bank, being employed by the buyer’s bank, has no relationship with the buyer. In addition to this lack of relationship, the buyer’s bank [whether issuing or requesting bank] is exempt from liability to the buyer for any act or omission of the intermediary bank. This leads to the result that in situations where the intermediary bank

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3U.C.C. §5-102(3).

4U.C.C. §1-103.
commits an act or omission that causes the buyer financial loss, he would not be able to bring an action against the intermediary bank because there is no privity of contract between them. Equally he cannot sue the issuing bank because of the exemption clauses. In attempts to find a solution that protect the buyer’s interest the U.C.C. Article 5 and the U.C.P. provisions were examined. It was also suggested that other provisions of the U.C.C. should be applied to the relationship between the buyer and the intermediary bank by way of analogy. Furthermore, it was argued that the intermediary bank should be held liable to the buyer for negligent misrepresentation.

However, none of the discussed solutions give adequate and conclusive protection to the buyer in every case where he has suffered loss as a result of the act or omission of the intermediary bank. In view of the necessity of filling the gap which presently exists, it is to be hoped that in future revision of Letter of Credit Law, the drafters, having taken account of the unjust result caused by the lack of privity and the exemption clauses, add an appropriate provision to avoid such result. In doing so they should ensure that the solution does not threaten the beneficiary’s right, nor should it effect the speed and the efficiency with which the letter of credit operates.

The relationship between the beneficiary and the intermediary bank differs according to the role assumed by the latter. Hence, if the intermediary bank issues or confirms the credit it stands in the same position as the issuing bank in its relationship with the beneficiary. However if the intermediary bank assumed the role of advising the credit
it will have no contractual relationship with the beneficiary. This lack of contractual relationship gives rise to two difficulties. Firstly, the beneficiary will not be able to bring an action against the advising bank if he suffered financial loss as a result of the advising bank’s failure to advise the credit, advising the credit but too late for the beneficiary to assemble the required documents before the expiry date, or as a result of calling for documents other than those required by the credit. As regards the last possibility the advising bank is liable to the beneficiary for conveying inaccurate information under Section 5-107(1) of the U.C.C. There is no equivalent provision in the U.C.P., but it is hoped that an additional provision to the effect that the advising bank is liable directly to the beneficiary for the accuracy of its information will be taken into consideration in the next revision.

As regards the other two possible situations it was concluded that the advising bank is not liable to the beneficiary, firstly, because it is liable to the issuer for such failure. Secondly, the beneficiary has a right of action against the buyer if the credit was not advised or not advised on time. Thirdly, holding the advising bank accountable to the beneficiary in these situations would mean exposing it to a liability which is far greater than the fee that it charges for advising the credit.

The second difficulty is that if the advising bank’s role is not limited to advising the credit but includes accepting the beneficiary’s documents and making payment against them, would it be allowed to recover such money if it has accepted documents that are not in compliance with the terms of the credit if the issuing bank rejected them? In answering this
question a distinction should be drawn between two situations; firstly, if the payment was made by negotiating a bill of exchange the advising bank will have the ordinary right of recourse against the beneficiary if the bill was not honoured by the issuing bank. Secondly, if payment was made against documents that do not include a bill of exchange the advising bank may have a right of recourse if defects in the documents were hidden, but it is doubtful if it is entitled to recover if the discrepancies were apparent. However, in order to guard against such possibilities the advising bank, before making payment, should make an agreement with the beneficiary to the effect that it will be entitled to recover such money if the documents were rejected by the issuing bank for whatever reason "payment under reserve".

As regards the relationship between banks the buyer’s bank [whether issuing or requesting bank] is the party who communicates with the intermediary bank, and thus there is a contractual relationship between them. This contract is independent of the other relationships involved in the documentary credit transaction as is the case in all the other relationships. Therefore, the intermediary bank takes its instructions from the buyer’s bank alone, and it is under a duty to adhere strictly to them. Failing to do so may endanger its right of reimbursement.

The nature of the relationship between the applicant’s bank and the intermediary bank differs according to the role assumed by the latter. The nature of the contractual relationship between the requesting bank and the intermediary-issuer is identical to that between the buyer and the issuing bank.
The advising bank has been classified as an agent of the issuing bank. However, applying the rules of agency strictly to this contract may, in some circumstances, cause an unacceptable effect to either bank. On one hand, according to the agency law the advising bank as an agent is under an obligation to pay to his principal [issuing bank] any profit that it makes beyond the fee agreed between them. On the other hand as long as the agent acts within his ostensible authority he will bind his principal; hence the advising bank’s incorrect advice, which is within its ostensible authority, will bind the issuing bank. However, the best view is that the advising bank who is only employed to notify the beneficiary of the opening of the credit should be considered as an independent contractor who does not bind the issuing bank to terms that the latter does not intend to be bound to.

The confirming bank has also been classified as an agent of the issuing bank. This view also is not correct, since it is not capable of explaining the legal basis upon which the confirming bank can be held as being under a direct obligation towards the beneficiary.

It can be said in conclusion that the contracts between the issuing bank or requesting bank and the intermediary banks are similar to the other contract involved in the letter of credit operation, i.e., the contract between the applicant for the credit and the issuing bank. They also share some similarities with the agency contract. Despite these similarities these contracts have their own distinctive features. Therefore they should be considered as unique commercial contracts, to which the rules of agency and other contract rules in general should be
made applicable, provided that these rules are in harmony with the nature of these contracts.

The introduction of a bill of exchange into the letter of credit transaction gives rise not only to an additional group of rights and obligations between the parties but also, in some situations, to the involvement of additional parties.

The beneficiary may draw a time or sight draft under a straight\(^5\) or negotiation\(^6\) credit and submit it together with the documents to a local bank requesting the latter to present them to the paying bank on his behalf. In this situation such bank is a mere agent of the beneficiary for collection and has no relationship with the other parties.

If the draft is drawn under a straight credit and is negotiated by the beneficiary to a bank, such bank will become a holder of the beneficiary’s draft and their relationship will be governed by the law of negotiable instruments.

This bank has no relationship with the issuing bank under the credit, since it took the draft under a straight credit. Equally it has no right against the issuing bank on the draft, since it is a holder of an unaccepted draft to whom the law of negotiable instruments does not

\(^5\)In which the issuing bank’s promise to honour the draft is limited to the beneficiary.

\(^6\)In which the issuing bank’s promise to honour the draft is not limited to the beneficiary but extended to the bank or the banks that negotiate the beneficiary’s draft.
give any right against the drawee.

Due to this lack of contractual relationship, the issuing bank will be entitled to reject documents that are submitted by such bank whether they are facially non-complying with the terms of the credit or facially complying but they are in fact forged. However, if the issuing bank accepted documents that are facially non-complying with the terms of the credit or fraudulent the most acceptable view is the one which denies it a right of recourse on the bill of exchange against the unauthorized negotiating bank. This is because it is unjust to have recourse against such bank who on one hand is very likely to have changed its position in reliance on the acceptance of the documents, and on the other, despite the fact that it has a right of recourse against the seller on the draft, the latter would not likely to be solvent if the documents were fraudulent.

It should be noted that the buyer has no relationship with the unauthorized negotiating bank.

If the draft is drawn under a negotiation credit by the beneficiary and negotiated together with the other documents to a bank that is authorized by the issuing bank to negotiate the draft, such bank will be in the same position vis-à-vis the beneficiary as the unauthorized negotiating bank. However, if such bank took the beneficiary’s draft in reliance on the issuing bank’s promise in the negotiation credit a contract will come into existence between them. Under such contract the authorized negotiating bank is under a duty to submit to the issuing bank facially complying documents and the issuing bank under an obligation to accept them and
reimburse it, even if they were fraudulent to the knowledge of the issuing bank. Moreover, if the issuing bank accepted facially non-complying documents or complying documents that were discovered later to be forged it will have no right of recourse against the authorized negotiating bank.

In as far as the buyer is concerned the authorized negotiating bank has no privity of contract with him.

In some situations the beneficiary may draw a time draft and send it together with the other documents directly to the issuing bank who will examine them and keep them if they are regular on their face and stamp the draft "accepted" then send it back to the beneficiary. After receiving the draft the beneficiary will discount it at a local bank who will have under the bill of exchange a legal relationship with both the beneficiary as drawer of the draft and the issuing bank as acceptor of it.
APPENDIX 1

The Uniform Customs And Practice For Documentary Credits

(1983 Revision) ICC Publication No 400

A. General Provisions and Definitions

Article 1

These articles apply to all documentary credits, including, to the extent to which they may be applicable, standby letters of credit, and are binding on all parties thereto unless otherwise expressly agreed. They shall be incorporated into each documentary credit by wording in the credit indicating that such credit is issued subject to Uniform Customs and Practice for Documentary Credits, 1983 revision, ICC Publication No 400.

Article 2

For the purposes of these articles, the expression ‘documentary credit(s)’ and ‘standby letter(s) of credit’ used herein (hereinafter referred to as ‘credit(s)’), mean any arrangement, however named or described, whereby a bank (the issuing bank), acting at the request and on the instructions of a customer (the applicant for the credit),

(i) is to make a payment to or to the order of a third party (the beneficiary), or is to pay or accept bills of exchange (drafts) drawn by the beneficiary, or

(ii) authorizes another bank to effect such payment, or to pay, accept or negotiate such bills of exchange (drafts),

against stipulated documents, provided that the terms and conditions of the credit are complied with.

Article 3

Credits, by their nature, are separate transactions from the sales or other
contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the credit.

**Article 4**

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

**Article 5**

Instructions for the issuance of credits, the credits themselves, instructions for any amendments thereto and the amendments themselves must be complete and precise.

In order to guard against confusion and misunderstanding, banks should discourage any attempt to include excessive detail in the credit or in any amendment thereto.

**Article 6**

A beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the applicant for the credit and the issuing bank.

**B. Form and Notification of Credits**

**Article 7**

(a) Credits may be either

   (i) revocable, or

   (ii) irrevocable.

(b) All credits, therefore, should clearly indicate whether they are revocable or irrevocable.

(c) In the absence of such indication the credit shall be deemed to be revocable.

**Article 8**

A credit may be advised to a beneficiary through another bank (the advising bank) without engagement on the part of the advising bank, but
that bank shall take reasonable care to check the apparent authenticity of the credit which it advises.

**Article 9**

(a) A revocable credit may be amended or cancelled by the issuing bank at any moment and without prior notice to the beneficiary.

(b) However, the issuing bank is bound to:

(i) reimburse a branch or bank with which a revocable credit has been made available for sight payment, acceptance or negotiation, for any payment, acceptance or negotiation made by such branch or bank prior to receipt by it of notice of amendment or cancellation, against documents which appear on their face to be in accordance with the terms and conditions of the credit.

(ii) reimburse a branch or bank with which a revocable credit has been made available for deferred payment, if such branch or bank has, prior to receipt by it of notice of amendment or cancellation, taken up documents which appear on their face to be in accordance with the terms and conditions of the credit.

**Article 10**

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

(i) if the credit provides for sight payment - to pay, or that payment will be made;

(ii) if the credit provides for deferred payment - to pay, or that payment will be made, on the date(s) determinable in accordance with the stipulations of the credit;

(iii) if the credit provides for acceptance - to accept drafts drawn by the beneficiary if the credit stipulates that they are to be drawn on the issuing bank, or to be responsible for their acceptance and payment at maturity if the credit stipulates that they are to be drawn on the applicant for the credit or any other drawee stipulated in the credit;

(iv) if the credit provides for negotiation - to pay without recourse
to drawers and/or bona fide holders, draft(s) drawn by the beneficiary, at sight or at a tenor, on the applicant for the credit or on any other drawee stipulated in the credit other than the issuing bank itself, or to provide for negotiation by another bank and to pay, as above, if such negotiation is not effected.

(b) When an issuing bank authorizes or requests another bank to confirm its irrevocable credit and the latter has added its confirmation, such confirmation constitutes a definite undertaking of such bank (the confirming bank), in addition to that of the issuing bank, provided that the stipulated documents are presented and that the terms and conditions of the credit are complied with:

(i) if the credit provides for sight payment - to pay, or that payment will be made;

(ii) if the credit provides for deferred payment - to pay, or that payment will be made, on the date(s) determinable in accordance with the stipulations of the credit;

(iii) if the credit provides for acceptance - to accept drafts drawn by the beneficiary if the credit stipulates that they are to be drawn on the confirming bank, or to be responsible for their acceptance and payment at maturity if the credit stipulates that they are to be drawn on the applicant for the credit or any other drawee stipulated in the credit;

(iv) if the credit provides for negotiation - to negotiate without recourse to drawers and/or bona fide holders, draft(s) drawn by the beneficiary, at sight or at a tenor, on the issuing bank or on the applicant for the credit or on any other drawee stipulated in the credit other than the confirming bank itself.

(c) If a bank is authorized or requested by the issuing bank to add its confirmation to a credit but is not prepared to do so, it must so inform the issuing bank without delay. Unless the issuing bank specifies otherwise in its confirmation authorization or request, the advising bank will advise the credit to the beneficiary without adding its confirmation.

(d) Such undertakings can neither be amended nor cancelled without the agreement of the issuing bank, the confirming bank (if any), and the
beneficiary. Partial acceptance of amendments contained in one and the same advice of amendment is not effective without the agreement of all the above named parties.

Article 11

(a) All credits must clearly indicate whether they are available by sight payment, by deferred payment, by acceptance or by negotiation.

(b) All credits must nominate the bank (nominated bank) which is authorized to pay (paying bank), or to accept drafts (accepting bank), or to negotiate (negotiating bank), unless the credit allows negotiation by any bank (negotiating bank).

(c) Unless the nominated bank is the issuing bank or the confirming bank, its nomination by the issuing bank does not constitute any undertaking by the nominated bank to pay, to accept, or to negotiate.

(d) By nominating a bank other than itself, or by allowing for negotiation by any bank, or by authorizing or requesting a bank to add its confirmation, the issuing bank authorizes such bank to pay, accept or negotiate, as the case may be, against documents which appear on their face to be in accordance with the terms and conditions of the credit, and undertakes to reimburse such bank in accordance with the provisions of these articles.

Article 12

(a) When an issuing bank instructs a bank (advising bank) by any teletransmission to advice a credit or an amendment to a credit, and intends the mail confirmation to be the operative credit instrument, or the operative amendment, the teletransmission must state 'full details to follow' (or words of similar effect), or that the mail confirmation will be the operative credit instrument or the operative amendment. The issuing bank must forward the operative credit instrument or the operative amendment to such advising bank without delay.

(b) The teletransmission will be deemed to be the operative credit instrument or the operative amendment, and no mail confirmation should be sent, unless the teletransmission states 'full details to follow' (or words of similar effect), or states that the mail confirmation is to be the
operative credit instrument or the operative amendment.

(c) A teletransmission intended by the issuing bank to be the operative credit instrument should clearly indicate that the credit is issued subject to Uniform Customs and Practice for Documentary Credits, 1983 revision, ICC Publication No. 400.

(d) If a bank uses the services of another bank or banks (the advising bank) to have the credit advised to the beneficiary, it must also use the services of the same bank(s) for advising any amendments.

(e) Banks shall be responsible for any consequences arising from their failure to follow the procedures set out in the preceding paragraphs.

Article 13

When a bank is instructed to issue, confirm or advise a credit similar in terms to one previously issued, confirmed or advised (similar credit) and the previous credit has been the subject of amendment(s), it shall be understood that the similar credit will not include any such amendment(s) unless the instructions specify clearly the amendment(s) which is/are to apply to the similar credit. Banks should discourage instructions to issue, confirm or advise a credit in this manner.

Article 14

If incomplete or unclear instructions are received to issue, confirm, advise or amend a credit, the bank requested to act on such instructions may give preliminary notification to the beneficiary for information only and without responsibility. The credit will be issued, confirmed, advised or amended only when the necessary information has been received and if the bank is then prepared to act on the instructions. Banks should provide the necessary information without delay.

C. Liabilities and Responsibilities

Article 15

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. Documents which appear on their face to be inconsistent with one another will be considered as not appearing on
their face to be in accordance with the terms and conditions of the credit.

Article 16

(a) If a bank so authorized effects payment, or incurs a deferred payment undertaking, or accepts, or negotiates against documents which appear on their face to be in accordance with the terms and conditions of a credit, the party giving such authority shall be bound to reimburse the bank which has effected payment, or incurred a deferred payment undertaking, or has accepted, or negotiated, and to take up the documents.

(b) 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, it must determine, on the basis of the documents alone, whether to take up such documents, or to refuse them and claim that they appear on their face not to be in accordance with the terms and conditions of the credit.

(c) The issuing bank shall have a reasonable time in which to examine the documents and to determine as above whether to take up or to refuse the documents.

(d) If the issuing bank decides to refuse the documents, it must give notice to that effect without delay by telecommunication or, if that is not possible, by other expeditious means, to the bank from which it received the documents (the remitting bank), or to the beneficiary, if it received the documents directly from him. Such notice must state the discrepancies in respect of which the issuing bank refuses the documents and must also state whether it is holding the documents at the disposal of, or is returning them to, the presenter (remitting bank or the beneficiary, as the case may be). The issuing bank shall then be entitled to claim from the remitting bank refund of any reimbursement which may have been made to that bank.

(e) If the issuing bank fails to act in accordance with the provisions of paragraphs (c) and (d) of this article and/or fails to hold the documents at the disposal of, or to return them to, the presenter, the issuing bank shall be precluded from claiming that the documents are not in accordance with the terms and conditions of the credit.

(f) If the remitting bank draws the attention of the issuing bank to any
discrepancies in the documents or advises the issuing bank that it has paid, incurred a deferred payment undertaking, accepted or negotiated under reserve or against an indemnity in respect of such discrepancies, the issuing bank shall not be thereby relieved from any of its obligations under any provision of this article. Such reserve or indemnity concerns only the relation between the remitting bank and the party towards whom the reserve was made, or from whom, or on whose behalf, the indemnity was obtained.

Article 17

Banks assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any documents, or for the general and/or particular conditions stipulated in the documents or superimposed thereon; nor do they assume any liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods represented by any documents, or for the good faith or acts and/or omissions, solvency, performance or standing of the consignor, the carriers, or the insurers of the goods, or any other person whomsoever.

Article 18

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 any telecommunication. Banks assume no liability or responsibility for errors in translation or interpretation of technical terms, and reserve the right to transmit credit terms without translating them.

Article 19

Banks assume no liability or responsibility for consequences arising out of the interruption of their business by Acts of God, riots, civil commotions, insurrections, wars or any other causes beyond their control, or by any strikes or lockouts. Unless specifically authorized, banks will not, upon resumption of business, incur a deferred payment undertaking, or effect payment, acceptance or negotiation under credits which expired during such interruption of their business.

Article 20

(a) Banks utilising the services of another bank or other banks for the
purpose of giving effect to the instructions of the applicant for the credit do so for the account and at the risk of such applicant.

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

(c) 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.

**Article 21**

(a) If an issuing bank intends that the reimbursement to which a paying, accepting or negotiating bank is entitled shall be obtained by such bank claiming on another branch or office by the issuing bank or on a third bank (all hereinafter referred to as the reimbursing bank) it shall provide such reimbursing bank in good time with the proper instructions or authorization to honour such reimbursement claims and without making it a condition that the bank entitled to claim reimbursement must certify compliance with the terms and conditions of the credit to the reimbursing bank.

(b) An issuing bank will not be relieved from any of its obligations to provide reimbursement itself if and when reimbursement is not effected by the reimbursing bank.

(c) The issuing bank will be responsible to the paying, accepting or negotiating bank for loss of interest if reimbursement is not provided on first demand made to the reimbursing bank, or as otherwise specified in the credit, or mutually agreed, as the case may be.

**D. Documents**

**Article 22**

(a) All instructions for the issuance of credits and the credits themselves and, where applicable, all instructions for amendments thereto and the amendments themselves, must state precisely the document(s) against which payment, acceptance or negotiation is to be made.
(b) Terms such as 'first class', 'well known', 'qualified', 'independent', 'official', and the like shall not be used to describe the issuers of any documents to be presented under a credit. If such terms are incorporated in the credit terms, banks will accept the relative documents as presented, provided that they appear on their face to be in accordance with the terms and conditions of the credit.

(c) Unless otherwise stipulated in the credit, banks will accept as originals documents produced or appearing to have been produced:

(i) by reprographic systems;
(ii) by, or as a result of, automated or computerized systems;
(iii) as carbon copies,
if marked as originals, always provided that, where necessary, such documents appear to have been authenticated.

Article 23
When documents other than transport documents, insurance documents and commercial invoices are called for, the credit should stipulate by whom such documents are to be issued and their wording or data content. If the credit does not so stipulate, banks will accept such documents as presented, provided that their data content makes it possible to relate the goods and/or services referred to therein to those referred to in the commercial invoice(s) presented, or to those referred to in the credit if the credit does not stipulate presentation of a commercial invoice.

Article 24
Unless otherwise stipulated in the credit, banks will accept a document bearing a date of issuance prior to that of the credit, subject to such document being presented within the time limits set out in the credit and these articles.

D. 1. Transport documents (documents indicating loading on board or dispatch or taking in charge)

Article 25
Unless a credit calling for a transport document stipulates as such document a marine bill of lading (ocean bill of lading or a bill of lading
covering carriage by sea), or a post receipt or certificate of posting:

(a) banks will, unless otherwise stipulated in the credit, accept a transport document which:

(i) appears on its face to have been issued by a named carrier, or his agent, and
(ii) indicates dispatch or taking in charge of the goods, or loading on board, as the case may be, and
(iii) consists of the full set of originals issued to the consignor if issued in more than one original, and
(iv) meets all other stipulations of the credit.

(b) Subject to the above, and unless otherwise stipulated in the credit, banks will not reject a transport document which:

(i) bears a title such as 'Combined transport bill of lading', 'Combined transport document', 'Combined transport bill of lading or port-to-port bill of lading', or a title or a combination of titles of similar intent and effect, and/or
(ii) indicates some or all of the conditions of carriage by reference to a source or document other than the transport document itself (short form/blank back transport document), and/or
(iii) indicates a place of taking in charge different from the port of loading and/or a place of final destination different from the port of discharge, and/or
(iv) relates to cargoes such as those in Containers or on pallets, and the like, and/or
(v) contains the indication 'intended', or similar qualification, in relation to the vessel or other means of transport, and/or the port of loading and/or the port of discharge.

(c) Unless otherwise stipulated in the credit in the case of carriage by sea or by more than one mode of transport but including carriage by sea, banks will reject a transport document which:

(i) indicates that it is subject to a charter party, and/or
(ii) indicates that the carrying vessel is propelled by sail only.
(d) Unless otherwise stipulated in the credit, banks will reject a transport document issued by a freight forwarder unless it is the FIATA Combined Transport Bill of Lading approved by the International Chamber of Commerce or otherwise indicates that it is issued by a freight forwarder acting as a carrier or agent of a named carrier.

Article 26

If a credit calling for a transport document stipulates as such document a marine bill of lading:

(a) banks will, unless otherwise stipulated in the credit, accept a document which:

(i) appears on its face to have been issued by a named carrier, or his agent, and
(ii) indicates that the goods have been loaded on board or shipped on a named vessel, and
(iii) consists of the full set of originals issued to the consignor if issued in more than one original, and
(iv) meets all other stipulations of the credit.

(b) Subject to the above, and unless otherwise stipulated in the credit, banks will not reject a document which:

(i) bears a title such as ‘Combined transport bill of lading’, ‘Combined transport document’, ‘Combined transport bill of lading or port-to-port bill of lading’, or a title or a combination of titles of similar intent and effect, and/or
(ii) indicates some or all of the conditions of carriage by reference to a source or document other than the transport document itself (short form/blank back transport document), and/or
(iii) indicates a place of taking in charge different from the port of loading, and/or a place of final destination different from the port of discharge, and/or
(iv) relates to cargoes such as those in Containers or on pallets, and the like.

(c) Unless otherwise stipulated in the credit, banks will reject a
document which:

(i) indicates that it is subject to a charter party, and/or

(ii) indicates that the carrying vessel is propelled by sail only, and/or

(iii) contains the indication ‘intended’, or similar qualification in relation to

- the vessel and/or the port of loading - unless such document bears an on board notation in accordance with article 27(b) and also indicates the actual port of loading, and/or

- the port of discharge - unless the place of final destination indicated on the document is other than the port of discharge, and/or

(iv) is issued by a freight forwarder, unless it indicates that it is issued by such freight forwarder acting as a carrier, or as the agent of a named carrier.

Article 27

(a) Unless a credit specifically calls for an on board transport document, or unless inconsistent with other stipulation(s) in the credit, or with Article 26, banks will accept a transport document which indicates that the goods have been taken in charge or received for shipment.

(b) Loading on board or shipment on a vessel may be evidenced either by a transport document bearing wording indicating loading on board a named vessel or shipment on a named vessel, or, in the case of a transport document stating ‘received for shipment’, by means of a notation of loading on board on the transport document signed or initialled and dated by the carrier or his agent, and the date of this notation shall be regarded as the date of loading on board the named vessel or shipment on the named vessel.

Article 28

(a) In the case of carriage by sea or by more than one mode of transport but including carriage by sea, banks will refuse a transport
document stating that the goods are or will be loaded on deck, unless specifically authorized in the credit.

(b) Banks will not refuse a transport document which contains a provision that the goods may be carried on deck, provided it does not specifically state that they are or will be loaded on deck.

Article 29

(a) For the purpose of this article transhipment means a transfer and reloading during the course of carriage from the port of loading or place of dispatch or taking in charge to the port of discharge or place of destination either from one conveyance or vessel to another conveyance or vessel within the same mode of transport or from one mode of transport to another mode of transport.

(b) Unless transhipment is prohibited by the terms of the credit, banks will accept transport documents which indicate that the goods will be transhipped, provided the entire carriage is covered by one and the same transport document.

(c) Even if transhipment is prohibited by the terms of the credit, banks will accept transport documents which:

   (i) incorporate printed clauses stating that the carrier has the right to tranship, or

   (ii) state or indicate that transhipment will or may take place, when the credit stipulates a combined transport document, or indicates carriage from a place of taking in charge to a place of final destination by different modes of transport including a carriage by sea, provided that the entire carriage is covered by one and the same transport document, or

   (iii) state or indicate that the goods are in a Container(s), trailer(s), ‘LASH’ barge(s), and the like and will be carried from the place of taking in charge to the place of final destination in the same Container(s), trailer(s), ‘LASH’ barge(s), and the like under one and the same transport document.

   (iv) state or indicate the place of receipt and/or of final destination as ‘C.F.S.’ (container freight station) or ‘C.Y.’ (container yard) at, or associated with, the port of loading and/or the port of
destination.

Article 30
If the credit stipulates dispatch of goods by post and calls for a post receipt or certificate of posting, banks will accept such post receipt or certificate of posting if it appears to have been stamped or otherwise authenticated and dated in the place from which the credit stipulates the goods are to be dispatched.

Article 31
(a) Unless otherwise stipulated in the credit, or inconsistent with any of the documents presented under the credit, banks will accept transport documents stating that freight or transportation charges (hereinafter referred to as ‘freight’) have still to be paid.

(b) If a credit stipulates that the transport document has to indicate that freight has been paid or prepaid, banks will accept a transport document on which words clearly indicating payment or prepayment of freight appear by stamp or otherwise, or on which payment of freight is indicated by other means.

(c) The words ‘freight prepayable’ or ‘freight to be prepaid’ or words of similar effect, if appearing on transport documents, will not be accepted as constituting evidence of the payment of freight.

(d) Banks will accept transport documents bearing reference by stamp or otherwise to costs additional to the freight charges, such as costs of, or disbursements incurred in connection with, loading, unloading or similar operations, unless the conditions of the credit specifically prohibit such reference.

Article 32
Unless otherwise stipulated in the credit, banks will accept transport documents which bear a clause on the face thereof such as ‘shipper’s load and count’ or ‘said by shipper to contain’ or words of similar effect.

Article 33
Unless otherwise stipulated in the credit, banks will accept transport documents indicating as the consignor of the goods a party other than the beneficiary of the credit.
Article 34
(a) A clean transport document is one which bears no superimposed clause or notation which expressly declares a defective condition of the goods and/or the packaging.
(b) Banks will refuse transport documents bearing such clauses or notations unless the credit expressly stipulates the clauses or notations which may be accepted.
(c) Banks will regard a requirement in a credit for a transport document to bear the clause ‘clean on board’ as complied with if such transport document meets the requirements of this article and of article 27(b).

D. 2. Insurance documents
Article 35
(a) Insurance documents must be as stipulated in the credit, and must be issued and/or signed by insurance companies or underwriters, or their agents.
(b) Cover notes issued by brokers will not be accepted, unless specifically authorised by the credit.

Article 36
Unless otherwise stipulated in the credit, or unless it appears from the insurance document(s) that the cover is effective at the latest date of loading on board or dispatch or taking in charge of the goods, banks will refuse insurance documents presented which bear a date later than the date of loading on board or dispatch or taking in charge of the goods as indicated by the transport document(s).

Article 37
(a) Unless otherwise stipulated in the credit, the insurance document must be expressed in the same currency as the credit.
(b) Unless otherwise stipulated in the credit, the minimum amount for which the insurance document must indicate the insurance cover to have been effected is the CIF (cost, insurance and freight... ‘named port of destination’) or CIP (freight/carriage and insurance paid to ‘named point of destination’) value of the goods, as the case may be, plus 10%.
However, if banks cannot determine the CIF or CIP value, as the case may be, from the documents on their face, they will accept as such minimum amount the amount for which payment, acceptance or negotiation is requested under the credit, or the amount of the commercial invoice, whichever is the greater.

**Article 38**

(a) Credits should stipulate the type of insurance required and, if any, the additional risks which are to be covered. Imprecise terms such as 'usual risks' or 'customary risks' should not be used; if they are used, banks will accept insurance documents as presented, without responsibility for any risks not being covered.

(b) Failing specific stipulations in the credit, banks will accept insurance documents as presented, without responsibility for any risks not being covered.

**Article 39**

Where a credit stipulates 'insurance against all risks', banks will accept an insurance document which contains any 'all risks' notation or clause, whether or not bearing the heading 'all risks', even if indicating that certain risks are excluded, without responsibility for any risk(s) not being covered.

**Article 40**

Banks will accept an insurance document which indicates that the cover is subject to a franchise or an excess (deductible), unless it is specifically stipulated in the credit that the insurance must be issued irrespective of percentage.

**D. 3. Commercial invoice**

**Article 41**

(a) Unless otherwise stipulated in the credit, commercial invoices must be made out in the name of the applicant for the credit.

(b) Unless otherwise stipulated in the credit, banks may refuse commercial invoices issued for amounts in excess of the amount permitted by the credit. Nevertheless, if a bank authorised to pay, incur a deferred payment undertaking, accept, or negotiate under a credit
accepts such invoices, its decision will be binding upon all parties, provided such bank has not paid, incurred a deferred payment undertaking, accepted or effectuated negotiation for an amount in excess of that permitted by the credit.

(c) The description of the goods in the commercial invoice must correspond with the description in the credit. In all other documents, the goods may be described in general terms not inconsistent with the description of the goods in the credit.

D. 4. Other documents

Article 42

If a credit calls for an attestation or certification of weight in the case of transport other than by sea, banks will accept a weight stamp or declaration of weight which appears to have been superimposed on the transport document by the carrier or his agent unless the credit specifically stipulates that the attestation or certification of weight must be by means of a separate document.

E. Miscellaneous Provisions

Quantity and amount

Article 43

(a) The words ‘about’, ‘circa’ or similar expressions used in connection with the amount of the credit or the quantity or the unit price stated in the credit are to be construed as allowing a difference not to exceed 10% more or 10% less than the amount or the quantity or the unit price to which they refer.

(b) Unless a credit stipulates that the quantity of the goods specified must not be exceeded or reduced, a tolerance of 5% more or 5% less will be permissible, even if partial shipments are not permitted, always provided that the amount of the drawings does not exceed the amount of the credit. This tolerance does not apply when the credit stipulates the quantity in terms of a stated number of packing units or individual items.

Partial drawings and/or shipments

Article 44
(a) Partial drawings and/or shipments are allowed, unless the credit stipulates otherwise.

(b) Shipments by sea, or by more than one mode of transport but including carriage by sea, made on the same vessel and for the same voyage, will not be regarded as partial shipments, even if the transport documents indicating loading on board bear different dates of issuance and/or indicate different ports of loading on board.

(c) Shipments made by post will not be regarded as partial shipments if the post receipts or certificates of posting appear to have been stamped or otherwise authenticated in the place from which the credit stipulates the goods are to be dispatched, and on the same date.

(d) Shipments made by modes of transport other than those referred to in paragraphs (b) and (c) of this article will not be regarded as partial shipments, provided the transport documents are issued by one and the same carrier or his agent and indicate the same date of issuance, the same place of dispatch or taking in charge of the goods, and the same destination.

**Drawings and/or shipments by instalments**

**Article 45**

If drawings and/or shipments by instalments within given periods are stipulated in the credit and any instalments is not drawn and/or shipped within the period allowed for that instalment, the credit ceases to be available for that and any subsequent instalments, unless otherwise stipulated in the credit.

**Expiry date and presentation**

**Article 46**

(a) All credits must stipulate an expiry date for presentation of documents for payment, acceptance or negotiation.

(b) Except as provided in Article 48(a), documents must be presented on or before such expiry date.

(c) If an issuing bank states that the credit is to be available ‘for one month’, ‘for six months’ or the like, but does not specify the date from which the time is to run, the date of issuance of the credit by the issuing
bank will be deemed to be the first day from which such time is to run. Banks should discourage indication of the expiry date of the credit in this manner.

**Article 47**

(a) In addition to stipulating an expiry date for presentation of documents, every credit which calls for a transport document(s) should also stipulate a specified period of time after the date of issuance of the transport document(s) during which presentation of documents for payment, acceptance or negotiation must be made. If no such period of time is stipulated, banks will refuse documents presented to them later than 21 days after the date of issuance of the transport document(s). In every case, however, documents must be presented not later than the expiry date of the credit.

(b) For the purpose of these articles, the date of issuance of a transport document(s) will be deemed to be:

(i) in the case of a transport document evidencing dispatch, or taking in charge, or receipt of goods for shipment by a mode of transport other than by air - the date of issuance indicated on the transport document or the date of the reception stamp thereon whichever is the later.

(ii) in the case of a transport document evidencing carriage by air - the date of issuance indicated on the transport document or, if the credit stipulates that the transport document shall indicate an actual flight date, the actual flight date as indicated on the transport document.

(iii) in the case of transport document evidencing loading on board a named vessel - the date of issuance of the transport document or, in the case of an on board notation in accordance with Article 27(b), the date of such notation.

(iv) in cases to which Article 44(b) applies, the date determined as above of the latest transport document issued.

**Article 48**

(a) If the expiry date of the credit and/or the last day of the period of time after the date of issuance of the transport document(s) for
presentation of documents stipulated by the credit or applicable by virtue of Article 47 falls on a day on which the bank to which presentation has to be made is closed for reasons other than those referred to in Article 19, the stipulated expiry date and/or the last day of the period of time after the date of issuance of the transport document(s) for presentation of documents, as the case may be, shall be extended to the first following business day on which such bank is open.

(b) The latest date for loading on board, or dispatch, or taking in charge shall not be extended by reason of the extension of the expiry date and/or the period of time after the date of issuance of the transport document(s) for presentation of document(s) in accordance with this article. If no such latest date for shipment is stipulated in the credit or amendments thereto, banks will reject transport documents indicating a date of issuance later than the expiry date stipulated in the credit or amendments thereto.

(c) The bank to which presentation is made on such first following business day must add to the documents its certificate that the documents were presented within the time limits extended in accordance with Article 48(a) of the Uniform Customs and Practice for Documentary Credits, 1983 revision, ICC Publication No 400.

Article 49
Banks are under no obligation to accept presentation of documents outside their banking hours.

Loading on board, dispatch and taking in charge (shipment)

Article 50

(a) Unless otherwise stipulated in the credit, the expression ‘shipment’ used in stipulating an earliest and/or a latest shipment date will be understood to include the expressions ‘loading on board’, ‘dispatch’ and ‘taking in charge’.

(b) The date of issuance of the transport document determined in accordance with Article 47(b) will be taken to be the date of shipment.

(c) Expressions such as ‘prompt’, ‘immediately’, ‘as soon as possible’, and the like should not be used. If they are used, banks will interpret them as a stipulation that shipment is to be made within thirty days from
the date of issuance of the credit by the issuing bank.

(d) If the expression ‘on or about’ and similar expressions are used, banks will interpret them as a stipulation that the shipment is to be made during the period from five days before to five days after the specified date, both end days included.

Date terms

Article 51
The words ‘to’, ‘until’, ‘till’, ‘from’, and words of similar import applying to any date term in the credit will be understood to include the date mentioned. The word ‘after’ will be understood to exclude the date mentioned.

Article 52
The terms ‘first half’, ‘second half’ of the month shall be construed respectively as from the 1st to the 15th, and from the 16th to the last day of each month, inclusive.

Article 53
The terms ‘beginning’, ‘middle’, or ‘end’ of a month shall be construed respectively as from the 1st to the 10th, the 11th to the 20th, and the 21st to the last day of each month, inclusive.

F. Transfer

Article 54
(a) A transferable credit is a credit under which the beneficiary has the right to request the bank called upon to effect payment or acceptance or any bank entitled to effect negotiation to make the credit available in whole or in part to one or more other parties (second beneficiaries).

(b) A credit can be transferred only if it is expressly designated as ‘transferable’ by the issuing bank. Terms such as ‘divisible’, ‘fractionable’, ‘assignable’, and ‘transmissible’ add nothing to the meaning of the term ‘transferable’ and shall not be used.

(c) The bank requested to effect the transfer (transferring bank), whether it has confirmed the credit or not, shall be under no obligation
to effect such transfer except to the extent and in the manner expressly consented to by such bank.

(d) Bank charges in respect of transfers are payable by the first beneficiary unless otherwise specified. The transferring bank shall be under no obligation to effect the transfer until such charges are paid.

(e) A transferable credit can be transferred once only. Fractions of a transferable credit (not exceeding in the aggregate the amount of the credit) can be transferred separately, provided partial shipments are not prohibited, and the aggregate of such transfers will be considered as constituting only one transfer of the credit. The credit can be transferred only on the terms and conditions specified in the original credit, with the exception of the amount of the credit, of any unit prices stated therein, of the period of validity, of the last date for presentation of documents in accordance with Article 47 and the period for shipment, any or all of which may be reduced or curtailed, or the percentage for which insurance cover must be effected, which may be increased in such a way as to provide the amount of cover stipulated in the original credit, or these articles. Additionally, the name of the first beneficiary can be substituted for that of the applicant for the credit, but if the name of the applicant for the credit is specifically required by the original credit to appear in any document other than the invoice, such requirement must be fulfilled.

(f) The first beneficiary has the right to substitute his own invoices (and drafts if the credit stipulates that drafts are to be drawn on the applicant for the credit) in exchange for those of the second beneficiary, for amounts not in excess of the original amount stipulated in the credit and for the original unit prices if stipulated in the credit, and upon such substitution of invoices (and drafts) the first beneficiary can draw under the credit for the difference, if any, between his invoices and the second beneficiary’s invoices. When a credit has been transferred and the first beneficiary is to supply his own invoices (and drafts) in exchange for the second beneficiary’s invoices (and drafts) but fails to do so on first demand, the paying, accepting or negotiating bank has the right to deliver to the issuing bank the documents received under the credit, including the second beneficiary’s invoices (and drafts) without further responsibility to the first beneficiary.

(g) Unless otherwise stipulated in the credit, the first beneficiary of a
transferable credit may request that the credit be transferred to a second beneficiary in the same country, or in another country. Further, unless otherwise stipulated in the credit, the first beneficiary shall have the right to request that payment or negotiation be effected to the second beneficiary at the place to which the credit has been transferred, up to and including the expiry date of the original credit, and without prejudice to the first beneficiary’s right subsequently to substitute his own invoices and drafts (if any) for those of the second beneficiary and to claim any difference due to him.

Assignment of proceeds

Article 55

The fact that a credit is not stated to be transferable shall not affect the beneficiary’s right to assign any proceeds to which he may be, or may become, entitled under such credit, in accordance with the provisions of the applicable law.
Uniform Commercial Code
(United States of America)
Article 5 - Letters of Credit

Section 5-101 SHORT TITLE

This Article shall be known and may be cited as Uniform Commercial Code - Letters of Credit.

Section 5-102 SCOPE

(1) This Article applies
   (a) to a credit issued by a bank if the credit requires a documentary draft or a documentary demand for payment; and
   (b) to a credit issued by a person other than a bank if the credit requires that the draft or demand for payment be accompanied by a document of title; and
   (c) to a credit issued by a bank or other person if the credit is not within subparagraphs (a) or (b) but conspicuously states that it is a letter of credit or is conspicuously so entitled.

(2) Unless the engagement meets the requirements of sub section (1), this Article does not apply to engagements to make advances or to honor drafts or demands for payment, to authorities to pay or purchase, to guarantees or to general agreements.

(3) This Article deals with some but not all of the rules and concepts of letters of credit as such rules or concepts have developed prior to this act or may hereafter develop. The fact that this Article states a rule does not by itself require, imply or negate application of the same or a
converse rule to a situation not provided for or to a person not specified by this Article.

Section 5-103 DEFINITIONS

(1) In this Article unless the context otherwise requires

(a) ‘Credit’ or ‘letter of credit’ means an engagement by a bank or other person made at the request of a customer and of a kind within the scope of this Article (Section 5-102) that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit. A credit may be either revocable or irrevocable. The engagement may be either an agreement to honour or a statement that the bank or other person is authorized to honor.

(b) A ‘documentary draft’ or a ‘documentary demand for payment’ is one honor of which is conditioned upon the presentation of a document or documents. ‘Document’ means any paper including document of title, security, invoice, certificate, notice of default and the like.

(c) An ‘issuer’ is a bank or other person issuing a credit.

(d) A ‘beneficiary’ of a credit is a person who is entitled under its terms to draw or demand payment.

(e) An ‘advising bank’ is a bank which gives notification of the issuance of a credit by another bank.

(f) A ‘confirming bank’ is a bank which engages either that it will itself honor a credit already issued by another bank or that such a credit will be honored by the issuer or a third bank.

(g) A ‘customer’ is a buyer or other person who causes an issuer to issue a credit. The term also includes a bank which procures issuance or confirmation on behalf of that bank’s customer.

(2) Other definitions applying to this Article and the sections in which they appear are:

‘Notation of Credit’ Section 5-108

‘Presenter’ Section 5-112 (3)

(3) Definitions in other Articles applying to this Article and the sections in which they appear are:
(4) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

Section 5-104 FORMAL REQUIREMENTS; SIGNING

(1) Except as otherwise required in subsection (1) (c) of Section 5-102 on scope, no particular form of phrasing is required for a credit. A credit must be in writing and signed by the issuer and a confirmation must be in writing and signed by the confirming bank. A modification of the terms of a credit or confirmation must be signed by the issuer or confirming bank.

(2) A telegram may be sufficient signed writing if it identifies its sender by an authorized authentication. The authentication may be in code and the authorized naming of the issuer in an advice of credit is a sufficient signing.

Section 5-105 CONSIDERATION

No consideration is necessary to establish a credit or to enlarge or otherwise modify its terms.

Section 5-106 TIME AND EFFECT OF ESTABLISHMENT OF CREDIT

(1) Unless otherwise agreed a credit is established

(a) as regards the customer as soon as a letter of credit is sent to him or the letter of credit or an authorized written advice of its issuance is sent to the beneficiary; and
(b) as regards the beneficiary when he receives a letter of credit or an authorized written advice of its issuance.

(2) Unless otherwise agreed once an irrevocable credit is established as regards the customer it can be modified or revoked only with the consent of the customer and once it is established as regards the beneficiary it can be modified or revoked only with his consent.

(3) Unless otherwise agreed after a revocable credit is established it may be modified or revoked by the issuer without notice to or consent from the customer or beneficiary.

(4) Notwithstanding any modification or revocation of a revocable credit any person authorized to honor or negotiate under the terms of the original credit is entitled to reimbursement for or honor of any draft or demand for payment duly honored or negotiated before receipt of notice of the modification or revocation and the issuer in turn is entitled to reimbursement from its customer.

Section 5-107 ADVICE OF CREDIT; CONFIRMATION; ERROR IN STATEMENT OF TERMS

(1) Unless otherwise specified an advising bank by advising a credit issued by another bank does not assume any obligation to honor drafts drawn or demands for payment made under the credit but it does assume obligation for the accuracy of its own statement.

(2) A confirming bank by confirming a credit becomes directly obligated on the credit to the extent of its confirmation as though it were its issuer and acquires the rights of an issuer.

(3) Even though an advising bank incorrectly advises the terms of a credit it has been authorized to advise the credit is established as against the issuer to the extent of its original terms.

(4) Unless otherwise specified the customer bears as against the issuer all risks of transmission and reasonable translation or interpretation of any message relating to a credit.

Section 5-108 ‘NOTATION CREDIT’; EXHAUSTION OF CREDIT
(1) A credit which specifies that any person purchasing or paying drafts drawn or demands for payment made under it must note the amount of the draft or demand on the letter or advice of credit is a ‘notation credit’.

(2) Under a notation credit

(a) a person paying the beneficiary or purchasing a draft or demand for payment from him acquires a right to honor only if the appropriate notation is made and by transferring or forwarding for honor the documents under the credit such a person warrants to the issuer that the notation has been made; and

(b) unless the credit or signed statement that an appropriate notation has been made accompanies the draft or demand for payment the issuer may delay honor until evidence of notation has been procured which is satisfactory to it but its obligation and that of its customer continue for a reasonable time not exceeding thirty days to obtain such evidence.

(3) If the credit is not a notation credit

(a) the issuer may honor complying drafts or demands for payment presented to it the order in which they presented and is discharged pro tanto by honor of any such draft or demand;

(b) as between competing good faith purchasers of complying drafts or demands the person first purchasing has priority over a subsequent purchaser even though the later purchased draft or demand has been first honored.

Section 5-109 ISSUER'S OBLIGATION TO ITS CUSTOMER

(1) An issuer’s obligation to its customer includes good faith and observance of any general banking usage but unless otherwise agreed does not include liability or responsibility

(a) for performance of the underlying contract for sale or other transaction between the customer and the beneficiary; or

(b) for any act or omission of any person other than itself or its own branch or for loss or destruction of a draft, demand or document in transit or in the possession of others; or
(c) based on knowledge or lack of knowledge of any usage of any particular trade.

(2) An issuer must examine documents with care so as to ascertain that on their face they appear to comply with the terms of the credit but unless otherwise agreed assumes no liability or responsibility for the genuineness, falsification or effect of any document which appears on such examination to be regular on its face.

(3) A non-bank issuer is not bound by any banking usage of which it has no knowledge.

Section 5-110 AVAILABILITY OF CREDIT IN PORTIONS; PRESENTER’S RESERVATION OF LIEN OR CLAIM

(1) Unless otherwise specified a credit may be used in portions in the discretion of the beneficiary.

(2) Unless otherwise specified a person by presenting a documentary draft or demand for payment under a credit relinquishes upon its honor all claims to the documents and a person by transferring such draft or demand or causing such presentment authorizes such relinquishment. An explicit reservation of claim makes the draft or demand non-complying.

Section 5-111 WARRANTIES ON TRANSFER AND PRESENTMENT

(1) Unless otherwise agreed the beneficiary by transferring or presenting a documentary draft or demand for payment warrants to all interested parties that the necessary conditions of the credit have been complied with. This is in addition to any warranties arising under Articles 3, 4, 7 and 8.

(2) Unless otherwise agreed a negotiating, advising, confirming, collecting or issuing bank presenting or transferring a draft or demand for payment under a credit warrants only the matters warranted by a collecting bank under Article 4 and any such bank transferring a document warrants only the matters warranted by an intermediary under Articles 7 and 8.
Section 5-112 TIME ALLOWED FOR HONOR OR REJECTION; WITHHOLDING HONOR OR REJECTION BY CONSENT; ‘PRESENTER’

(1) A bank to which a documentary draft or demand for payment is presented under a credit may without dishonor of the draft, demand or credit

(a) defer honor until the close of the third banking day following receipt of the documents; and

(b) further defer honor if the presenter has expressly or impliedly consented thereto.

Failure to honor within the time here specified constitutes dishonor of the draft or demand and of the credit [except as otherwise provided in subsection (4) of Section 5-114 on conditional payment].

(2) Upon dishonor the bank may unless otherwise instructed fulfil its duty to return the draft or demand and the documents by holding them at the disposal of the presenter and sending him an advice to that effect.

(3) ‘Presenter’ means any person presenting a draft or demand for payment for honor under a credit even though that person is a confirming bank or other correspondent which is acting under the issuer’s authorization.

Section 5-113 INDEMNITIES

(1) A bank seeking to obtain (whether for itself or another) honor, negotiation or reimbursement under a credit may give an indemnity to induce such honor, negotiation or reimbursement.

(2) An indemnity agreement inducing honor, negotiation or reimbursement

(a) unless otherwise explicitly agreed applies to defects in the documents but not in the goods; and

(b) unless a longer time is explicitly agreed expires at the end of ten business days following receipt of the documents by the ultimate
customer unless notice of objection is sent before such expiration date. The ultimate customer may send notice of objection to the person from whom he received the documents and any bank receiving such notice is under a duty to send notice to its transferor before its midnight deadline.

Section 5-114 ISSUER'S DUTY AND PRIVILEGE TO HONOR; RIGHT TO REIMBURSEMENT

(1) An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary. The issuer is not excused from honor of such a draft or demand by reason of an additional general term that all documents must be satisfactory to the issuer, but an issuer may require that specified documents must be satisfactory to it.

(2) Unless otherwise agreed when documents appear on their face to comply with the terms of the credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (Section 7-507) or of a security (Section 8-306) or is forged or fraudulent or there is fraud in the transaction

   (a) the issuer must honor the draft or demand for payment if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course (Section 3-302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (Section 7-502) or a bona fide purchaser of a security (Section 8-302); and

   (b) in all other cases as against its customer, an issuer acting in good faith may honor the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honor.

(3) Unless otherwise agreed an issuer which has duly honored a draft or demand for payment is entitled to immediate reimbursement of any payment made under the credit and to be put in effectively available funds not later than the day before maturity of any acceptance made
under the credit.

[(4) When a credit provides for payment by the issuer on receipt of notice that the required documents are in possession of a correspondent or other agent of the issuer

(a) any payment made on receipt of such notice is conditional; and

(b) the issuer may reject documents which do not comply with the credit if it does so within three banking days following its receipt of the documents; and

(c) in the event of such rejection, the issuer is entitled by charge back or otherwise to return of the payment made.]

[(5) In the case covered by subsection (4) failure to reject documents within the time specified in sub-paragraph (b) constitutes acceptance of the documents and makes the payment final in favour of the beneficiary.]

Section 5-115 REMEDY FOR IMPROPER DISHONOR OR ANTICIPATORY REPUDIATION

(1) When an issuer wrongfully dishonors a draft or demand for payment presented under a credit the person entitled to honor has with respect to any documents the rights of a person in the position of a seller (Section 2-707) and may recover from the issuer the face amount of the draft or demand together with incidental damages under Section 2-710 on seller’s incidental damages and interest but less any amount realized by resale or other use or disposition of the subject matter of the transaction. In the event no resale or other utilization is made the documents, goods or other subject matter involved in the transaction must be turned over to the issuer on payment of judgment.

(2) When an issuer wrongfully cancels or otherwise repudiates a credit before presentment of a draft or demand for payment drawn under it the beneficiary has the right of a seller after anticipatory repudiation by the buyer under Section 2-610 if he learns of the repudiation in time reasonably to avoid procurement of the required documents. Otherwise the beneficiary has an immediate right of action for wrongful dishonor.
Section 5-116 TRANSFER AND ASSIGNMENT

(1) The right to draw under a credit can be transferred or assigned only when the credit is expressly designated as transferable or assignable.

(2) Even though the credit specifically states that it is non-transferable or non-assignable the beneficiary may before performance of the conditions of the credit assign his right to proceeds. Such an assignment is an assignment of a contract right under Article 9 on Secured Transactions and is governed by that Article except that

   (a) the assignment is ineffective until the letter of credit or advice of credit is delivered to the assignee which delivery constitutes perfection of the security interest under Article 9; and
   
   (b) the issuer may honor drafts or demands for payment drawn under the credit until it receives a notification of the assignment signed by the beneficiary which reasonably identifies the credit involved in the assignment and contains a request to pay the assignee; and
   
   (c) after what reasonably appears to be such a notification has been received the issuer may without dishonor refuse to accept or pay even to a person otherwise entitled to honor until the letter of credit or advice of credit is exhibited to the issuer.

(3) Except where the beneficiary has effectively assigned his right to draw or his right to proceeds, nothing in this section limits his right to transfer or negotiate drafts or demands drawn under the credit.

Section 5-117 INSOLVENCY OF BANK HOLDING FUNDS FOR DOCUMENTARY CREDIT

(1) Where an issuer or an advising or confirming bank or a bank which has for a customer procured issuance of a credit by another bank becomes insolvent before final payment under the credit and the credit is one to which this Article is made applicable by paragraphs (a) or (b) of Section 5-102(1) on scope, the receipt or allocation of funds or collateral to secure or meet obligations under the credit shall have the following results:

   (a) to the extent of any funds or collateral turned over after or before
the insolvency as indemnity against or specifically for the purpose of payment of drafts or demands for payment drawn under the designated credit, the drafts or demands are entitled to payment in preference over depositors or other general creditors of the issuer or bank; and

(b) on expiration of the credit or surrender of the beneficiary’s rights under it unused any person who given such funds or collateral is similarly entitled to return thereof; and

(c) a change to a general or current account with bank if specifically consented to for the purpose of indemnity against or payment of drafts or demands for payment drawn under the designated credit falls under the same rules as if the funds had been drawn out in cash and then turned over with specific instructions.

(2) After honor or reimbursement under this section the customer or other person for whose account the insolvent bank has acted is entitled to receive the documents involved.
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