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PhD thesis

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The nature and importance of the bank's  
security under the commercial letter of  
credit, and the central concepts of pledge  
lien and hypothec.

by

KENNETH GEORGE CHRYSTIE

For the Degree of Doctor of Philosophy

The University of Glasgow

1973.

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## SUMMARY

This thesis is divided into five chapters. It was not thought helpful to further sub-divide the chapters, and footnotes are used principally for the citation of authority and not for lengthy discussions. In view of the specific nature of the topics discussed, such introductory remarks to the subject as are necessary are dealt with in the Preface.

Chapter I is an analysis of the nature of the bank's security over documents of title "pledged" to it; the concept of "pledge" in this connection is discussed in detail. North Western Bank focuses the issue and the Scots and English authorities, and their particular relevance, are dealt with in turn. The English concept of "special property" is examined as is the statutory authority. The conclusions are then applied to the commercial credit situation, the particular difficulties of which are noted and discussed.

Chapter II is the logical sequel, examining the realisation of the bank's security under the letter of credit. Just as pledge is discussed at some length in Chapter I here the notion of "hypothec" is examined. The major proposition is that the nature of the security and its realisation in due course are, and must be, logically consistent; realisation does not depend on a device of mercantile genius. Early English authorities are discussed in detail and it is seen that many of them turn on specialities of English terminology or/

or equity. The position in Scotland is examined and it is suggested that despite theoretical differences the practical positions in the two countries are not dissimilar.

Chapter III is a detailed examination of the 3rd security concept, that of "lien", in the banking context; and in this part of the thesis the discussion is not limited to the commercial credit. It is in two parts: an examination of the early Scottish authorities and those English authorities which are helpful (pointing out the technical specialities of which Scots lawyers must beware) in clarifying the principles applicable to what is conventionally thought of as the banker's lien; and a detailed analysis of the recent case of Halesowen v. Westminster Bank and the earlier authorities discussed therein. It is submitted that a definitive judgment is still required.

In Chapter IV a very uncertain area of the law relating to commercial credits - the problems of false and forged documents - is discussed. The documents tendered under the letter of credit are of great concern to the bank as it relies on them for security for advances while at the same time having very little knowledge of the trade concerned. The documents concerned: bills of exchange, documents of title, i.e., tendered under the credit, and the letter of credit itself - are examined in turn from the point of view first of forgery, then of falsity, particular attention being paid to helpful American authorities, especially Sztejn's case.

In/

In the final Chapter, Chapter V, the bank's role under the credit system comes in for close scrutiny. Inevitably the bank has to exercise its discretion in dealing with the credit - but to what extent, and what are its obligations as opposed to its entitlements? The position varies with the type of credit established and the effects of this are noted, as are the difficulties inherent in trying to define the credit. So too when a bank is called on to accept documents, the way in which it exercises its discretion may be very critical for its customer. Such questions as: what is a clean bill? are usual bills acceptable? should an indemnity be accepted? - are discussed in the concluding paragraphs.



## PREFACE AND INTRODUCTORY COMMENTS

### Content

This thesis is principally concerned with the nature and extent of the bank's security under the commercial credit.

No attempt has been made in this thesis to provide a comprehensive treatise on the law of bankers' commercial credits. Although not considered from a Scots law standpoint, the general treatments of Gutteridge and Magrah and Davis are of great assistance. The various topics précised in the chapter headings are examined from the bank's point of view. By virtue of the framework in which the credit operates the bank's role as security-holder is by no means passive; its involvement in the transaction is considerable and its responsibilities rather greater than those shouldered by mere financiers wishing to safeguard their investment. It must be remembered that while the bank are financing the operation, their role should not be misunderstood - basically they are providing a banking service.

The nature of the bank's security and the realisation of that security form the basis of the first two chapters. Two particular aspects are then treated separately: banker's lien and the problems posed to the bank in dealing with false documents. Banker's lien is one of the 3 main concepts of central importance in this field (the others being hypothec and pledge) and on which there has recently been a fair amount/

amount of judicial comment. It was thought necessary in considering this topic not to confine the discussion to the narrower field of commercial credits. In contrast to banker's lien the problems posed by the presentation of false documents are only now being analysed in any depth - nor are the solutions propounded necessarily legal; in many cases they are practical. The concluding chapter is an attempt to draw together the various themes developed elsewhere in a relatively comprehensive look at the discretionary role of the bank in the credit mechanism.

The concepts of lien, hypothec and pledge are of central importance in this discussion and the specialities of the bank's lien and the recent judicial pronouncements on it are the basis of the third chapter.

#### Authorities and Scope

The work on this thesis has been done principally at the University of Glasgow, and the authorities cited are mostly those available to me from the University's library shelves. I have also from time to time consulted authorities at and used the facilities of the library of the Faculty of Procurators, Glasgow.

In January, 1972 I was fortunate enough to receive a Rotary Fellowship which allowed me to spend 4 months studying at the University of Virginia in America (not exclusively in connection with this thesis) where I had access to their excellent library facilities and was able to/

to consider in detail some of the more pertinent American decisions.

I have made reference to such general works, both English and Scottish, as seem to me to have a bearing on the subjects discussed. No bibliography has been attached, such acknowledgement as is customary being made by way of footnote. English authorities are cited without apology although specialities of Scottish or English law and consequential limitations on the bearing which the authorities may have are underlined. Even greater care must be exercised in dealing with American authorities, many of which are extremely helpful.

In a field such as this, any responsible discussion of the problems must be of assistance but care must be taken not too readily to assume that judicial attitudes in the various countries are and have been interchangeable.

#### Acknowledgements

In preparing this thesis I have obviously drawn heavily on existing authorities and text-books, to the writers of which I am indebted. Particular assistance and encouragement have been given to me by Professor J. Bennett Miller and my Partners (until recently my employers) at McClure, Naismith, Brodie and Company. Without an award from the Trustees of the Faulds Fellowship this thesis would not have been undertaken and a grant from Rotary Foundation/

Foundation financed my sojourn in the United States where I had access to many useful authorities. And, lastly, but perhaps most importantly, I owe thanks to my Secretary, Mrs. Ellen McManus, for her work in typing and checking the thesis, and those of my friends who assisted in the tedious job of comparison in the final stages.

For the mistakes of commission and omission, I, unfortunately, remain solely responsible.

The treatise is submitted on the basis that the opinions expressed and the statements of principle reflect the authorities available to me as at 1st January, 1973 and where possible all relevant precedents prior to that date have been considered.

Chapter I.

THE NATURE OF THE BANK'S SECURITY  
OVER DOCUMENTS TENDERED IN THE  
COURSE OF THE CREDIT TRANSACTION

(1)

There is no doubt that the Bank has a security right over the documents tendered to it in the course of the commercial credit transaction. It is on this fundamental premiss that the whole international system of financing commerce by the letter of credit is based. Although the existence of the security right has constantly been assumed, its nature has only been analysed imperfectly, and often only in passing. For example,

(2)

Scrutton L.J. in Rosenberg v. International Banking Corporation said:

"Bankers' liens or bankers' pledges, effected in such a way give, according to the views of merchants, the bankers a right of sale. Whether you talk about it as an express pledge or ..... as an implied pledge, in my view such a transaction gives an independent right or right of property to the bank to secure the amount which they have advanced ....."

(3)

Gutteridge and Magrah accept the nature of the security as being/

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(1) In this thesis "the bank" is the issuing bank; differences in the position of the intermediary bank will be discussed as and when they arise.

(2) (1923) 14 Ll.L.Rep.344 at 347.

(3) The Law of Bankers' Commercial Credits 3rd Edition.

All subsequent footnoted references to this work will be abbreviated thus: G. and M.

(4)  
being pledge without examining it closely. But that is exactly what this chapter is intended to do - to examine the authorities, the situations and the theories propounded to ascertain whether or not there is a logical consistency to this section of the law.

Theoretical soundness is an essential pre-requisite of consistency of decision and confidence in mercantile dealings. And although the merchant may feel reassured by the common acceptations of the business world, this confidence has frequently been misplaced. The reconciliation of practice and legal theory is, moreover, and this is not the least consideration, a matter of academic satisfaction. On the other hand, it must be admitted that there are many problems in this field of law which simply do not have a solution. This must not be overlooked. There is a great danger of attempting to achieve artificial reconciliations of theory and practice.

The security of the bank is of paramount importance in assuring the commercial viability of the bank's role in this field of law. It is the only assurance that the bank has in many cases when making its facilities available to its customers in foreign trade.

Most of the general pronouncements judicial and otherwise, including the above dictum relate, of course, to English law.  
They/

They require rather closer examination before they are extended to Scots law. The Scots law of pledge is not the same as the English - this is quite clear, e.g., the pledgee's right of sale. The security may also vary according to the circumstances in which it is created and the forms of the documents which are held.

Central to the argument on the present topic must be North Western Bank v. Poynter Son and Macdonalds.<sup>(5)</sup> This case is quoted with authority in all the major text-books on the subject, cited frequently in both Scots and English courts, applied at least in the latter, and has never been seriously called in question as to its actual decision.

The facts of this case are well-known:

Page & Co. asked the bank if they were willing to advance to them £5,000, security being provided by way of pledge of 1,629 tons of phosphate rock then in the process of being shipped. The bank agreed and the relative bills of lading were delivered, indorsed in blank, to the bank. Thereafter the bank wrote to Page & Co. setting out the terms on which they held the documents; these included a power of sale.

Before the 2nd Division of the Court of Session in an action of multiple-pounding the bankers pleaded that they had property rights in the phosphate rock represented by the bills of lading and although they apparently continued to use the word "pledge" they obviously viewed themselves as having fuller rights than those traditionally associated with pledge.<sup>(6)</sup> The other claimants/

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(5) (1894) 22 R(HL)1

(6) See further infra.

claimants in the multiple-poinding argued that

"it depended on the contract upon which the bills of lading were transferred whether the property in the goods in the full sense passed. If it was sale it did. (7)  
Here it was pledge".

Lord Justice-Clerk Macdonald in his judgment certainly talks of pledged goods and at page 518 says:

"The bank's case is that they were in<sup>the</sup> ownership of the goods ..... but this can only be maintained if the written contract is ignored ..... its express words indicate that the bank receive the bills of lading as a security only for an advance".

The alternative theories were clearly before the Lord Justice-Clerk at this point. His decision was based on an unwillingness to distinguish Tod and Son v. Merchant Banking Company, (8) not on any broader theoretical disagreement with the House of Lords' reasoning at the appeal stage. Lord Young's dissent (9) which was later upheld by the House of Lords also clearly envisages a pledge situation. Lord Trayner, supporting the Lord Justice-Clerk, also faces the choice squarely; he supports the argument of Poynter Son & Macdonalds, in particular the distinction between pledge and sale:

"If/

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(7) (1894) 21 R 513 at 517.

(8) (1883) 10 R 1009.

(9) (1894) 21 R at 519.



"If the contract, however, be pledge, not sale, then the delivery of the indorsed bill of lading completes the contract just as if the goods themselves had been deposited with the pledgee, but gives the pledgee no greater or higher right to the goods than delivery of the subject of pledge to the pledgee gives him".<sup>(10)</sup>

He does not distinguish the English from the Scots law of pledge. In neither case does the pledgee obtain property rights. His decision rests on a strict application of the Institutional authorities and, of course, Tod's case. In essence, the bank lost its real right in exchanging it for a personal one.

The principal appeal judgment in the House of Lords was given by Lord Herschell LC.<sup>(11)</sup> He was content, as were the parties, to base his decision on Scots law. There was no question of it being based on English law; in fact, he said that if English law were applied the point at issue would not be arguable for a moment. Lord Herschell approaches the problem as one of pledge, not of ownership:

"I do not understand it to be disputed that if in fact the goods sold were the property of the North Western Bank, then, although the sale may have been made by Page & Co. to Cross & Co., yet being made by Page & Co. on behalf of the bank as owners, it could not be attached by a creditor of Page & Co."<sup>(12)</sup>

It/

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(10) *ibid* at p.524.

(11) [1895] A.C. at p.64.

(12) *ibid*.

It has been suggested that, despite this apparently clear statement of principle, the House of Lords' decision was based on ownership.<sup>(13)</sup> Lord Herschell's only difficulty arose in disputing Lord Trayner's assertion that the bank's security was lost with possession passing out of its hands. The issue was clearly fixed.<sup>(14)</sup> The authorities cited are three in number: Erskine's Institutes, Bell's Commentaries and Tod's case.<sup>(15)</sup> These will be discussed at length later. Erskine is dismissed as not covering the point; Bell, too, although this is much more doubtful; and Tod is distinguished. One suspects that the basis of the decision, however, lies in the following statement: speaking of 'Lord Trayner's rule', Lord Herschell says:

"It does not seem to me to be a reasonable rule. If the rule exists, it is one which runs counter to .... every-day commercial understanding of commercial transactions".<sup>(16)</sup>

The fact that 'commercial understanding' supports what he considers an undisputed English rule is considered conclusive.<sup>(17)</sup>

Lord Watson's short judgment merely re-iterates the proposition/

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(13) Gow: The Mercantile and Industrial Law of Scotland (hereinafter referred to as "Gow") pp.274 and 278.

(14) [1895] AC at p.68.

(15) Ersk. 3.1.33.

(16) [1895] AC at p.69.

(17) ibid p.75.

proposition that the Scots and English laws applicable are the same and supports Lord Young's dissent in the 2nd Division.

The decision in North Western Bank has been set forth in some detail at this point in the argument, because it is, paradoxically, both of limited help in settling the problem and yet of central importance in summarising and focussing it. It is a useful basis on which to build a further analysis. Particular factual distinctions in the case which must be considered are the form of the bill of lading, i.e., the lack of indorsement at any stage in the transactions, the intention clearly stated that pledge was to operate, and the very fact (often overlooked) that the framework in which the litigation arose was not that of a commercial letter of credit.

(18)  
Although the "degree of property" passing may vary according to the circumstances it might be argued that the bank deals with the documents as if it had complete right of ownership. North Western Bank does not altogether contradict this practical proposition, though in theory it clearly points to its limitations. The House of Lords' decision gives the pledgee very extensive rights closely analogous to those of an owner. It is noticeable that Tod was the only case discussed in either of the two appeal courts. The Institutional writings which were discussed are only of guidance on the general law of pledge, not on the construction of a special type of/

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(18) Paget: Law of Banking 8th Ed. p.581

(hereinafter referred to as Paget)

of security. And Gloag and Irvine<sup>(19)</sup>, to which any student of the peculiarities of the Scots law of security rights inevitably turns for guidance, must be examined critically in view of the special field we are studying, one presumably not in mind at the time of their writing. The English decisions are of considerable help in that they envisage more closely analogous problems and cover a multiplicity of situations. Again, there are limitations: the specialities of the Scots law, the differences in the basic concepts of the two systems.

North Western Bank itself must be examined in two lights: as an authority on pledge or ownership, and as an authority on commercial credits. The former must be discussed before its relevance to the latter can be considered. This is essentially the task of defining the ratio of North Western Bank. This in turn revolves around the pledge as against the ownership argument. Gloag and Irvine are quite clear<sup>(20)</sup>, at least at one part of their treatment:

"the right given to the indorsee in security of a bill of lading in Scotland is of the nature of an absolute right of property qualified by an obligation to reconvey .....

As we shall see, there is no statutory authority for this dogmatic/

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(19) Law of Rights in Security

(hereinafter referred to, when footnoted, as G and I.)

(20) *ibid* p.278 footnote 2.

dogmatic contradiction of the professed ratio of North Western Bank, a decision regarded as authoritative at least on the merits of the case by Gloag and Irvine.<sup>(21)</sup> They indicate that the Scots position must not be identified with that in England. This can only be so on the basis of cases decided prior to North Western Bank, Hayman v. McLintock<sup>(22)</sup> only being decided in 1907. Before examining these cases, however, some attention should be paid to the terms in which Gloag and Irvine give their point of view. The categorical statement above quoted is in fact a footnote referring to the application in Scotland of Sewell v. Burdick.<sup>(23)</sup> Elsewhere they decline to commit themselves. At page 274 they say:

"the effect of the indorsement and delivery of the bill of lading depends upon the contract between the indorser and the indorsee ..... It may not be intended to pass the property outright, but only to transfer the goods in security".

At the very least this is an ambiguous approval of the ownership theory. There then follows, however, an acceptance of Bowen J's judgment in Sanders v. Maclean,<sup>(24)</sup> widely regarded as the locus classicus of the symbolic theory of the bill of lading.  
Part/

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(21) ibid at p.288.

(22) 1907 S.C.936.

(23) Sewell v. Burdick (1884) 10 App.Cas.74.

(24) (1883) 11 QBD 327.

Part of this, quoted in full by Gloag and Irvine is to the effect that

"property in the goods passes by such indorsement and delivery of the bill of lading, whenever it is the intention of the parties that such property should pass, just as, under similar circumstances, the property would pass by an actual delivery of the goods"<sup>(25)</sup> .

Expanded by Bowen L.J. in the Court of Appeal during his dissent in Sewell v. Burdick<sup>(26)</sup> , this reasoning forms the basis of the House of Lords' decision in that case. And it is Sewell, of course, which Gloag and Irvine refuse to follow or approve.

At page 284, the "leading case of Lickbarrow v. Mason"<sup>(27)</sup> is discussed as follows:

"From some expressions in the judgment of Buller J it was at one time thought that the indorsement passed the property, whatever was the contract between indorser and indorsee; but this difficulty has now been cleared up, and it is settled that the property only passes if that was the intention of the parties in the contract upon which the indorsement was made".

In support of this, Gloag and Irvine cite Lord McLaren's note to Bell's Commentaries, and the cases of Sewell v. Burdick and Sanders v. Maclean.<sup>(28)</sup> While admittedly this contradiction is when/

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(25) (1883) 11 Q.B.D.327, at 341.

(26) (1884) 13 Q.B.D. 170.

(27) 1 Smith's L.C. 10th Ed. p.674.

(28) These cases are cited infra and discussed more fully.

when discussing the right of the seller to stop in transitu, the conjunction of conflicting authorities is clearly unfortunate.

Gloag and Irvine eventually reach their consideration of the conflict of the 'pledge' and 'ownership' theories at page 287:

"As the effect of the indorsement of a bill of lading in transferring the property of the goods depends, as has already been shown, on the contract in pursuance of which the indorsement was made, it might appear that the indorsee in security does not become the owner, but only the possessor, of the goods. That is to say, that his right is of the nature of a pledge, and not of an ex facie absolute transfer".

They go on to say that, despite this, the ownership theory was assumed in Tod and Son v. Merchant Banking Co. <sup>(29)</sup> but that this decision was in turn doubted in North Western Bank. Their conclusion is not at all dogmatic:

"the point may still be held to be open. It is also doubtful whether the indorsement of a bill of lading to one who takes it merely in security gives the indorsee any power to sell the cargo, if such a power is not expressly given, as it usually is" <sup>(30)</sup> .

I have criticised Gloag and Irvine not because their treatment of the subject is unhelpful but to illustrate that the theoretical analysis of the problems involved has frequently been imperfect and has been accompanied by an indiscriminate reliance/

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(29) supra cit.

(30) at page 287.

reliance on English authorities in a field where the English and Scots positions have frequently been asserted to be at variance. Too often the decision and the ratio of an English judgment have been artificially separated. We must now turn to the Scottish authorities which Gloag and Irvine had available prior to Hayman v. McLintock.

(31)  
Hamilton v. Western Bank of Scotland, acknowledged as a leading case on the law of securities, dealt specifically with delivery orders. It held that where the bank agreed to give a borrower an advance and in security obtained a delivery order, intimated the transfer to the warehouse keeper and had the property registered in its name, in these circumstances the bank was not the pledgee but the owner of the goods. In other words, the bank is the ex facie absolute proprietor, whose real right is only qualified by an obligation to restore the security subjects on the satisfaction of the debt.

The fact that the document in this case was a delivery order, and not a bill of lading, is of paramount importance. In one the delivery in question is constructive, in the other symbolical. Lord President McNeill accepts this distinction in (32) Hamilton and stresses that in cases of constructive delivery the essential characteristic of pledge, namely custody, is lacking. He stresses intention and finds in it support for the ownership (33) theory. Lord Ivory also stresses intention but only as a means of construing the rights of the parties inter se when the transfer/

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(31) (1856) 19D 152.

(32) *ibid* at p.159.

(33) *ibid* at p.164.



transfer is not pledge. The right to sell was regarded by  
Lord Curriehill<sup>(34)</sup> as indicative of property rights while Lord  
Deas said:

"actual delivery if stipulated for and given, would,  
I think, have constituted the different and inferior  
right of pledge"<sup>(35)</sup> .

There are, therefore, two ways of construing the contract:  
by examining the incidents of the contract (e.g. the rights  
of the parties and the nature of the delivery), and by  
examining the intention of the parties. On either basis the  
decision in Hamilton is probably acceptable on its facts. But  
where the professed intention of the parties and the incidents  
of the contract clash, the case seems to authorise a disregard  
of the former. It is not willing to recognise a pledge plus an  
added right of sale by virtue of an express term of the  
contract; it does not, however, go so far as to say that no  
document of title can be pledged. In Hayman v. McLintock,  
Lord McLaren explains the decision thus:<sup>(36)</sup>

"The result of that decision is that where documents  
of title were taken in security of advances, the  
contract to be inferred was not strictly a contract  
of pledge, but the transference of a proprietary  
right, under which the bank was held entitled to  
retain the goods until the advances were repaid".

There/

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(34) *ibid* at p.164.

(35) *ibid* at p.165.

(36) 1907 S.C. 936 at 952.

There are two points about this précis that must immediately be questioned. Constructive delivery was contrasted with symbolic delivery in Hamilton and the consequences of each are clearly different. The extension of the ratio from delivery orders to all documents of title is therefore unjustified without further argument. Moreover, Lord McLaren talks of the bank being entitled to retain the goods until the advances were repaid<sup>(37)</sup>. While this is an inaccurate description of the situation regarding delivery orders, and may be forgiven as such, it does focus the point that it is a realistic description where bills of lading are involved. And since the whole basis of Hamilton is the inability of the bank to retain the goods in any real sense as pledges, it can not be extended to bills of lading.

Within the judgments in Hamilton there are indications that the implications of pledge were not fully appreciated by the judges. There is a certain lack of consistency in their judgments. For instance, Lord President McNeill talks of the absence of custody<sup>(39)</sup>, which he terms the necessary characteristic of pledge. In contrast, Lord Ivory distinguishes the custody of a carrier or a workman from the 'possession' of 'proper pledge'<sup>(38)</sup>, He explains the latter as being 'that which in England is said to confer a special property in the article itself'. This approach removes at once the mystique of the English 'technicality'. The differences in the two judgments/

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(37) *ibid* p.952.

(38) (1856) 19 D at 161.

(39) *ibid* at p.159.

judgments may or may not be dismissed as differences in terminology. What can not be so dismissed, however, is the Court's attitude to the intention of the parties. At page 162, Lord Ivory says:

"It is by force of law, and not by the intention of the parties, that the ultimate right of parties arises";

and Lord Deas at page 165:

"That the parties intended to pledge it I have very little doubt".

There are two ways of looking at this apparent disregard of the parties' intentions: either the incidents of the contract and the powers of the parties thereunder are decisive, or there is some legal disability preventing a document of title being pledged in any circumstances. Lord Curriehill clearly supports the former:

"Moreover, if the right had been merely a pledge, the defendants could not have sold the goods without  
(40)  
judicial authority".

This approach does not find favour with Gloag and Irvine but in any case it certainly stops short of the latter view that a document of title can not be pledged. Justification for the view may be sought in the Lord President's judgment. If pledge were possible, he says, "it would tend to complicate  
(41)  
transactions and create confusion". Unfortunately he does not/

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(40) *ibid* p.164.

(41) *ibid* p.159.

not elaborate this theme, and apart from a division of possessory and proprietary rights, the very basis of pledge, it is difficult to see what objections can be taken on these grounds as between the parties to the contract. The effect on third parties is, of course, a matter of separate concern and one which will be discussed later.

The decision in Hamilton is, of course, only binding in any real sense on the position of delivery orders. Too much can not be read into obiter discussions of theory. A delivery order can only be effectively transferred by delivery plus intimation unlike a bill of lading which differs from a negotiable instrument only as regards the position of a holder in due course. While it is a document of title in terms of the Factors Acts, <sup>(42)</sup> a delivery order is not a symbol of the goods. It is the latter disability which prevents the approximation of constructive and symbolic delivery. Third party notice is required for effective transfer. And while <sup>(43)</sup> Hamilton may be considered fairly conclusive on its merits, it is this which allows us to distinguish the position of a bill of lading. Gloag and Irvine point out the de-merits and consequences of Hamilton <sup>(44)</sup> and Lord McLaren expressed his disapproval of it in a Note to Bell's Commentaries. <sup>(45)</sup> The arguments/

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(42) Factors (Sc) Act 1890 53 & 54 Vict c40 extending the English Factors Act 1889 (52 & 53 Vict c45) to Scotland.

(43) as it is by Gow, Gloag and Irvine and in Hayman v. McLintock, all cited previously.

(44) at p.256.

(45) Bell's Comm.ii 21.(7th Edition). Further references to Bell will be, unless otherwise stated, to this Edition.

arguments, complex and confusing as they are, can alone scarcely justify the widespread extension of theories of law proffered in a case where the law as laid down is in clear conflict with the usual understanding of business men.

Hamilton has nevertheless found considerable support and was followed in Mackinnon v. Max Nanson and Co.,<sup>(46)</sup> where the document in issue was again a delivery order. It must be noted in passing that the terms of a delivery order vary considerably in contrast to those of a bill of lading which are fairly uniform at least in lay-out and content. Lord President Inglis spoke of Hamilton as 'establishing very clearly and satisfactorily a great principle of mercantile law'.<sup>(47)</sup> The emphasis on actual possession is again repeated and Lord Deas saw no reason to doubt the opinions expressed in Hamilton. Six years earlier the possibility of pledging the title-deeds of heritage was discussed in Christie v. Ruxton.<sup>(48)</sup> This case has been cited by Gow in support of his statement that 'Scots law does not recognise as a concept the pledge of a document of debt or obligation'.<sup>(49)</sup> In fact, however, the ratio of Christie does not bear this construction and has a very narrow application, unless a very restricted meaning is given/

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(46) (1868) 6 M 974.

(47) *ibid* at p.975.

(48) (1862) 24 D 1182.

(49) Gow, Page 284.

given to the term 'document of debt or obligation'. Certainly Christie does not point to any difference between the Scots (50) and English law. Lord Benholme's judgment is as follows:

"title deeds and documents of debt having no intrinsic value in themselves are truly extra commercium. Their only value is relative to or as adjuncts of and accessory to, separate rights, whether of property or of obligation, with which rights the supposed pledgee, ex hypothesi, has no concern".

A bill of lading could by no stretch of the imagination be described as extra commercium. All that is meant is that the title deeds of property can not be transferred independently of the property, whether in sale or security. The security over the titles of heritage is merely that of nuisance value by way of lien. A bill of lading is in no sense merely an accessory of the property; for practical purposes, recognised at law, it is a symbol of and represents the property.

Lord Benholme does, however, indicate a further criterion of pledge. Referring to a lecture of Baron Hume:

"In Scotland those moveables only can become the subjects of pledge which are in their own nature valuable or substantially serviceable, and therefore (51) would fetch a price when brought to market".

Bills of lading certainly satisfy this criterion. And far from/

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(50) supra cit at page 1185.

(51) quoted at p.1186.

from distinguishing the English position, Lord Benholme points out that as regards title deeds exactly the same position exists there.

Two of the earlier cases on security rights over delivery orders and documents of title are Pochin and Co. v. Robinows (52) and Marjoribanks (53) and Mitchell v. Heys. In neither of these is there any close analysis of the position of the security-holder, but several of the judgments do talk rather loosely of pledge. In Pochin and Co., Lord President Inglis shows the same approach as was later to be used in Tod and Son v. Merchant Banking Company:

"If a creditor in return for his advance, receive a transfer of property, or an assignation of a debt or personal obligation of any kind, in terms absolute and unqualified, such as would be employed in a transfer to a purchaser of the property or right of credit, he has all the powers of a proprietor or absolute assignee for the purpose and to the effect of enabling him to recover his advances"<sup>(52)</sup>.

Apart from this statement, there is little discussion of theory, Lord Ardmillan merely mentioning the "very important and delicate questions of law ..... which do not require to be decided"<sup>(54)</sup>.

Mitchell v. Heys was decided on the facts at issue and an application of principles of personal bar. The Lord Ordinary/

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(52) (1869) 7 M 622 at 630.

(53) (1893) 21R 600.

(54) supra cit at page 634.

Ordinary cited London Joint Stock Bank v. Simmons (55) in these terms:

"The decision, therefore, goes no further than this, that the bona fide pledgee for value of a negotiable instrument can retain it for the debt for which it was pledged against the true owner. The same rule, I apprehend, also applies to the impledging of documents of title, such as an indorsed bill of lading .....".

This typifies the very loose usage of the term 'pledge' but certainly shows that there was at that time no fixed rule excluding the pledge of bills of lading. Inglis v. Robertson (56) was yet another case which talked of the pledging of delivery orders. This House of Lords' decision is significant in the present context for the unwillingness of the Earl of Halsbury to distinguish the Scots and English laws of pledge (57) and for Lord Watson's opinion that North Western Bank was properly a (58) decision on English law.

There is, then, no consistent line of Scots authorities to guide us on the theoretical difficulties of the 'pledge' of a bill of lading. It is only in 1883 that the ownership theory was first fully canvassed in a case concerning bills of lading, namely, Tod and Son v. Merchant Banking Co. of London. (59) The facts/

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(55) supra cit at p.604.

(56) (1897)25 R(H.L.) 70 - discussed further infra.

(57) ibid at 72.

(58) ibid at 73.

(59) (1883) 10R 1009.



facts were similar to those in North Western Bank:

bills of lading, blank indorsed, were held as security by the purchaser's bankers in exchange for the latter accepting the shipper's drafts for payment of the cargo. The security subjects were then released to the purchaser on the undertaking that the purchaser would obtain from the party to whom he had subsequently sold the goods an obligation to pay them, the bankers. The price was arrested in the hands of the sub-purchaser prior to this obligation being obtained and the Court preferred the arrester's right to that of the former security-holder, the bank. At first instance, Lord McLaren (60) said:

"it is plain from the negotiations ..... that it was not intended that the bankers should have anything to do with the disposal of the cargo by mercantile contract" but despite this, he held that "there was a title of property with an equity to reduce that right to a security on a settlement of accounts (61) between them and their bankers".

On appeal the bank argued for the adoption of the ownership theory, relying on Hamilton. The respondents on the other hand argued on a basis of pledge. Lord Westbury in Barber v. Meyerstein (62) was cited for the following proposition:

"It/

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(60) *ibid* Page 1012.

(61) *ibid* Page 1015.

(62) (1870) LR 4 E & I App 336.

"It is unquestionable that the handing over of the bill of lading for any advance ..... as completely vests the property in the pledgee as if the goods had been put into his own warehouse".

The Lord President's appeal judgment rather fell between the two although none of the reasoning is completely unambiguous:

"No one disputes, at the same time, that the true nature of the transaction between Bryant, Ridley and Company and the Merchant Banking Company was simply this, that the bank held the bill of lading of the cargo and had under it a title of property, but that they <sup>truly</sup> held it in security for the advances they had made and that when Bryant, Ridley and Company were in a condition to pay these advances the title to the cargo would revert to them".  
(63)

This sanguine approach to the alternatives put before the Court does not further the analysis of the nature of the security. The reason for this approach was probably the acceptance that whether pledge or ownership correctly described the security-holder's title, the result was the same.

When Tod was considered by the House of Lords in North Western Bank it was on the basis of pledge. The method by which the case was distinguished is interesting. Lord Chancellor Herschell emphasised that the delivery to the eventual purchaser was not accomplished via the bank's customer.

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(63) supra cit at p.1018.

customer. In these circumstances, he refused to hold that the pledger sold on the bank's behalf; "he made these sales on his own account in the course of his own business". (64)

Surely this assessment of the practical situation is equally true of that in North Western Bank. The only distinction was the existence of a letter purporting to appoint the pledgors agents for the limited purpose of sale. The practical background was identical.

Nevertheless, Tod may still be authoritative on the particular facts of that case. (65) It certainly can not be given the wider consequences to which it pretended. Moreover, if, as was suggested, Tod followed the ownership theory, it is submitted that the decision should be reconsidered. If the bank were the owners, it would surely be irrelevant that Bryant, Ridley and Company obtained the purchaser in their normal course of business.

There are several other cases which throw some light on the nature of the rights of the holder of the bill of lading. These, however, do not consider the position of the security-holder. They merely re-inforce the symbolic theory. (66)

Until/

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(64) [1895] AC at 72.

(65) as Gloag & Irvine suggest at p.288.

(66) Cowdenbeath Coal Co. (1895) 22R 682;  
(1871)  
Pirie & Sons v. Warden/9M 525.

Until Hayman v. McLintock in 1907, there could be no conclusive decision in favour of the ownership theory. It is mainly on this case that Gow's theoretical assertion must be based. The facts of Hayman's case, although providing the opportunity for airing the problem of the 'pledge' of bills of lading, are not closely related to those of a commercial credit transaction.

The argument in favour of the 'pledge' theory was clearly brought before the court, although the authority relied upon was principally Sewell v. Burdick.<sup>(67)</sup> The Lord Ordinary<sup>(68)</sup> distinguished this case on the facts and stressed that the indorsees in Sewell were bankers who would not in their normal course of business take possession of or deal with the goods. He continued by saying:

"But we are here dealing with the Scots law of pledge" and talked of this as apparently involving "absolute property with reversionary right".<sup>(69)</sup>

It is, therefore, to the appeal court that we must look for a consistent statement of principle. The Lord President's treatment of the argument based on Sewell emphasises that it was an English case. His approach to the concept of special property is, however, extremely unusual:

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(67) (1884) 10 A.C.74

(68) 1907 SC at p.942.

(69) 1907 S.C. at p.949.

"There is no such thing in Scots law as the term special property, and there cannot be according to the law of Scotland a distinction between the property and the special property. But the form of security effectuated by what in the law of England is called a special property is perfectly well-known in the law of Scotland. There is a very well-known leading authority upon the matter, namely, the case of Hamilton v. Western Bank"<sup>(70)</sup>.

So far as it goes, this is at least an arguable legal proposition. Expanding this, however, he continues:

"the law of Scotland is certainly this, that the condition of affairs in which a pledgee may lose his rights by losing possession applies only to the proper case of corporeal moveables. It is very often a confusion of ideas or a quibble of words to talk of losing possession where what is given to you is not the property itself but documents which transfer the property. You cannot lose possession of the moveables <sup>(71)</sup> unless you lose the document".

In other words, the Lord President construes the 'special property' concept of Sewell not as the possession required by the Scots law of pledge but as equivalent to the transfer of the absolute right of property under the obligation/

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(70) *ibid.*

(71) *supra cit*; *ibid.*p.950.

obligation to reconvey on satisfaction of the security.  
The term pledge is used loosely <sup>(72)</sup> and seems to infer that the form which pledge takes with incorporeal moveables is the absolute ownership concept. The whole criterion of possession on which pledge is commonly said to rely and on which Hamilton is decided is undermined. The Lord President accepts that the only possession of the goods which is possible is possession of the documents, and then denies that this has any significance.

Neither of the judgments above can really be accepted as satisfactory justification for the extension of the ratio of Hamilton to the situation involving bills of lading. In one case the facts are treated as crucial, and in the other the basis of Hamilton is undermined. Lord McLaren, giving the only other lengthy judgment <sup>(73)</sup> returned to the criterion of possession to say:

"Under the Roman law of pledge there must be actual perception of the subject of pledge"

and that the result of Hamilton, as the ratio is laid down by Lord President McNeill, is that

"where documents of title were taken in security of advances, the contract to be inferred was not strictly a contract of pledge, but the transference of a proprietary right, under which the bank was held entitled to retain the goods until the advances were repaid". <sup>(74)</sup>

This/

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(72) perhaps the only characteristic common to all the authorities.

(73) Lords Kinnear and Pearson concurred.

(74) 1907 SC at 952.

This right of the security holder is identified in all substantial respects with the right of a holder of a security over heritable property constituted by ex facie absolute disposition.

Again, Lord McLaren is content to use the word 'pledge' to describe this transaction although it is quite clear in this instance that it is not pledge, properly speaking, to which he is referring. His uncritical extension of Hamilton is not justified by him apart from his bare assertion of the state of Roman law. In fact, he is earlier at pains to distinguish the delivery order from the bill of lading. (75)

As we have seen, Hayman is regarded in some circles as conclusive authority in favour of the ownership theory. (76) Gloag and Irvine had, however, suggested that the point would earlier be settled in the case of Inglis v. Robertson and Baxter. (77) The fact that it was not is partly due to the fact that the case dealt with delivery orders and partly because it eventually reached the House of Lords after having been considered by the whole Court of Session. On matters of theory pertaining exclusively to Scots law it is perhaps to be regretted that this situation can arise.

In the House of Lords, Lord Chancellor Halsbury would not/

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(75) *ibid.*

(76) Gow *supra cit.*

(77) 1896 3 SLT No.326; on appeal: (1897) 24 R 758;  
and in the House of Lords: (1898) 25 R (H.L.) 70.

not commit himself to the existence of any differences between  
the English and Scots laws of pledge. <sup>(78)</sup> Lord Watson was  
rather more specific regarding the nature of the security  
right created:

"I can see no reason to doubt that, by Scottish law  
as well as English, the indorsement and handing over  
of delivery-orders in security of a loan, along with  
a letter professing to hypothecate the goods  
themselves, is sufficient in law, and according to  
mercantile practice, to constitute a pledge of the  
documents of title, whatever may be the value and  
effect of the right so constituted". <sup>(79)</sup>

The real right in the goods is dependant in the case of  
delivery orders on the completion of the security by  
intimation to the custodier. It is this speciality of  
intimation which is under close scrutiny in this case and in  
examining the learned judgments this must be borne in mind.  
Intimation is, of course, unnecessary when bills of lading  
are at issue and it is only lack of intimation which prevents  
Lord Watson giving full effect to the statutory statements  
in the 1889 and 1890 Factors Acts. <sup>(80)</sup>

For/

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(78) (1898) 25R (H.L.) at 72.

(79) *ibid* at 73.

(80) these will be examined *ad longum* below.



For a perceptive treatment of the theoretical difficulties, we must turn to the Court of Session's judgments. At first instance Lord Kyllachy underlined the point which is crucial when we come to consider the general application of the theories put forward on appeal, namely, the inherent differences of the bill of lading from other documents of title. He describes the suggestion that bills of lading be equated to other documents of title as 'a (81) startling proposition'.

With this in mind, we must examine the appeal judgments. Lord McLaren, in contrast to his opinion later given in Hayman v. McLintock, seems to support the possibility of pledge, provided it is based on possession created by constructive delivery perfected by intimation. He would construe section three of the Factors Act with reference to the first section defining 'pledge' as including 'any contract pledging or (82) giving a lien or security on goods'; the general effect of this is left to the general law of contract; but at no point does he limit the concept of pledge by reference only (83) to corporeal moveables.

On the construction of the concept of possession, several of the other judgments are extremely revealing. For instance, Lord Kinnear: /

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(81) 1896 SLT 326.

(82) (1898) 24R 777.

(83) This judgment was supported by the Lord President and Lord Adam.

Lord Kinnear:

"But at all events it is not by the law of Scotland a pledge of the goods; because there can be no completed pledge without transfer of possession, and the pledgee has not been put in possession, inasmuch as the transfer of the warrant was not intimated to the warehouse -keeper'.<sup>(84)</sup>

This restricted definition would not discriminate against the pledge of bills of lading; nor would it justify the Court in Hayman v. McLintock following Hamilton v. Western Bank. Unfortunately this concept of possession is not discussed at length elsewhere, the issue before the Court being a narrower one involving the right of the holder of an unintimated delivery order. Possession is passed over without discussion of its nature in the judgments both of Lord Kyllachy<sup>(85)</sup> and Lord Kincairney,<sup>(86)</sup> the latter specifically approving Hamilton v. Western Bank and McKinnon v. Nanson.<sup>(87)</sup>

Lord Stormonth-Darling points out that the suggested construction of section three would put pledges of delivery orders in an anomalous and privileged position compared with other contracts involving these documents. It is largely this which is the basis of the unwillingness to hold pledge as being created, not the conceptual difficulties of possession and custody. This does not extend to bills of lading. Lord Low is/

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(84) at p.780.

(85) *ibid* p.782. This judgment seems to favour pledge as a conceptual possibility.

(86) *ibid* p.785.

(87) *ibid* p.789.

is clear as to delivery:

"Neither in England nor in Scotland is a pledge of goods possible without delivery". And he follows Lord Kinnear's interpretation of what is required to constitute the possession of the pledgee, namely, intimation. (88)

The major difficulty which most of the judges felt when dealing with the question of possession was that of conferring the 'real' right which is to a certain extent the criterion of pledge. (89)

The judgments in this case have been treated selectively. There is no alternative in view of their variety and verbal distinctions. On the other hand, it is open to others to select differently. The salient points, however, are these: whether or not Inglis (90) is binding or even persuasive authority where bills of lading are an issue; the attitude of the court to the concept of possession; and the meaning attributed to the term 'pledge'. Inglis is of course principally concerned with the requirement of intimation to complete a security right in the light of section 3 of the Factors Act. To this extent it is not in point; and it is on this basis that the judgments must be evaluated. So far as possession is concerned, there are dicta in the judgments which go far in recognising that constructive delivery completed by intimation is an acceptable equivalent. If this is so, there is a clear conflict with Hayman. And, in any event, there is nothing in the judgments which goes further than Hamilton v. Western Bank in denying the conceptual possibility of the pledge of bills of lading.

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(88) *ibid* p.792.

(89) e.g. Lord Pearson at p.797.

(90) (1897) 24R 758; (1898) 25R (H.L.) 70.

The broad span of the cases thought to be of help in a Scots law context have been discussed. Dogmatic conclusions would be naive and could at best only be opinions of probabilities, if not mere possibilities, of future judicial approaches. The feasibility of the extension of the concept of pledge to documents of title has never been satisfactorily denied. The position still awaits clarification. Prediction, of course, does not rely solely on judicial precedent. In this field, especially, there are several subsidiary sources to which appeal may be made; 'subsidiary' not in the sense of being less valuable, but in the sense of requiring to be examined with an awareness of their built-in limitations, limitations existing partly because of their professed field of influence and partly because in certain cases they merely bear to be opinions.

Of the Institutional writers, Bell alone gives any specific guidance in his Commentaries, a guidance which is made even more specific under the editorial footnotes of McLaren. Bell confirms the judicial emphasis on the possession of the creditor under the pledge:

"The creditor who receives a pledge, holds the possession for the debtor; but the property in the goods remains unchanged. The creditor is said indeed in English law to have a special property in the thing pledged; but the meaning of this is only that he is entitled to keep possession till the claim, in security of which he received it, is satisfied; and that in order to protect himself in the enjoyment of his right, he/

he has all the remedies by which a proprietor is  
(91)  
protected".

This would support what has been maintained earlier in this discussion, namely, the refusal to accept that the English 'special property' is a technical division of property in any real sense. (92) Special property is used elsewhere in Bell's Commentaries (93) to describe the fiduciary duties of the shipmaster in the course of the carriage of goods. No-one can doubt that in this context at least, the term is merely a convenient short-hand description. Too rigid adherence to the independence of Scots theory in the field of pledge is, moreover, unrealistic. Perhaps such authorities as Lickbarrow v. Mason are relied upon rather too readily by Bell. But when the identity of the Scots and English positions could find judicial support as late as 1895, (94) it does suggest that Bell's approach has at least some justification.

McLaren, in his footnotes to the Commentaries, mentions that 'there may be cases, however, of sale cum pacto de retrovendo which are difficult to be distinguished from (95) pledge'/'

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(91) Bell's Commentaries i 278 - this is when Bell is talking about 'possession'.

(92) See supra especially pp.21, 24 and 25.

(93) Bell's Commentaries i 591.

(94) N.W. Bank supra cit.

(95) Bell's Commentaries i 278 footnote 5 (7th edition).

pledge' and refers to Stair<sup>(96)</sup> and to the case of Latta  
v. Park and Co.<sup>(97)</sup> The latter was largely decided on its  
facts. It concerned the transfer of moveables in security and  
the choice before the court was clearly that of pledge or  
paction de retrovendendo. Importance was attached to the  
intention of the parties as illustrated by the written  
agreement<sup>(98)</sup> and it is thought that the decision is beyond  
criticism on this basis. The significance of the case is,  
however, in highlighting the role of intention and in showing  
that the device of security by transfer of ownership of  
moveables is no sense the special domain of documents of title.  
Latta should be regarded as an authority of similar  
significance to the English case of Barber v. Meyerstein.<sup>(99)</sup>

Dealing with the problem of the pledge of documents of  
title, Bell has this to say:

"In the contract of pledge, a moveable subject, or the  
title-deeds, vouchers or muniments of a jus incorporale  
or debt are delivered to the creditor, in security  
of debt, to remain with him, and be detained in his  
possession, till the debtor shall redeem them .....

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(96) Stair i.14.4.

(97) (1865) 3M508.

(98) Ibid at P.511 per/<sup>Inglis</sup>LJC and P.513 per Lord Cowan.

(99) cited infra.

it is in the law of Scotland, a real right, but not attended with any other effect than the power to retain the pledge, and to apply judicially for a warrant to have it sold for the debt".<sup>(100)</sup>

By title-deeds it is, I think, clear that Bell did not have in mind any exception to the rule in Christie v. Ruxton<sup>(101)</sup> or any extension of the rules above discussed. But it is noticeable that delivery and detention in possession are emphasised in terms which dictate a reference to Bell's description of the transfer of a bill of lading:

"The effect of the endorsement of a bill of lading is to vest the indorsee where he is a holder for value and bona fide with authority to receive the goods beyond recall or countermand".<sup>(102)</sup>

Does this not satisfy the criterion necessary for pledge?

McLaren faces the problem squarely when discussing constructive delivery, and what he has to say merits a full quotation:

"And as there seems to be no legal necessity for the opinion that a pledge may not be constituted by constructive delivery, so there is not only no mercantile convenience, but much mercantile inconvenience in it, as there always is wherever the law from mere theoretic subtleties needlessly sets itself to deny effect to the real intention of the contracting parties. It is mischievous/

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(100) ii.19.

(101) (1862) 24D 1182.

(102) Bell's Comms. i.594.

"mischievous to trade and commerce to say that no real right less than dominium can be acquired or held through an agent, because it prevents merchants from dealing with their goods in warehouses according to their real intention, and forces on them a fictitious form of (103) transaction they do not mean to enter into."

A fortiori where the bill of lading is in issue and 3rd party intimation is unnecessary; also where the document is only in use because, by force of circumstances, the goods themselves are out of commission by reason of their being in transit by sea. The practicality of McLaren's argument obviously commends itself in any discussion of the situation arising out of the use of the letter of credit.

As is to be expected, the legislature has committed itself only to interstitial intervention, in the first section of the Bills of Lading Act 1855 (104) and in the Factors Act 1889 as applied to Scotland by the Factors (Sc) Act 1890. (105) Both of these have led to leading cases and in no sense can be said to have clarified the issues - not that the statutes were ever so intended.

The first section of the Bills of Lading Act 1855 states:/

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(103) *ibid* ii. 21 footnote 1 (7th Edition)

(104) 18 & 19 Vict c 111.

(105) 53 & 54 Vict c 40.



states:

"Every consignee of goods named in a bill of lading and every indorsee of a bill of lading, to whom the property in the goods therein mentioned shall pass upon or by reason of such consignment or indorsement, shall have transferred to and vested in him all rights of suit, and be subject to the same liabilities in respect of such goods as if the contract contained in the bill of lading had been made with himself".

This legislative affirmation of the symbolic theory of the bill of lading led to the adoption in Sewell v. Burdick of the "technicality" of special property. Whether this is necessary for Scots lawyers is doubtful. The Act only refers to indorsees to whom the property passes. It does not dictate that the property must pass to every indorsee. If possession only passes as it would in pledge the Act does not apply. The ownership remains with the proprietor. In Barber v. Meyerstein,<sup>(106)</sup> Lord Westbury spoke of "both the right of property and the right of possession passing by a symbol, the bill of lading, which is at once both the symbol of the property and the evidence of the right of possession". This comes very close to the suggestion in the judgments of Lord Kinneir and Lord Low in Inglis v. Robertson and Baxter,<sup>(107)</sup> and can be expressed simply as follows: the owner of the property does not require a badge to prove his rights of ownership (the owner of corporeal moveables has no such badge if he chooses to pledge them); the possessor, on the other hand,

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(106) (1870) LR 4 HL 317; Lord Westbury at P.337.

(107) supra cit at P.24 & 25.

hand, does require some tangible evidence of his right and this is provided by either the bill of lading, or by constructive delivery completed by intimation.

The Bills of Lading Act 1855 did not refer to the pledge of bills of lading; it is not clear that pledge was ever envisaged. If it had been there would not have been the problems that were experienced by the judiciary in Sewell v. Burdick. The Factors Acts did, however, refer to both of the basic concepts we are here discussing, possession and pledge.

As to possession, the definition in section one is of very limited help because it is so phrased as to cover both the possession of goods and the documents of title to goods. In any case it identifies custody with possession, an unjustifiable extension for Scots law. When defining a document of title, however, there is included "any other document used in the ordinary course of business as proof of the possession or control of the goods"<sup>(108)</sup>. This definition, in every sense couched in practical terms, is not so very far removed from the theories of Scots law. And, of course, it is<sup>(108a)</sup> applied to Scotland by the Factors (Scotland) Act 1890.

It is scarcely satisfactory to conceive that such legislation, ill-considered from the point of view of its application to Scots law, could fundamentally alter or dogmatically re-state such delicate conceptual notions. While it is unwise to talk of legislation by inadvertence there have been no judicial comments in Scots authorities suggesting that/

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(108) S1 1889 Act. (52 and 53 Vict. c45)

(108a) supra cit.

that this legislation is other than persuasive, and the judicial tendency has been to limit its application.

The third section is the one around which the arguments in Inglis v. Robertson and Baxter revolved:

"A pledge of the documents of title to goods shall be deemed to be a pledge of the goods".

In the House of Lords it was accepted that this section applied only to "Dispositions by Mercantile Agents"<sup>(109)</sup>; and in the Court of Session the judiciary were at pains to limit its effect. Lord Kinnear, for instance, said:

"its only effect ..... is that, as against the owner of the goods, a pledge by an agent intrusted with documents of title is as effectual when made by pledging the document as it is when made by pledging the goods themselves"<sup>(110)</sup>.

There seems to be general agreement with Lord Kyllachy that "section three neither declared nor introduced any doctrine or rule of general law", although not necessarily with his interpretation that the section "provided only that, for the purposes of the Act [note this limitation], a pledge of goods - that is to say, a contract of pledge of goods - may be constituted by a contract impledging the document of title representing the goods"<sup>(111)</sup>.

Apart/

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HL  
(109) (1898) 25R/at 76 and 71.

(110) (1897) 24R at 779.

(111) ibid at 782.

Apart from the construction of the term 'pledge' as meaning a contract of pledge which causes Lord Kyllachy to expand on this statement at a later point, this statement would seem to go far to recognising as viable the concept of pledge of documents of title. The introduction of the complication of the two apparently coincident terms "pledge" and "contract of pledge" is explained by referring to the terms of the earlier Factors Act of 1842 where the reference in section four was to "contracts pledging ..... documents of title".<sup>(112)</sup> Lord Kyllachy makes the point that the 1889 Act was not in its terms concerned to create a different effect. Lord Kincairney<sup>(113)</sup> confirms this approach.

Lord Low's distinction of the two terms is rather more critical. According to his interpretation, there can be a contract of pledge without possession i.e. a contract undertaking to pledge, whereas the pledge contracted for<sup>(114)</sup> requires possession. Despite this, section three is construed as serving the same purpose as the earlier section four, and the distinction is justifiable particularly in the context of a discussion of the need for the perfection of the real right in constructive delivery by intimation. The restricted interpretation accorded to section three is merely to prevent the creation of an anomaly in the treatment of the pledge of delivery orders.<sup>(115)</sup>

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(112) 5 & 6 Vict c 39 s4.

(113) *ibid* at p.785.

(114) *ibid* at p.792.

(115) See Lord Pearson at p.800.

The very fact that the judiciary agree that section three introduced neither new doctrines nor effected a change in the basic concept of pledge confirms that little guidance can be received from the legislative interventions. They do, however, seem to presuppose the existence of the concept for the purposes of documents of title - an assumption certainly acceptable for English law, and probably also acceptable for Scots law, at least in the light of our interpretation of the authorities above discussed. The doubts left unresolved after our examination of the judicial precedents have not been dispelled by our further consideration of Bell's Commentaries and the relevant statutes.

Our conclusions on the purely Scottish authorities can, therefore, be no more dogmatic than before. We have discovered no criterion on which to exclude documents of title from pledge other than a very restricted interpretation of possession. And it is contended that this restricted interpretation is unrealistic and would not find support in future judicial considerations. There may, of course, remain many situations in which the intention of the parties - for our hypothesis reaffirms the role of the parties' intentions - may dictate that the relationship is not that of pledgor and pledgee, but that arising from qualified sale. We shall have to consider the implications of the latter, namely, paction de retrovendendo, at a later stage against the peculiar background of the commercial credit.

One consequence of our interpretation of the above authorities is that the English cases have much to offer by way of/

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of expanding the imperfect treatment of the Scots cases. It must not be thought that there have been no differences of opinion in England concerning the theoretical analysis of the relationship between the indorser and the indorsee of the bill of lading. R.P. Colinvaux in *British Shipping Laws*<sup>(116)</sup> indicates that the older view was that the proprietary rights inevitably followed the possessory.

"On the other hand, the view now established is that the bill of lading merely represents the goods, not the right to them; and that possession of it is only equivalent to a physical possession of them. The right of property in the goods depends upon the transaction between the parties, of which the transfer of the bill of lading may or may not have been an accident. Such a transfer indicates nothing more than a delivery of the goods would do".

This statement of principle is both accurate and helpful.

Barber v. Meyerstein<sup>(117)</sup> is indicative of the older attitude. At first instance, Willes J said that the case was not one of sale, but simply of pledge.<sup>(118)</sup> The House of Lords, however, held that the "whole and complete ownership of the goods passed".<sup>(119)</sup> This case is now commonly regarded merely as/

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(116) R.P. Colinvaux: Vol.3 - *British Shipping Laws: Carriage by Sea*, para.1075.

(117) (1870) LR 2 CP 38,661.

(118) *ibid* at 51.

(119) (1870) LR 2 CP 326 - Lord Hatherley.

as an example illustrating that intention may vary the legal  
consequences of a transfer in security. (120)

Similar difficulty was obviously experienced in  
Glyn v. East and West India Dock Company (121) where in the  
Court of Appeal Brett LJ said that the property was transferred  
subject to

and  
"an equitable right to resume the legal/absolute  
ownership of the sugar on repayment of the advance,  
and an equitable right that the plaintiff should not  
for a specified time exercise any rights of ownership  
over the sugar, but that Cottam, Morton and Co.  
(the pledgors) might exercise any such rights, which  
would not be inconsistent with the validity of the  
plaintiff's security." (122)

On this basis ownership is certainly not the solution  
to the "confusion and uncertainty" of pledge. Indeed these  
characteristics would appear to be/<sup>the</sup>domain of ownership in  
English law at least. Just what could the pledgors do in  
intruding with the property? And what would justify the  
exercise of ownership rights by the latent proprietor? Would  
the documents be security for further advances not made  
specifically on that basis? Bramwell L.J. avoided these  
uncertainties by holding that "what took place was a pledge at  
common law", (123) albeit with a right of sale in certain  
circumstances/

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(120) G and M p.138.

(121) 6 Q.B.D.475; 7 A.C.591.

(122) 6 Q.B.D. at 480.

(123) supra cit. at 490.

circumstances and a right to redeem in the pledgors. He identifies the symbolical delivery of the bill of lading with the actual physical delivery of corporeals. The House of Lords avoided the problem by barely stating that both the rights of property and possession were with the bankers.

(124)  
It was not until 1884 that Sewell v. Burdick finally seems to have laid down that the effect of an endorsement on a bill of lading must be ascertained, in each case, by reference to the intention with which it was made. In this case the ownership theory was again advanced by the Court of Appeal (125) with the dissent of Bowen L.J. whose judgment was later adopted by the House of Lords - a House containing Lord Bramwell who had earlier dissented in Glyn's case. Bowen L.J.'s judgment must be cited ad longum: (126)

"what property passes ..... appears to me to be a question of fact in each case that depends, so far as the rights between themselves of the immediate parties are concerned, on the express or implied agreement between them".

He would protect the "freedom of disposition" of the owner while the goods were at sea. He continues:

"the cargo being at sea, no actual delivery of it is possible before the ship arrives. During this period of flotation and transit, the bill of lading becomes and/

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(124) (1884) 10 App Cas 74.

(125) 1884 3 Q.B.D. 159.

(126) 1884 13 Q.B.D. at 170.



and remains the token or symbol of the goods and the delivery and endorsement of the bill of lading is equivalent, so far as the passing of property is concerned, to a symbolical delivery of the goods. Upon principle and reason, therefore, apart from authority, one would suppose that it is to the agreement between the original parties that we ought to look if we wish to discover the effect/<sup>as</sup>between themselves of a delivery of the/<sup>indorsed</sup>bill of lading, just as it is to the agreement between them that we should look to determine the legal consequences that follow (126a) on the corporate delivery of the goods".

To Scots lawyers, this is undoubtedly the most convincing and succinct reasoning in favour of the pledge theory available in an English decision. There is no question of it being a technical treatise on the "special property" basis rejected in Scots law. It is a theory dictated by basic principle and reason, and it must be noted that throughout the judgment, Lord Bowen emphasises that he is dealing with the position as between the parties to the security transaction and not viz-à-viz third parties.

In the latter context, the law of personal bar may well operate in one of its many guises. At the very least the technicality of the theory of special property was formulated to circumvent a difficulty created by the Bills of Lading Act 1855, a difficulty which we have already considered and judged to be illusory.

Where/

Where Sewell's decision goes too far along the road to "special property" is where Lord Selborne says (127) that an indorsee who is not entitled to the benefit of the contract (of carriage) in the first instance might become so by obtaining the possession of the goods under the bill of lading. This reasoning would appear to neatly circumvent the problem posed in Sewell. His opinion is, however, criticised in (128) Brandt v. Liverpool, Brazil etc. Steam Navigation Co., (129) and the better view now appears to be, as Colinvaux says, that the pledgee can only sue or be sued in contract if a new contract between him and the ship-owner can be inferred, as will generally be the case where the pledgee presents the bill of lading and accepts the goods. In this instance personal bar might well apply.

It is not considered that the earlier English cases repay detailed examination. (130) We must, however, rely on certain of the leading authorities to supplement the limited guidance given by the Scots cases. In common with many of the earlier Scottish decisions, Barber v. Meyerstein is guilty of using such terms as "ownership", "pledge" and "constructive delivery" (131) very loosely. The Lord Chancellor refers to the/

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(127) (1884) 10 AC at 86.

(128) [1924] 1KB 575.

(129) supra cit.

(130) for instance, Lickbarrow v. Mason 1 Sm.L.C. 753 and 5 T.R. 683 which although cited by Bell and in Sewell can not be described as a satisfactory precedent for Scots law.

(131) for the use of the term "constructive delivery" see Lord Chelmsford at p.334. (1870) LR 4 HL 317.

the bankers concerned as mortgagee and says:

"Now if anything could be supposed to be settled in mercantile law, I apprehend it would be this, that when goods are at sea the parting with the bill of lading ..... is parting with the ownership of the goods".  
(132)

He goes on to say, however, that when the bills were returned to the original mortgagor, he at once "pledged" two of them to Meyerstein. Conclusions on the basis of this case would clearly be frivolous.

Sewell v. Burdick, on the other hand, was a case in which the issue of pledge as against ownership was clearly focussed by the word "property" in the 1855 Bills of Lading Act. The judges were not, correctly perhaps, content merely to construe the phrase "to whom the property shall pass" as governing or qualifying the word indorsee; they regarded the phrase as definitive at least in one sense. The Lord Chancellor gave the term "property" its non-legal sense: the only property which passed was that which it was the intention to transfer, which might or might not only be possession.  
(133)

Both Lickbarrow and Barber v. Meyerstein were interpreted in their least favourable light as regards the possibility of pledge. Despite this, the Lord Chancellor regarded Erle C.J. in the latter case as supporting the proposition that "the indorsement and delivery of the bill of/

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(132) at p.325. *ibid.*

(133) (1884) L.R. 10 A.C. at p.80.

of lading by way of pledge was equivalent, and not more than equivalent, to a delivery by way of pledge of the goods themselves".<sup>(134)</sup>

That is a very similar reasoning to that employed at an earlier point in this discussion when it was pointed out that the "pledgee" or holder in security of a bill would be a favoured anomaly, whose rights of ownership would logically diminish when the powers of ownership were exercised by a taking of physical possession. As to the existence of "special property" as a technicality of English law, the Lord Chancellor's attitude is clear:

"The statute relates to a subject of general mercantile law, in which not Englishmen only but foreigners also may be, and often are, concerned ..... It seems to me inconceivable that the construction of the words "the property in the goods" in such a statute can have been intended to depend upon any such technical distinction as that made in English law between legal and equitable titles".<sup>(135)</sup>

Lord Blackburn in Sewell accepts that the role of intention is paramount and does, it is submitted, identify the rights of special property and possession.<sup>(136)</sup> Brett L.J. in Glyn v. East and West India Dock Co. is, in effect,<sup>(137)</sup> over-ruled./<sup>(138)</sup>

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(134) *ibid* at p.83.

(135) *ibid* at p.85.

(136) *ibid* at p.98.

(137) 6 Q.B.D. 480.

(138) *ibid* at p.102.

over-ruled. And Lord Bramwell supports this judgment on the ground that "the property does not pass by the indorsement, but by the contract in pursuance of which the indorsement is made".

The decision in Sewell was approved in Bristol and West of England Bank v. Midland Railway Co. (139) although Fry L.J. did expose the terminological barrier between Scots and English law in the use of the word property:

"they were the pledgees of the bill of lading; they had the property in the goods". (140)

This apparent contradiction in terms is only troublesome if property used in an extra-legal sense is equated to ownership in the technical Scottish sense.

Sewell also found support in Brandt's (141) case although some of the reasoning of the Lord Chancellor was questioned; at least some of the apparent implications of that reasoning were. And in Official Assignee of Madras v. Mercantile Bank of India (142) the privileged position of bills of lading was reaffirmed by the Privy Council. (143) The attitude taken was that "the principle that goods might be pledged by pledging the documents of title had been fully established by the Act of 1844". (143)

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(139) [1891] 2QB 653.

(140) *ibid* at p.662.

(141) *supra* cit.

(142) [1935] A.C.53

(143) *ibid* at 62.

(144) [1922] 2 Ch 211 at 216 c.f. Bell's Comms *supra* cit. where the remedy of sale is stated to exist only on Sheriff's warrant.

There are, of course, differences between the English and Scots laws of pledge. In re David Allester Ltd.,<sup>(144)</sup> Astbury J. stated that "as pledgee the bank had a right to realise the goods in question from time to time". Assuming, however, that there is a general identity of purpose in the two systems, and an agreement of the general concepts involved, we must now turn to their particular relevance to documents offered in security under the commercial credit transaction. It is as well once more to reiterate the framework in which the security arises and to emphasise the points about it which appear, at least at first sight, to be specially significant.

The security-holder is the bank with whom the eventual purchaser of the goods has arranged the credit facilities - in normal parlance the bank would be the pledgee and the purchaser the pledgor. The contract between the parties is contained in the letter of credit and there are normally specific terms governing the nature of the bank's security and the powers of the bank as security-holder. Among these is commonly the right of sale. The bank is also indemnified against liabilities incurred as security-holder.

Delivery of the subjects of the pledge is effected by the seller of the subjects either directly or by means of an intermediary bank. The eventual purchaser does not handle the documents prior to the creation of the pledge; and the security/

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security is <sup>normally</sup> created by means of an irrevocable contract (145) so that once the credit is instructed the security is inevitable provided the bank complies with its instructions. The security is the basis of <sup>the</sup> whole credit transaction, and while the bank does not profess to deal in the goods which it accepts as security, it does insist on the right to realise them in the event of not receiving satisfaction of the advance normally made by them. In many cases the purchaser can not satisfy the repayment of the advance before the value of the goods is realised by re-sale or by incorporation in saleable products. For this reason, the realisation must be effected (146) without prejudice to the bank's security and to this end letters of trust and hypothecation are employed. Whether these are in any real sense effective or necessary will form the subject of a later discussion. Of vital importance in any consideration of the theoretical problems is the admission that the credit facility could not exist without an effective security.

There is, of course, nothing to prevent the credit instructions being given verbally. This is unusual and would be manifestly unwise. One subsidiary benefit of this, however, (147) is that the intentions of the parties are clear. Moreover, the/

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(145) at least in the normal case.

(146) the economic background is explained at length in Davis and Gutteridge and Magrah in their introductory chapters.

(147) on one view of the authorities above discussed this is vital.

the establishment of the credit is notified to the seller and he can be in no doubt as to the role of the bank in the transaction.

Within these general outlines there are many variations, partly because the parties are free to dictate their own terms and partly because business transactions and relationships are seldom as simple as our basic model would suggest. Yet another difficulty is in the form of the documents used. The bills of lading may be indorsed in blank or in name of one or other of the parties to the transaction. While blank indorsement is the usual custom and has most frequently come before the courts, it is in no way inevitable. In the commercial credit transaction there can be no question of the bill of lading being indorsed in the seller's name or in the name of an agent appointed by him. This common device of the c.i.f. contract would completely negate the whole purpose of the credit facility. Apart from this, however, the bill could be indorsed to the various holders of the documents in order of their holding; it could also be indorsed in the name of the eventual purchaser; but normally, as we have said and as we have seen in the cases so far discussed, the bill is indorsed in blank.

Gutteridge and Magrah consider the situation where the bills are in favour of the eventual purchaser; <sup>(148)</sup> in such cases, they say, "the banker clearly has no enforceable pledge." The term "enforceable" seems in this context merely to indicate that/

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(148) at p.139.



that there is no right of sale. In Scots law a pledge is only enforceable in this sense on a warrant by the Sheriff. Nevertheless, where the bill is in the purchaser's name, the bank would appear only to have the power to detain the goods, a right mainly of nuisance value. The bank in this situation could prevent its customer obtaining the release of the goods; it could not in any real sense be said to have the requisite control or possession essential for pledge. The intention of the parties in this situation would partly be dependant on the facts and partly on the construction to be put on the specific indorsement of the bill of lading. In so far as the latter is concerned there would seem to be nothing to contradict the assumption of deposit only.

Other situations do not offer such clear solutions; nor is it suggested that there is one solution of uniform application. Scrutton L.J. in Rosenberg v. International Banking Corporation casts doubt on the nature or source of the pledge:

"Whether you talk about it as an express pledge, or whether, as Lord Campbell does, you talk about it as an implied pledge, in my view such a transaction gives an independent right, or right of property, to the bank to secure the amount which they have advanced". (149)

(150) Davis adopts the assumption of implied pledge, the implication existing "by the very fact of paying against documents".

While/

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(149) (1923) 14 Ll.LR 344 at 347.

(150) supra cit at p.188.

While the pledge is often specified in the letter of credit, it would seem an unjustifiable extension to talk of an implied pledge unless the authority of the pledgor, in all cases the eventual purchaser, can be supported by the circumstances. The relevant circumstances which might convey that authority of pledge has been given are the creation of the credit facility in the first place and the notification of the arrangements for presentation of the various documents of the credit given to the seller of the goods. Although there is no specific decision on the implication of pledge arising from these circumstances, its existence is, it is submitted, more than possible.

The bank obtains the documents of title in terms of its undertaking to do so on satisfactory tender of the documents in terms of the credit. There are thus two conditions precedent to the bank's security: the instructions in the credit and the satisfaction of its terms, the former given by the purchaser and the latter provided by the seller or by the seller by way of an intermediary. It is thought that it is the former which is the causa causans of the security and that there is an authority given to the seller to provide the possessory rights essential to the security of pledge. In other words, the pledgor is the purchaser, the seller only being his agent for the purposes of providing the essential real right in pursuance of their contract.

More difficult is the question "what is pledged?"

This/

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This question was posed by Devlin J. in Chao and Others v. British Traders and Shippers Ltd.,<sup>(151)</sup> when discussing possible prejudice to the right of the purchaser to reject the goods as disconform to contract. His solution is that the pledgor is dealing only with a conditional right in the goods.<sup>(152)</sup> Atkin L.J. in Hardy and Co. v. Hillerns and Fowler had put forward two possible views:

"One was that, notwithstanding that the documents had been tendered, the property in the goods did not pass until the goods had been examined or until an opportunity for examination had been given. The other was that it passed but only conditionally, at the time when the documents were tendered, and that it could be re-vested if the buyer properly rejected the goods."<sup>(153)</sup>

Devlin J.'s objections to the former were the lack of authority and the complications which would follow. The example chosen to illustrate the latter is unfortunate:

"If the property in the goods has not passed to him,<sup>(153a)</sup> how can the buyer pledge?"

But this is exactly what happens where the commercial credit is used to finance the transaction. Prior to the creation of the pledge there can by the very nature of things be no title in the purchaser.

Devlin J.'s/

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(151) [1954] 1 All E R 779.

(152) [1923] 2 KB 490.

(153) [1954] 1 All E R at p.795.

(153a) *ibid* at p.796.

Devlin J.'s solution is as follows:

"I think the true view is that, when the documents of title are given to the buyer, he obtains the property in the goods, subject to the condition that they re-vest if on examination he finds them not in accordance with the contract".<sup>(154)</sup>

In short, where the buyer pledges the goods or the documents of title he creates in the pledgee "a special property" in a "conditional property".<sup>(155)</sup>

As Davis<sup>(155)</sup> correctly points out, however, the bank's security, be it express or implied, is created when it pays against tender of the documents. Moreover, it is created by the hand of the seller with, presumably, full knowledge of the security rights of the bank. If the bank merely has possession, as we have suggested above, the property or ownership does not pass until the documents are passed to the eventual purchaser. The bank is not the purchaser's agent for the purposes of receiving delivery of the goods in terms of section 35 of the Sale of Goods Act 1893.<sup>(156)</sup> It may be questioned, therefore, whether Atkin L.J.'s first alternative should be rejected out of hand. It would certainly fit with the facts of the letter of credit situation. Any other would tend to make the credit transaction an exception and a theoretical anomaly.

The alternative which Devlin J. prefers (and there can be no question of one view being right and one wrong in absolute terms) would tend to support the theory that ownership/

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(154) [1954] 1 All E R at 796  
(155) Journal of Institute of Bankers at p.188. He also has the support of (1954) Vol.75 p.183.  
(156) 56 & 57 Vict c 71.

ownership passes at each stage of the credit transaction. This would be a theoretical reconciliation at the price of disregarding the intention of the parties. The only certainty in the situation, one which would be agreed by proponents of both theories, is that the holding of the bank is not "an act which is inconsistent with the ownership of the seller" in terms of s.35 of the 1893 Act.

The dictum of Devlin J. has been considered both by Gutteridge and Magrah and Professor Bennett Miller in his Casebook on Commercial Credits, although neither profess to have settled the point. Gutteridge and Magrah comment:

"Seeing that under an irrevocable credit, the pledge actually derives from the seller, acting either as principal or as the buyer's agent, if the seller by so pledging could destroy the buyer's right to reject, the whole purpose of documentary credits would be lost, at any rate so far as the buyer is concerned, because he could rarely afford to dispense with his right to reject".<sup>(157)</sup>

They emphasise two points of particular interest:

the role of the seller and the viability of the credit system.

In support of their argument that the seller is either a principal or the buyer's agent for the purposes of creating the security, they cite Lord Wright in Ross T. Smyth and Co. Ltd.<sup>(158)</sup> v. T.D. Bailey Son and Co.

"The/

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(157) p.139 and 140.

(158) [1940] 3 All E R at 68.

"The whole system of commercial credits depends on the seller's ability to give a charge on the goods and the policies of insurance".

This must be construed in the limited sense which we have indicated above, that the seller provides the possession necessary as the real right to complete the security contracted for between the purchaser and the bank. It is agency in the sense that the seller is directed how to make delivery by the purchaser.

The practical point is correctly treated by Professor Miller:

"The point made is cogent but its cogency is in relation to the usefulness of the credit as an instrument of commerce and does not resolve the perplexities of the legal theory surrounding the  
(159)  
credit".

McCardie J. in Diamond Alkali Export Corporation v. Bourgeois (160)  
reinforced this when he admitted that his decision might be disturbing to business men but that he could not be dictated to by views of convenience.

One of the few consolations in dealing with this topic of law in which we have been unable to be dogmatic in our conclusions is that the suggested approach avoids this conflict of theory and practice.

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(159) Casebook: p.103.

(160) [1921] 3 K.B. 443 at 455.

THE REALISATION OF THE BANKER'S SECURITY

UNDER THE LETTER OF CREDIT

The banker's security under the letter of credit and the realisation of that security have to a certain extent been treated as separate topics by the academic writers who have studied this field of law. Nor is this merely a concession by them to chronological order. For English writers, the realisation of the security involves the introduction of further concepts, of further documents such as letters of hypothecation, lien and trust. These are variously defined by reference to English technical terms such as bailment, custody and equitable charge. The picture drawn in this way is, not surprisingly, most unsatisfactory so far as Scots law is concerned.

The approach of the present writer has accepted that the realisation of the security must be examined separately and in detail. It will be suggested, however, on the basis of arguments to follow, that the security and the realisation thereof are merely parts of a theoretical and logical whole and that any concession to chronology is merely that, not an admission of concepts and terms which are not accepted in Scots law.

If the Scottish position is to be regarded as following  
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a logical unity, the English authorities offer a wide selection of technical weapons to deal with the difficulty that is encountered. This difficulty is felt to be inherent in the fact that, commercially, realisation can only expediently be accomplished by allowing the customer to sell the goods for the highest price obtainable on the open market. To do this, the customer must clearly have the documents of title. And it is at this point that the possible prejudice to the banker's position arises and for this purpose that the document variously known as the "letter of hypothecation", "letter of trust", "letter of lien" or "trust receipt" has evolved.

Whether this difficulty is real or imagined is, of course, crucial in any discussion of the suggested solution and this will be the subject of later discussion. <sup>(1)</sup> It may be that the only conclusion possible is that not only the security of the banker but his means of realising it exist in terms of the letter of credit, and that further documents are superfluous.

The terms used must, however, be discussed in outline at least, and there are available several helpful definitions. It must be pointed out that letters of trust, lien and hypothec are to some extent used interchangeably, by academics and courts alike, and that rigid differentiation may lead to artificial difficulties. <sup>(2)</sup> "Hypothecation" is defined by Gloag and Irvine as

"a real right in security, in favour of a creditor,  
over/

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- (1) See p.25 hereof and following pages.  
(2) For a discussion of this term and its particular "meaning" for Scots law, T.B. Smith's: A Short Commentary on the Law of Scotland at p.472 et seq.



over subjects which are allowed to remain in the possession of the debtor".<sup>(3)</sup>

When used in the special context of banking transactions, it has been suggested that

"hypothecation may, so far as <sup>the</sup> goods are concerned, be regarded as a conversion of the possession of the owner of goods into that of a bailee from the pledgee, or as an equitable agreement by the owner to create a pledge at a future date".<sup>(4)</sup>

In contra-distinction to hypothec, a lien<sup>(5)</sup> describes a right of retention of the possession of subjects, a right which may be limited by reference to a single contract or which may apply within a course of dealing to a right to retain for a balance outstanding. Lien, then, is based on possession, hypothec being independent of and unrelated to possession. Both of these concepts are recognised by Scots authorities in particular fields; and it may well be that letters of hypothecation and lien are appropriate shorthand descriptions of mercantile devices. The letter of trust is, however, defined exclusively by reference to its use:

"The object of the letter of trust is to enable the banker as pledgee of the bill of lading to redeliver it to the buyer without forfeiting his rights as pledgee by parting with possession ..... The rights enjoyed by a banker ..... are clearly of an equitable/

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(3) p.406.

(4) G & M p.141.

(5) loosely used by Scrutton L.J. in Rosenberg (1923) 14 Le L R 344 at 347.

equitable character".<sup>(6)</sup>

"The relationship appears to be partly bailment, partly agency, and partly trust".<sup>(7)</sup>

And for bailment,<sup>(8)</sup> we must refer to English authority:

"the delivery of the possession of goods on a condition, express or implied, that they shall be returned to the bailor or dealt with according to his directions as soon as the purpose for which they were bailed is ended.<sup>(9)</sup> There are many common everyday transactions of bailment" - "for mere custody, for loan, for hire, for pledge, for carriage".<sup>(10)</sup>

These few definitions illustrate the difficulties which face a Scots lawyer in dealing with this field of law. It is necessary to examine how the concepts have been applied before their authority can be estimated.

Early judicial statements are of doubtful relevance in view of their concern with particular English statutory provisions. For example, in Ayers and Others v. The South Australian Banking Company,<sup>(11)</sup> a Privy Council decision, the respondents relied on an agreement for "preferential lien", an artificial device supported by an Australian statute of 1855; the/

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(6) G & M p.142-3.

(7) Davis p.190.

(8) See also Pollock and Wright: Possession p.163 and <sup>generally</sup> Paton: Bailment (1952).

(9) Steven's Merc. Law 14th Ed. p.444.

(10) Examples given in Anson's Law of Contract, 18th Ed. at p.111

(11) (1871) LR 3 P.C.548.

the issues were special and the case is of interest only for its illustration of the fact that special security devices may be justified, and indeed supported by statute, in particular economic situations. The following year, the case of in re Slee e.p. North Western Bank<sup>(12)</sup> was decided and the court were faced with many of the terms which now call for comment: hypothecation, equitable charge, pledge and reputed ownership. A warehousekeeper had "pledged" certain goods with the bank in terms of a "letter of hypothecation", no possession thereof <sup>OR?</sup> of warrants therefor being granted by the warehousekeeper, although delivery of the latter was promised. The bank obtained possession through an employee of the warehousekeeper only after the latter had absconded and the question arose as to whether or not they had acquired a good security title.

Sir James Bacon C.J. held that they had, differing only from the judge at first instance as regards the nature of the warehousekeeper's rights. Provided that the property was the warehousekeeper's to deal with, the learned judge held that the "hypothecation might operate as an equitable charge"<sup>(13)</sup>. The nature of the bank's holding is not entirely clear. The bank are spoken of as "true owners" and later:

"The mode in which the advance was made was in the ordinary course of trade, the engagements entered into by the bankrupt were complete, and the goods from that time were charged with the loan of, and became the property/

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(12) (1872) LR 15 Eq.69. See also Regina V. Townshend (1884) Cox CC 466 referring to this decision and using the term "hypothecation note".

(13) *ibid* p.73.

(14)  
property of, the bankers".

In Lutscher v. The Comptoir D' Escompte de Paris (15) the right of the security-holder was again discussed; the facts can very shortly be given in the words of Cockburn C.J:

"there was a specific engagement between the plaintiff and the consignor that the goods should be bought with money advanced by the plaintiff and that the bill of lading should be forwarded to the plaintiff as security (16) for his advance".

When bankruptcy supervened the court were asked to enforce the agreement by obtaining the release of the goods to the plaintiffs. It was held that there was a clear equitable right in the plaintiffs which would be protected by a court of equity particularly where third party interests did not intervene.

Third party rights did call for protection, however, in (17) the later case of Joseph v. Lyons in 1884. This case turned partly on the special position in English law of "chattels after-acquired (i.e. after an agreement concerning them had been made between mortgagor and mortgagee) to be sold in the course of trade" and much of the legal debate concerns differences between legal and equitable remedies. A jeweller assigned stock to be acquired to the plaintiff with a proviso for redemption; in breach of this agreement, the stock was thereafter pledged to the defendant. There was an attempt to argue/

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(14) *ibid* .

(15) (1876) 1 Q.B.D. 709.

(16) *ibid* at 712.

(17) (1884) LR 15 QB 280.

argue that the jeweller was acting as a factor for the mortgagee but Lindley L.J., supported by the court, said:

"how can a mortgagor of chattels to be sold in the course of a trade be the agent of the mortgagee?"<sup>(18)</sup>

It is at this point that the English court drew the line, rather later than a Scottish court would, between "only an interest and not the property in the goods" passing.<sup>(19)</sup> The Factors Acts were held not to apply on the grounds that the jeweller was selling on his own account in order to repay his debt; "the Factors Acts relate to one who sells for a principal". Similarly, of course, this argument can be put forward as regards the position of the banker in a commercial credit transaction; at what point does the banker become in any real sense the principal? What if the goods are never in fact delivered to him in terms of the documents of title?

Few of these authorities examine closely the nature of the security documents with which they deal. Contrasting with in re Slee e.p. North Western Bank<sup>(20)</sup> are the discussions of the concepts of "property" and "control" contained in the case of re Hamilton, Young and Co. e.p. Carter.<sup>(21)</sup> Letters of lien were the instruments at issue and the practice regarding them was described in detail by Vaughan Williams L.J.<sup>(22)</sup> The letter of lien narrated that goods were "held on account and under lien" for the security-holder with an undertaking that indorsed bills/

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(18) *ibid* p.282.

(19) *ibid* p.284.

(20) (1872) LR 15 Eq.69.

(21) [1905] 2KB 772.

(22) *ibid* 784.

bills of lading would be delivered to the security-holder on shipment of the goods. Vaughan Williams L.J. distinguished the management and control of the borrower from the sole right of the bank who, until they received bills of lading, had only a right in equity to restrain the borrower from doing anything inconsistent with the security. In apparent contradiction to this statement the court held that the letters of lien were "documents used in the ordinary course of business as proof of the possession or control of the goods". It is to be noted that the possession referred to is closely identified with control and the judgment of Vaughan Williams L.J. leaves little doubt that in practice the "lien-holder" did not have practical control. The use of the word "lien" is also unfortunate in that there is no suggestion of actual possession either of the goods or bills of lading by the security-holder.

The limitations of the equitable charge or mortgage of goods without possession thereof are illustrated in Ladenburg and Co. v. Goodwin, Ferreira and Co. Ltd. <sup>(23)</sup> where sellers of goods attempted to give their bankers security rights over goods sold to South American customers. Pickford J.'s decision, which was not appealed, is attractive in its simplicity and clarity, although the point at issue eventually turned yet again on the construction of an English statute:

"In the circumstances of this case it is difficult to see how any valid charge or mortgage on the goods could/

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(23) [1912] 3 KB 275.

could have been given to the plaintiffs, for there was no interest in the goods remaining in the defendant company....Therefore the only thing remaining which could be the subject of hypothecation was the proceeds (24) of the goods".

When this judgment was referred to in re David Allester, (25) it was distinguished on the basis that "the bank had no pledge or other right in the goods at all before the transaction in question". And it is in the judgment of Astbury J, a judgment dealing principally with technicalities of English statutes, that we find one of the clearest expositions on the rights of the bank, as security-holder, to realise its security:

"The pledge rights of the bank were complete on the deposit of the bills of lading and other documents of title. These letters of trust are mere records of trust authorities given by the bank and accepted by the company stating the terms on which the pledgors were authorised to realise the goods on the pledgee's behalf. The bank's pledge and its rights as pledgee do not arise under these documents at all, but under the (26) original pledge".

The justification for this is clearly business (27) convenience supported by such precedents as e.p. Hubbard and North/

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(24) *ibid* p.280.

(25) [1922] 2 Ch 211 at 218.

(26) *ibid* p.216.

(27) (1886) 17 Q.B.D. 690.

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North Western Bank v. Poynter. As to the letters of trust which had been drawn up to cover the realisation, they were "mere records of authorities given to the pledgors to act as trustee agents for sale on behalf of the bank".<sup>(29)</sup>

Very similar authority, though couched in different terms, is offered by the Privy Council decision in Official Assignee of Madras v. Mercantile Bank of India.<sup>(30)</sup> The main question at issue was that of the "pledge" of documents in security, the topic which was dealt with in detail in the earlier discussion on this point. After detailed examination of this, however, the Privy Council, in the judgment delivered by Lord Wright, disposed of the contention that the respondents had parted with their pledge on these goods by giving back possession of the railway receipts to the insolvents. It was held that this contention was based on a misuse of the word "possession". "The respondents did not part with the possession of the goods or the receipts in the juridical sense of that word; they merely parted with the custody, by entrusting the receipts to the insolvents as their agents or mandatories for the special purpose of convenient dealing with the goods".<sup>(31)</sup> This, it was said, was in the usual course of business. Obiter, in as much as the above conclusions were sufficient to dispose of the appeal, the letter of hypothecation was defined in terms substantially the same as those/

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(28) supra cit.

(29) [1922] 2 Ch at 217

(30) [1935] AC 53.

(31) ibid p.63-64.



those of Astbury J. in David Allester's case. The Privy Council, however, could not resist the further comment that the "letter of hypothecation constitutes a good equitable charge".

"Equitable charge" or "equitable assignment" was the subject of the earlier case of Palmer v. Carey,<sup>(32)</sup> also a decision of the Privy Council; in contrast to the attractively simple explanations quoted above, this case highlights the subtleties of the technical term "equitable charge" and its relative unsuitability for adoption into Scots law. The principle approved and discussed was laid down by Lord Truro in Rodick v. Gandell<sup>(33)</sup> as follows:

"an agreement between a debtor and a creditor that the debt owing shall be paid out of a specific fund coming to the debtor, or an order given by a debtor to his creditor upon a person owing money or holding funds belonging to the giver of the order, directing such person to pay such funds to the creditor, will create a valid equitable charge upon such fund, in other words, will operate as an equitable assignment of the debts or fund to which the order refers".

The two elements necessary are the agreement and the fact that an obligation has been imposed in favour of the creditor to pay the debt out of the fund received from the sale of the goods. It was on the latter that the case turned, and the words of the Chief Justice, endorsed by the Privy Council, show the importance/

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(32) [1926] AC 703.

(33) 1 D.M. and G. 763, 777 and 778.

importance which is attached to the words of the agreement: (34)

"The words of the agreement on which the appellant relies are apt to express a contract by the bankrupt to apply the money in the purchase of goods, to sell those goods, and to pay the proceeds of the sale into the appellant's bank account, but I can see nothing in them to indicate that the intention was to assign any interest in goods purchased by the bankrupt or to create either a charge over or a trust of such goods in favour of the appellant".

Lloyds Bank Ltd. v. Bank of America National Trust and Savings Association (35) came before the courts in 1937 and provided a discussion of the position of the pledgor who is given possession in order to effect a sale on behalf of the pledgee. The bank had given banking accommodation to a company Strauss and Co. Ltd. in exchange for the security of certain bills of lading and invoices, the terms of the transaction being set out in a letter of hypothecation and two agreements. The bank surrendered the goods to Strauss and Co. to enable them to sell the goods, this being a course of business which the two parties had followed for a number of years. On this occasion, however, Strauss and Co. pledged the documents with the defendants who were acting in completely good faith. In the action by the plaintiffs for recovery of the documents, the decision turned on an application of the Factors Acts and on the construction of the terms "possession" and "ownership". At first instance, Porter J./

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(34) [1926] AC.707.

(35) [1937] 2 KB 631 and [1938] 2 KB 147.

Porter J. held that the plaintiffs could not succeed as they were owners of the goods and Strauss and Co. were their mercantile agents for the purpose of sale: "Looking at their mandate, namely, the trust receipts, I think they were employed as agents";<sup>(36)</sup> the learned judge referred to such cases as North Western Bank, in re David Allester and the Official Assignee of Madras.<sup>(37)</sup> On appeal the result was upheld, although Sir Wilfrid Greene M.R. found it difficult to be as dogmatic as Porter J. when talking about the respective ownership and possessory rights of Strauss and Co. and the bank:

"It seems to me that, where the right of ownership has become divided among two or more persons in such a way that the acts which the section (s.2(1) Factors Act 1889) is contemplating could never be authorised/<sup>save</sup> by both or all of them, these persons together constitute the owner".<sup>(38)</sup>

The situation in which a third party is asked to sell should be identified with that where the merchant himself re-takes possession. The learned judge stated also his alternative ratio as being that the bank were given, by virtue of the contract, all the rights of ownership over the goods, in which case Strauss and Co. were in possession with the consent/

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(36) [1937] 2 KB at 639.

(37) [1938] 2 KB 147.

(38) ibid at 162. See also pp.163 and 164.

(39)

consent of the owners.

It was contended in argument before the court that the trust receipt did not create an agency relationship but merely released the general property of Strauss and Co. from the bank's pledge. This emphasis on the general property of the pledgor was held to be misconceived in as much as Strauss and Co. were only given re-possession in terms of and on the faith of the trust receipt. Their capacity to sell was, it was suggested, completely expressed as that of a "trust agent", and although this would seem to contradict the learned judge's earlier treatment of the ownership question, it is clear that the trust agency was really no more than a mercantile agency in the sense of the Factors Acts. Too much must not be read into the continued use of the word "trust" in discussing the position of the merchant, and it may be that it only confuses the position. (40)

The practical point that the result of the case might discourage security-holders from releasing documents of title to the original pledgors was put into perspective by Lord Justice MacKinnon:

"The truth is that almost every aspect of commercial dealing is not proof against the possible result of the frauds, that a lawyer, thinking of the possibilities of such things, might suppose to be so easy, but which in business in fact occur so rarely ..... I have no doubt that this very convenient business method will continue; and can do so because the whole basis of business rests upon/

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(39) *ibid* p.164.

(40) *ibid* p.165.

upon honesty and good faith, and it is very rarely  
(41)  
that dishonesty or bad faith undermines it". (42)

Mercantile Bank of India v. Central Bank of India

concerned a similar mercantile practice, whereby railway receipts were pledged as security for a loan with a bank. The bank on this occasion passed the receipts to their own warehouse-keeper who in turn released them to the pledgors for the specific purpose of uplifting the goods and storing them in the bank's warehouse. The merchants fraudulently pledged the documents with another bank with whom they had been in the habit of dealing and the question arose as to the right of the first bank in the goods. In distinction to Lloyds Bank, the Privy Council held that the first bank had dealt with "their own property" in the usual course of business and that there were no grounds on which they could be estopped from asserting their title. The very clear principle on which the decision was based was that estoppel or personal bar existed only where there was some related duty. Of more interest to the present discussion, however, was the strict construction applied to the passing of the receipts from bank to warehouse-keeper to pledgor, and the clear indication that the special provisions of the Factors Acts will materially alter the respective positions of the parties. The facts of this case were of course unusual and in most instances there will be no doubt that the Acts apply. It has been/

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(41) [1938] 2 KB at 166.

(42) [1938] AC 287.

been clearly held, as we have seen, that a pledgor can for the purpose of a pledgee realising his security be considered to be a mercantile agent.

We have now examined most of the English authorities which tend to throw some light on the theoretical relationship between the pledgor and the security-holder wishing to realise his security and certain conclusions can be drawn. There has been no attempt to exhaustively investigate the meaning of the various technical terms used by the English courts. Some of them have been defined in passing. But many of them are so closely related to the individual facts of the case as to defy accurate definition, and even such terms as "equitable charge" and "assignment", defined by Lord Truro above, have caused difficulties in comparatively recent cases, as, for example, in in re Kent and Sussex Sawmills Ltd.<sup>(43)</sup> where the registration of a charge on the book debts of a company was at issue. In re David Allester<sup>(44)</sup> also illustrated the fact that technical statutory requirements can place a strain on the definition of terms which might otherwise be used quite loosely. And on occasions the English courts have been unable to avoid confusing the technical with the straight-forward e.g. in Official Assignee of Madras. Although this has not led to inconsistency of decision, it makes the rationalisation of the various authorities extremely difficult and the over-riding principles/

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(43) [1946] 2 All ER 638.

(44) supra cit.

principles rather obscure. It is also the writer's opinion that the too-ready recourse to the technical term has concealed the substantial similarity of the English and the Scots approaches. And this is the theme which it is now intended to develop and justify at some length.

As we have seen, many of the technicalities introduced into English law to deal with the realisation of the security are superfluous. Others, such as lien and hypothecation, are not strangers to Scots law though their application may be somewhat restricted. Hypothecation is an exception to the general rule that a security over moveables can only be maintained by a security-holder so long as possession or control is retained. It is generally true to say that only a security perfected by the passing of possession or ownership will convey the right to realise the security subjects if such becomes necessary, but the lesser right of control, such as the control of title-deeds or of documents falling short of documents of title, may have a substantial nuisance value to the "security" holder.

Hypothecation as a doctrine has always been strictly construed by Scots law. Stair's justification of this is well-known: so "that commerce may be the more sure, and everyone (45) may more easily know his condition with whom he contracts"; and, statutory exceptions such as floating charges and hire purchase notwithstanding, this has remained the foundation of the/

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(45) Institutions I.14.

the Scots law of securities. Hypothecs are of two types: tacit, or legal, and conventional. "A tacit hypothec is a species of pledge," said Erskine, (46) "constituted without paction, in which the debtor retains the possession of the subject impignorated". It must be noted in passing that pledge is misused in this context in that the creation of pledge, strictly speaking, is completely dependant on possession. It is preferable to consider hypothecs as anomalies in modern law justified by the special situations in which they operate. There are three classes who are thought to merit this protection: law agents, (46a) landlords and superiors; and there is a small group of maritime hypothecs protecting those with rights against ships. Conventional hypothecs are completely restricted to the maritime securities of bonds of bottomry and respondentia. (47) And although the commercial credit operates most frequently in a framework of bills of lading and marine transport it is well-settled that no new hypothecs can be created.

If, therefore, the term "letter of hypothecation" is to be used to describe a document which is undoubtedly in common use by banks in obtaining a realisation of their security, or in providing the borrower with the means by which he can realise "his" goods and repay the bank, it is only in the sense that the "security-holder" sacrifices the possession normally essential outwith the narrow ranges of hypothec. In Official/

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(46) 3.1.34.

(46a) Unfortunately only in one very special case!

(47) See Gloag and Irvine p.406 et seq. and the Institutional authorities there referred to.



Official Assignee of Madras the Privy Council stated:

"the letter of hypothecation creates a good equitable  
(48)  
charge".

Against this we must weigh the statement of Gloag and Irvine that "the doctrine of equitable mortgage is unknown to the law  
(48a)  
of Scotland" and the authorities cited by those learned writers. Scots law insists on a completed transfer or assignation, and the final test of a security, the bankruptcy of the borrower, illustrates the need for some formal conveyance and intimation.

The contrasting approaches of Scots and English law are illustrated in their treatment of the delivery of share certificates and policies of assurance. In England if there is a transfer of these documents accompanied by an intention that they  
(49)  
should serve as security, there is created an equitable mortgage. Scots law insists on a formal assignation.

(50)  
In Robertson v. The British Linen Co., a company limited by guarantee and empowered to create a guarantee fund was apparently authorised (in terms of its memorandum and articles of association) and did in fact attempt to pass letters of guarantee from subscribers to the fund to the bank by way of security for an advance; the question then arose on the voluntary liquidation of the company as to whether or not the security was effective. Both Hume and Bell were cited in the judgment of the Lord  
(51)  
Ordinary, Stormonth Darling, and apart from the decision/

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(48) [1935] AC 53 at

(48a) supra cit at p.520.

(49) See Société Generale de Paris v. Walker(1885) 11 AC 20.

(50) (1891) 18 R 229.

(51) ibid at 1232.

decision on the powers of the company, it was held that the pretended lien or hypothecation was ineffective. The company's constitution could not validate a security which was bad at common law. While the facts of the case were very special, this was a clear indorsement of the general principles of Scots law that possession is an integral part of a proper security and that in the normal case delivery of documents can not be treated as equivalent thereto. Christie v. Ruxton,<sup>(52)</sup> already discussed, was also referred to with approval.

We must now turn to the decision which, for Scots law, should have answered many of the questions which long remained unsolved.

In North Western Bank v. Poynter Son and Macdonald, a case whose importance for Scots law has already been considered in another context, the terms of the security agreement referred to the nature of the security as pledge and continued:<sup>(53)</sup>

"It is distinctly agreed that we are to have immediate and absolute power of sale, and under that power we authorise and empower you to enter into contracts for the sale of the merchandise on our behalf in the ordinary course of business, and we expressly direct you to pay to us from time to time the proceeds of all such sales immediately and specifically as received by you to be applied toward payment of the said advance, interest, commission, and all charges".

In the normal course of business the bills of lading were thereafter re-delivered to the pledgor in terms of a letter/

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(52) (1862) 24 D 1182.

(53) [1895] AC at p.57.

letter which narrated:

"we transfer to you as trustees for us the bill of lading ..... and we further authorise and empower you to enter into contracts for the sale of merchandise (54) on our behalf".

The interpretation of "trustees" selling for principals was supported by Counsel for the appellants, the reasoning going so far as to argue that trust money from the sale could not be arrested to found jurisdiction. The case, as has been pointed out, was professedly decided on Scots law. And the House of Lords showed no disinclination to take the agreement on its face value. It will be noted that the letter accompanying the transference from bank to borrower of the bill of lading was in very similar terms to those of the pledge agreement itself. The letter was not a "letter of hypothecation" in a formal sense; it did not profess to be a security document as such, although it was in similar terms to those documents which have been the subject of the English cases discussed. As to the position in English law the Lord Chancellor felt no doubt; it was only because the Court felt that Scots law had to be applied that any question of difficulty arose. We have already argued that the nature of the security should be accepted as being pledge, and, pace J.J. Gow, (55) it is submitted that it is only on this basis that the conclusions of the learned judges have any meaning whatsoever. Lord Chancellor Herschell pointed out that something more than pledge/

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(54) *ibid* p.58.

(55) p.274.

pledge was given to the bank but this was only in the sense that an additional power of sale was given; and the general propositions are still valid, it is submitted, in the context of "pure" pledge. Erskine's <sup>(55a)</sup> statement that "the creditor who quits the possession of the subject loses the real right he had" <sup>(56)</sup> is distinguished as not covering the situation where possession is parted with only for a particular purpose. And since it is established that possession can be given to a third party without prejudice to the security, and since sale could be carried through similarly without prejudice, at least in so far as a third party was employed, there can be little doubt, it is respectfully agreed, that Erskine's limited advice must be distinguished.

The view expressed in Bell's Commentaries, although in <sup>(56)</sup> considerably more detail, likewise fell to be distinguished by the learned Lord Chancellor. Voet's clear expression of disapproval of the Roman theory by which the possession of the pledge goods could be surrendered to the debtor on the basis of a separate contract is cited and endorsed in the following terms:

"the doctrine delivered by Voet is sound, where the possession is given up without necessity to the owner <sup>(56a)</sup> of the goods"

The/

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(55a) 3.1.33.

(56) [1895] AC at p.69 et seq.

(56a) ibid p.70.

The Lord Chancellor distinguished this authority on the basis that the surrender in question was not only necessary but in the ordinary course of the administration of the security. In as much as sale is not within the normal scope of the pledgee's powers, it might be argued that sale would be treated as an exceptional case. Where, however, the right of sale was expressly conveyed, it would be anomalous to allow the pledgee unrestricted powers of management and yet to prejudice his security when he took steps to realise his security by virtue of specific terms designed to make the security commercially viable. It is not disputed that surrender of possession involves the possibility of fraud: the pledgor may sell or pledge in breach of the agreement. But sale is not a special case. The risk is, of course, placed in perspective by Lord Justice Mackinnon in Lloyds Bank,<sup>(58)</sup> and the contrary decision in Tod proceeded on the basis of a different interpretation of the facts, namely that the pledgor could not be said to make the sales on behalf of the pledgee.

A few words must again be said here as to the framework within which these theories will operate. The credit issued necessarily involves the tender in security of the shipping documents, and the pledge agreement must be made specifically with the bank. The bills of lading may either be indorsed or made out originally in the bank's favour, failing which the bills/

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(57) [1938] 2 KB at 166.

(58) Tod & Son v. Merchant Banking Co. (1883) 10 R 1009.

bills may be indorsed in blank and transferred to the bank. The third possibility, namely that the bills are in name of the eventual purchaser or borrower, although extremely unlikely to occur in practice, does raise a different problem. It is suggested that in this situation the bank is merely receiving custody of the shipping documents in much the same way as banks in practice often hold the heritable titles of a customer. There is no pledge since the element of possession is absent: there is no physical possession of the goods, nor is there the means to control the goods. And if in this situation the bank were to surrender the bills of lading for purposes of realising their "security," it is thought that they would lose whatever security their tenure gave them. On the other hand, their "security" has a nuisance value in as much as they can prevent their customer obtaining access to "his" goods for the purpose of selling them. To release their hold on the shipping documents the bank could quite competently convert their holding into that of pledge simply by obtaining their customers' indorsement in blank and thereafter the documents could be returned to the customer, as in North Western Bank, for re-sale. A similar device would be available to the bank in the unlikely event of no express right of sale being given; the bank would only release the documents on their right of sale being made an express part of the security agreement. What if this was not done? In that case the bank's release of the pledge for the purpose of sale would not/

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not be the release of control to an agent for the purpose of carrying out something in the bank's power. Quite simply, the "agent" could not as an agent do something, namely sell the subjects, which was not in the bank's powers. Authority for this proposition is clearly expressed in the judgment of Lord Chancellor Herschell in North Western Bank <sup>(59)</sup> where he is talking about Tod and Son v. Merchant Banking Corporation.

Davis suggests at page 190 that "the written acceptance of [the letter of trust's] terms by the customer amounts to a trust receipt". With respect, it seems unlikely that any acceptance is necessary except in so far as there must clearly be a security agreement prior to the security situation arising. Where a letter is issued by the bank in terms closely related to the original pledge agreement, as in North Western Bank, acceptance of terms is unnecessary. Receipt of the documents with instructions to sell is sufficient in itself. And Davis appears to accept this later when he says:

"the letter of trust thus merely evidences the  
reached  
agreement/between the banker and his customer .....

[ who ] does not become a trustee in the commonly accented meaning of that term, as the banker does not divest himself thereby of the property which he has in the goods". <sup>(60)</sup>

The/

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(59) [1895] AC at 71.

(60) Davis supra cit p.190.

The notion that the customer acts as the bank's agent now calls for some examination. For the purposes of the Factors Acts a "mercantile agent" is defined as "a mercantile agent having in the customary course of his business as such agent authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods, or to raise money on the security of goods"<sup>(61)</sup>. Where the pledgor obtains possession of the documents of title, he does so as an agent whose business at least involves buying and selling in commercial circles. Moreover, the security device is by no means an unusual one; it is a normal method of financing foreign business; and although the particular transaction may be the first of its type in which the pledgor has become involved, this is apparently irrelevant. There is no requirement that the agent should be one selling in his normal business capacity of mercantile agent. In Lowther v. Harris,<sup>(62)</sup> the judgment of Mr. Justice Wright dealt with this point. An art dealer agreed to sell for a customer certain furniture and a tapestry. He was an agent for one principal only. It was held by the learned judge that this was irrelevant. He emphasised that the duties of the art dealer were extensive, covering the conclusion of a bargain, the delivery of the goods, the collection of the price and a subsequent accounting to the plaintiff. Earlier authority was discussed, and although it may be that the learned/

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(61) s1(1) Factors Act 1889. (52 and 53 Vict. c.45)

(62) [1927] 1KB 393.



learned judge's reasoning was not entirely consistent, his conclusion has not been challenged. The duties of the agent in this case were extremely similar to those of the selling pledgor in the commercial credit transaction, and the English authorities we have above referred to in another context (63) seem to confirm that the application of the Factors Acts is extremely broad.

It must be remembered that the agency of the pledgor will in most cases be a specific term of the agreement and even if it is not, it is submitted that the pledgor's dual capacity is no more inconsistent than the relationships between the various parties to the commercial credit transaction being defined almost exclusively in terms of agency. It seems also to be clear that the agency concept must be applied to its logical conclusions, subject to the inherent limitation that the agency is strictly ad hoc.

The bank's right of sale, being only in terms of the security agreement, must be construed according to that agreement. In North Western Bank the agreement stipulated:

"It is distinctly agreed that we are to have immediate and absolute power of sale". (64)

And Gutteridge and Magrah's style states:

"we give you full discretionary power of sale over the merchandise at such times, either before or after arrival,/"

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(63) See e.g. Lloyds Bank [1937] 2 K.B. 631.

(64) [1895] AC at 57.

(65)  
arrival, as you may deem fit".

In England, the bank has a common law right of sale. Lord Justice Scrutton in Rosenberg v. International Banking Corporation said: "bankers' liens or bankers' pledges, effected in such a way, give, according to the views of merchants, the bankers a right of sale". (68) There has been a certain amount of judicial discussion as to how this power should be exercised. In in re Richardson (66) it was suggested that reasonable notice should be given to a pledgor if no time for sale had been specifically contracted for. This was (67) endorsed a year later by Lord Justice Cotton in in re Morritt. When the requirement for reasonable notice was considered by Vaughan Williams L.J. its justification was quite clear:

"to give the mortgagor a reasonable opportunity to (69) redeem".

While bankers and merchants in Scotland might also feel, as Lord Justice Scrutton did, that there is an implied right of sale, it is suggested that it is correct to say that to be effective the right must be expressly conferred on the Scots pledgee. That being so, the question is one of construing the express right. It is suggested that the term allowing the security-holder this further power would fall/

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(65) p.195. Appendix C.

(66) (1885) 30 Ch 396 at 403.

(67) (1886) 18 Q.B.D. 222 at 232.

(68) (1923) 14 Le LR 344 at 347.

(69) [1902] 1 Ch 579 at 590.

fall to be construed contra proferentem, although this canon of construction is a judicial device which has not yet required to be considered by the Scottish courts in this context. Its application would, however, be tempered in that it should properly only operate where there is some ambiguity. Nothing could be clearer than the bank's stipulation in North Western Bank that it should have "immediate and absolute right of sale". The credit and the security are so interwoven as to make this entirely justified; and the commercial situation of the parties might well make any requirement of notice inconvenient or, at the very least, economically hazardous. In practice, of course, the bank would exercise its power with due regard to the interests of the debtor and this duty is one which would, it is thought, be enforced by law.<sup>(70)</sup> The resultant position, then, may not be so very far removed from that of English law, but it is well to remember that the underlying theories are by no means uniform.

The content of this Paper has been devoted to the rights of the banker as security-holder i.e. the issuer of the credit. Other parties have, however, an interest in the security subjects and whether or not their interests receive similar protection has also been the subject of discussion. Davis is quite clear that parties other than the issuing banker "are not in such a favoured position"<sup>(71)</sup> and reference/

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(70) Ferguson v. Grant (1856) 18 D 536.

(71) at p.202.

reference is made to the well-known judgment of Lord Justice Cairns in *Banner v. Johnstone*:<sup>(72)</sup>

"The order to send home the shipping documents and the condition annexed to the promise to accept - that the shipping documents shall be sent to them - are for the protection of the bankers and not, as it seems to me in any way for the protection of the persons who negotiate the bills of exchange".<sup>(73)</sup>

This case concerns documents which are presented to the bank and accepted in terms of the credit. At that point of time, the presenter "no longer" has any security over the security subjects. In the words of Lord Cairns again, "that cotton passes into the hands of the bankers themselves".<sup>(73)</sup> This, however, is no more than an application of the general rule which restricts security without possession, and Lord Chancellor Hatherley correctly, it is respectfully suggested, puts the position in perspective when he says:

"the result would be that in the case of every one letter of credit of this kind, the bankers giving it would be held to constitute themselves trustees for every bill-holder ..... and they would be held bound, as trustees for the various bill-holders, to keep a separate account of the proceeds of the goods consigned to them by way of security".<sup>(74)</sup>

These/

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(72) (1871) LR 5HL 157.

(73) supra cit at p.174.

(74) ibid p.168.

These dicta are confirmed in later authorities and, a fortiori, would be followed in Scots courts. They do not, however (nor do they profess to) apply to the situation of the third party or interim-holder of the security documents.

THE BANKER'S LIEN

The concepts of lien, pledge and hypothec are of central importance in the consideration of the special nature and extent of the banker's security over moveables; that of lien is of particular interest in as much as the law has conceded that the banker has special interests which should be and require to be protected and has bestowed on him a general lien with its own particular characteristics and difficulties.  
(2a)

Lord McLaren in Robertson's Trustee v. The Royal Bank of Scotland stated:  
(1)

"It is a general principle in our law that every agent has a lien or right of retention against his principal for the balance due to him, and this right of retention is not confined to moneys collected, such as rents and dividends, but may extend to securities, the precise extent of the lien being determined by the nature or character of the agency. The so-called banker lien is an example of this rule of law".

Gloag and Irvine defined "retention" as "a right to resist a demand for payment or performance till some counter obligation be paid or performed".  
(2) While the conjunction of these two statements does shed some light on the nature of the banker's lien, the definition is by no means complete. The characteristics of/

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(1) (1890) 18 R 12 at 19.

(2) at p.303.

(2a) The concepts of "pledge" and "hypothec" received more detailed discussion in the first two chapters.

of lien are its emphasis on the possession of the security-holder and the fact that the security arises by implication from the relationship under which it is created.

Lien is prima facie a "nuisance" security; with one exception of considerable importance which will be considered later, it enforces performance or payment rather than itself providing the means for the performance or payment. And in this it is unique. The retention of title deeds by a bank "in security" of an advance made in connection with heritage is also often spoken of as a nuisance security. <sup>(3)</sup> Lien, however, gives a more effective security than this. In the course of the business relationship the power of the lien can induce the lender to provide accommodation, dictate the terms on which he will lend and allow him effectively to control the financial mobility of the borrower. It gives a floating security - it comprises whatever is in fact held by the lender, always provided that it is capable of being subjected to a lien. Moreover, on the bankruptcy of the borrower, the lender is given protection for his security providing that possession is retained throughout.

Lien has most frequently been defined by example only, by an explanation of the circumstances in which it arises. As in so many other legal definitions (so-called) the definitive sentence merely serves to highlight the conflicts of/

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(3) the nuisance element of which is in large measure eliminated by section 45 of the Conveyancing and Feudal Reform (Scotland) Act 1970. (c.35)

of writers of great authority. In contrast to Lord McLaren's judgment cited above, Gloag and Irvine state:

"Originally, indeed, it would appear that the doctrine of retention is a part of the law of Scotland, derived from the civil law, while lien is an equitable right introduced from the law of England"<sup>(4)</sup>.

The distinction which has been justified by Professor More does seem artificial, if not untenable, and it is respectfully submitted that it is now of historical significance only and that for all practical purposes the terms are synonymous.<sup>(5)</sup>

There is little doubt that, whatever its origin, retention is by nature an "equitable" security, and it may well be that lien and retention are merely derivatives of an original remedy which both legal systems, Scots and English, acknowledged as being commercially expedient. Within certain limitations, English authorities on the subject have come to be accepted in the Scottish courts and such academic writing as there is clearly accepts the large area of identity. Within the special scope of the banker's lien, however, there are differences of importance: in origin, in scope and in enforcement; these will require detailed consideration. In this discussion the term "lien" will be used exclusively although the authorities cited tend to use "lien" and "retention" indiscriminately/

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(4) at p.329.

(5) except of course where "retention" is being used in a special sense e.g. in sale of goods.



indiscriminately if not interchangeably; and English authorities will be cited without apology unless some speciality or distinction dictates otherwise.

The two principal characteristics of lien, its emphasis on possession and its reliance on an implied agreement, serve to distinguish it from other security rights. Possession distinguishes the lien from the ex facie absolute property which gave a security in such cases as Hamilton v. Western Bank <sup>(6)</sup> and from hypothec which requires neither physical control nor the means of obtaining that control. Lien allows some of the flexibility of the hypothec while not involving the uncertainty and commercial risks which are also inherent in the latter concept. The fact that lien arises by implication from certain circumstances distinguishes it from pledge, although where the two concepts overlap there may be an area of theoretical difficulty. In National Bank of Scotland v. Dickie's Trustee <sup>(7)</sup> a stockbroker who held stock in his own name for a client transferred it to a bank in security of an advance for his client; the fact of agency was disclosed to the bank. In his judgment, Lord Kyllachy said:

"there can, I think, be no doubt that a pledge for a particular debt excludes the general lien, where, as in the present case, the bank had notice and knew that the securities belonged to someone else than the pledger, and/

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(6) (1856) 19 D 152.

(7) (1895) 22 R 740. See also Lord Campbell in Brandao (1846) 12 Cl. & Finn. at 805.

and were being pledged by the latter for special loans effected by him, as a stockbroker, for behoof, if not on behalf of clients".<sup>(8)</sup>

While lien is a security right conferred by law to protect the creditor against the default of his debtor, not his debtor's disclosed principal whose own debts have been specifically secured, a fact which was recognised by Lord McLaren in the same case,<sup>(9)</sup> the areas covered by the concepts of lien and pledge are generally distinct, the former properly speaking being concerned only with negotiable securities. The use of the word "lien" in this case may not be entirely satisfactory in view of the fact that the security related to stock; it is suggested with respect that the situation was more closely related to the ex facie absolute ownership of Hamilton v. Western Bank although, of course, on the facts, the bank's rights clearly had to be limited by reference to the bank's knowledge and the express agreement between banker and customer. Distinguishing between pledge and lien, the rule of law conveyed in the phrase "assignatus utitur iure auctoris" limiting the right of the security holder, diminishes the/

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(8) *ibid* at p.749.

(9) *ibid* at p.755; and confirmed in *Farrar and Roeth v. N.B. Banking Co.* (1850) 12 D 1190.

the responsibility on the bank so far as enquiry into the origin of the security is concerned. The limitation which applies equally is, however, the reference which the court will make to any agreement, express or implied, which the customer can prove in connection with the bank's possession.

Although the general concept of possession will not be discussed in detail in this paper, there are special difficulties in applying the concept within the scope of the banker's lien which do require to be considered. In general, the criterion of possession is limited by that of implied agreement. The possession must be in consequence of that agreement and not in any way in conflict with it. It must not be the result of chance, error or fraud,<sup>(10)</sup> or in breach of a specific agreement excluding lien.<sup>(11)</sup> There is no general rule of law which falls to be applied. Each set of circumstances requires to be considered to see whether there is the requisite control and whether that control has been obtained in the furtherance of an implied agreement and in the course of a banking relationship. In Pattens v. Royal Bank of Scotland<sup>(12)</sup> the ratio of the decision, as given by Lord Cuninghame,<sup>(13)</sup> was that the dividend was paid to the bank in error/

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(10) See Pattens v. Royal Bank (1853) 15 D 617.

(11) Cases referred to infra at p.16

(12) (1853) 15 D 617; facts summarised by Gloag & Irvine at p.343.

(13) *ibid* p.619.

error and that accordingly the bank were in the same position as unlawful intrmitters or intrmitters without a title. Not only was the possession obtained in error, the very error vitiated whatever title might have justified the lien.

The requisite control has been considered in several English authorities which are at least illustrative of the considerations which would apply in the Scottish courts. In Giblin v. McMullen,<sup>(14)</sup> a case concerning the standard of care to be exercised in relation to goods lodged with a bank for safekeeping, the box containing the securities being in the bank strongroom, the key of the box being in the customer's possession, there was clearly not the requisite possession for lien even if the securities had been within the scope of the lien. In contrast, in United Service Company,<sup>(15)</sup> certain certificates were lodged for "safekeeping", the bank undertaking to receive dividends for a small commission. Although the case concerned the standard of care shown by the bank, Sir W.M. James L.J. said:<sup>(16)</sup>

"In this case, although it is true that the possession of these particular documents was not essential to the collection of the moneys which the bank were authorised to collect, it appears to us that they came into their custody in the ordinary course of their business as bankers,/"

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(14) (1868) LR 2 PC 317.

(15) (1870) LR 6 Ch App 212.

(16) at p.217.

bankers, that they were deposited with the bank by a customer of the bank, and that such deposit was made under such circumstances as would have entitled the bank to a lien upon them for their general banking account".

With respect, it seems as though the court in this instance wrongly interpreted the application of the qualifying phrase "in the ordinary course of their business as bankers". Banks commonly undertake many tasks not in the ordinary course of banking business, and while the receipt of a small commission may have had a bearing on the standard of care to be shown, it should not have affected the nature of the holding nor have permitted the exercise of a lien. Nor was the decision consistent with the earlier leading case of Brandae v. Barnett<sup>(17)</sup> where the banker was employed to collect interest on certain exchequer bills and it was held that there was no lien over the bills for a general balance. In the course of his judgment, Lord Campbell pointed out<sup>(18)</sup> that the mere fact of the bank handling the bills was not sufficient per se for a lien to exist. There must also be some banking operation involving them. It had been argued before the court that "the nature of the general lien of the banker is not yet accurately settled. It is not yet settled what is the lien of a banker upon plate left with him by his customer for safe custody,/"

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(17) (1846) 12 Cl & Finn.787.

(18) *ibid* p.808.

custody, or whether he has any?" The principle at least was quite clearly laid down in Lord Campbell's judgment.

(19)

In Robertson's Trustee v. Royal Bank of Scotland,

certain bonds were lodged with a bank by their customer in accordance with a receipt stating that the bonds were held "for safekeeping on your (the customer's) account and subject to your order". In the course of his judgment, the learned Lord President conceded that <sup>(20)</sup> "the object for which the bonds were handed to the bank partly was to place them in safer custody than he could himself command" and that "so long as the customer's account remains in a wholesome condition, I think the receipt very fairly expresses the relation of the parties". With respect, it is suggested that it would have been more satisfactory if the learned Lord President had made it clear that if the original relationship was that of banker and customer, the former acting as safekeeper, then that could only thereafter have supported a lien if there was some further specific arrangement to that effect. On the facts of the case, the Lord President's expressed view on this matter was not essential to the decision, the various judgments being more concerned with presumptions of intention and the onus of proof. It is not, however, acceptable to say that the relationship between banker and customer materially alters whenever the customer's account/

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(19) (1890) 18 R 12.

(20) at p.17.

account goes into overdraft(!) unless there is agreement  
to this effect. <sup>(21)</sup> The exercise of the security right may  
well in practice depend on the state of the account; the  
right itself, and the nature of the holding on which it is  
based, does not so vary.

There is no particular difficulty in distinguishing  
possession from custody as far as banking is concerned; it  
is quite clear that the requisite degree of control is not  
conferred by physical control per se. There must be the  
right to control and the intention to use that right if the  
circumstances so require. <sup>(22)</sup> Gloag and Irvine state that:  
"the civil possession which the indorsee of a bill of lading  
obtains by the indorsement to him is not sufficient, if he  
has not obtained actual delivery of the cargo, to entitle him  
to claim a preference over it, on the ground of retention, on  
the bankruptcy of the indorser". <sup>(23)</sup> While it is quite clearly  
the case that there is no lien in these circumstances, it is  
suggested that this is not as a result of the lack of the  
required possession. The merits and de-merits of this point  
of view have already been mentioned in connection with pledge  
and it need only be repeated here that there is nothing  
inherent in the civil possession which leads one to conclude  
that the requisite degree of control does not exist. The  
simple/

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(21) Borthwick v. Bremner (1833) 11S 716 at 717.

(22) at p.341.

(23) See Bell's Comm. ii 87; Kinloch v. Craig 1789 1 RR 664.

simple reason justifying Gloag and Irvine's conclusion is that the possession of the banker only supports lien where certain subjects are involved: bills of exchange, promissory notes, warrants payable to bearer and other negotiable securities. It is this special scope which serves to delimit the banker's lien. There is no mystery in this classification; nor, quite clearly, can it now be extended. It comprises those subjects which the banker obtains in the course of its employment as a monetary agent and which it is involved in "using" on its clients behalf. Outwith this classification, whatever security right the bank may have is not constituted as a lien; it may just be the nuisance right of retention (in the loose sense) of title deeds or it may be by virtue of a specific transfer of ownership. In passing, it is interesting to note that banks in Scotland are in the habit of asking for the deposit of title deeds when also obtaining a bond of cash credit in security of a loan and that this deposit is in practice narrated in the bond as being "further security". It is clear that this specific transfer does not impart any special effectiveness to the nuisance security.

The distinction of ownership and possession is of importance in examining the bank's rights over particular bills of exchange presented by the customer. Generally speaking, there are two purposes for which a bill may be presented: the bank may be requested to discount or buy the/  

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the bill at a price which takes into account the risk element and the normal business acknowledgement that money now is more valuable than money in the future. In such cases the bill ceases to be the customer's property. Ownership of the bill and its proceeds pass to the bank and it can either pay the customer in cash, credit the customer's account or on the client's instructions apply the price in reduction of any outstanding overdraft. In any event, the bill is not held for the client and the concept of lien is simply not relevant.

The bank may, however, obtain a bill from its customer in order to present it for collection on the customer's behalf and so obtain payment.<sup>(24)</sup> In these circumstances the property remains in the client, only possession passing to the bank. The distinction between this and the transfer above described is discussed at some length in Wallace and McNeil's Banking Law<sup>(25)</sup> and an example of the difference which may result in practice is given by Gloag and Irvine.<sup>(26)</sup> It is to be noted that the presumption operated by the courts is in favour of discounting where the customer has indorsed the bill. This presumption can be displaced by evidence of book entries made by the banker at the time of the bill passing showing the contrary/

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(24) See the Cheques Act 1957 S2 where the situation is acknowledged.

(25) 8th Ed. p.42 et seq.

(26) p.373 et seq.

contrary or in fact by any other evidence tending to show that the bank is only holding the bill for the purposes of collection on the client's behalf. In Glen v. National Bank of Scotland,<sup>(27)</sup> a firm lodged with its bank a promissory note which had been granted in its favour as an accommodation bill by a third party. Around the same time the bank arranged advances in favour of the firm but did not discount the accommodation bill. The circumstances of the lodging of the bill and the existence of an agreement concerning the lodging were disputed between the acceptor of the bill and the bank, the former arguing that the bill was lodged for discounting, the latter that it was intended in security of their advances. The case was distinguished from the special circumstances of Borthwick v. Bremner<sup>(28)</sup> and Lord Justice Clerk Hope emphasised that the transaction was in all respects in the ordinary course of banking business and that the action of the bank in discounting other bills in other circumstances corroborated the bank's averments. The onus of proving special agreement is with the customer and in this instance it had not been discharged. The onus is not, however, always on the customer as was shown in Borthwick v. Bremner,<sup>(28)</sup> where the Lord Ordinary (upheld on appeal) allowed a proof before answer on allegations that a bill originally presented to the bank for discounting had specifically been made the subject of lien by arrangement between customer and banker. The general rule was/

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(27) (1849) 12 D 353.

(28) (1833) 11S 716.

was stated thus:

"When a bill is transmitted to a banker for discount, he is not entitled to retain it in security of any prior claim. He must either comply with the request to discount it, or return it. But if the party in a bill presents it to a bank for discount, while the bank declines to discount it, it may be retained, with consent of the holder (presenter), as a security for prior advances".<sup>(29)</sup>

And as the bank was unable to prove such agreement, there was no security right over the bill. The various other authorities on this particular topic illustrate the general rules and presumptions and must be interpreted as showing that the court's concern is always with the agreement, express or to be implied, between banker and customer.<sup>(30)</sup> The most recent judicial comment having a bearing on this topic is contained in Lord Justice Buckley's judgment in Halesowen v. Westminster Bank Ltd.<sup>(31)</sup> where Lord Justice Buckley underlined that banking operations concerning bills and cheques may well affect the existence of lien and the nature of the bank's rights.

In the main, the elements of the decision as to whether or not the bank has the required possession to found lien are not special to the banking relationship. Examination of the notion/

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(29) *ibid* p.717.

(30) See *Matheson v. Anderson* (1822) 1S 486; *Haig v. Buchanan* (1823) 2S 412.

(31) [1970] 3 All E R at 487.

notion of presumed intention, fundamental to the right of lien, does, however, disclose particular difficulties. One (32) of the earliest authorities, Anderson v. Laurie and Co., clearly drew the distinction between "general rights of retention" and "liens or limited rights of retention". The former rights exist where "in certain trades and employments, a usage has received effect to retain goods for a general balance, though deposited at first for a special purpose". This usage has been justified by reference to an implied agreement assumed where in certain circumstances security goods come into the hands of the security holder. There is a presumption that the intention of the parties was to confer security rights. Whether this presumption is realistic in practice is now no longer of more than academic interest, having been established beyond question in several early authorities.

In Robertson's Trustee, the facts of which have already been narrated, the Lord Ordinary thought that the terms of the receipt created a presumption as to the nature of the bank's holding which required to be revoked if lien were to operate. Lord President Inglis, on appeal, varied the Lord Ordinary's judgment on this matter. (33) The original presumption was of possession sufficient for lien and it was that presumption which/

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(32) (1853) 15 D 404.

(33) (1890) 18 R 12 at 17.

which the terms of the receipt might or might not vary. In the circumstances the lodging of the bonds coincided with the granting of overdrafts to the customer and this was considered crucial both by the Lord President and Lord Adam. (34) The written receipt's terms would only have been given effect to if they could have been said to constitute an express agreement varying the normal rule, or if the writing had disclosed to the bank facts which clearly made an implied agreement untenable. (35) In Farrar and Rooth v. North British Banking Co. (36) a blank bill was sent to a bank by a broker accompanied by a letter in the following terms: "The enclosed has been sent me from Huddersfield to send to Glasgow for discount, and if you can do it for me on moderate terms, it will oblige". As the fact of agency was disclosed to the bank there could be no lien in respect of the agent's own debts, and, as Lord Cuninghame pointed out, (37) since the arrangement was specifically for discount, there could not be a lien in respect of the principal's debts. Similar authority (38) is given in National Bank of Scotland v. Dickie's Tr. where pledge of stock by an agent for specific accommodation clearly/

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(34) *ibid* at 18.

(35) *Dunlop's Trs. v. Clydesdale Bank* (1893) 20 R (HL) 59.

(36) (1850) 12 D 1190, at 1191.

(37) *ibid* at p.1193.

(38) (1895) 22R 740.

clearly excluded the lien.

The implication is only operative where the security is created in the "ordinary course of banking business". It is thought that it is this qualification <sup>(39)</sup> that limits the scope of the lien to cover bills of exchange, promissory notes and other negotiable instruments. In Robertson's Trustee, the Lord President said that the precise extent of the lien was determined by the nature or character of the agency. Share certificates and title deeds are of course handled by banks in the course of their business. The distinction, however, is that they are not held for the purposes of banking but only by virtue of particular agreements either of security or for safekeeping. Exactly the same limitation applies to the debts secured: these do not include charges for acting as safekeepers <sup>(40)</sup> or agents not in a banking capacity. The question might well arise in the future as to the bank's rights over bills where they are originally presented in the normal course for collection but where the customer thereafter countermands his instructions and asks either for the return of the bills or for their discounting. It is conceived that in these circumstances the bank would require to comply with these new instructions varying the "implied agreement". The bank would, however, be entitled on receipt of the instructions to consider whether at that moment/

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(39) already discussed at p.7.

(40) Bell: Comm ii 115.

moment it was in a position to exercise its lien and if so to retain in terms of the implied agreement. Any other solution would permit evasion by the customer of the consequences of the lien. It is submitted that authority for this view can be obtained from Paul and Thain v. Royal Bank of Scotland (41) and Ireland v. North of Scotland Banking Company. (42) In the former case the bank claimed to have "good reason to doubt the sufficiency" of their customer and to be entitled to exercise their right of lien. Lord Ormidale (43) approves Professor Bell's statement that:

"One who is due money presently payable cannot defend himself against the demand by setting off money due to him six months after, or the payment of which depends upon a condition". (44)

The corollary to this is that present debts outstanding will entitle the bank to use its security rights without the customer having any unilateral right to vary the agreement. In Ireland v. North of Scotland Banking Company, where there was no sequestration (and a trust deed for creditors was said to be "no concern of the bank") Lord President Inglis (45) said:

"There/

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(41) (1869) 7M 361; also *Ferrier v. British Linen Co.* there cited.

(42) (1880) 8R 215.

(43) *supra cit* at p.364.

(44) *Comm. ii* 122 (cited by Lord Ormidale at p.128)

(45) (1880) 8R 215 at 217.

"There is nothing more plain than this, that while a customer has funds in a bank his right to draw on his account is absolute, unless the bank has a right of retention over the money, or some other equally good answer".

As has already been pointed out, lien is by nature a nuisance security, a fact which is inherent in the alternative term more commonly used by Institutional writers and judges of the 19th/<sup>century</sup>- retention. In distinction from the English position, there is no special right conferred on bankers to realise the security subjects. This was made clear by Lord McLaren in Robertson's Trustee v. Royal Bank of Scotland,<sup>(46)</sup> and by Professor Bell in his Commentaries.<sup>(47)</sup> The property in the bills remains with the customer. The consequences of this is well illustrated by Gloag and Irvine.<sup>(48)</sup>

The bank does, however, continue to have a responsibility to honour the instructions of his customer so long as the security is not prejudiced. And as bills for collection are subject to lien, in the normal course of events the banker will obtain cash for the bills and so in effect realise their security. This exception is only by virtue of the special agreement in terms of which the bills passed into the bank's hands. And it operates in this way only because the banker has a right to set-off sums of money owed to the customer against/

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(46) (1890) 18 R 12.

(47) Comm. ii 23.

(48) at p.374.



against sums of money payable by him. It is this most important right which we now must consider.

It is stated by Gloag and Irvine, and normally accepted without comment that "the subjects which a banker may retain under his lien are bills of exchange, promissory notes, bonds or share warrants payable to bearer and other negotiable securities"<sup>(49)</sup>. Often spoken of under the heading of "lien", however, is the banker's right to set off a credit balance on his customer's account against a debit balance on another account.<sup>(50)</sup> Gloag and Irvine prefer to describe this right<sup>(51)</sup> as a right to readjust the form of the account and assume that the duplicity or multiplicity of accounts is merely a formal separation of funds for convenience which is only binding on the bank where there is a special contract to that effect. Support for this interpretation is given by the fact that on the bankruptcy of the bank, the customer has a similar right to demand a combined accounting.<sup>(52)</sup> In so far as the "lien" of the bank allows it to reduce or eradicate the debt, the adjusting of accounts is exceptional. In general, a lien only gives a potential security, not the means/

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(49) p.372.

(50) See Comments of Roskill J. in Halesowen [1970] 1 All ER at pp.38 & 46.

(51) p.381.

(52) Bailey v. Finch (1871) LR 7 QB 34.

means of realising that security. The set-off of accounts by the bank does, as we shall see, share with lien the emphasis on presumed intention, and the right of set-off is affected by the nature of the banking relationship. Several recent authorities have accepted without comment the use of the word "lien" in describing the rights of the bank in this area. The Court of Appeal in Halesowen v. Westminster Bank Ltd. (53) did, however, consider the question to be worthy of some discussion. Lord Denning M.R. preferred to speak simply of the "right to combine accounts" or "'to set-off' one account against the other". (54) Winn L.J. envisaged a combination bringing about a set-off. (55) It was left, however, to Buckley L.J. to rationalise the nature of the bank's right: (56)

"The money or credit which the bank obtained as the result of clearing the cheque became the property of the bank, not the property of the plaintiffs. No man can have a lien on his own property, and consequently no lien can have arisen affecting that money or that credit. The amount of the credit of the plaintiffs on the No. 2 account was, of course, increased, but this credit represented indebtedness by the bank to the plaintiffs as its customer .....

Properly, /

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(53) [1970] 3 All E R 473.

(54) *ibid* at p.477.

(55) *ibid* at p.480.

(56) *ibid* at p.487.

Properly, he said, the situation in which there are a number of accounts is not one of set-off, nor of lien but simply of accounting i.e. ascertaining a balance of mutual dealings. Accepting that the distinction is well-taken and theoretically well-founded, it is suggested that the nature of the right is well-understood and the term lien will be used and quoted (56a) without further apology. One is tempted to suggest, however, that if Lord Buckley's rationalisation is accepted much of the justification for the majority decision in Halesowen is open to question. The facts of this case may be summarised as follows: the plaintiffs had what was described by the bank's manager as a "dormant overdraft" which kept getting larger and larger. After pressure from the bank, the plaintiffs opened a No. 2 Account in April 1968 which was to be used as a trading account, which was to be kept in credit and separate from the original (now No. 1) Account which was to remain frozen "in the absence of materially changed circumstances". On 20th May, 1968 the plaintiffs called a meeting for 12th June to consider a resolution to wind up. Although notice of this meeting came to the bank it took no action other than deciding to "keep a close watch" on the account. On the morning of 12th June 1968 a cheque for £8611.5.10 in favour of the plaintiffs was lodged for the credit of the No. 2 Account; on the afternoon of that same day the plaintiffs went into voluntary liquidation. The cheque/

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(56a) It must be admitted that this statement was first made before the House of Lords judgment (see infra) was available and perhaps this apology now requires to be underlined!

cheque was subsequently credited to the No. 2 Account and cleared, leaving a balance to credit of £8,634. (57) The Bank only then advised the liquidator that it proposed to set-off this credit against the overdraft of £11,879 and prove for the balance. The Liquidator challenged this purported right of set-off and accordingly brought this action. (58) The judgment of Roskill J. at first instance reviewed carefully the issues involved and many of the earlier authorities. Before considering the decision in detail, it might perhaps be appropriate to define, so far as possible, the characteristics of the bank's right of set-off as accepted prior to Halesowen: the right of set-off is confined to circumstances in which both accounts are opened by the bank for the customer in the same capacity. An executry account, for instance, could not be combined with the executor's private account. (59) And where the terms of the two Accounts make it quite clear that the duplicity is not merely for personal convenience, but for purposes of proper accounting for the customer's various responsibilities, then again the two can not be combined by the bank. (60) One way of looking at this facet of the rule is that it is simply an application of the general rule that the banker's lien will be excluded by/

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(57) there were other smaller transactions which need not here concern us.

(58) [1970] 1 All E R 33.

(59) Bailey v. Finch (1871) LR 7 Q.B.34 particularly at 41.

(60) e p Kingston (1871) LR 6 Ch 632.

by specific agreement or clear implication of contrary intention. The onus of proving such agreement is the customer's, and the bank's duty of inquiry into the customer's reasons for opening the accounts is not as onerous as in other spheres. Assuming that there is a right to combine in a given set of circumstances, it was very early decided in the case of Garnett v. McKewan that the right could be exercised at any point in time without prior notification to the customer. It was held that it is the customer's responsibility to know the state of each account and the state of the balance of them and if he draws a cheque when the combined effect is that he is overdrawn, without the prior agreement of the bank, then he must not expect the cheque to be met. The converse is equally true: the bank is not entitled to exercise its right of lien unless the general balance on all the customer's accounts is adverse to the customer, subject, of course, to any special arrangement to the contrary.

The relationship between the various accounts opened by the one customer has long given rise to difficulty. And it seems clear that this is not solely because the facts of each case require to be considered carefully to see what arrangement was in fact made between banker and customer. The reasons/

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(61) See cases referred to in Gloag and Irvine p.383.

(62) (1872) LR 8 Ex 10.

(63) re European Bank (Agra Bank Claim) (1872) LR 8 Ch.App.41.

reasons for opening No. 2 Accounts (and sometimes a customer may have several accounts all numbered separately) vary considerably: it may be a question of convenience, to allow the customer to budget for certain recurring expenses, household or otherwise; it may be that the customer finds it convenient to have accounts in various branches of the bank (in which case the accounts will not be numbered); it may be that the accounts are opened by the one person acting in different capacities; and it may be that the customer is using one as a current account for day-to-day operation by cheque in the normal way and the other as a loan account in which the balance will not vary to the same extent. (64) The request for the separation of the accounts may come from the customer or from the bank, and the effect of the numbering will vary accordingly in many cases.

(65)  
In Bradford Old Bank Ltd. v. Sutcliffe, the facts clearly showed that one account was opened specifically to record a loan which was itself secured by a deposit of debentures and two personal guarantees. In these circumstances, Pickford L.J. said:

"The facts clearly show that the accounts were to be kept distinct <sup>(65a)</sup> by arrangement between the plaintiffs and the company. If it were otherwise the company would be/

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(64) as in Bradford Old Bank Ltd. v. Sutcliffe [1918] 2 KB 833.

(65) supra cit.

(65a) "my emphasis"

be extremely hampered in their business for they could never safely draw on the current account so long as the credit balance did not exceed the amount due on the loan account".<sup>(66)</sup>

Because of the arrangement, stated Scrutton L.J. "the sums paid into the current account are appropriated by the customer to that account and cannot be used by the bank in discharge of the loan account without the consent of the customer".<sup>(67)</sup>

Six years later Swift J. tried a case which is summarised in the headnote as follows:<sup>(68)</sup>

"A banker who has agreed with a customer to open two accounts in his name, and who holds bills which the customer has specifically appropriated to one account, is not entitled, without the customer's consent, to transfer, the proceeds of such bills to the other account".

Thus far, the ratio is quite acceptable and consistent with Bradford Old Bank. Swift J., however, in answer to Defendant's Counsel's argument that the banker was entitled to deal with both accounts as being one whole and entirely under his control, stated:<sup>(69)</sup>

"If a banker agrees with his customer to open two or more accounts he has not in my opinion without the assent of the customer any right to move either assets or/

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(66) *ibid* p.839.

(67) *ibid* p.847.

(68) [1924] 2 KB 153 - Greenhalgh (WP) and Sons v. Union Bank of Manchester Ltd.

(69) *ibid* at p.164.

or liabilities from the one account to the other; the very basis of his agreement with his customer is that the two accounts shall be kept separate".

With respect, it is suggested that this generalisation is too wide unless it is qualified effectively by the use of the word "agreement" and Mr. Justice Swift's emphasis later in his judgment on the "agreement between the banker and customer". Swift J. would appear to have held that the very opening of two accounts creates a presumption of an agreement to separate operation and therefore exclusion of lien; in such an event the burden of proof would lie not with the customer but with the bank.<sup>(70)</sup>

The varying consequences of the numbering of accounts was illustrated in the case of in re E.J. Morel (1934) Ltd.<sup>(71)</sup> where the one overdraft account of the company was frozen when a further two accounts, one a normal trading current account and the other a wages account, were opened. It was conceded in argument that although the No.2 and No.3 Accounts were nominally separate, they were truly interdependent and operated together. The judgment of Buckley J. was principally concerned with the position of the No. 1 Account, and the argument of learned Counsel for the Liquidator was cited approvingly as follows:<sup>(72)</sup>

"it/

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(70) this dictum of Swift J. was disapproved by Lord Denning MR in Halesowen - [1970] 3 All ER 478.

(71) [1962] 1 Ch 21.

(72) ibid p.29.



"it would be contrary to common sense and to business practice to treat what is paid into current account from time to time as capable of being appropriated. by the bank at any moment to discharge the loan account or the frozen account, because it is of the essence of the arrangement, they say, that the customer should know that he is able to deal with the credit balance on his current account, and to draw cheques against it for the purpose of his current needs".

This reasoning does not, however, apply where the question at issue is the relative positions of banker and customer when the latter is bankrupt or in liquidation; nor where for some other reason the banking relationship is at an end. Moreover, it is submitted that frozen and loan accounts are subject to different considerations. In practice, their origins are to be distinguished. An overdraft on current account can, and often does accumulate without specific authority or at least only with authority for each cheque as it is drawn or presented. The bank may well have no intention of granting loan facilities other than very temporary accommodation. Thereafter if the customer is not in a position to clear off the overdraft almost immediately, or if the customer is observed to be in difficulties, the bank may consider it preferable to regularise the position by stopping operations on the overdraft account and allowing the customer to/

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to open another account, place funds to its credit, and then to operate it under close supervision. The bank should not thereby be taken to be sacrificing its right of lien or compensating the accounts for ever; it is at most merely suspending its rights. In practice, the freezing of an account in this way is often the bank's last attempt to give its customer a chance to continue business operations and perhaps to operate profitably, without venturing further overdraft facilities.

The loan account, on the other hand, is created in furtherance of a specific agreement to provide overdraft facilities. The bank's choice of position is taken prior to the creation of the loan, not after it. In this case, the independence of the two accounts is necessary for its operation as a loan and there may be more in the argument for the complete separation of the accounts even in liquidation or bankruptcy.

In his judgment in re E.J. Morel, Mr. Justice Buckley would confine the ratio of Garnett v. McKewan to the position where there are two or more current accounts. He justified<sup>(74)</sup> the separate treatment of accounts by the liquidator by their separate operation in the course of the banking relationship. It is suggested that evidence of this sort/

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(73) at p.30.

(74) at p.33.

sort should not have a conclusive bearing on the rights of the bank on the termination of its relationship with the customer. The most important criterion is surely: what was the agreement at the time the "loan" relationship was set up? Did the bank merely agree not to exercise its right of lien for a period of time to be determined by reference to the duration of the banking relationship or some arbitrary period? Or did the bank ab initio agree that the loan account was to be distinct and that no other funds held by it were to afford any security for the loan?

The earlier authority of in re European Bank (Agra Bank Claim) <sup>(75)</sup> had illustrated that the naming of the accounts is not to be considered conclusive. In this case there were three accounts, "loan", "discount" and "general". The customer was another bank. On the voluntary liquidation of both banks, there arose <sup>the</sup> question of Agra and Masterman's Bank's lien over three bills lodged as security for accommodation. Sir W.M. James L.J. considered not only a letter which accompanied <sup>(76)</sup> the lodging of the bills but also the bank books:

"But when we look at the books, it is clear that there was no particular reason for treating these three accounts as distinct matters. It was only for convenience that the loan account was kept separately ...  
In/

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(75) (1872) 8 Ch App 41.

(76) *ibid* at p.44.

In truth as between banker and customer, whatever number of accounts are kept in the books the whole is really but one account and it is not open to the customer, in the absence of some special contract, to say that the securities which he deposits are only applicable to one account".

It might be thought that where the customer was a bank there might be some special reason for amalgamating the accounts, for treating both parties as principals, but in the circumstances of this case the true relationship was that of banker and customer and the latter was just as dependant on the bank's extending whatever credit had been arranged. Here, however, the loan account was in no sense frozen and it is significant that the question fell to be resolved when the parties were in voluntary liquidation. The case involves an application of the same principles as those of Garnett v. McKewan, a case which was decided contemporaneously therewith, although in another court.

Even allowing for extremity of generalisation, for instance Swift J. in Greenhalgh's case and Sir W.M. James L.J. in the Agra Bank Claim, there were clearly unresolved points of difficulty prior to Halesowen;<sup>(77)</sup> nor did re Kever e.p. The Trustee v. Midland Bank Ltd.<sup>(78)</sup> afford any clear assistance other than a professed application of the principle of the Agra/

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(77) See Paget 7th Ed. p.125 et seq.

(78) [1966] 3 All E R 631.

Agra Bank Claim. Counsel for the defendant bank in this case did, however, state that on a bankruptcy or liquidation there must be a combination of accounts notwithstanding arrangements to the contrary during the currency of the banking relationship.<sup>(79)</sup> And it was upon this argument that Mr. Justice Roskill based his decision in Halesowen.

The facts of Halesowen have already been recounted. Two arguments were put forward by Counsel for the plaintiffs to justify the continued separation of the two accounts: firstly, that there had been an "express oral agreement" that the bank would "in no circumstances" seek to set-off any balance on that No. 2 Account against the frozen overdrafts on the No. 1 Account. The onus of proving such an agreement clearly lay on the plaintiffs and on the evidence before the court it was not discharged.<sup>(80)</sup> The facts of the case showed that the customer's financial standing prior to the arrangement, while not unusually precarious in that its assets were considerable, was giving cause for concern. The possibility of liquidation was sufficiently feared to be in the mind of the customer's financial adviser before the arrangement was entered. One would imagine that it would require the clearest of evidence in these circumstances before the bank could be held to have sacrificed its right of lien irrevocably.

The/

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(79) reported in [1967]Ch at p.188.

(80) this finding in fact was of course binding on the Court of Appeal.

The principal question for decision was whether or not there was some rule of law which prevented the bank setting off the two accounts in the event of liquidation in view of the bank's undertaking that the first account should remain frozen with no sums being debited or credited to it, no steps being taken by the bank to recover the balance outstanding and the interest payable being debited to the second account. The learned judge at first instance reviewed the relevant authorities fully, most of which could be reconciled on their facts although the judgments contrasted in emphasis. The particular point which fell to be decided was, however, only squarely faced in the case of in re Kever, and there only by the defendant's counsel who stated:

"the bank has never suggested it was entitled to combine a loan account with a current account whenever it liked: such a course has to be with the customer's consent otherwise the purpose of making a loan would be avoided; but on a bankruptcy or liquidation there must be combination".<sup>(81)</sup>

Mr. Justice Roskill read the judgment of Ungood - Thomas J.<sup>(82)</sup> in Keever as impliedly accepting that submission, and there seems no doubt that the learned judge in Halesowen was similarly impressed.

Plaintiff's counsel had emphasised in argument that the accounts/

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(81) [1967] Ch at p.188.

(82) at p.51. ([1970] 1 All E R)

accounts were not physically combined after liquidation. With respect, it is submitted that Roskill J. took the correct line when he advised that the mechanics by which the bank sought to exercise its lien were irrelevant so long as the claim was properly stated to the liquidator.

The ratio of the decision at first instance is contained in a correction of Swift J.'s generalisation which has already been cited; <sup>(83)</sup> says Roskill J:

"The true view, as I think, is that if a banker agrees with his customer to open two or more accounts, the banker has, by virtue of his lien, the right to move either assets or liabilities from one account to the other without the customer's consent, unless the banker has expressly or impliedly agreed with his customer that he will not do so; such agreement may be for a limited period or it may be indefinite in the duration, or it may be only for such period as the banker/customer relationship subsists"; and <sup>(83)</sup> later:

"the critical question must always be, 'what was the contract?' and not whether a particular account or accounts bear one title rather than another".

It is possible for the bank to exclude its lien completely on this reasoning although it is submitted that the/

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(83) at p.49.

the rule of construction to be applied should be strongly against this interpretation of any agreement which would bear to extend into the situation where the customer was bankrupt or in liquidation. In that event the protection of the customer in using his banking facilities is no longer in issue. Indeed, it is difficult to see why any agreement, not completely specific, should affect the right of lien on bankruptcy or liquidation and it would be arguable that the implication is always in favour of this limitation on any exclusion of the bank's lien. It is submitted that the courts should look more favourably on a suspension of a bank's right under its lien than on a complete exclusion thereof. Support for this is to be found in the judgment of Roskill J. when considering the arguments of plaintiff's counsel at p.50; and later when justifying his decision in logic he says:

"I can see no logic in the view that a restriction on the exercise of a banker's right of lien which arises by virtue of the terms of the contract made between the banker and the customer when the banker/customer relationship exists must continue to bind the banker once that relationship has been determined by death, insanity, liquidation or  
(84)  
bankruptcy, or for any other reason".

And while the decision can rest on a narrower ratio and this/

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(84)     ibid at p.52.



this statement of principle may not have been entirely accepted by the House of Lords it has a certain logical attraction; and it seems to me that the Court of Appeal, in reversing the decision of Roskill J. did largely accept the ratio. In any event the basis of the Court of Appeal's decision was, it is respectfully suggested, not altogether clear and the issues were hardly clarified by the somewhat strikingly contrasting opinions of the Court.

It is clear that the decision was reversed not on a different interpretation of the principles of law involved but on a different interpretation of the agreement reached between bank and customer and recorded in letters of 17th and 22nd April 1968, which narrated, in part:

" ..... in the absence of materially changed circumstances in the meantime we for our part will adhere to the present scheme of arrangements for this period of time"

i.e. four months.

in the Court of Appeal (85)  
On appeal/ the three learned judges all envisaged the necessity of the bank giving notice of its intention to take advantage of any such changed circumstances. There was no stated consensus as to what notice would be required; probably notice would be effective immediately on receipt thereof./ (85a)

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(85) [1970] 3 All E R. Lord Denning M.R. at 476; Winn L.J. at 481; and Buckley L.J. at 488.

(85a) also the opinion given in the House of Lords (see infra)

thereof. It must be noted, however, that the agreement does not itself stipulate that there should be notice. And it can not be assumed that the bank would at any time feel itself restricted by a requirement to give notice especially in the highly uncertain financial situation of the company and the continuing risk it (the bank) was taking. Rather it might well have had just this situation of insolvency in mind when it would wish to take immediate advantage of "changed circumstances". The agreement was partly to the advantage of the bank in that it at least secured the interest on the overdraft but it was principally to the benefit of the company which was being permitted to remain in business.

One finds it difficult to see the bank agreeing, expressly or impliedly, to the result suggested by the Court of Appeal. If the combination of accounts is merely an accounting, albeit one which normally allows a preference, it is difficult to see why the court should tend towards excluding the normal rule in the absence of the clearest intention to that effect.

(86)

Lord Denning interpreted the agreement as follows:

"The agreement was, I think, an agreement which continued over the liquidation of the plaintiffs, so as to prevent the bank from combining the accounts or setting off one against the other - to the prejudice/

prejudice of the general body of creditors".

It is submitted that it is not helpful to think of the agreement in terms of whether or not it was prejudicial to the creditors. The bank's preferential right to combine accounts is in the normal case no less prejudicial. The agreement restricting the right of combination was for the company's benefit not in any way for the protection of its creditors. The transfer of the banking account was a perfectly natural request made by the bank in return for its continued tolerance of the unsatisfactory state of the overdraft account. Moreover, Lord Denning's emphasis on the bank's continued separate operation of the accounts and its failure to give notice of intention to terminate the agreement at an earlier stage seem to disregard what most banks would probably regard as normal practice. The effectiveness of lien (if such the right be called) is in this one category of cases most striking at the stage of insolvency and the bank might consider it should be forgiven for not precipitating the liquidation by revoking the agreement and presumably thereafter seeking to recover the balance owed. There can be no doubt that there was a change in circumstances - this was accepted by each of the judges of appeal and, of course, by Roskill J. at first instance. Apparently the only justification for disregarding this change/

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change (which was concurred in by Buckley L.J.)<sup>(87)</sup> was the absence of the notice.

Lord Justice Winn did not, however, accept this<sup>(88)</sup> view as to the length of operation of the agreement:

"However, I agree that the agreement was, as counsel for the bank contended in the course of his main submission, one which would endure and the effect of which would operate only so long as the relationship of banker and customer obtained between the bank and the plaintiffs; it was an agreement regulating and restricting the conduct of the bank qua banker".

The learned judge took the view that this did not mean that the agreement did not govern the bank's dealings with the cheque:

" ..... an agent who has in his hand cash belonging to his principal and is owed a debt by that principal is not entitled to pay himself out of that cash without authority, express or implied, from his principal".<sup>(89)</sup>

But this is exactly the significance of the bank's lien which would have existed in this case without any question at/

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(87) *ibid* at 488.

(88) *ibid* at p.481.

(89) *ibid* at p.481. See Lord Cross's comment on this judgment - [1972] 1 All E R 654.

at all if there had been no agreement. The learned judge took the view <sup>(90)</sup> that the first account having been converted into a debt or loan account and the second account having been subject to the agreement for separate operation there was no time in the course of the banking relationship when the two accounts could be combined. This seems to presuppose the termination of the banking relationship on liquidation, surely not a tenable proposition so far as the effectiveness of lien is concerned.

Leave having been granted to appeal to the House of Lords an appeal was proceeded with <sup>(91)</sup> and Roskill J.'s judgment at first instance and the dissenting judgement of Buckley L.J. in the Court of Appeal found final approval. Although much of his judgment revolved round the interpretation of Section 31 <sup>(92)</sup> of the Bankruptcy Act 1914 as applied by <sup>(93)</sup> Section 317 of the Companies Act 1948, Viscount Dilhorne agreed with Roskill J. that the agreement between banker and customer ended with the winding up resolution. So far as the use of the term "lien" was concerned the learned judge agreed <sup>(94)</sup> with Buckley L.J.'s comment that:

"The money or credit which the bank obtained as a result of clearing the cheque became the property of the bank not the property of the (company). No man can/

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(90) *ibid* at p.485.

(91) [1972] 1 All E R 641.

(92) which does not apply in Scotland.

(93) *ibid* at 651.

(94) *ibid* p.646.

can have a lien on his own property, and consequently no lien can have arisen affecting that money or that credit".<sup>(95)</sup>

It seems to have been agreed by the judges that the term "lien" is inappropriate to describe the banker's right to combine accounts;<sup>(96)</sup> and although notice requires to be given by the bank that it is exercising the right of combination, Lord Kilbrandon approved<sup>(97)</sup> Buckley L.J.'s opinion that it takes effect immediately.

In passing, it is pleasing to note that Lord Kilbrandon troubled to point out that the absence of an equivalent to Section 31 in Scots law does leave a difference between the way in which the set-off is effected, albeit of minor practical importance.<sup>(98)</sup> And perhaps his suggestion for a re-statement of the law of bankruptcy for both England and Scotland is the only conclusion in the case to which absolutely no exception may be taken. So far as Halesowen is concerned the decision finally reached by the House of Lords conforms to what would in most cases be the normal commercial understanding of the parties involved and to that extent is liable to meet with long-term approval.

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(95) 1970 3 All E R at 477.

(96) See Lord Cross reported at p.563.

(97) *ibid* at 662.

(98) *ibid* p.664.

DIFFICULTIES CREATED BY "FALSE" DOCUMENTS

The term "false" is used in an attempt to delineate the scope of this discussion; it is not used as a term of art. Only incidentally will its meaning concern us; its importance is in covering a miscellany of situations in which for some reason the documents do not correctly represent the goods, or in which they may be described as misleading, either on their face or in substance; also discussed is the position of false bills of exchange tendered in the credit transaction. While clearly the system of commercial credits is designed to operate on the transfer of documents not goods, and therefore prima facie such discrepancies between the two should be disregarded, such cases as Sztejn v. J. Henry Schroder Banking Corporation (1) have at least highlighted difficulties which the British courts may have to face.

One of the underlying themes which it is hoped to bring out more fully in this context is the dichotomy between the general and the particular. To explain: the law of forged documents in the field of commercial credits depends both on the general principles and theories underlying the system and on particular considerations arising because forgery and dishonesty are involved, and because the nature of forgery is such that it may be difficult/

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(1) (1941) 31 NY Supp (2d) 631.

difficult to detect. In reverse, too, the judicial authorities on forged documents have been instructive both in the general background and theory of the subject <sup>(2)</sup> and in giving solutions to many particular problems. There remains inevitably a large area of the law ripe for speculation and hypothesis, an area which may never be completely clarified as a result, quite simply, of the infrequency of judicial decisions. This treatment of this particular topic has both in mind, the general and the particular.

The obvious difficulty is one of sources and authority. The general principles of the system all too often permit varying interpretations when particular difficulties are to be faced. Nor should judicial dicta intended only to apply in the circumstances under review be extended in solution of difficulties not then envisaged. Care must be taken in adopting the principles of closely related subjects such as agency or c.i.f. contracts - the issues involved are seldom strictly the same. One of the more recent authorities underlining the independence of the credit transaction from the sale contract is Malas v. British Imex Industries Ltd. <sup>(3)</sup> where the bank's obligation was stated to be "irrespective of any dispute there may be between the parties [buyer and seller] <sup>(4)</sup> as to whether the goods are up to contract or not". Forgery, too, introduces notions of morality, justice and public policy which may, on occasion, dissuade courts from rigid/

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- (2) e.g. Guaranty Trust Co. v. Hannay [1918] 1 KB 43, 2 KB 623; the American decision based on the same facts is reported at 210 Fed Rep 810.
- (3) [1957] 2 Lloyd's Rep 549; [1958] 2QB 127.
- (4) *ibid* at p.129.



rigid adherence to principle. This is at least one reason why the United States authorities on the subject must be treated with great care. In other ways also the trends in the United States, for instance, regarding the banker's responsibilities, are by no means necessarily to be reflected in the British courts. <sup>(5)</sup> Even the English authorities can at times be questioned not so much on the grounds of differing trends, but more on the basis of varying theoretical justifications. <sup>(6)</sup>

All this merely by way of introduction - the subject to be discussed clearly emphasises the problems caused by forged documents. It will be convenient to treat of these first (and so far as possible, separately) both because of the particular difficulties involved and because the propositions there decided upon can be considered and tested in relation to other circumstances involving falsity in some wider sense. As suggested elsewhere, <sup>(7)</sup> the various documents fall to be treated separately depending on whether they are cheques or drafts, documents of title, or letters of credit themselves.

The position of the cheque or draft is unique in two respects: the general principles of a well-defined department of the law, i.e. negotiable instruments, are applicable, and the position has been made reasonably clear by Scots decisions. The relevant statutory provisions are contained in sections 24 and 64/

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(5) Scrutton L.J. in *Greenwood v. Martins Bank Ltd.*

[1932] 1 KB at 384.

(6) e.g. *Guaranty Trust Co. supra cit.*

(7) e.g. J.B. Miller: *Casebook* p.86, 87.

24 and 64 of the Bills of Exchange Act 1882<sup>(8)</sup> and the law may, with one or two exceptions, be taken as well-settled.

The guiding principle on which most questions in<sup>(9)</sup> this area are based is to be found in Orr v. Union Bank, where the Lord Chancellor was reported as stating:

"It is the law both of England and Scotland that payment on a forged cheque or order is not of itself any payment at all as between the party paying and the party whose name is forged, although cases may exist where such payment may be made valid by collateral matters".

While the first part of this statement must be regarded almost as trite law, there are several comments to be made. Clearly the "collateral matters" referred to are either those leading to an inference of personal bar or estoppel or facts revealing that the party whose name is forged has received a benefit as a result of the payment. The latter unusual set of circumstances is mentioned later. Although the former inference is a question which will be considered more fully under the heading of forged letters of credit, it may be remarked at this point that estoppel in general depends on the existence of a duty, and the circumstances in which this duty may be inferred may well differ where the letter of credit forms one link of the relationship between banker and customer. In other words although the basic rule is unchanged, /

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(8) 45 & 46 Vict c61.

(9) Orr and Barber v. Union Bank of Scotland (1852) 14 D 395; (1854) 17 D (HL) 24 at 26.

unchanged, the prospects of proving personal bar are increased. Orr v. Union Bank also indicates that there is nothing inherently impossible or unacceptable in ascribing to the banker responsibilities against the breach of which he can take few effective precautions. It is to be noted that the letter of credit involved in this case was by no means typical, <sup>(10)</sup> a consideration which may well be relevant in deciding where liability lies. Its nature, however, was clearly stated:

"a letter of credit is not a negotiable instrument. It merely gives authority to the bank to honour the cheque of Orr and Barber. The bank ought to have made inquiry as to who were the drawers of the cheque, and satisfied themselves as to the genuineness of the signature. The fact that it was presented by a person who held and gave up the letter of credit only raised a presumption that it had been drawn by the proper party; and <sup>if</sup> the bank chose to act on such a presumption, they must abide by the consequences". (10a)

Thus mere possession of the letter of credit by the presenter of the cheque will not justify the bank in accepting a forged cheque, although it may be that the person instructing by letter of credit has a duty to take care in the way in which it/

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(10) It was addressed to the bank in Liverpool and ran "Please to honour the drafts of Messrs. Orr and Barber to the extent of £460.9/- which charge the bank signed J. Watson, Cashier".

(10a) supra cit. at p.26.

it is drawn or communicated to the bank. This will be discussed later. In Orr's case, the issuing bank, the defenders, had recompensed the bank to whom the letter of credit was addressed and which had made payment to the person presenting the letter of credit with the forged cheque. The court clearly indicated that the issuing bank could recover in turn from the other bank but held that as between the party requesting the credit and the bank, the latter had no right to recovery. The proceedings originally arose because Orr and Barber, the beneficiaries of the credit, could not get their cheque honoured, and joined with the drawer of the letter in suing the issuing bank with whom the drawer at least had some contractual relationship. (11)

Again in the slightly later case of Caledonian Insurance Co. v. British Linen Co. (12) the letter of credit involved was by no means the conventional modern document. It was issued in satisfaction of a loan application the papers for which were forged along with the indorsement of the proper payee (King, by name). The actual terms of the letter of credit are not detailed in the report. The decision is generally (and justifiably) regarded as supporting Orr and the Pursuers' arguments (which were successful) were put on that basis; but it is of most interest because of an obiter dicta of Lord Benholme:

"Had/

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(11) The form in which the action was brought was extremely unusual and caused many of the conflicts contained in the Court of Session judgments.

(12) (1859) 21 D 1197; (1861) 23 D (HL) 3.

"Had the genuine signature of King been adhibited to the letter (of credit) the Pursuers would have been entitled to recover the amount from King. For by adhibiting his own signature to a letter of credit in his own favour ..... King would have become (13) accountable".

This is surely one of the clearest applications of the doctrine of personal bar, and it does indicate that a Scottish court might be persuaded to take a verycritical view of a party who did not take reasonable care in his dealings with the letter of credit.

The question as to whether a banker who pays a person presenting a draft bearing a forged signature can recover from that payee on discovery of the forgery has not yet been settled. (14) Although related to the general law of bills of exchange and not particularly to letters of credit, this matter is of great practical importance and is one of those points at which Scottish theory may lead to an answer at variance with that given by the English authorities. A few comments may therefore be appropriate.

Although the question has been considered ad longum in/

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(13) (1859) 21 D at p.1203 and 4.

(14) See generally, Paget - Law of Banking (8th Ed) at 379 et seq.

in England, there does remain considerable doubt except in the clear case where the presenter is responsible for the forgery, either directly or indirectly, and must therefore remain liable to re-pay any sums paid as a result thereof. Paget's criticisms of the rule laid down in Imperial Bank of Canada v. Bank of Hamilton <sup>(15)</sup> may, it is suggested, not be well-founded. The case itself has never been over-ruled. <sup>(16)</sup> Paget points out that the right to give notice of dishonour can not be lost in the way in which the Privy Council inferred in Imperial Bank. He concludes that the bank's right of recovery would therefore be unlimited in time, and suggests that it would not therefore be prejudiced. This is not, however, the necessary conclusion and the ratio of Imperial Bank seems only to mitigate what the Privy Council regarded <sup>(17)</sup> as the severity of the rule laid down in Cocks v. Masterman i.e. recovery will be allowed where notice of mistake is given in a reasonable time and where no prejudice has been incurred. The mere fact that the right to give notice of dishonour is not lost does not mean that the party's position has not been prejudiced and it is this prejudice over which the Privy Council was concerned.

The situation is further complicated for Scots law by the possible differences occasioned by the operation of the/  
the/

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(15) [1903] AC 49.

(16) cit supra at p.378

(17) (1829) 9 B & C 902.

the condictio indebiti. This doctrine has been judicially recognised as an equitable one and "it will not be granted by the court unless it clearly appears that it would be inequitable for the party to whom a payment has been made to retain the sums alleged to have been paid under error".<sup>(18)</sup> Where "equity" is to be substituted for a supposedly fixed rule of law, we may be justified in ignoring those English decisions which preach inflexibility. On the other hand London and River Plate Bank v. Bank of Liverpool,<sup>(19)</sup> one of these decisions, was clearly influenced by its own different interpretations of equity. But at least the question must be regarded as open for the Scottish courts. Gloag<sup>(20)</sup> cites Imperial Bank as an example of the application of the condictio indebiti and while it is difficult to know how far the doctrine may be carried, the decision of the Privy Council has received some support in Jones v. Waring and Gillow Ltd.,<sup>(21)</sup> where Lord Shaw of Dunfermline said:

"In the language, for instance, of Lord Lindley in Imperial Bank of Hamilton: 'As regards negligence in paying the cheque: It cannot be denied that when the Bank of Hamilton paid the cheque on January 27 it had means of ascertaining from its own books that the cheque had been altered. But means of knowledge and actual knowledge are not the same:<sup>(22)</sup> and it was long ago/

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(18) 1909 SC 510 at 521 - Lord Ardwall in Henderson & Co. v. Turnbull & Co.

(19) [1896] 1 QB 7.

(20) Contract (2nd Edition) p.61 et seq.

(21) [1926] AC 670, at 689.

(22) Contrast the reasoning in Clydesdale Bank v. Royal Bank cited *infra*.

ago decided in Kelly v. Solari<sup>(23)</sup> that money honestly paid by a mistake in fact could be recovered back, although the person paying it did not avail himself of means of knowledge which he possessed. This decision has always been acted on since".

It was on the principle of this case i.e. Kelly v. Solari, that Jones v. Waring and Gillow Ltd. was decided. Lord

Sumner indicated that from his interpretation of the facts he did not think that there was a duty owed as between the two parties involved and that in the absence of such duty

Jones was entitled to recover the money paid under mistake of fact.<sup>(24)</sup>

Even if this qualification of the rule by the introduction of notions of duty does apply, it is submitted that there is no duty incumbent on the bank vis-à-vis the presenter of a draft to take more than normal precautions against forgery.<sup>(25)</sup>

It is difficult to see how the equity lies in favour of the presenter instead of the bank. The presenter, has after all, been closer in time at least to the source of the forgery and may therefore have more opportunity to suspect its existence or recover from the perpetrator. Any notion of the bank having a duty to protect the presenter is artificial. The bank's duty extends in this situation primarily to its customer.

Before/

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(23) (1841) 9 M & W 54.

(24) supra cit at p.691.

(25) What are "normal" precautions is of course another question and involves an examination of the circumstances in which the bank might be assumed to have been "put on enquiry".



Before leaving this matter, however, some mention should be made of the rather contradictory authority of Clydesdale Bank v. Royal Bank <sup>(26)</sup> in which a stockbroker's clerk incurred obligations on the Exchange for which his principal was responsible; in an attempt to meet these obligations the clerk presented to his principal's bank a cheque on which the drawer's and indorser's signatures were forged. The cheque was credited to the principal's account and the principal's bank then recovered the sum from the payee's bank, the pursuers in this case. Only thereafter was the forgery discovered and proceedings raised against the principal's bank. The court took the view that the principal's bank was acting as the principal's agent only and that as between two innocent parties, the respective banks, the payee's bank would require to bear the loss:

"The Clydesdale Bank, when they paid money on a draft of their own customer, were bound to satisfy themselves that the signature was genuine. The Royal Bank, which presented the cheque, had not necessarily any knowledge of the signature, but the Clydesdale Bank must have known the signature of their own customer. They were in the everyday habit of cashing his cheques. It seems to me that in a question between the two banks the Clydesdale is liable". <sup>(27)</sup>

With/

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(26) (1876) 3 R 586.

(27) *ibid* p.590, per Lord President.

With respect, it does seem that the arguments of Dean Ames<sup>(28)</sup> attacking this statement of the ratio are well-founded and that while the alternative ratio suggested by the learned author is not particularly appropriate in Scots law, it is suggested that the case can be justified on a much narrower ground than that emphasised by the court, namely the role of the bank as agent for the alleged payee. This point was mentioned by the Lord President<sup>(29)</sup> and is sufficient, it is submitted, for the disposal of the case. Nor does it conflict, as the alternative ratio appears to, with the ratio underlying Orr and Barber and the Caledonian Insurance Company.<sup>(30)</sup> The defenders were merely recovering payment for their principal and any payment by them was merely in anticipation of their principal being placed in funds in early course and in recognition of their faith in his creditworthiness. The sequel of the case, a successful action by the Clydesdale Bank against the principal, the Stockbroker,<sup>(31)</sup> supports this view. Although the court decided the matter on general principles of agency law and the benefit obtained by the stockbroker it is clear that the action could also have been argued successfully on the lines suggested by Orr and Barber.

In conclusion it must again be noted that we have been/

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(28) cited infra footnote 43.

(29) supra cit. at (27)

(30) supra cit. It is with respect, suggested that Lord Mure was not correct in stating at page 588 that the latter of these cases ruled the decision in Clydesdale Bank.

(31) (1877) 4 R 626.

been dealing with part of the law of bills of exchange. Only where notions of duty intrude will the relationship occasioned by the letter of credit be of importance and it is in this connection that we shall be looking further at the applications of personal bar.

Most questions of difficulty in letter of credit transactions arise in relation to the documents to be presented with the cheque in terms of the letter. Forgery is no exception. As a result, there are more authorities, though they do have to cover a wider area. And it is here that the general principles and practice of the system are at their most helpful.

Guaranty Trust Company of New York v. Hannay has in many ways been one of the most productive cases on commercial credits, mainly because it both explains the practical background and examines the legal principles involved. The decision itself is beyond question. It does, however, provoke discussion both of hypothetical situations and an examination of the reconciliation of the decision with principles of Scots law.

The judgment of Bailhache J. in the Kings Bench, although subsequently overturned on its interpretation of U.S. law, is significant for the manner in which it faces each possible theoretical argument for the defendants as they attempted to attach to the presenter of documents successive liabilities. It was argued that there was a warranty by the party/

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party presenting the shipping documents that they were  
(32)  
genuine. He replied:

"The answer seems to me to depend upon what was the object and effect of Knight, Yancey and Co. handing the bill of lading to the plaintiffs and of their handing it in turn to the Bank of Liverpool ..... If the true transaction was that by the indorsement and delivery of the bill of lading to the plaintiffs the property in the goods passed to them and was by them transferred to the defendants, there would, I think, be a warranty of genuineness by the plaintiffs. Now a transfer of a bill of lading has such efficacy as is necessary for the carrying out of the transaction ..... It may or may not pass the property in the goods".

(33)

And in this case, it did not, said Mr. Justice Bailhache.

While this argument based on "special property" may be satisfactory for purposes of English law, I would question its relevance for Scots law. (34) Indeed neither the admission as to warranty where the property does pass nor the invoking of the "special property" concept seem to be necessary. Clearly there can be no question of an express warranty - it could only be implied - and that implication can only arise out of the situation between the parties concerned. The party who accepts the documents and complains on discovering them/

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(32) [1918] 1 KB 43 at 51.

(33) ibid at p.52.

(34) This question is to be examined fully elsewhere.

them to be forged has not relied on a representation or warranty as to genuineness. He has relied on the security of the credit system. This seems to be the gist of Scrutton L.J.'s judgment in the Court of Appeal, <sup>(35)</sup> and of Bailhache J.'s answer to the suggestion that there was a <sup>(36)</sup> representation as to genuineness.

It was also argued before Bailhache J. that there was a "mutual mistake of fact". He replied:

"Assuming the doctrine of mutual mistake of fact to apply, I ask myself what possible reason can there be for shifting the loss from the shoulders of the innocent party on whom it has fallen onto shoulders of an equally innocent party who has escaped the loss. I can find none ..... as I have already pointed out, the duty of ascertaining the genuineness of the bill <sup>(37)</sup> of lading was primarily that of the defendants".

While it is difficult to know to what extent the Scots courts would hold themselves to be restrained by Scots principles and to what extent they would rely on "new" principles formulated for the system on the basis of English law, it is again clear that the Scottish position may not be completely identified with the English one. Prima facie in the circumstances above described by Bailhache J. there would/

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(35) [1918] 2 KB at 662.

(36) [1918] 1 KB at 53.

(37) *ibid* at p.54.

would seem to be what Scots law would term an error common to both parties, and justifying reduction. Apart from difficulties of restitutio in integrum in such complicated situations, however, it is submitted that this is one clear example where the courts would or should hold that there had been a common acceptance of a risk.<sup>(38)</sup> This would certainly accord with the commercial realities. Nor is it enough to say that there can be no possible reason for shifting the loss<sup>(39)</sup> from the shoulders of one innocent party to those of another. In fact, the party who may be called upon to accept the documents eventually, i.e. the buyer, has undertaken in terms of his letter of credit to repay on the strength of the documents. It is his contractual risk that the documents may be forged. And it is his responsibility not to satisfy himself as to their genuineness, but rather to ensure that for his own sake the situation does not arise where forged documents can be tendered. Clearly as between the fraudulent party and the issuing bank, the fraud may be pleaded in defence<sup>(40)</sup> of the latter's entitlement to refuse. Apart from this, however, the loss does not merely fall on the party holding the documents when they are discovered to be forged. Prima facie the only duty on intermediary parties is to ensure before acceptance that the documents are valid on their face. If/

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(38) See Pender-Small v. Kinloch's Trustees 1917 SC 307, at 315.

(39) as Bailhache J. puts in in Guaranty Trust Co.

(40) Gutteridge & Magrah at p.112.

If there were to be a duty to detect forgery, and if mere detection thereof were to give some remedy, the purchasers would be entitled to refuse to accept from the issuing bank documents which had been proven forgeries. No case has gone as far as this.

The facts of Guaranty Trust Co. are not typical:

"the Bank of Liverpool sent their usual communication to the defendants requesting them to call and inspect the documents at once so that the draft, if in order, might be accepted without delay. The defendants called, inspected the documents, found them to be apparently in (41) order, and instructed the Bank to accept the draft".

The problem of the case arose when suspicions as to the genuineness of the bill of lading arose subsequent to acceptance but prior to payment. The accepting bank felt that it was bound by its acceptance and recovered from the defendants in the action. The plaintiffs argued that the defendants were not bound to pay the accepting bank and that any payment so made was gratuitous. The action was raised in the form of a declaratory action. The arrangement for the buyer to inspect the documents before acceptance was a specific term of the contract between the bank and its customer. But in most cases of course it is irrelevant to ask whether or not the customer is satisfied with the documents. The operation of the credit would be prejudiced by any requirement/

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(41) [1918] 1 KB at p.47.

requirement of consultation between banker and customer before acceptance. In the normal case the banker would not even be entitled to seek his customer's approval. The banker is under a contractual obligation to the presenter of the documents to meet the draft if no objections are clear from the appearance of the documents; his obligation is not solely, or even primarily in this instance, to his customer, and he may not allow the latter's discretion to be substituted for his own responsibility.

On the facts of Guaranty Trust Company, the purchasers would seem contractually to be entitled so to dictate the acceptance or non-acceptance of the bank. The bank in these circumstances could not be held liable on a bill which it had not accepted, nor could it be forced to accept a bill presented not for its inspection but for the purchaser's. Clearly the purchaser in this case had not been content to rely on the bank's discretion and had specifically safeguarded itself. This, however, could not be the normal mode of operation of the letter of credit. It would result in prejudice both to the intermediary bank and to the honest purchaser, to the former because of the uncertainty of relying on the individual purchaser, and the latter because consultation takes time.

Lord Justice Scrutton clearly saw that any representation as to the genuineness of the documents presented would have to be implied from the actings of the parties, and it seems that the implication of the actings was best expressed,/<sup>(42)</sup>

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(42) [1918] 2 KB 623 at 663.



expressed, although in another context, by Dean Ames,<sup>(43)</sup>  
cited in Guaranty Trust Co. by Lord Justice Pickford:<sup>(44)</sup>

"The holder [of a bill of exchange] is not a bargainer.

By presentment for payment he does not assert, expressly or by implication, that the bill is his, or that it is genuine. He in effect says: Here is a bill which has come to me, calling by its tenor for payment by you. I accordingly present it to you for payment, that I may get the money or protest it for non-payment".<sup>(45)</sup> The learned/

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(43) Harvard Law Review IV p.297 at 302.

(44) [1918] 2 KB at 631 and 632.

(45) It should be pointed out that this quotation is taken from an article discussing the "Doctrine of Price v. Neal" (3 Burr 1354; 1 W Bl 390 S.C.) a case in which a drawee paid to an indorsee on a bill of exchange the amount of the bill and thereafter discovering the drawer's signature to be false (a fact not known to the indorsee) sought to recover from the indorsee. The court held that no recovery was possible and the quotation cited was Dean Ames' suggested explanation for the rule, which seems also to apply in Scotland by virtue of the decision in Clydesdale Bank v. Royal Bank [ (1876) 3 R 586 ] although the justification for the rule is differently stated in the judgments of the Court of Session and, as has been suggested, may still be open to question.

learned judge thought this applied equally to the holder and presenter of a bill of lading.

Perhaps one of the most difficult problems in evaluating judicial decisions in this field is to keep clearly in focus the issues which have been decided and those which have not. Guaranty Trust Company held that presentation of documents did not ipso facto involve a warranty as to genuineness and that payment made on the strength of them could not thereafter be recovered. It did not decide whether or not payment could be refused where forgery was discovered after acceptance of the draft but prior to the date for payment although the bank in Guaranty Trust declined so to refuse payment, apparently on the basis that it could not go back on an acceptance given and received in good faith. One imagines that the bank would not have followed this course as against the forger had he been the presenter and had no indorsee relied on that acceptance.

In the earlier case of Woods v. Thiedemann (46) a purchaser of wheat wrote to the bank in the following terms:

"We shall feel obliged by your requesting the Union Bank of London to accept the drafts of Mr. Otto F. Homeyer of Wolgast, for 2400 l against a properly indorsed bill of lading of 8320 scheffels of wheat, per Anna, F. Kell master, on our account". (47)

The/

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(46) (1862) 1 H & C 478 or 130 RR.611.

(47) *ibid* quoted at p.621.

The court held that the words of this letter did not import that the bill must be "genuine". In reaching this decision the learned judges leant heavily on the practicability of the situation. At page 620, Pollock C.B. said:

"the transaction is simply this - the defendant having entered into a commercial speculation and wishing to accommodate the person with whom he was dealing, and for whose honesty he ought to be responsible, requests the plaintiffs to procure their London agents to accept drafts against a properly indorsed bill of lading. It seems contrary to all usage to assume the plaintiffs undertook to be responsible if it should turn out that the bill of lading was not signed by the Captain, or no goods were on board".<sup>(48)</sup>

This statement is of the very greatest significance in a wider context as it aptly describes the relative positions of the parties.

The American courts in Brown v. Rosenstein<sup>(49)</sup> also accepted that the buyer must be assumed to have accepted responsibility for the acts of his seller having selected him in the first place.

<sup>(50)</sup>  
Bramwell B. apportioned the responsibilities in similar fashion:

"the/

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(48) *ibid* p.620.

(49) (1923) 120 Misc N7 787 at 797.

(50) *supra cit.* at p.623.

"the banker has not the slightest opportunity of ascertaining whether the bill of lading is genuine, whereas the customer may always make himself safe, for he need never give an order to pay the bill till he's satisfied himself that the goods have been shipped and a genuine bill of lading<sup>has</sup>/issued".

This, on the other hand, should not be too widely construed for once again the facts reveal that the situation was not one in which a letter of credit was issued in the normal way. The purchaser can always get someone at the place of despatch of the goods to ensure that the genuine goods are in fact sent. Normally this will be done by requesting presentation of a certificate of quality. <sup>(51)</sup> But Bramwell B. does not say that there is a right of cancellation after the documents have left the seller's hands. Again in this case, as in Guaranty Trust Co., the bank was only brought in after the goods had been despatched. Although in these circumstances the purchaser retained some control, the normal procedure is for the instructions in the letter of credit to precede the despatch of the goods. This is the idea behind the credit and there can be no residual right in the purchaser to defeat the object of the credit.

Woods v. Thiedemann emphasised more than did Guaranty Trust Co. the importance to be given to the duties of the banker involved in the credit transaction. This emphasis was/

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(51) which does not eliminate all risk - see infra.

was continued in Basse and Selve v. The Bank of Australasia, a case involving fraud rather than forgery, and in which the decision turned on the duties incumbent on the banker.

Bigham J.'s judgment<sup>(53)</sup> is most instructive:

"their duties<sup>(54)</sup> did not begin until O. brought the documents to them. What these duties then were is in my opinion quite plain. The defendants were in the first instance to see that they dealt with the right man; this they had to do at their own peril. If they had parted with the money to someone who was not in fact the man indicated in the mandate, they could not I think have required the plaintiffs to repay the amount; and it would not have mattered how careful they might have been in making their inquiries. But once they were in touch with the right man the defendants' only remaining duty was to see that the documents which he brought purported on their face to be the documents described in the mandate. It was no part of their duty to verify the genuineness of the documents".

While this general submission seems clearly to be correct it is difficult to see whether identity could ever become material unless it was expressly stipulated in the mandate. And even if it is expressly stipulated, it seems somewhat/

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(52) [1904] 20 TLR 431.

(53) *ibid* p.433.

(54) *i.e.* the bank's duties of care.

somewhat doubtful that an apparently higher standard should be applied where the bank is deceived by a person misrepresenting his identity than that where the genuineness of the documents is at issue. In normal circumstances, however, such questions do not arise.

Thus far the issues are relatively clear. Certain situations have arisen and have been decided. Only the judgments themselves must be treated critically lest they be extended beyond their authors' original intentions. The true ground for debate relates to the "entitlement" or the "obligation" of the bank to reject in certain cases. The materiality of the alterations or forgery must also be considered. The problem of "obligation" and "entitlement" however, is absolutely fundamental and its resolution has important consequences in many aspects of the law of commercial letters of credit.

Unfortunately, though inevitably, the issues are largely hypothetical and undecided - "unfortunately", because the system has few outside sources on which to rely; and "inevitably" because the courts are very much a last resort in commercial matters. General guidance is, however, given by such well-known statements as "a bank is not bound or indeed entitled to honour drafts ... unless those drafts with the accompanying documents are in strict accord with the credit as opened".<sup>(55)</sup> Moreover, the documents "have to be taken up/

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(55) English, Scottish and Australian Bank v. Bank of South Africa (1922) 13 Ll L Rep 21, at 24.

up or rejected promptly<sup>and</sup> without any opportunity for prolonged enquiry; they have to be such as can be re-tendered to sub-purchasers and it is essential that they should so conform to the accustomed shipping documents as to be reasonably and readily fit to pass current in commerce". (56)

Davis would seem to state the rule more narrowly: (57)

it is the duty of the banker "to exercise care in the examination of the documents, and if on such examination he is satisfied as to their genuineness, he may pay the draft and debit the buyer with the amount of it". If this view implies some special duty as to investigating the genuineness of documents other than to ensure that there are no indications of falsity on their face, it's wisdom must be doubted. Prima facie it would appear that the bank should refuse payment where the documents show signs of having been altered, or where, for instance, the forgery is so crude as to be perfectly obvious on cursory examination. But should every alteration and erasure lead to such far-reaching consequences?

It is suggested that to answer this question in the affirmative would be to place an unwarrantably onerous duty of care on all parties dealing with the documents which are, it must be remembered, designed for use in mercantile matters in which formality is not as a practical matter to be overstressed./

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(56) *Hansson v. Hamel & Horley* [1922] 2 AC 36, at 46.

(57) at p.146.

stressed. It may be that obvious alteration or erasure puts a bank on enquiry but it is thought that in following through that enquiry the bank can not be held responsible if it reasonably takes the view that the alterations or erasure were not the product of fraud or evidence of falsity. (58) Some guidance is given by re Salomon and Naudzus an authority on sales contracts in which divergent opinions were given by Mr. Justice Darling and Mr. Justice Philimore the former prevailing when the latter opinion was withdrawn. (59) Mr. Justice Darling stated

"They were perfectly put on enquiry when the three documents which were to be tendered to them by the contract were tendered, and it was their duty thereupon to inquire, at all events to this extent, to look at the other document and see whether they could come to the conclusion that it was an honest transaction".

The learned judge refused to allow the party receiving the documents to abdicate this position of responsibility. He pointed out that the dispute would in fact never have arisen had not the market price altered dramatically and although this is not sufficient reason for reaching the decision (many cases have been decided in just such a situation with one party being found entitled to the benefit of what would normally/

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(58) (1899) 81 LT 325; also discussed infra at p.48.

(59) at p.328.



normally be ignored as a technicality) it is sufficient reason for the court to postulate a rule which is reasonable in the circumstances; no qualification of the requirement of "clean" or "unusual" documents is, of course, intended.

Where the genuineness of the documents is placed in doubt, however, as opposed merely to there being alterations therein, the courses open to the bank are as follows: firstly, to hold themselves bound to accept documents clean on their face without further investigation; secondly, to hold themselves entitled to refuse (implying also an entitlement to accept) documents until further investigation has proved whether they are genuine or not; thirdly, to hold themselves bound to refuse tender of the documents until their genuineness is proved; and finally to insist on an indemnity. The first involves no extension of the bank's duty; the third involves a considerable extension, in that any investigation short of court proceedings would require to be conducted by the bank itself. In no circumstances involving a "normal" <sup>(60)</sup> letter of credit could the decision be left to the whim of the purchaser. The middle course would involve the use of discretion by the bank and in this as well there is an implied extension of the bank's responsibility. Again, clearly the standard of satisfaction to prevail would be the bank's. If it were reasonably satisfied, /

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(60) i.e. not as in Guaranty Trust where the instructions were specific.

satisfied, it is difficult to see how it could then be denied recompense from the purchaser. The analogy of ambiguous instructions in the letter of credit at once suggests itself in support of this standard of reasonableness. (61)

(62) Davis suggests that when the banker "knows" of the falsity of the documents accompanying the seller's drafts he would appear to be not only entitled but also bound to refuse tender of the documents. This seems to introduce yet another concept, that of "knowledge". (63) It is difficult, however, to see what criterion is to be adopted if it is not "reasonable grounds to believe". Shientag J. in the American case of Sztejn v. J. Henry Schroder Banking Corporation (64) seems to have this criterion in mind when he says: (65)

"The Chartered Bank, which stands in no better position than Transea, should not be heard to complain because Schroder is not forced to pay the draft accompanied by documents covering a transaction which it/

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(61) See Equitable Trust Co. of New York v. Dawson Partners Ltd. (1926) 25 Ll L Rep 90.

(62) at p.150.

(63) There are some interesting and stimulating comments in Professor Ellinger's recently published book, Documentary Letters of Credit (1970) particularly at page 183 et seq. This book is of special interest in that it sets out to give a comparative study of the solutions reached in respect to commercial credit problems and is the first work to be constructed round the U.C.P.

(64) (1941) 31 NY Supp (2d) 631 - hereinafter referred to as Sztejn's case.

(65) at p.634.

it has reason to believe is fraudulent".

And if "reason to believe" is to mean no more than "suspicion" an American court has already indicated its disapproval of this criterion. <sup>(66)</sup> The bank moreover, is obviously in a difficult position in regard to any investigation. It is not generally in a position to know what has been shipped, nor to investigate the circumstances surrounding shipment. From the nature of things, the goods will usually be in transit when questions as to the validity of the documents arise. Short of a conviction for fraud based on the facts in issue it will be difficult for the bank to make any sort of rational judgment as to validity. Moreover, the party most likely to inform it of the forgery is the purchaser, whose motivations must be suspect.

Assuming, however, that it could be conclusively proved that the documents were false or forged it is not clear on what basis the bank should be held bound to reject the documents. It may be that public policy is the sole basis for the bank's obligation to reject and if this were so each case would require to be decided on its facts. On the other hand, it may be argued that the obligation is inferred from the bank's duty to its customer as purchaser. Or it may be that the bank is justified in rejecting since the documents are the basis of its own security until it has/

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(66) Dulien Steel Products v. Bankers Trust Co. 298 F (2d) 836 (1962).

has been recompensed by the purchaser. This last reason does not, however, justify an obligation on the bank to reject - at most it might perhaps justify an entitlement to reject.

It is to be noted that the bank in accepting or rejecting documents in terms of a letter of credit must exercise an independent role - <sup>(67)</sup> independent, at least, in the sense that duties are owed both to the purchaser, namely to accept only in terms of the letter of credit, and to the seller, that is, to accept when the documents are in order. Schientag J. in *Sztejn's* case adds very little when he <sup>(68)</sup> says:

"In such a situation, where the seller's fraud has been called to the bank's attention before the draft and documents have been presented for payment, the principle of the independence of the bank's obligation under the letter of credit should not be extended to protect the unscrupulous seller".

One wonders whether the notion of extension of duty is not superfluous; and one should not necessarily accept the assumptions implicit in the judgment, namely that the law as it stands (or did before *Sztejn*) did not protect, at least indirectly, the unscrupulous seller. Prima facie there is no extension of the bank's duty if it merely examines the documents/

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(67) See e.g. *Urquhart Lindsay v. Eastern Bank Ltd.* [1922] 1 KB 318.

(68) (1941) 31 NY supp (2d) 631 at 634. This case is discussed infra at p.50 et seq.

documents on face values only. The extension is only where the bank is required to go further. 'Sztejn's case seems rather to have been decided on public policy considerations as related to the particular facts of the case. Where public policy is concerned the facts must be of prime importance - general conclusions are almost impossible. It may well have been that in Sztejn's case to allow the bank to accept would have been to put a premium on fraud. But in another case, Pearce L.J. said:

"Trust is the foundation of trade; and bills of lading are important documents. If purchasers and banks felt that they could no longer trust bills of lading, the disadvantage to the commercial community would far outweigh any conveniences provided by the giving of clean bills of lading against indemnities".

He saw any qualification of the practice of "clean" bills being acceptable as in some degree prejudicial to the credit system. The system is built upon trust. Moreover, at least one element in public policy is surely the safeguarding of the expediency of a sound commercial device only occasionally affected by dishonesty. Nor is any condonation of fraud<sup>necessarily</sup> direct in that it is not always the wrongdoer who is demanding satisfaction. If it were, the fraud would be a clear defence to any action for enforcement always assuming that fraud could be proved, a very large assumption in most legal systems.

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(69) Brown, Jenkinson & Co. v. Percy Dalton (London) Ltd.  
[1957] 2 QB 621.

(70) *ibid* at 639.

Many different situations may arise: it may be, for instance, that the shipowner has interfered with the goods, or, the seller may well have presented the documents to an intermediary bank who is in turn relying on the security of the goods<sup>(71)</sup> only until presenting the documents in its turn to the issuing bank.

The issue of public policy is not really one in which the guidance of the American courts can be anything more than an illustration of one possible approach. Again, the variety of ways in which the credit may be operated is hardly conducive to generalisations on public policy. At most it is an overriding doctrine which would probably be applied where there was any question of injuring innocent parties at the expense of fraudulent ones. If the fraud or forgery has been committed and all that remains is the natural progression of the documents to the purchaser, public policy is not helpful.

It must be doubted whether there is a duty as such on the bank owed to the purchaser to refuse documents where they are known to be forged - i.e. a duty apart from considerations of public policy. Given a prima facie independence, it is difficult to see where forgery justifies special treatment. Woods v. Thiedemann<sup>(72)</sup> settled the point that the bank was not responsible for the seller's honesty, and it has been specifically denied that the instructions in a letter of credit can be interpreted as requiring genuine/

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(71) represented by the documents.

(72) 130 R R 611.

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genuine documents. If the bank is not responsible for the seller's honesty, neither should it be responsible for ensuring honesty in the particular case before it carries out its primary duties; and it should also be noted at this stage that the concept of "knowledge" of fraud itself involves many difficulties on which there is very little judicial guidance: what standard is to apply, is an honestly held belief sufficient, what is to be the effect of reasonable grounds for suspicion, who is to judge when knowledge is to be attributed to a bank, what regard is a bank to pay to a customer's allegations of fraud or falsity? The duty, it is to be remembered, is imposed as a result of the system, not by virtue of any speciality in the banker-customer relationship.

In most cases in which documents are presented for the bank's acceptance the documents have two functions: they are to be presented to the purchaser for acceptance in normal course, and they are to serve as security for the bank should the customer for some reason fail to so accept. In two ways the bank will be prejudiced by having to accept forged documents. The purchaser, the bank's customer, will not/

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(73) *ibid* at p.620,623. Continental National Bank 69F (2d) 312 at 317 underlines and perhaps extends the implications of this view. See discussion *infra* p.58.

not in all probability have the goods he was relying on to resell in order to repay the bank; and in lieu of this right of repayment, the bank will not have the goods to fall back on. The question then becomes; has the bank a duty to itself or, putting it another way, can the bank consider the risks it assumes in accepting documents suggested by one source or another to be false or forged, and will this entitle it to reject documents reasonably believed to be false. This of course relates only to entitlement, not obligation in terms of the contract with the customer. If, as I have suggested, there is no obligation to refuse, the bank accepting the documents will retain its rights of recovery against the purchaser, whatever these may be worth. Where the goods themselves are valueless, the value of them might clearly depend on the financial standing of the purchaser, though just as clearly the bank's entitlement can not be related simply to this factor. The presenter, on the other hand, may well only have the security of possibly valueless goods in addition to a possible action for fraud against the seller, again not likely to be of great value. Moreover, the presenter has acted in reliance on the terms of the letter of credit which vis-à-vis the banker does not require valid documents. It therefore becomes difficult to see why, even admitting that it must naturally be concerned to minimise its/

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its own risks arising out of the transaction, the bank should have any special entitlement over and above its normal duties. Assuming that the courts will not permit a party to take advantage of his own fraud should it be proved in court, the most difficult questions arise between equally innocent parties, one of whom, the presenter, has relied on the representation of the other, the bank, in the letter of credit. Is not the latter's risk something which should be reflected in the commission fixed between bank and customer? The courts have emphasised the fact that the bank relies on the security of the goods.<sup>(74)</sup> But no case has been decided on that fact alone.

Two further points cause concern: should the bank's reasonable beliefs as to the documents' falsity not be upheld on investigation, the delay may cause great prejudice to the presenter. Who would be responsible for this loss? Surely not the presenter. But if the bank is entitled to stop to investigate it would not be responsible for the loss. Moreover, the general rule is that the bank is normally expected to take up or reject the documents promptly.<sup>(75)</sup> Any enquiry into genuineness would clearly take some time and contradict this.

It is thought that the analogy suggested by Davis<sup>(76)</sup> is/

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(74) See for instance Szejn's case supra cit at p.635, and Cardozo J.'s dissent in O'Meara (1925) 239 NY 386 at 401.

(75) Hansson v. Hamel and Horley Ltd. [1922] 2 AC 36 at 46.

(76) at p.150.

is of very limited help. In the case relied on, Karberg v. Blythe, Green & Co.,<sup>(77)</sup> the buyer under a c.i.f. contract was held entitled to reject documents which, although as specified by the contract, had ceased to be enforceable by the buyer under the rule of public policy refusing validity to contracts entered into with enemy aliens. This set of facts is analogous to that of a "known" forgery in that the fact of unenforceability was readily ascertainable. But as, has been pointed out, "knowledge" in this sense can only very rarely be ascribed to the bank; normally, only a reasonable suspicion can exist. If actual knowledge was required it is difficult to see any circumstance other than criminal conviction which would satisfy the requirement of "knowledge". In Karberg, such public policy decisions as Esposito v. Bowden<sup>(78)</sup> were applied and it would seem that the court did no more than apply a well-decided rule. Towards the end of his judgment, however, Scrutton L.J. said:

"I do not suppose Hamilton J. in Biddell v. E. Clemens Horst & Co. had this point in mind when he used the phrase 'an insurance ..... which will be available for the benefit of the buyer,' but I cannot believe that contracts which are illegal and void can be regarded as good tenders and available for the benefit of the buyer".<sup>(79)</sup>

Scrutton L.J./

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(77) [1915] 2 KB 379.

(78) (1857) 7 E & B 763.

(79) <sup>supra cit</sup>  
/at p.392.

Scrutton L.J. clearly suggests the analogy on which Davis seeks to rely; but he just as clearly points out its limitations. First of all, the question of a contract with an alien enemy is one of the best examples of the application of public policy, and secondly, Hamilton J.'s remarks were directed only to the one particular situation. We are in our case dealing with a three-cornered transaction where there is no question of illegality as such between the parties, nor any pressing consideration of public policy.

The question of the materiality of the forgery or falsity scarcely arises. If the falsity is clear on the face of the documents the general rule as to the bank's duty (80) would clearly preclude their acceptance. Where the falsity is not clear from examination of the documents the materiality would merely be one element in deciding the application or not of the doctrine of public policy. (81) In Kwei Tek Chao v. British Traders and Shippers Ltd., (82) Devlin J. said:

"If someone forges the signature to a document, that document is wholly fictitious from beginning to end, and it is, of course, null and void as soon as forgery is proved, but I do not think that that is any authority for the view that any material alteration to a document destroys it and renders it null and void. Deciding/

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(80) they would not be "clean".

(81) See Salomon and Naudzus supra cit.

(82) [1954] 1 All E R 779.

Deciding the matter in the absence of authority and on principle, I think the true view is that one must examine the nature of the alteration, and see whether it goes to the whole or to the essence of the instrument, or not. If it does ..... then the instrument is destroyed, but if it corrupts merely a limb, then the instrument remains alive, though, no doubt, defective".

This is no doubt the case where the contract is c.i.f. and where the issue is between damages or reduction of the whole contract. As regards the letter of credit situation where a bank has the instructions of a letter of credit to follow, all that is necessary to justify rejection is a defective deed, one that it cannot insist on the purchaser accepting.

Devlin J. also approved the dicta in Clough v. London and North Western Railway Co. to the effect that where fraud or forgery is involved, the party who is to accept the documents may take longer in deciding whether or not he is going to accept them. This, however, was only intended to apply where the question is whether or not to affirm a contract. The bank is in no position to affirm. It is only an intermediary, though with its own interests to protect. The expediency of the system and the judgment of Lord/

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(83) at 787.

(84) at 786.

(85) (1871) LR 7 Exch.35.

Lord Sumner in Hansson v. Hamel and Horley<sup>(86)</sup> are clearly against any extension of the bank's discretion.

Regarding the letter of credit itself, there are no specific authorities; those suggested by previous writers have been based on analogies with the law of negotiable instruments.<sup>(87)</sup> Although the letter of credit is not of course a negotiable instrument, the guidance afforded by this section of the law is not to be underestimated. Its limitations are, however, obvious. The element of negotiability may be a very vital one, and the frameworks in which the two instruments operate can not be identified with each other.<sup>(88)</sup> Gutteridge and Magrah suggest that where the letter of credit is fraudulently altered, the position is as in the law of bills of exchange. It is submitted that the problems raised can not so simply be resolved. The bank has in most instances an active role to play in the issuing of a letter of credit. It is thought that where the letter of credit has been forged there can be no doubt that the bank is entitled to reject any tender of documents; acceptance by the bank could only be on its own account, not on the basis of an expectancy of recovery from the purchaser. This applies where the letter of credit is a nullity; where the instrument's/

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(86) supra cit.

(87) See G & M p.108, and Davis p.146.

(88) at p.108.

instrument's signature has been forged or its terms materially altered.<sup>(89)</sup> If the bank's attention is drawn to the possibility of forgery, it must investigate or take the risk of failing to recover from the purchaser. On the other hand, the purchaser could not be allowed merely by pleading forgery to escape liability; and the existence of forgery may not be easily proved. There seems to be no alternative to giving the responsibility of investigation to the bank. The situation is a special one: the bank's duties only arise on the basis of the letter of credit. Until it can be sure that there is a mandate it should not act. Against this, it must be admitted that the person tendering the documents is normally entitled to an immediate decision as to their acceptance. If the bank has reasonable grounds to suspect the genuineness of the letter, it must surely be given a reasonable opportunity to investigate. The principal responsibilities in this situation are undoubtedly the bank's. It should not be thought that this is alien to the bank's position within the field of commercial credits - in Equitable Trust Company of New York v. Dawson Partners,<sup>(90)</sup> the bank had to pay for the consequences of an error in communication.

The position as regards the recovery of payments made on the strength of a forged bill of exchange has already been examined. It is thought that the considerations discussed apply equally where the letter of credit has been forged.

The/

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(89) c.f. Lord Devlin *supra cit.*

(90) *supra cit.*

The element of negotiability is not a vital one in this connection since one of the documents presented will normally be a bill of exchange and since the doctrine in question is in both cases that of payment under mistake of facts.

The major difficulties are in the duties of the purchaser or customer towards the bank named in the letter of credit firstly in signing and presenting the letter and secondly when he knows of the forgery although not himself directly responsible for it. While the duties incumbent on the drawer of a cheque do give some guidance, it is thought that the particular situations in which the letter of credit operates are significant. The system is intended for the benefit of both purchaser and seller, with maximum security to both - it is a more complicated concept than the bill of exchange where the bank's responsibilities as regards forgeries are very onerous indeed. In credit transactions, the bank's involvement is by way of individual instruction and until its mandate reaches it, it has theoretically no control over the letter whatsoever. (91) The customer or purchaser has. In London Joint Stock Bank v. Macmillan and Arthur, (92) when talking of duty of care in drawing cheques, Lord Shaw of Dunfermline said:

"it appears to me that a crucial consideration in a case such as the present is this, namely, what is the point of time at which these respective obligations/

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(91) in practice, of course, the modern bank is intimately involved in the preparation of the letter.

(92) [1918] AC 777.

obligations meet. The point of time is the presentation of the cheque. Not until that moment is the banker confronted with any mandate or order"<sup>(93)</sup>

He goes on to stress that negligence is the crucial ratio in such cases.<sup>(93)</sup> A fortiori where the buyer approaches the bank for use of credit facilities, it is reasonable that he should take care both in signing and presenting the letter of credit to the bank. And it may well be that his responsibility goes further than this. Thus if the purchaser were to send to the seller a letter of credit to be presented to a certain bank by the seller, (not, of course, the normal situation now, although it was frequently the case with the earlier forms of travellers' credits<sup>(94)</sup>) it is thought that providing the signature was genuine and no forgery or falsity obvious on its face, the buyer would be responsible for alterations fraudulently made by the sellers. In the more usual case, however, where the letter of credit is given directly by the buyer to the bank in the sense that he signs a document prepared by the bank the circumstances in which forgery could intervene are somewhat difficult to envisage. If the signature is not genuine or some other matter in the letter forged and the purchaser presents the document to the bank, it would seem clear that the purchaser is personally barred as against the bank from disowning the letter or subsequently founding on the forgery. In the normal case, the/

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(93) at p.824.

(94) Davis p2 et seq.



the major banks have stereotyped forms for letters of credit which are completed and signed according to the customer's special requirements. In this situation it does not seem unreasonable to place the bank in a position of responsibility as to the genuineness of the documents. It may well be that the bank would not be entitled in such a case to delay payment on presentation of documents in order to verify the letter's genuineness. Normal principles of personal bar would apply. The duties and responsibilities of the bank before the credit machinery is set in motion have no logical connection with the duties involved thereafter.

The most delicate questions are those of alterations in the letter of credit where there is a genuine signature. For example, the instruction to accept the draft only on presentation of three bills of lading may be altered to allow acceptance on the presentation of two. It seems that any alteration must prima facie be regarded as material where the bank or banks involved must, from force of circumstance, operate without close acquaintance with the trade background. The above example would be a clear example of a fundamental alteration with the same result as that of the addition of a nought to the figure in a cheque. <sup>(95)</sup> And despite Devlin J.'s observations on the effect of alterations in dates in c.i.f. contracts, <sup>(96)</sup> it would seem that such alteration would also justify/

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(95) Chao supra cit. at p.787.

(96) *ibid.*

justify the rejection of the document as a complete nullity.

The importance of exact conformity with stipulated dates  
has already been stressed in several cases. <sup>(97)</sup> More

generally, the rejection of the de minimis principle contained  
in the case of Moralice (London) Ltd. v. E. D & F Mann Ltd. <sup>(98)</sup>

should be extended to such alterations in the letter of credit.

The buyer or customer's general duties as to letters  
of credit known by him to be forged or in some respect false  
must also be considered. The duty to inform the bank of  
such falsity could arise conceivably by reason of a general  
course of dealing in commercial credits, by reason of trade  
usage, or simply as a result of the banker/customer

relationship. Generally there is no duty to correct another's  
misapprehension and no responsibility can be inferred from  
mere silence. <sup>(99)</sup> In Polack v. Everett, <sup>(100)</sup> however,

Blackburn J. said: "if a man stands by and allows another  
to act without objecting when, <sup>the</sup> from/usage of trade or  
otherwise, there is a duty to speak, his silence would  
preclude him as much as if he proposed the act himself".

Similar sentiments have been expressed by Parke B. in Freeman v.  
Cooke <sup>(101)</sup> and by Bramwell J. in Russell v. Thornton. <sup>(102)</sup> In  
Scotland, /

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(97) e.g. Midland Bank v. Seymour [1955] 2 LL 1 Rep 147.

(98) [1954] 2 LL Rep 526.

(99) Jones v. Waring & Gillow Ltd. [1926] AC 670.

(100) (1876) 1 QBD 669 at 673.

(101) (1848) 2 Exch 654 at 663.

(102) (1859) 4 H & N 788 at 798.

Scotland, Mackenzie v. British Linen Co. (103) may be regarded as authoritative support for these decisions.

While all aspects of the relationship between purchaser and issuing banker have not been judicially examined as yet, it is submitted that some guidance may be given by the judgments in Greenwood v. Martins Bank Limited, (104) particularly that of Scrutton L.J. Lord Justice Scrutton examined (104a) the two (101) grounds of liability put forward in Freeman v. Cooke: statement by conduct and conduct by omission where there was a duty to disclose the truth. These must be carefully distinguished and while the facts of an individual case might highlight the first, the second will more often arise merely by reason of the juxtaposition of the parties. The court in Greenwood's case relied on the continuing nature of the relationship of banker and customer in the operation of a current account to formulate a duty on the one to inform the other of forgeries detected by them or brought to their notice. (105) The duty was conceived by Scrutton L.J. to be mutual.

Now clearly the operation of the letter of credit does not dictate a continuing relationship in the sense that a current account does. There will, of course, usually be such a relationship in the background. It is not on this, however, that reliance should be placed. As Lord Justice Tomlin/

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(103) (1881) 8 R (HL) 8.

(104) [1932] 1 KB 371; on appeal [1933] AC 51

(104a) at p.379 et seq.

(105) *ibid* at p.381.

(106)  
Tomlin pointed out, the duty depends solely on the circumstances; and, leaving aside for the present any question of usage of trade, it takes little imagination to formulate a duty arising from the circumstances of the credit's establishment. If the individual purchaser and the bank had negotiated a credit, some element of which thereafter came to the attention of the purchaser as being forged or false, there would be a duty arising out of the agency relationship. And where there had been prior dealings in commercial credits or even in other banking facilities rendering the bank likely or open to deception by third parties, there would seem good grounds on the ratio of Greenwood for holding the customer under an obligation arising from the banker/customer relationship. Where there had been no prior communications between purchaser and banker, there would be no such duty - in these circumstances, however, no bank would be justified in proceeding without satisfying itself that the mandate was good. Two other judicial observations on this field are also helpful. In Union Credit Bank v. Mersey Docks and Harbour Board, (107) Bigham J. (108) referred to the case of Swan v. North British Australian Co., (109) the headnote of which would suggest that the doctrine of estoppel/

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(106) Greenwood supra cit. at 59.

(107) [1899] 2 QB 205.

(108) ibid at 210.

(109) (1863) 2 H & C 175.

estoppel by executing instruments in blank is confined to negotiable instruments:

"if this semble means that the doctrine of estoppel does not extend to cases of other documents even where authority has been given to fill up the blank, I say there is nothing in the judgments to justify the semble; nor indeed do I think there is anything to justify it as it stands".

(110)  
And in Greenwood, Scrutton L.J. commented on a passage in Paget "to the effect that neither estoppel nor adoption can be relied on if the banker's negligence has in part contributed to the loss". (111) He pointed out that this was not supported by English authorities and that the U.S. law had gone further than English law in developing the mutual duties of banker and customer. Rather they have developed in a different way, perhaps one which is correctly less one-sided.

One further point which arose from the case of Brown, Jenkinson and Co. v. Percy Dalton (London) Ltd. (112) was the suitability of the indemnity device in circumstances suggesting forgery or falsity. Although the court in this case was commendably clear in its condemnation of this middle course, apparently so commercially popular, it is inevitable that in many cases the indemnity device will be utilised and that accordingly many disputed or doubtful cases will not come before the courts. Two conclusions are clearly stated/

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(110) supra cit. at p.384.

(111) 4th Ed. PS 330 & 345.

(112) [1957] 2 QB 621.

stated in the judgments: firstly that clean bills of lading do not require to be supported by indemnities; and secondly, that an indemnity should not be used to cover up for false documents, or documents which throw doubt on the existence of the goods. Business pressures do not, however, generally admit of such niceties.

The major topics relating to forged documents in the field of commercial credits have now been considered and we may turn to the subsidiary questions of alterations in documents and of documents false in a sense other than forged. Both general principles and particular situations are involved.

The position as regards alterations, already touched upon, can generally be settled by application of principle. If the alterations are obvious, the bank's duty is clearly to refuse the documents as not being clean. It would be a question of circumstances, which so far as not arisen, as to whether or not such altered documents might, though not "clean", qualify as "usual".<sup>(113)</sup> The only guidance is that offered by the judgments in re Salomon and Co. and Naudzus,<sup>(114)</sup> where the special responsibilities created by the credit system seem at first sight to be better catered for in the judgment of Phillimore J.<sup>(115)</sup> The facts of the case are interesting.

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(113) See National Bank of Egypt v. Hannewig's Bank (1919)  
1 Ll L Rep 69.

(114) (1899) 81 LT 325.

(115) at 329/<sup>329/</sup>330. The judgment conflicted with that of Darling J. and was withdrawn, the latter judgment being given as that of the court.

An invoice correct and unaltered on its face was presented together with a bill of lading and a certificate of insurance both bearing a date which though the same as the invoice's had clearly been altered. The documents were refused as being unclean. Darling J., whose judgment prevailed, (116) stated that the party who was to accept the documents had been put on his enquiry so as to investigate whether or not there had been some falsity but that there was no entitlement to reject out of hand. He emphasised that the goods had fallen in value and that this was undoubtedly the true (117) reason for the rejection. He concluded in favour of the old dictum "that the law is best applied when it is subservient to the honesty of the case". This, of course, merely provokes the retort that "hard cases make bad law". Phillimore J. answered the suggestion of the duty of enquiry as follows:

"In this class of cases a man specially requires a good marketable title. He is probably dealing largely on borrowed money, and he is possibly buying to sell again. In either case he requires not only documents that would satisfy him, but documents which (118) he can compel others to take as being satisfactory".

This reasoning may be more appropriate to the circumstances likely to arise with a letter of credit transaction. Where the alterations were not clear from reasonable inspection of the/

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(116) at 328.

(117) at 329.

(118) ibid

the documents, the courts would require to apply the general rule as to the banker's duty as expressed by Gutteridge and Magrah at page 68 and explained by Lord Sumner (119) in Hansson v. Hamel and Horley Ltd.

The problems posed by documents otherwise false are focussed by a series of American authorities which, though subject to consideration of factors not necessarily similarly viewed in British courts, have formed the basis of suggestions made by earlier writers as to the position which the British courts would adopt. (120) It may well be that this ready acceptance is not beyond criticism.

In Sztejn, (121) the seller fraudulently shipped "worthless rubbish" and presented his draft together with shipping documents to the intermediary bank in order that the latter might present them for collection to the defendant bank. The seller who had by this time learned of the fraud was granted an injunction to prevent the payment of the draft. The terms of the letter of credit were significant, providing:

"drafts by Transea for a specified portion of the purchase price of the bristles would be paid by Schroder upon shipment of the described merchandise and presentation of an invoice and a bill of lading covering/

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(119) supra cit.

(120) See G. & M. p.111 and Davis p.150.

(121) supra cit.



covering the shipment, made out to the order of  
(122)  
Schroder".

The terms were not for "shipment ..... as evidenced by ....."  
However, there is no indication in the reported judgment  
that any great significance was attached to the wording of  
the letter.

The case has attracted sufficient discussion to  
justify a very close scrutiny of Mr. Justice Shientag's  
judgment. After holding that fraud had been proved he went  
(123)  
on to say:

"It would be a most unfortunate interference with  
business transactions if a bank before honoring  
drafts drawn upon it was obliged or even allowed to  
go behind the documents at the request of the buyer  
and enter into controversies between the buyer and  
seller regarding the quality of the merchandise  
shipped. If the buyer and seller intended the bank  
to do this they could have so provided in the letter  
of credit itself and in the absence of such a  
provision the court will not demand or even permit  
the bank to delay paying drafts which are proper in  
form ..... of course the application of this doctrine  
presupposes/

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(122) as quoted in Shientag J.'s judgment at p.633.

(123) ibid p.633/4.

presupposes that the documents accompanying the draft are genuine and conform in terms to the requirements of the letter of credit".

It might be suggested that this case was exactly one where the letter did provide the solution requiring as it did "shipment" and "presentation". But no mention was made of this. And while the general statement of principle is clearly well-founded one must, with respect, question the presupposition of genuineness emphasised in the last sentence. It seems to conflict with such authorities as Woods v. Thiedemann.

The basis of Shientag J.'s decision was that "where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payment the principle of the independence of the bank's obligation under the letter of credit should not be extended to protect the unscrupulous seller"<sup>(124)</sup>. He also pointed out that the bank was relying on the security of the goods represented by the documents, goods which were apparently "cowhair, other worthless material and rubbish". As has already been indicated, the element of public policy seems to have been very much to the fore in this decision, and while this may be justified vis-à-vis the "unscrupulous seller" it is doubtful whether the case's ratio can bear a wider/

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(124) *ibid supra cit.* p.634.

wider application. Professor Ellinger<sup>(125)</sup> mentions that "some London bankers think the rule should ..... be limited to cases of forged documents" on the basis apparently that they are concerned with documents not goods. While this view has some attraction it would be extremely ironic if it were to be given effect to, Sztejn's case being one concerning documents which were false rather than forged. Professor Bennett Miller argues<sup>(126)</sup> that the American decision "appears to accord well with the general theory and purpose underlying bankers' commercial credits" and Davis uses it to support his reasoning regarding forged documents. The latter's treatment has already been discussed. It also seems that Professor Miller's generalisation may be questioned. He supports Sztejn on the grounds of the bank's mandate despite the fact that it has already been decided that the mandate does not infer "genuine documents only".<sup>(127)</sup> The question of the buyer's authority is irrelevant/

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(125) cited *supra*(p. 28) at p. 194

(126) Casebook p. 94

(127) Woods v. Thiedemann *supra* cit.

irrelevant except in so far as it is contained in the letter of credit, and the possible prejudice of the bank's security over the goods is not per se sufficient to justify refusal. Judicial support for .Sztejn is scarce. The learned judge recognised that he was not bound by previous authority. In Old Colony Trust v. Lawyers Title and Trust Co. (128) there was an obiter dicta in the following terms:

"Obviously, when the issuer of a letter of credit knows that a document, although correct in form, is, in point of fact, false or illegal, he cannot be called upon to recognise such a document as complying (129) with the terms of a letter of credit". Not only was this statement obiter. In Continental National Bank et al v. National City Bank of New York (130) it was pointed out that the judgment appeared to lay down as a general principle that a requirement for documents inferred that the documents should be "truthful" and that the bank could refuse payment if the goods did not in fact comply with the documents. Clearly, as a matter of settled law, this is not the case, and it would be unwise to rely on a decision which was expressed in such ambiguous terms. In looking for support for .Sztejn, reference may also be made to an obiter dicta of Tindal C.J. in/

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(128) 2 Cir 297F 152.

(129) ibid at p.153.

(130) 69F (2d) 312.

in the authoritative case of Robinson v. Reynolds: (131)

"nor would the want of consideration between the drawer and acceptors [ render the acceptance on the bill of exchange not binding ] unless they took the bill with notice of the want of consideration".

"Want of consideration" is, however, an entirely different thing where the goods are supposed not to be truly represented by the documents. One immediately faces problems with degrees of non-conformity. There is a comforting (132) certainty in the generalisation of Gutteridge and Magrah:

"It is submitted that in the United Kingdom the banker would be bound to pay whatever his knowledge of the shipment".

Where the tenderer of the documents was himself the fraudulent seller, a refusal could, however, be safely given since the fraud would be an adequate defence to any legal action to enforce acceptance. This refusal could not however be enforced by the purchaser unless the fraud could be conclusively proved. And in this case the ground could only be that of public policy, the independence of the credit precluding the ground of breach of contract.

Sztejn is obviously a very clear example of fraud and thus perhaps a very clear example of where public policy should operate. On the other hand, American examples of public/

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(131) (1841) 2 QB 196 or 57 R.R.649 at 656.

(132) at p.112.

public policy are not generally acceptable for English courts. And while the clarity of the situation in *Sztejn* lent itself to a policy decision, it does not justify fixed rules of law readily extended to the more two-sided situations that may well arise. This was recognised in America by Greenbaum J. in the case of Frey v. Sherburne and National City Bank: (133)

"It would be a calamity to the business world ..... if for every breach of contract between buyer and seller a party may come into a court of equity and enjoin payment of drafts drawn upon a letter of credit issued by a bank".

One can readily envisage a situation where a fraudulent seller ships goods which although not intrinsically valueless are either valueless to the purchaser either because of his requirements or because of the market in the purchaser's country. The fraud is no less grave than in *Sztejn's* case, nor the loss any the less. But is the bank to be forced to arbitrate in such disputes? In Frey's case and in Benecke v. Haebler (134) the courts certainly took the view, consistent with general principles, that the bank were not concerned with quality disputes, no matter how well documented were the complaints. It has been suggested (135) that the rule in *Sztejn's*/

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(133) 193 App Div 849 (1920)

(134) 38 App Div 344; App'd 166 NY 631 (1899)

(135) E.P. Ellinger: *Documentary Letters of Credit* 1st Ed. 1970 at p.190.

Sztejn's case derives some support from English cases.

The authorities cited <sup>(136)</sup> are not, however, at all persuasive other than in acknowledging that a party may not rely in court on his own fraudulent conduct to gain an advantage.

And a subsequent American case <sup>(137)</sup> in which the plaintiffs sought to rely on the "fraud principle" of Sztejn's case indicated the court's unwillingness to apply the principle in any but the clearest instance of knowledge of fraud. The line of authority based on O'Meara's case was preferred and on appeal it was stated:

"But here Bankers never had notice of the type of fraud Sztejn seems to require. Dulien's [i.e. the purchaser and plaintiff] own behavior was indicative more of one merely suspicious of than one certain of fraud". <sup>(138)</sup>

There were further indications that any application of the principle in Sztejn's case would only be appropriate in an action raised by the purchaser against the bank by way of injunction prior to payment of the draft. In other words an extension of the bank's obligations does not appear to be envisaged, and Professor Ellinger <sup>(139)</sup> may well be correct in suggesting/

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(136) Societe Metallurgique etc (1922) 11 Ll LR 168 at 170; Malas etc. v. British Imex Industries [1958] 2 QB 127 at 130.

(137) Dulien Steel Products v. Bankers Trust Co. 189 F Supp 922 (1960) affirmed 298 F 2d 836 (1962)

(138) ibid p.841.

(139) supra cit at p.196.

suggesting that in any case where a seller's fraud or forgery is suspected by the buyer the bank should disregard the allegation unless and until a court action is brought by the buyer, albeit with the bank's encouragement. This is especially so in English & Scottish courts where the authority of Sztejn's case is debatable. Interim interdict, at least, has the advantage of speed. It would be interesting to see what standard of proof would be required by a Scottish court before granting an interim order.

More subtle problems than that of Sztejn have been suggested by the earlier American decisions in O'Meara and Continental National Bank v. National City Bank of New York. (140)

In the former case, the Bank refused to pay on the strength of documents presented to them because they had no proof that the goods in fact conformed to the description in the documents as to their tensile strength. This is a situation in which the purchaser would have been well-advised to have stipulated for a certificate of quality which would have been attested by an independent qualified party, and been an added safeguard against fraud or non-conformity. Even this, however, could not eliminate the inherent risk of all such transactions. (141a) It is submitted that Davis (141) goes too far when he suggests that the stipulation of such a certificate radically/

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(140) (1934) 69 F (2d) 312.

(141) at p.155.

(141a) e.g. Commercial Banking Co. of Sydney Ltd. v. Jalsard

✓ Pty. Ltd. [1972] 3 WLR 566 where it was pointed out that 'certificate of inspection' was itself ambiguous, in this case it gave no effective protection.



radically alters the position. Provided the certificate was acceptable on its face the bank would have no obligation or right to delve further into its genuineness, short of the overriding safeguard that fraud could be pleaded in defence against the action of a dishonest party. There is, however, no special rule where a certificate of quality is to be presented. As was pointed out by Mr. Justice McLaughlin in (142) O'Meara:

"A provision, giving [the bank the right to see that the description of the merchandise contained in the documents presented is correct], or imposing such obligation, might, of course, be provided for in the letter of credit".

The learned judge goes on to question how exhaustive the bank's tests would require to be in that situation. Would sample testing be adequate?

In O'Meara where there was no question of such a certificate nor of a special provision in the letter of credit it was correctly held that the bank were neither entitled to have the goods tested nor to inspect them. Although this decision differs at least in degree, and probably in the absence of dishonesty, from Sztejn, its importance in limiting the ratio of Sztejn should not be underestimated.

The dissent of Mr. Justice Cardozo is illuminating in the different emphasis which is placed on the elements of decision-making: /

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(142) supra cit at p.397.

decision-making:

"I assume that no duty is owing from the bank to its depositor which requires it to investigate the quality of the merchandise. I dissent from the view that if it chooses to investigate and discovers thereby that the merchandise tendered is not in truth the merchandise which the documents describe, it may be forced to make payment of the price irrespective of its knowledge". (143)

The non-existence of a duty was settled for the American courts in Laudisi v. American Exchange National Bank (144) and for English law in Urquhart Lindsay and Co. Ltd. v. Eastern Bank. (145)

With respect, it is in assuming that the bank has the freedom to choose to investigate that the learned judge is incorrect. Nor is the distinction drawn between disputes with holders in good faith and for value and disputes with the parties alleged to have misrepresented the goods helpful in this context. Where the prevailing opinions in O'Meara's case emphasised the bank's independence from the sales contract, the dissent was based almost entirely on the falsity of the documents and if it has a relevance to modern law at all the dissent is important for underlining how many situations/

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(143) 239 NY at 401.

(144) 239 NY 234 see especially Hiscock C.J. at 243.

(145) [1922] 1 KB 318 Compare the dictum last referred to in Rowlatt J.'s judgment at p.322/3.

situations can be looked at in entirely different lights. For instance, Mr. Justice Cardozo complains that if the bank was only concerned with documents then "the bales tendered might have been rags instead of paper" - exactly the predicament which came to court in Sztejn's case. In fact if <sup>Justice</sup> Mr./Shientag is to obtain any inspiration from previous judicial opinion it can only be from this dissent and it is respectfully suggested that the reasons given in criticism of the dissent apply equally to Sztejn.<sup>(146)</sup> Only on the basis of public policy can Sztejn be distinguished, and it is illogical and unsatisfactory to try to formulate different rules other than in this one very exceptional case.<sup>(147)</sup>

The ratio of O'Meara was applied and perhaps extended in Continental National Bank. In this case the court refused to look behind the documents of title despite a contention that the goods did not in fact conform to the standards laid down by the letter of credit. Although it is true that, as Professor Miller states,<sup>(148)</sup> this decision might put the bank in the position of having to accept false documents, it must be pointed out that "knowledge" is relative, and that there is no reason for supposing that the bank should not assume some risk within the operation of the credit facility. The bank has both an intermediary and an independent role to play/

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(146) See 1925 34 YLJ 775 at 777.

(147) See Miller: Casebook p.39.

(148) *ibid.*

play - the latter may lead to assumption of risk as much as the former leads to duties. Should this risk assumption weigh heavily with the bank (an unlikely prospect) the solution is to raise its fee for acting in the credit transaction. It is too easy to say that risk placed on the bank prejudices the expediency of the credit, and the courts have not indicated that they are prepared to accept such an excuse. It is interesting to note that in Continental National Bank among the documents stipulated for was a certificate of quality. Both Laudisi and O'Meara were considered by the court which pointed out that in any situation like this where there was inevitably a question that one or other of the parties had been dishonest there was no reason to favour the buyer:

"To hold that the issuing bank may refuse to honor (sic) because of the quality of the goods would throw the risk of the buyer's bad faith upon the party who would normally be less able to calculate it. Thus the conclusion that the bank of issue may not refuse to honor drafts because of the failure of the goods to comply with the documents is consistent both with the legal theory and commercial use of letters of credit".

The court also emphasised that merely to describe the goods as complying with a certain standard in the letter of credit did not create a condition that the bank could or should ensure that the goods in fact conformed. It is suggested/

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(149) 69F (2d) 312 at 316.

(150) *ibid* at p.317.

suggested that a British court would follow this statement of principle, one of very considerable practical importance, which is in line with the authority of Woods v. Thiedemann.

Further support for the principle is obtained from the decision in Bank of Taiwan v. Union National Bank of Philadelphia <sup>(151)</sup> where the court refused to go behind the bill of lading despite a bank's averments that the date of shipment was false and held that as "the relations between the parties to this litigation grew out of the letter of credit ..... they should be confined to it". <sup>(152)</sup>

In conclusion, there are two general comments occasioned by this treatment of false documents apart from the particular principles discussed above. I have tried to maintain what I feel is so important in the treatment of a subject such as commercial credits, that is, a central theme and attachment to principle. In other more settled and tested areas of commercial law there may be room for diversion of decision with every changing circumstance - this is not so with commercial credits. On the other hand, this uniformity is not to be forced and it is appreciated that the varying situations which can occur within the system do admit of varying conclusions.

Supporting this uniformity, certain generalisations are instantly attractive and generally helpful in anticipating the/  
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(151) 1F (2d) 65.

(152) *ibid* p.66.

the possible attitude of the courts in future decisions.

Lord Justice Pearce, for example, said:

"Trust is the foundation of trade; and bills of lading are important documents. If purchasers and banks felt that they could no longer trust bills of lading, the disadvantage to the commercial community would far outweigh any inconveniences provided by the giving of clean bills of lading against indemnities".

(153)  
(154)  
And Scrutton L.J. in Guaranty Trust Co. approved Bowen L.J.'s dictum that "the practice of merchants is not based on the supposition of possible frauds".

The courts have not, however, been blind to the dangers of fraud where they could be eliminated by one party.

Other generalisations are often only of significance by reason of the qualifications and restrictions surrounding them. Perhaps the most famous of these is Ashhurst J.'s dictum that "whenever one of two innocent persons must suffer by the acts of a third, he who has enabled such third person to occasion the loss must sustain it". And if these were/

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(153) supra cit.

(154) supra cit at p.660. Also Continental National Bank 69F (2d) 312 at 316.

(155) Sanders v. Maclean [1883] 11 QB 327 at 343.

(156) Lord Finlay in London J. & Stock Bank - [1918] AC 777 at 789.

(157) Lickbarrow v. Mason 1787 2 T.R. 63 at 70.

were adopted literally the unenviable purchaser might find himself in a very perilous position; it is not thought, however, that the courts will in future determinations be willing this easily to allow the bank to abdicate its position of responsibility.

THE DISCRETIONARY ROLE OF THE BANK IN  
THE CREDIT SYSTEM.

The inter-relation of the bank's rights, obligations and privileges under the letter of credit, the extent to which a bank is entitled to look to its own interests which may perhaps be in conflict with the interests of those parties with whom it has contractual relationships, be they buyers, sellers or intermediaries, and the whole question of how much discretion can and should be given to the bank within the credit system- these are all matters which are of central importance to any discussion based on the letter of credit.

The system, of course, is based on the bank's substituting its own financial reputation and strength for those of its customer. It would be strange indeed if the bank were to hazard its name and reputation without taking extensive precautions to reserve to itself rights, privileges and discretions designed to protect it from the inflexibility of fixed rules of law and to safeguard it from too close an identification with the perils of its customer's undertakings. From the very nature of the system the bank occupies in part an intermediary role standing between buyer and seller and having obligations to both, and in part a position of independence in which the bank has to protect its own financial interests/

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interests by relying on documents tendered under the credit for what may be described as the period of risk and where therefore it should be concerned to ensure that these documents give as complete a security as possible.

The position of the bank varies of course according to whether it is the bank "issuing" the credit, an intermediary acting on the instructions of another bank or merely an advising bank. The issuing bank is master of its own destiny. In the normal case it prepares its own mandate, an excellent example of the standard contract in operation, and is therefore in a position to limit its area of responsibility and of risk. On the other hand in questions of dispute between banker and customer, as principal and agent, it is clear that the mandate should be construed *contra proferentem* and should therefore be as precise as possible. (1a) In the style letter appended to Gutteridge and Magrah, (1) for instance, the customers

"agree to hold you (the issuing bank) and your correspondents harmless in respect of any loss or damage that may arise in consequence of error or delay in transmission of your or your correspondents' message, or misinterpretation thereof, or from any cause beyond your or their control".

This clause covers or is intended to cover the situation which/

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(1) at p.196.

(1a) In the recent case of Commercial Banking Company of Sydney Ltd. v. Jalsard Pty. Ltd. [1972] 3 WLR 566 it was argued that because of this relationship the bank had a responsibility in drafting the letter to advise the client on its terms; the issue is still open but the dangers for the bank are clear.

which arose in Equitable Trust Company of New York v. Dawson Partners,<sup>(2)</sup> where a mistake was made in the cable transmission of the terms of the credit as a result of which the customer refused to reimburse the bank; and while its effectiveness for this particular purpose can hardly be questioned there could clearly be difficulties in interpreting such words as "control". It might also be suggested that the phrase "or from any cause beyond your or their control" governs the earlier contingencies although one's impression is that the disjunctive "or" would prevent this construction. It is within the bank's power to go much further in excluding its responsibilities e.g. in the style provided by Davis<sup>(3)</sup> the bank is not to be held responsible "for any error, fault or mistake in the description, quality, quantity or delivery of any goods" and their right to repayment is not to be affected by "any such error fault or mistake or by any invalidity or irregularity or misdescription of or in any draft or document".

(4)

In British Imex Industries v. Midland Bank, Salmon J. commented:

"According to their (the defendants) case, it was their duty for a remuneration of £18 to read through the multifarious clauses in minute print on the back of these bills of lading, and ..... to consider their legal/

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(2) (1926) 25 Ll L Rep. 90; (1927) 27 Ll L Rep. 49.

(3) at p.209.

(4) [1958] 1 QB 542 at 552.

legal effect and then to call for an acknowledgement that there had been compliance".

In other words either the duty is unreasonably onerous or the rate for the job too low. This receives some support in the judgment of Scrutton L.J. in National Bank of Egypt v. Hannevig's Bank; <sup>(5)</sup> and in Midland Bank v. Seymour, <sup>(6)</sup> Mr. Justice Devlin said "it is not for the bank to ask itself what legal value such a description might have". But is investigation so abhorrent in a mercantile contract of credit? In National Bank of South Africa v. Banca Italiana di Sconto, <sup>(7)</sup> for instance, Lord Atkin said that the document tendered must be such as is an effective business substitute for what is specified (in this case a delivery order). The determination of an "effective business substitute" or any notion of "usual" documents clearly involves investigation or at least some intimate knowledge of the trade in question. Salmon J. was obviously impressed by the ratio of the bank's remuneration to the value of the credit; but this is merely what the bank has asked for in opening the credit. It is not a criterion of the bank's liability so much as an indication of what they thought the service was worth. No more could they abdicate their position of responsibility by modifying the payment to £1. It is for the bank to fix the rate for the service. If the/

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(5) (1919) 1 Ll L Rep.69.

(6) [1955]2Lloyd's Rep. 147 at 151.

(7) (1922) 10 Ll. L Rep.531.

the liability is disproportionate, the remedy is simple - to raise the change. That is not to say, however, that the courts should completely disregard the practicality of the credit system by seeking to impose duties which would prejudice what is a mercantile device largely unspoiled by legal sophistications.

The intermediary bank has, in contrast, a mandate over which it does not have exclusive control. It acts on the basis of an agreement with another bank and its relationship with that bank depends solely on that agreement. This was emphasised in Bank Melli Iran v. Barclays Bank <sup>(8)</sup> by Mr. Justice McNair. The decision itself is, however, open to question. The two points at issue were as follows: the disconformity of documents tendered under the letter of credit and the entitlement of the principal to rely thereon. The ratio of the latter appears to be that the principal ratified the acts of its agent. It is suggested that the alternative ratio which should have prevailed, albeit with the same result, was that the principal bank was personally barred from repudiating the intermediary's acts and that the intermediary was entitled to know within a reasonable time whether the documents were to be rejected. This ratio would prevail whether or not the relationship was one of agency.

The role of the intermediary bank varies: it can be asked merely to advise the beneficiary of the availability and/  
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(8) [1951] 2 Lloyd's Rep. 367.

and terms of the credit without itself undertaking any responsibility to the seller of the goods. In addition the intermediary may be given an undertaking that the bank will honour drafts provided they are tendered in compliance with the terms of the credit; and it is quite clear in Scots law that such an undertaking is enforceable by the intermediary bank. <sup>(9)</sup> In its capacity as adviser of the credit, the intermediary is acting as the issuing bank's agent <sup>(10)</sup> and is therefore bound by the terms of its mandate; and in negotiating the drafts under the credit the intermediary relies on the undertaking in its letter of instruction.

The intermediary may be required to go further, to confirm the availability of the credit and provide its own backing to the letter of credit. In many cases the seller will indicate which bank is to act as correspondent and as in this situation the seller is relying on the correspondent's undertaking, some authorities have suggested that the intermediary is rather more than an agent. <sup>(11)</sup> Gow states

"the correspondent being in terms of the contract (i.e. between buyer and seller) of sale the originating banker, because whatever undertaking he may get from the buyer's bank, it is his letter of credit which will issue to the buyer or other payee".

For/

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(9) as a promise in re mercatoria.

(10) Cape Asbestos Co. Ltd. v. Lloyds Bank [1921] W N 274.

(11) at p.470, footnote 94.

For "buyer" in the last paraphrase of this statement must be substituted "seller". But the questions raised by Gow are much more fundamental. The authorities referred to in support of the proposition appear to have little direct relevance. It is suggested with respect that it is distortion to think of the correspondent as the originator of the credit. The letter itself is drafted by the buyer's bank and its terms are communicated by that bank to the correspondent who is to tender accordingly. The confirming intermediary is also bound by these terms. While the correspondent is undoubtedly in these circumstances more than an agent in as much as the seller relies on its undertaking not on the issuing bank's, it is the undertaking and not the letter of credit which is correctly described as "the correspondent's". In the technical legal sense at least the issuing bank remains the originating bank no matter whether the credit be confirmed or not. The two authorities referred to merely support the proposition that it is the intermediary's undertaking upon which the seller relies; and in Courteen Seed Co. v. Hong Kong and Shanghai Banking Corporation <sup>(12)</sup> it was stated that "where a bank buys a draft relating to a letter of credit, it does not act as agent of the drawee. The transaction is at its own risk. It owes no duty to the drawee" (i.e. the issuing bank). A fortiori where the credit is confirmed - it is only where the/

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(12) (1927) 245 NY 377.

the intermediary pays under the credit that it acts as a principal, and where it is bound to look not only at the supposed mandate but also to consider its own security. In article 5 of the Uniform Customs and Practice the position is accurately stated:

"When the issuing bank instructs another bank to confirm its irrevocable credit and when the latter does so, the confirmation implies a definite undertaking of the confirming bank as from the date on which it gives confirmation".

As the bank's responsibilities vary according to its role, so too does the form of the credit have important consequences. It is not intended here to embark on a detailed discussion of all the forms which may be used. The variety is infinite. What is significant for present purposes is the effect which the form of the letter has on the bank's liabilities. There is a danger in the field of commercial credits of ascribing legal significance to terms which merely express common practical forms and devices; and this is a danger of which not only the academic need beware. The courts have shown an increasing tendency to develop the legal sophistication of the credit device. Compare, for instance, the comment of the Lord Chancellor (Lord Halsbury) <sup>(13)</sup> that a

"business sense must be given to business documents"  
<sup>(14)</sup>  
and that of Hill J:

"if/

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(13) Glyn v. Margetson [1893] AC at 359.

(14) Myers v. Sarl (1860) 3 E & E 306, at 318.

"if a contract be made with reference to a subject matter as to which particular words and expressions have by usage acquired a peculiar meaning ..... the parties to such a contract ..... must be taken to have used them in their restricted and peculiar signification".

The bank providing a credit for use in a particular trade and referring to its particular terms must therefore accept the risk of being bound by terms which it does not and can not be expected to fully understand. In Diamond<sup>(15)</sup> Alkali, McCardie J. pointed out that the courts could not be ruled by considerations of commercial expediency:

"It may well be that this decision is disturbing to business men. It is my duty, however, to state my view of the law without regard to mere questions of convenience".

And in Mann, Taylor and Co. Ltd. v. Royal Bank of Canada<sup>(16)</sup> the court was asked to accept a special and restricted meaning for the term "documentary credit", namely that it was always issued to facilitate the sale of goods. In this particular instance, where an advance had been given on the security of documents of title, the court held that the term must be interpreted according to the local banking usage spoken to by the bank's witnesses and that the bank had conformed thereto. It is to be noted that the court found in/

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(15) [1921] 3 KB 443 at 457.

(16) (1935) 40 C.C. 267.



in favour of a local usage and not one, it is su  
would necessarily be upheld by an English or Scottish court.  
This case merely hints at the difficulties with which banks  
may be confronted when the courts come to "define" such terms  
as "revolving", "transmissible" and "divisible" all of which are  
used internationally by reason of the very purpose of the  
letter of credit.<sup>(17)</sup> Until the courts do define these  
terms, the banks must assume this additional burden in  
interpreting their instructions, although one must with  
respect concur with Bailhache J.'s view expressed in Nordskog  
that strict interpretation is to be avoided if at all  
possible.<sup>(18)</sup> And provided banks are aware of the possibility  
of confusion there would seem to be little need to incorporate  
them as terms of art in letters of credit; the difficulty  
is more likely to arise as between buyer and seller where  
the means of payment might well be referred to loosely and  
so create problems in enforcement of the contract. This,  
however, is a problem of private international law with  
which we are not here concerned.

In contrast to terms which have to date principally  
been of importance in describing variations in the practical  
application of the letter of credit, the terms "revocable"  
and "irrevocable" have already been judicially discussed and  
analysed/

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(17) see the case of Nordskog v. National Bank (1922) 10 Ll L R  
652 where two conflicting definitions of the "revolving"  
credit were referred to.

(18) for a discussion of the term "documentary" see Davis  
p.26 et seq.

analysed at length by academic writers. Styles of both types of credit are appended to both Gutteridge and Magrah<sup>(19)</sup> and Davis;<sup>(20)</sup> those in the former are taken for present purposes as convenient examples.

In the Uniform Customs and Practice, article 3 states: "all credits, unless clearly stipulated as irrevocable, are considered revocable even though an expiry date is specified"

and article 4 states:

"revocable credits are not legally binding undertakings between Banks and beneficiaries. Such credits may be modified or cancelled at any moment without notice to the beneficiary. When a credit of this nature has been transmitted to a branch or to another Bank its modification or cancellation can take effect only upon receipt of notice thereof by such branch or other Bank, prior to payment or negotiation, or the acceptance of drawings thereunder by such branch or other Bank".

These provisions are of course no more than an attempt to standardise banking practice in relation to commercial credits and they are in no way legally binding statements of law;<sup>(21)</sup>  
and/

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(19) at p.200 et seq.

(20) at p.211 et seq.

(21) although they may be of some assistance in ascertaining banking practice and custom which the courts have shown themselves willing to consider.

and they have not been accepted as authoritative.

The example of a revocable credit given by Gutteridge and Magrah includes in its narrative the term "revocable" and expressly states that it "may be cancelled or modified at any time without notice".<sup>(22)</sup> Davis considers such a credit as "merely an advice ... that he (the beneficiary) is authorised to draw on the banker issuing it, but it contains no undertaking on the part of the banker that bills drawn in conformity with the credit will be met".

With respect, in Scots law at least, it is incorrect to suggest that the revocable credit has no contractual significance so far as the bank is concerned. It certainly indicates a channel by means of which the beneficiary may seek payment. But more than this, it is a contractual undertaking enforceable by the beneficiary albeit an undertaking which the bank is entitled to revoke at any time and, in Gutteridge and Magrah's example at least, without notice.<sup>(23)</sup>

It is unhelpful, moreover, to confuse notions of "revocability" with whether or not a credit is confirmed.<sup>(24)</sup>

In Cape Asbestos Co. Ltd. v. Lloyds Bank,<sup>(25)</sup> the credit was advised/

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(22) at p.33.

(23) See T.B. Smith's Short Commentary and the authorities there referred to on the "unilateral promise" - p.742 et seq. This undertaking is of course in re mercatoria.

(24) as in Davis' example p.33.

(25) [1921] WN 274.

advised to the plaintiffs by the defendants with the statement "this is merely an advice of the opening of the above-mentioned credit, and is not a confirmation of the same". The defendants were notified at a later date of the cancellation of the credit but neglected to give notice to the plaintiffs (it was accepted that the bank should reasonably have and would have in the normal case).

Bailhache J. held that there was no legal obligation to advise the cancellation of the credit, originally revocable in form. The decision is completely correct on the very simple ratio that the bank specifically restricted its role to that of adviser. The bank did not itself issue the credit, and, in passing, it is noted that the issuing bank did give notice of the cancellation of the credit, although the point did not arise as to whether it considered itself under an obligation to give such notice.

Where, however, there is no statement that the credit is revocable without notice, difficult questions may arise particularly in Scots law. Gutteridge and Magrah state (26) that "it is doubtful whether or not such a credit can be revoked", but do not elaborate on this other than to say that in any event revocation can only be effective after reasonable notice. It is suggested that it is at this point that Scots law is forced to consider analytically the relationship between the issuing banker and the seller. While it is true, as/

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(26) at p.36.

as Gow states, <sup>(27)</sup> that consideration is irrelevant to enforceability, the promise being enforceable as a writ in re mercatoria, the right to revoke does depend on what view is taken of the relationship between banker and seller. It has been assumed by such learned writers as Gutteridge and Magrah that the only theory which is satisfactory in explaining this relationship is one which applies equally to revocable and irrevocable credits. On this basis the so-called "offer and acceptance" theory is dismissed. But where, as in <sup>(28)</sup> Scots law, there is no problem of "creating" a consideration, this theory has much to commend it. It is suggested that the revocable letter of credit is more than an expression of intent which would not create an obligation. It is, at least so far as the example given in Gutteridge and Magrah is <sup>(29)</sup> concerned, an undertaking - expressed in the words "hereby open ..... in your favour" - upon which the beneficiary is invited to act, and the beneficiary is told how he may use the facility - "by draft on us at sight". It is suggested that the offer is in the communication of the terms of the credit, and the acceptance is the act of tendering the documents specified therein. Use of the word "revocable" clearly expresses the right to revoke; but even if the nature of/

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(27) at p.471.

(28) a problem one is happy to leave to English lawyers.

(29) for this particular argument it must be supposed that there is no last paragraph specifically excluding the need for notice.

of the credit is unstated, the credit is revocable on the basis that an offer may be withdrawn at any time before acceptance by the tender of documents. The authority of Cape Asbestos may be distinguished as applying only to the advising of a credit.

If this interpretation is accepted, there is no difficulty in accepting Gutteridge and Magrah's suggestion (30) that the credit can only be revoked after reasonable notice. It is suggested, however, that to be "reasonable" notice need only be communicated to the beneficiary prior to the tendering of the documents. The doctrine of enforceable unilateral undertaking only applies to a credit which is irrevocable. (31)

Demogue's criticism (31) that Gutteridge has created "a third type of credit which can be revoked after notification to the beneficiary" is met, therefore, by the answer that Gutteridge's third type is in fact the standard revocable credit and the right to revoke without notice must be specifically reserved in the communication of the credit.

In any event, it is unrealistic to seek artificially to restrict the types of credit. Each credit is liable to be interpreted in its own circumstances. For instance, Atkin L.J. is reported in the decision in International Banking Corporation v. Barclays Bank (32) as holding that, on the evidence, a credit was irrevocable unless it appeared on its/

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(30) at p.36.

(31) *Le crédit documentaire en droit anglais* (1934) at 62.

(32) *Legal Decisions affecting Bankers* Vol.5 p.1.

(33)

its face to be revocable.

Further it is submitted that there is no justification for placing an intermediary bank in a more favourable position than the beneficiary where a revocable credit is concerned. As stated in the American case of Courteen Seed Co. v. Hong Kong & Shanghai Banking Corporation,<sup>(34)</sup> the intermediary "buys commercial paper relying on the credit of the drawer and the security that is offered". If the intermediary has merely been asked to advise the credit to the beneficiary, notice of revocation is only necessary to the beneficiary and while any revocation would normally be communicated through the intermediary, the bank should for its own safety ascertain the continuing availability of the credit prior to negotiating drafts.

Although there appears to be no authority dealing with this point, it would seem that the right to effectively revoke the credit can only rest with the bank albeit acting on the buyer's (the bank's customer in the normal case) instructions.<sup>(35)</sup> If the theory expounded above is accepted, the notice of revocation must be conveyed through the bank to the seller. To this extent the independence of the issuing bank which is an important feature of the irrevocable credit does not apply where the credit is revocable. In conveying the notice of revocation it is suggested that the bank must be/

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(33) c.f. U.C.P. article 3.

(34) (1927) 245 NY 377.

(35) possible authorities: Lord Sumner in Sassoon [1927] 2 AC at 724 also U.S. Case: Moss v. Old Colony Trust (1923) 140 NE 803.

be regarded as the agent of the customer (buyer). Until, however, this matter is the subject of judicial discussion, there must remain some doubt which should be removed by a clear statement in the letter of credit. (36)

It is the position of independence in which the bank is placed by the irrevocable credit that has given rise to the considerable judicial comment on the terms "irrevocable" and "confirmed" e.g. in Donald H. Scott and Co. v. Barclays Bank (37) Scrutton L.J. said:

"the appellants gave a confirmed credit to the respondents; that is to say, they entered into contractual relationships with them from which they could not withdraw except with the consent of the other party";

(38)  
and in Sassoon v. International Banking Corporation,

Viscount Sumner said:

"Neither the letter of agreement nor the letter of advice nor any document, which relates to them, makes them in terms 'irrevocable', the term 'confirmed' alone being used, yet both words were stipulated for by M. Sassoon and Company ..... it is not easy to see in what respect either word or both of them together would carry the matter further than the word 'contract'/'

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(36) c.f. Davis's style at p.208.

(37) [1923] 2 K B 1 at 14.

(38) [1927] AC 711 at 724, a Privy Council decision.



used (39)  
'contract'/in its strict sense would have done,  
for apparently a confirmed credit is something  
formerly provisional, and now turned into something,  
definite by way of promise, and the word irrevocable  
simply closes the door on any option or locus  
poenitentiae and makes the agreement definite and  
binding".

In both these learned judgments, there are indications  
that the terms "irrevocable" and "confirmed" are indisting-  
uishable in that they both convey the contractually binding  
and irreversible nature of the bank's undertaking. "Irrevocable,"  
however, is a term properly applied to the credit as issued  
by the issuing bank. "Confirmation" is the function of the  
intermediary bank which is to assume a separate and additional  
responsibility on a credit opened by the issuing bank. An  
irrevocable credit may be confirmed or unconfirmed without  
affecting the binding nature of the credit or the undertaking  
of the issuing bank. (39a) Lord Sumner's statement that a confirmed  
credit is something formerly provisional must therefore be  
open to question. And there would seem to be no reason why  
a revocable credit should not be confirmed though in such  
cases the confirmation would not create irrevocability but  
merely place the intermediary bank in the same position as  
the/

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(39) it is not clear what meaning is here intended by  
Sumner L.J.

(39a) See Denning MR in *W.J. Alan Ltd. v. El Nasr Co.* [1972]  
2 All ER 127 at pages 135 and 136.

the issuing bank i.e. as having made an offer which may be accepted on tender of documents prior to revocation. In the unlikely event of a revocable credit being confirmed, the intermediary is in a precarious position as its offer will require to be withdrawn by notice to the beneficiary in the same way as the issuing bank's offer; and as the issuing bank is under no obligation to notify the intermediary of its withdrawal of offer (although it normally would) it would accept this role only if specifically requested so to act.

Professor Bennett Miller when considering the question of revocability and confirmation <sup>(40)</sup> takes the view that the revocable credit is also a "contract to supply credit facilities". It is respectfully suggested that the revocable credit is an offer in distinction to the irrevocable credit which has by itself a binding force.

The distinction between "irrevocable" and "confirmed" may be illustrated by reference to the case of Panoutsos v. Raymond Hadley <sup>(41)</sup> where the contract specifically stipulated for the opening of a "confirmed bankers' credit". The seller was subsequently advised of the opening of the credit; the bank stated "we are acting merely as agents for our foreign correspondents and cannot assume any responsibility for its continuance". Irrevocable or not, the credit did not provide the seller with the security of a bank in his own country accepting/

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(40) Casebook at pp. 6 and 7.

(41) [1917] 2 KB 473.

accepting a separate and additional responsibility for payment, and as such the credit was not conform to contract and the sellers held entitled not to deliver the goods. If, however, the stipulation in the contract had merely been for an irrevocable credit, confirmation, or the absence of it, would have been irrelevant. And while Lord Sumner<sup>(42)</sup> was unwilling to grant the terms separate and legally individual meanings, Panoutsos does show that the courts may have no alternative, and on the basis of Mann Taylor and Company and other authorities mentioned above, they would be given their "normal business sense" in banking circles.

It is the contractual relationship between banker and beneficiary that ensures the independence of the former and to that extent displaces the duty of the banker (as agent) to the purchaser (principal and customer):

"When a client induces a bank to give a letter of credit to a third party, he cannot of his own will compel the bank to cancel the letter, for the contract does not exist between the client and the bank, but<sup>(43)</sup> between the bank and the third party".

The purchaser's remedy is by action for breach of<sup>(44)</sup> contract. The most recent statement of the independent role/

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(42) supra cit.

(43) Sovereign Bank of Canada v. Bellhouse etc. [1911] 23 QR (KB) 413.

(44) Urquhart Lindsay & Co. Ltd. v. Eastern Bank Ltd. [1922] 1 KB 318 per Rowlatt J. at 323.

role played by the bank is the judgment of McNair J. in Soproma s P R v. Marine and Animal By-Products Corporation,<sup>(45)</sup> a case concerned partly with a second tender of documents direct to the purchasers outside the period of the credit. It was held that this second tender was to be disregarded. The two-fold function of the bank was to be impartial security on which both parties could rely, the one for payment on the drafts and the other for professional vetting of the documents of title. This case confirmed the decision of Newman Industries Ltd. v. Indo-British Industries Ltd.,<sup>(46)</sup> at least the obiter dicta in that case of Sellers J, to the effect that payment under the credit was all that the seller was entitled to but that this was not to be treated as payment by the purchaser under his contract with the seller for which the purchaser remained responsible should the bank not be able, for any reason, to make payment.

The decision in Plastimoda Societa per Azioni v. Davidsons (Manchester) Ltd.<sup>(47)</sup> raises an interesting question. This case was concerned with the waiver by the sellers, for their own purposes, of strict conformity with the purchasers' obligations under the contract so far as establishing the credit. It was held that in the circumstances the sellers were bound to notify the buyers when they wished to avail themselves/

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(45) [1966] 1 Lloyds Rep. 367.

(46) [1956] 2 Lloyds Rep. 219.

(47) [1952] 1 Lloyds Rep. 527.

themselves of the credit in order that the buyers might then make the necessary arrangements. Arising as they do entirely under the contract of sale, the bank is not concerned in such matters. Once, however, the bank has been instructed it is not yet decided whether a similar waiver so far as operations under the credit are concerned would be effective. At that stage the contract is between banker and beneficiary. It is clear that the buyer can not impose more onerous conditions under the credit. But is the buyer entitled to waive strict compliance with the credit's terms even where it would presumably have, or could obtain, the concurrence of the seller? It is suggested that any waiver would require the compliance of the bank. Variation of the terms might well involve some possible prejudice to the bank's security or the period of risk. The bank's contract with the buyer fixes the bank's remuneration on the basis of, inter alia, these factors. Assuming that both buyer and seller were agreed on the modification, the bank would at least be entitled to re-negotiate the terms of its contract with the buyer. To that extent the two contracts are clearly interdependent. The bank's independence is not, then, solely the independence of a neutral; it is the independence of a party having separate, identifiable interests in the credit and its subject matter. Both of these aspects are clearly illustrated in a series of cases all dealing with the right of/

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of the bank to decline acceptance of documents rendered under the credit.

In American Steel Co. v. Irving National Bank (48) the purchasers were unable, due to supervening legislative control, to obtain a licence for the exportation of the goods for which documents had been rendered to the bank. The bank accepted the purchasers' instructions and refused the documents. Roger J. stated:

"the defendant in effect seeks to read into the contract a provision that the plaintiff's rights under the letter of credit should be subject to the superior right of the MacDonell Chow Corporation (the buyers) to modify the contract which the bank had made with the plaintiff. We do not so understand the law".

This decision in fact asserts the complete independence of the two contracts i.e. between buyer and banker and between banker and seller. It would be possible to argue that the two contracts are interdependent. The consideration (or causa) for the latter is the buyer's expectation of receiving the goods contracted for. If the contract of sale is frustrated this consideration disappears. But when the credit has been advised or communicated to the seller its terms (i.e. the advice's) do not admit of any qualifications, and it is difficult, therefore, to see how payment could be refused.

Questions/

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(48) (1920) 266F 41. This situation is now at least in part guarded against by the establishment of the Export Credit Guarantee Department of the Board of Trade (in Britain).

Questions of bad faith do not arise. And the terms of the credit bind the bank in like terms, even where the value of the bank's security might be severely prejudiced. On the other hand if the legislation were to prevent the shipping of the goods it might be argued that any bills of lading were prima facie false in that they could not testify to the shipping of goods which was rendered illegal.

American Steel goes further than the similar authority of Frey v. Sherburne and National City Bank,<sup>(49)</sup> the ratio of which was stated in the judgment of Greenbaum J. The form of the credit in this case was more on the lines of the early "traveller's letter of credit" and the interests of innocent third parties were for this reason considered paramount. "It would be a calamity to the business world engaged in transactions of the kind mentioned in the complaint if for every breach of a contract between buyer and seller a party may come into a court of equity and enjoin payment of drafts drawn upon a letter of credit issued by a bank".<sup>(49)</sup>

Certainly not 'every' breach of contract should provide a remedy; but the courts have recently acknowledged that the degree in gravity of the breach is relevant. In Malas v. British Imex Industries Ltd.<sup>(50)</sup> the purchasers sought to cancel the credit on discovering that an early shipment of goods was of defective quality. The ratio of that case had /

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(49) (1920) 193 App.Div. 849.

(50) [1958] 2 QB 127.

had been established at least thirty years earlier in  
(51)  
Urquhart Lindsay.

Narrower questions are raised by three American  
cases. In O'Meara v. National Park Bank of New York,  
(52)  
the bank demanded proof that the descriptions in the  
documents tendered were correct. It was held that the bank's  
proper concern was with documents not the goods they  
represented. The bank in the later case of Continental  
(53)  
National Bank v. National City Bank of New York claimed  
to know that the goods were not conform to the documents to  
be tendered. In addition to the stipulation for the documents  
in the letter of credit there was the following statement:

"Cement to be of sound merchantable quality and  
standard of same shall meet with the requirements of  
the American Society for Testing Materials".

A certificate of quality was produced. The bank, however,  
sought further proof of the cement's quality, and in its  
absence refused payment under the drafts. In the course of  
its judgment the court stated:

"To accept this contention would practically  
undermine the general principle that the bank must  
honour the draft if the documents comply with the  
terms of the letter of credit" - with respect, it is  
the terms of the letter of credit with which the seller must  
comply, and in this respect the terms of this particular letter  
of/

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(51) [1922] 1 KB 318.

(52) (1925) 239 NY 386.

(53) (1934) 69 F (2d) 312.



of credit were highly unusual. The court's statement continued: "for any description of the goods in such a letter might quite as readily be interpreted to create such a condition" - in fact, however, the advice of the letter of credit does not normally contain such description. The ratio of the decision is contained in the following sentence:

"Admitting that the issue of a letter of credit may impose such a condition if it so wishes, it should be required at least to make such an intention perfectly clear".

With this statement at least, there can be little cause for argument. And on the basis of the report available to me, it is also difficult to question the court's interpretation. It is submitted that the ratio would be applied by the British courts.

(54)  
Professor Miller pointed out that this might force the bank to accept documents it "knew" to be false, always provided there was no statement sufficiently unequivocal to allow proof of non-conformity. This is one of the risks which the bank will require to accept. And even if the bank could rely on an additional condition in the credit, it seems that any such inspection would be carried out at the bank's risk. If inspection facilities were refused the bank could, it is submitted, /

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(54) Casebook at p.39.

submitted, only justify the refusal of the documents by successfully proving the disconformity of the goods.

The obvious risk is that of fraud or bad faith. Although this subject has been dealt with elsewhere in this Paper under "Forged Documents" it has particular relevance in any discussion of the bank's entitlement and obligation as to documents tendered.

Where forgery is discovered by the bank subsequent to its acceptance of the draft, the bank is obliged to pay to holders in due course although it is then entitled to recover that payment from the buyer. (55) And prior to acceptance, the bank is under no obligation to enquire as to the genuineness of the documents tendered. (56) As Bramwell B. said in Woods v. Thiedemann (57) the bank is not in a position to make such enquiry. If the purchaser chooses to make enquiry then that, of course, is his concern. In British Imex Industries Ltd. v. Midland Bank Ltd., Salmon J. stated:

"I doubt whether banks are under any greater duty to their correspondents than to satisfy themselves that the correct documents are presented to them and that the bills of lading bear no endorsement ..... which could reasonably mean that there was, or might be, some defect in the goods or their packing". (58)

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(55) Robinson v. Reynolds (1841) 2 QB 196.

(56) G. & Magrah at p.109.

(57) (1862) 1 H & C 478.

(58) [1958] 1 QB 542 at 552.

It is respectfully submitted that the judgment of Bailhache J. on this particular point should now be regarded as  
(59)  
authoritative:

"Now it is to be observed that the plaintiffs had no better means of knowing whether the bill of lading was a forgery than the defendants ..... It was not their duty but that of the defendants to satisfy themselves as to the genuineness of the bill of lading".

Although the facts in this case were special, the proposition is capable of general application.

There are, then, these two instances where the bank's obligation is clear. Where, however, the falsity of the documents appears prior to their tender the position is by no means clear. Davis "confidently submits" that where forgery is alleged as the ground of the document's invalidity, the case is "too clear for argument". He says:

"A forged bill of lading or policy of insurance cannot be said to constitute a contract of any validity whatsoever. The buyer would undoubtedly be entitled to reject such documents tendered in performance of a c.i.f. contract and equally, it would seem, a banker would be entitled and indeed bound to reject them when tendered in purported compliance/

compliance with the terms of a letter of credit". (60)

With respect, the parallel drawn between the c.i.f. contract and the tender under the letter of credit can not be taken too far. In the former the contract is between buyer and seller; in the latter it is between the seller and the bank. In the former the subject of the contract is goods; in the latter it is the documents of title. Davis purports to deal with two issues - namely the entitlement of the bank and, what must be considered separately, its obligation.

Let us first consider the bank's obligation. If the bank declines to accept the documents tendered it can not plead in justification merely the advice or "instructions" of its customer. (61) It would require to prove that the seller was fraudulently presenting the documents knowing them to be false. But even where forgery or falsity is concerned, there are still questions of degree. In Kwei Tek Chao v. British Traders etc., (62) for instance, the forgery of the date of the shipment did not go to the essence of the bill of lading although one can envisage circumstances where it clearly would. Moreover, how is the bank to be assured of the falsity; its knowledge is not likely to be in any sense "absolute" or first hand? It is probable that it will be advised of the irregularity by the buyer who will, of course, be anything/

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(60) at page 150.

(61) see authorities referred to supra.

(62) [1954] 2 QB 459.

anything but a disinterested party. If the bank is to accept its customer's instructions to reject the documents, it might well be put to some expense simply to justify its rejection. If the customer were to undertake to reimburse the bank not only for these expenses but also for the consequences of its failure to prove the falsity of the goods (and if the customer was in a position to give such an undertaking and to honour it), the bank would clearly have little to risk in adopting this course. But is the bank obliged to run this risk? There is no British authority directly in point although the situation was commented on in the judgment in Sztejn v. J. Henry Schroder Banking Corporation:<sup>(63)</sup>

"However in the instant action Schroder had received notice of Transea's active fraud before it accepted or paid the draft. The Chartered Bank which stands in no better position than Transea, should not be heard to complain because Schroder is not forced to pay the draft accompanied by documents covering a transaction which it has reason to believe is fraudulent".

In this case the Chartered Bank was simply the collecting agent for the seller whose fraud was alleged; and the action was raised not by the seller (or his agent) who failed to obtain the bank's acceptance but by the buyer in a successful effort/

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(63) (1941) 31 NY Supp. (2d) 631 at 634.

effort to restrain the bank from so accepting. Clearly if the buyer in this situation was able to satisfy the court of the falsity of the documents and that court was the one having jurisdiction over the bank the decision would to all intents and purposes be taken out of the hands of the bank. Without such a court order, however, it must be doubted whether the bank would be obliged to refuse acceptance of the documents where it simply had "reason to believe" they might be false. Consider, for example, the dictum of Salmon J. (64) in British Imex Industries Ltd.

As to the entitlement of the bank, Gutteridge and (65) Magrah state:

"it would seem that he can refuse to accept or pay, though direct authority is lacking on the point. It is submitted that a banker cannot be compelled to honour a credit unless all the conditions precedent have been performed, and that he ought not to be under an obligation to accept or pay against documents which he knows to be waste paper. To hold otherwise would be to deprive the banker of that security for his advances which is a cardinal feature of the process of financing carried out by means of the credit and must be within the contemplation/

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(64) supra cit at page 20.

(65) at page 111.

contemplation of anyone discounting drafts drawn with reference to it. Moreover, the buyer, unless otherwise agreed, cannot be deemed to have authorised the banker to pay against documents which are known to be forged".

The "conditions precedent" to which the learned writers refer are, however, the tendering of documents in terms of the letter of credit as advised by the bank. The seller would clearly not be entitled to benefit from his own dishonesty if it were proved in court proceedings. But it would be for the bank to justify its actions. It is certainly true that the bank might, by accepting documents believed to be false, be hazarding its security, and to this extent its dilemma is highlighted; but it is not necessarily correct to say that the bank's dependence on the security of the goods is foreseeable by parties relying on the letter of credit and it is not, therefore, thought that the bank's entitlement can be justified on this basis. Nor, as has already been discussed, can the buyer's authority qualify or modify the terms of the letter as originally instructed. Provided the falsity is not clear from the documents themselves, the credit itself gives no guidance to the bank.

In conclusion, the bank's entitlement is not an absolute one; it requires to be justified in each case and the risk in proving such justification must remain the bank's. It/

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It is certainly true, as a practical matter, that "the principle of the independence of the bank's obligation under the letter of credit should not be extended to protect the unscrupulous seller"<sup>(66)</sup> but this is assured not because of any principle of law but because the bank can only be held responsible for rejecting the documents tendered if it fails to prove their falsity and the risk in such process is outweighed by the bank's interest in the security subjects. In each case, however, the decision as to whether or not to reject, is the bank's and in so far as the judgment in Sztejn's case goes further it should not be followed in the Scottish courts.

If it is conceded that the bank may be called on under the credit to exercise its own judgment and discretion, it becomes a matter of debate to what extent this can and must be so.

"I apprehend, that, whenever a man undertakes to perform a duty he undertakes to perform it with a reasonable degree of skill and care; and that, where the performance has reference to a particular trade, necessarily involves an obligation on the party to make himself acquainted by due inquiry with the usages<sup>(67)</sup> of that trade".

The relevance of this in applying it to the bank's position under/

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(66) Sztejn's case - supra cit.

(67) Russian Steam Navigation Trading Co. v. Silva (1863)  
13 CB (NS) 610 at 617 per Willes J.



under the letter of credit is obvious. The facts of the case to which this judgment related were as follows: by a bill of lading in respect of wool from Odessa, freight was to be paid in London on delivery at a rate of eighty shillings per hundredweight of tallow and "other goods in proportion as per London Baltic printed rates". Extrinsic evidence was held to be admissible to show the meaning of these terms according to trade usage. The third party in this case was a warehouse keeper who had released the goods in his custody on receiving a sum which he thought to be equivalent to the freight due. The plaintiffs, however, claimed a much larger sum than this on the basis that the freight should have been calculated, according to trade usage, by reference to the price of tallow being but a standard against which the other prices should have been reckoned.

The limitations inherent in the judgment of Willes J. were to be seen elsewhere in the reports of the case: the bills of lading were vague and the judgments seemed to regard the duty of investigation as dependant on this; usage can clearly not prevail to qualify or contradict specific written provisions of contract. (68)

Mere ignorance of a usage or trade custom is not, (69)  
per se, necessarily a sufficient defence. In Hudson v. Ede,  
the/

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(68) See for Scots authority, the judgments in Steel Co. of Scotland v. Tancred Arrol & Co. (1892) 19 R 1062 and, in England, L. Sutro and Heilbut Symons & Co. [1917] 2 KB 348.

(69) (1868) LR 3 QB 412.

the customs of a port were held to bind a shipowner who was ignorant of them. Scrutton justifies this decision by saying that the custom construed a word which can only properly be understood in its surroundings. <sup>(70)</sup> In applying <sup>the</sup> ratio of this case and that of Russian Steam Navigation it may be that Scottish courts would adopt a more lenient and flexible attitude. Gloag and Henderson, when discussing custom as an implied term (as distinct from custom as local law) maintained that knowledge or notice of the usage must be brought home to the party against whom it is pled, failing which the party must be put on enquiry as to the usage of the term. An old Scots authority admits:

"There can be no doubt that we have never in Scotland gone so far as they have done in England in admitting evidence of understanding or usage in order to <sup>(71)</sup> construe thereby a written contract".

<sup>(72)</sup>  
In Holman v. Peruvian Nitrate Company it was observed that where a usage is purely local it cannot be taken to control the words of a written instrument unless it is known to both parties. Lord Deas in this case inclines towards the English construction, however, and as we do unfortunately suffer from a dearth of modern authority, it is at least arguable/

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(70) Charterparties (17th Edition) at p.28.

(71) Mackenzie v. Dunlop (1853) 16 D 129/- LJC Hope.  
at 139

(72) (1877) 5 R 657.

arguable that in this mercantile matter (like so many others) we would now follow the English line of authority. Russian Steam Navigation does not stand uncontradicted in English law and the Privy Council case of Kirchner v. Venus,<sup>(73)</sup> whose decision is more easily reconciled with the older Scots cases, concludes:

"It appears to their Lordships that it would be inconsistent alike with the rules of law and the convenience of commerce to affect the construction of a negotiable instrument in the hands of a bona fide holder for value by evidence of a local usage of which he was ignorant and could not be bound to take notice".

And while the position of the banker in a commercial credit transaction is not that of a bona fide holder for value the analogy may be helpful.<sup>(74)</sup> Nor is the definition of custom or usage in this sense particularly clear. In Postlethwaite v. Freeland<sup>(75)</sup> the House of Lords approved a direction to a jury which described a mercantile custom as not meaning custom "in the sense in which the word is sometimes used by lawyers, but (meaning) a settled and established practice of the port".<sup>(76)</sup> The standard of proof of such usage is less rigorous than that/

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(73) (1859) PC 12 Moore 361, at 399.

(74) although it can not clearly be pressed too far.

(75) (1880) 5 AC 599.

(76) *ibid* at p.616.

that for legal customs. On the other hand, there is a danger of inclining towards what Fletcher-Moulton L.J. describes as the layman's attitude of confusing custom and "that which is customarily done".<sup>(77)</sup> And in the Scots case of Strathlorne S.S. Co. v. Baird,<sup>(78)</sup> Lord Shaw of Dunfermline repeated this warning and distinguished the mere occurrence of instances of a practice and a "settled and established practice which amounts to the acceptance of a binding obligation of a custom".<sup>(78)</sup> As Sir George Jessel pointed out,<sup>(79)</sup> the custom must be so notorious as to amount to an implied term of the contract.

The precise issue of custom in the field of mercantile letters of credit has only come before the courts on one reported occasion, in the case of Dixon Irmaos and Cia Ltda v. Chase National Bank of the City of New York,<sup>(80)</sup> where the facts were unusual. The custom in question was that of accepting an indemnity from the seller where the latter was unable to tender what was required under the credit, namely "a full set bills of lading"; the issue was whether the bank should be bound by their own custom, evidence being led to the effect that this was notorious to banks, importers and exporters/

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(77) [1908] 2 KB 907 at 919.

(78) 1916 SC (HL) 134 at 141.

(79) Nelson v. Dahl (1879) 12 Ch 568 at 575.

(80) (1944) 144 F (2d) 759.

exporters alike. It was held that this custom was an implied term of the contract between the banker and seller. This decision has been attacked mainly on the basis that the custom conflicted with the express terms of the contract. (81) There is much to be said for this argument as applied to these particular circumstances; the principle, however, is unaffected. And it is submitted that arguments based on (82) Rayner v. Hambros Bank are not strictly in point for there the court was simply called on to construe terms used in the credit. (83) In Dixon's case there was no obvious prejudice to the buyer in the bank's acceptance of an indemnity. J. Honnold in an article supporting the decision (84) admitted that the bank would be justified in refusing an indemnity where there was some suggestion or suspicion that the documents did not properly conform with the goods. His main argument is précised as follows:

"to permit issuing banks to depart from fair-weather practice in time of financial stress, when the letter of credit serves its most important function, would disappoint the reasonable expectation of sellers who have relied on the custom and tend to undermine the integrity and value of letters of credit".

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(81) c.f. L.Sutro and Co. v. Heilbut Symons & Co. [1917] 2 KB348.

(82) [1943] 1 KB 37.

(83) See Backus and Harfield's article in 1952 CLR 589.

(84) 1953 C.L.R. 504.

It is certainly arguable that a British court would adopt a similar attitude to that of Bailhache J. in Cape Asbestos (85) where the bank's "customary" behaviour was considered merely a matter of courtesy. And until some guidance is available from the courts, one could not agree with Magrah that "it (86) looks like the thin end of the wedge".

Custom in the particular sense in which it has been discussed above is imported into the contract in question on the basis of the presumed intention of the parties; and, subject to proof, such presumed intention was at least relevant in so far as the contract between banker and seller was concerned. Where, however, the terms of the contract are as authorised in a further contract and the bank's right to recover from the purchaser is based on that further contract, the implication of presumed intention is less easily observed. The difficulty is obvious: if the bank accepts or is forced to accept the custom is the purchaser similarly compelled to accept the custom? The terms of the contracts are associated but distinct and it is submitted that unless the custom was known to the purchaser or he could reasonably have been said to accept it, there is no logical reason why the custom should apply equally in both contracts.

In view, however, of the stringent tests which the British/

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(85) *supra cit.*

(86) Gilbert Lectures on Banking 1952 at p.12.

British courts are likely to apply before admitting custom, such questions are not likely to arise frequently although the increasing uniformity of banking practice exemplified by the Uniform Customs may highlight this area of difficulty in the future. What has already been discussed extensively by the courts and academic writers is the discretion afforded to the bank in accepting documents which may, at first sight at least, appear to vary the terms of the letter of credit.

Statements of the broad principle are many:

"It is both common ground and common sense that in such a transaction the accepting bank can only claim indemnity if the conditions on which it is authorised to pay are, in the matter of accompanying documents, strictly observed".<sup>(87)</sup>

Strict observance" and "exact compliance" are the two phrases most popularly used.<sup>(88)</sup> Rowlatt L.J. in South African Reserve Bank v. Samuel draws attention to the 2-fold aspect of the bank's duty:

"when one has discovered what exactly the letter of credit means, then I think the person acting under it is bound to act under it quite literally".<sup>(89)</sup>

The/

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- (87) Equitable Trust Co. of New York v. Dawson Ptnrs (1927) 27 Ll LR 49 per Sumner L.J. at 52.
- (88) English, Scottish & Australian Bank Ltd. v. Bank of South Africa (1922) 13 Ll LR 21 at 24; Lamborn v. Lake Shore Banking Co. (1921) 196 App. Div. 504 at 507.
- (89) (1931) 39 Ll LR 87, at 93.

The two steps for the bank are, then, to ascertain its mandate and thereafter to act strictly in accordance with it. As Scrutton L.J. pointed out in L. Sutro and Co. v. Heilbut Symons & Co.<sup>(90)</sup> the first step may be complicated by the fact that business men frequently do not choose their words with the calculated precision which would be necessary to preclude ambiguity and uncertainty. In fact they may frequently be surprised by the meaning of what they have said.

The *raison d'être* of the rule of strict compliance is the protection of the buyer who must, by the very nature of things, deal at arm's length with the seller. The rule has been laid down in cases where there was a danger of prejudicing the buyer's protection; where this danger does not exist, its application should not be over-stressed. This view, best expressed by Scrutton L.J:

"business men will not be able to use the system .....  
if they take objections which are at the best  
<sup>(91)</sup>  
technical"

was not well-received in the House of Lords. And just as the buyer's interests are to be respected they must be balanced/

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(90) [1917] 2 KB 348 at 364.

(91) *Equitable Trust Co. of N.Y. v. Dawson Partners* (1925)  
25 Ll LR 90.



balanced against those of the bank dealing with documents current in a trade with which it is unlikely to be familiar.

The significance of the interposition of the bank is underlined in such cases as Moralice (London) Ltd. v. E.D. and F. Man <sup>(92)</sup> where the sale was of 500 metric tons (5000 bags) of sugar, payment to be effected by documents in accordance with a letter of credit which stipulated that "invoices must describe the goods exactly as above". To satisfy the contract the sellers themselves purchased "about 500 tons" of bagged sugar and the bank to whom the documents were in due course tendered accepted them only on the provision of an indemnity. The decision itself was concerned principally with questions arising under this indemnity <sup>(93)</sup> but in the course of his judgment McNair J. confirmed that the bank's rejection was perfectly proper although the "de minimis" principle <sup>(94)</sup> would have applied as between buyer and seller in a normal c.i.f. contract. The safeguard in excluding "de minimis" is two fold: it precludes any question of qualifying the buyer's clear mandate, superficially maintaining the protection of the buyer and it ensures that the bank is not obliged to consider the degree of any discrepancy or prejudice to the buyer. To that extent it is merely an example of the rule of "strict compliance" which has/

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(92) [1954] Lloyd's Rep 526.

(93) of which more anon.

(94) de minimis non curat lex.

has received almost universal judicial approval in principle if not always in practice. It must be pointed out, however, that its application may embarrass as well as protect the buyer. If, for example, the discrepancy is trivial and the bank for some reason is not offered or refuses an indemnity the buyer may be deprived of goods which he is awaiting to fulfil another contract. The bank is not bound and may not be in a position to take instructions when the discrepancy is brought to its notice - it may, for instance, merely be acting as an intermediary; and there are risks involved in accepting an indemnity. In these circumstances the buyer will have no remedy against the bank and any delay in obtaining specific instructions may involve a deterioration in the goods or the loss of a market. The alternative of giving the bank a discretion is clearly unacceptable. It is not for the bank to consider whether a discrepancy is material or not. An absolute discretion would be insupportable and any other discretion would be too easily challenged.

That is not to say, however, that the banks have not been involved in using their discretion. The very problem of discovering the exact meaning of their instructions in terms of the letter of credit may dictate the bank's involvement and discretion to an extent not envisaged in opening/

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opening the letter of credit. It is perhaps as well that the banks have taken advantage of reasonably comprehensive exclusion clauses protecting themselves against errors of judgment etc.

In Midland Bank Ltd. v. Seymour,<sup>(95)</sup> Devlin J. stated:

"When an agent acts upon ambiguous instructions he is not in default if he can show that he adopted what was a reasonable meaning".<sup>(96)</sup>

It is obvious that it is in the interests of both buyer and banker to eliminate ambiguity from the letter of credit. This, however, is easier said than done. What if the requirement is simply for "bills of lading"? Do these require to be "shipped" bills? Will "received for shipment" and "trans-shipment" or "through" bills suffice? In Yelo v. S.M. Machado and Co. Ltd.,<sup>(97)</sup> an irrevocable letter of credit was issued in terms of which the bank undertook to pay against, inter alia, "shipped" bills of lading. It was held that there was no proof that shipments were made before the due date and "received for shipment" bills only were tendered, and these the bank was justified in rejecting. It is thought that this case is an example of unambiguous instructions and proof of shipment was to that extent completely irrelevant. The bank is bound to accept or reject the documents without the benefit of a legal "proof".

In/

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(95) [1955] 2 Lloyd's Rep. 147.

(96) ibid p.153.

(97) [1952] 1 Lloyd's Rep. 183.

In Diamond Alkali Export Co. v. Bourgeois,<sup>(98)</sup> a case concerned with tender of documents under a c.i.f. contract, there was no specification of the type of bill of lading. A "received for shipment" bill was tendered but refused by the buyer. The court supported this rejection on the ratio that in the absence of agreement or custom a "received" bill is not good tender as it does not acknowledge shipment. The bank operating under a letter of credit is concerned with the documents normally tendered under a c.i.f. contract and to that extent the decision is obviously pertinent. It may be, however, that the ratio is too wide. In The Marlborough Hill<sup>(99)</sup> parties sought to vindicate their rights under a "received for shipment" bill on which they were indorsees. The court held that the parties were entitled to their remedy on the basis that the "received" bills were proper bills of lading in terms of the Act in question. This case was not, however, concerned with the documents' sufficiency under a c.i.f. contract and it may be reconciled with Diamond Alkali on the basis of the decision in Suzuki v. Burgett and Newsum,<sup>(100)</sup> where the bills were to be dated during the months of December 1919 or January 1920. The goods were first shipped within the specified period but thereafter they were transferred for shipment by ocean-going steamer. A bill of lading in the form "shipped or/

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(98) [1921] 3 KB 443.

(99) [1921] AC 444.

(100) (1922) 10 Ll LR 223.

or delivered for shipment" (equivalent to a "received" bill) was issued and in due course tendered. In fact the goods were not shipped till February 1920. Stating the decision of the court, Bankes L.J. said:

"the documents were not in order, because the shipment was not made in the contract time, and the bill of lading, although it may have truly stated the facts in reference to goods being ready for shipment, could not alter the fact that the shipment was not a January shipment but a February shipment".

Apart from the obvious distinction that in a credit transaction the bank can only be concerned with the documents, one principle is discernible from these three apparently contradictory authorities: where the bill specified requires to show a date of shipment a "received for shipment" bill is not a good tender. It is not enough to stipulate the date of shipment in the contract of sale if the tender is to be a bank operating under a letter of credit. Diamond Alkali and The Marlborough Hill may be reconciled on the basis that whether or not a received bill is a good tender, acceptance of such a bill will give the acceptor the normal remedies of a holder. <sup>(101)</sup> Diamond Alkali, of course, seeks to decide/

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(101) It is, with respect, suggested that the rule propounded by Professor Miller in the Casebook p.74 is accurate but unnecessary to distinguish these two cases. It is submitted that the more restricted distinction is supported by Bankes L.J. in Weis v. Produce Brokers Co. (1921) 7 Ll L Rep.211.

decide the point whether the received bill can in any event be a good tender and to this extent the decision may go too far. (102) It is certainly not binding on any court required to consider the bank's duties where a "received" bill is tendered under a letter of credit referring only to "bills of lading" - this would be an example of ambiguous instructions on which the bank would be entitled to put a reasonable interpretation. If it rejected such a bill it is also at least arguable that the seller would have a cause of action in as much as the "received" bill is a bill of lading so far as remedies thereunder is concerned. A specified date of shipment would place the matter beyond doubt. This argument (103) has apparently received support in certain American cases.

Where a "received" bill was stipulated for, it would seem that the bank could be compelled to accept a "shipped" bill on the close analogy of National Bank of South Africa v. Banca Italiana di Sconto (104) where the court held that on a construction of the credit contract the sellers required to tender delivery orders ex warehouse. In as much as this varied the original terms of the credit which called for delivery/

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(102) but see Yelo v. Machado [1952] 1 Lloyd's Rep.183 which appears to support it.

(103) Vietor v. National City Bank 200 App. Div. 557.

(104) (1922) 10 Ll LR 531.

delivery orders and/or bills of lading, this part of the decision must be considered to turn on the special facts of the case and should not be taken as a precedent. The Court of Appeal in rejecting the document tendered stated that the document to have been acceptable would at least have required to be "equivalent in the business sense" to a delivery order. Any notion of "equivalence", however, introduces difficult questions for the bank particularly where these may involve judgment on the legal effect of a document and it is submitted that the bank would be entitled to reject any document not bearing on its face to be of the type required under the letter of credit.

"Trans-shipment" or "through" bills of lading have been considered by the courts principally with reference to the protection which they offer to the party or parties relying thereon. In Landauer and Co. v. Craven and Speeding Bros.,<sup>(105)</sup> the contract between the parties stated that shipment should be from one of several specified ports within a specified period of time and the date of the bill of lading was to be conclusive evidence of the date of shipment. The goods were in fact shipped as required but they were trans-shipped at Hong Kong and the bill then attached to the goods was dated outwith the specified period, and related only to the passage from Hong Kong to the eventual destination. Scrutton J. (as he then was) held that tender of this bill was not acceptable. The/

The learned judge indicated that the seller must, at the time of shipment, procure a bill covering the whole journey; only a bill of this nature will allow the purchaser on its receipt to deal with the goods represented by the bill and to have contractual rights (and not merely an expectation of a further contract) in respect of losses at any stage of the voyage. The Umpire who heard evidence in this case had previously found that there was "no evidence ... of any custom affecting the Manila hemp trade or varying in any way the well-known mercantile usage with regard to contracts of sale on cost, freight and insurance terms ... it is by mercantile usage, unless otherwise agreed, the duty of the seller to provide by a contract of affreightment for the carriage of the goods from the port of shipment to the port of destination named in the contract, and by an indorsed bill of lading, or otherwise, to transfer to the buyer the benefit of the rights created by the contract of affreightment between the shipper and the shipowner for the entire voyage".<sup>(106)</sup> This was treated by Scrutton J.<sup>(106)</sup> as a finding on custom of trade that the seller must obtain a "through" contract. And provided the bill gave protection to the purchaser for the whole voyage, trans-shipment would not be a reason for rejecting the document. It is on the finding of custom that the earlier decision in Cox McEuen and Co. v. Malcolm and Co.<sup>(107)</sup> must be distinguished.

Landauer/

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(106) *ibid* at p.106.

(107) reported as a note at the end of Mr. Justice Scrutton's judgment.



Landauer was followed by the House of Lords in Hansson  
(108)  
v. Hamel and Horley Ltd. where the bill tendered was not  
a "through" bill but only bore to relate to the voyage as  
from a date of trans-shipment. Lord Sumner stated:

"the buyer is entitled to documents which substantially  
(108a)  
confer protective rights throughout"

and that the bills of lading must be procured "on shipment"  
in the sense, at least, that they cover the whole of the  
voyage. And in an earlier case involving a letter of credit,  
a banker was held entitled to reject a bill of lading which  
not only indicated trans-shipment but also omitted to specify  
that onward shipment to any of the specified ports was  
(109)  
included.

None of these authorities, however, justify Gutteridge  
(110)  
and Magrah's statement that "through" bills of lading can  
not be tendered at least unless supported by custom of trade.  
Judgments in both Hansson and Landauer seem to indicate that  
there is nothing inherent in the nature of a "through" bill  
which makes it unacceptable. That is not to say, however,  
that instances can not arise where "through" bills should be  
rejected because of some particular clausings which renders  
the bill "unclean". For instance, in Aberdeen Grit Co. v.  
(111)  
Ellerman's Wilson Line, an action of damages arising out  
of/

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(108) [1922] 2 A.C.36.

(108a) *ibid* at 46.

(109) *Brazilian and Portuguese Bank* (1868) 18 LT.823.

(110) at p.73.

(111) 1933 S.C.9.

of the delivery of goods which had been damaged by rain, it was held that a clause in the bill of lading excluding responsibility for lighterage was imported into the "through" bill of lading. The banker receiving tender of such a bill would be entitled to object that the bill did not cover the whole voyage inasmuch as he would require to take delivery not from the wharf but from the ship and that it was also to this extent "unclean" as it indicated a period of time for which the goods were not covered by the provisions of a bill of lading.

Nor would the bank be entitled to accept a bill which disclosed the goods had been carried on deck unless there was a specific provision allowing such shipment in the letter of credit. It is suggested that the bank would be obliged to refuse such bills as being "unclean". Article 21 of the Uniform Customs which states that "banks have the right to refuse bills of lading mentioning the storage of goods on deck" does not go far enough and it is submitted that the practice of British banks of refusing such bills, at least without an indemnity, is correct and is supported (112) by the American case of in re The Peter Helms.

The whole question of the cleanliness of a bill of lading/

lading is one which may involve the bank's discretion. As  
(113)  
Branson J. points out in N.V. Arnold Otto Meyer v. Aune:

"The characteristics generally required by the common law to exist in a bill of lading, if it is to be good tender under a c.i.f. contract, are so required because, and only because, it is the general custom of merchants of lading that such a bill/shall possess these characteristics".

Quid juris if custom would appear to vary the requirement for clean bills of lading? The rule is often considered to be a clear one: the bill should be clean and usual in the trade. But what if a dirty bill is usual? This question has, I submit, never been decided. It arose in National Bank of Egypt v. Hannevig's Bank (114) where the letter of credit provided for, inter alia, "bills of lading". Now this is an open term the construction of which could conceivably be "unusual" or "clean". It is an example of ambiguous instructions in a mandate. The bank paid against the tender of drafts and bills of lading on each of which there was a note to the effect that some of the bags containing the shipment were dirty or torn, or that the contents had been spilled. The buyers refused reimbursement on the ground that the documents were not clean. At first instance Bailhache J. accepted the defendant's contention that bills of lading meant/

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(113) (1939) 3 All E R 168 at 173.

(114) (1919) 1 Ll L. Rep.69.

meant clean bills of lading. This point, however, was left open in the Court of Appeal, although the actual decision in the case turned on different considerations - the terms of correspondence between the parties. Scrutton and Bankes L.J.J. refused to accept Bailhache J.'s dictum on "clean" bills, and there are indications that they preferred "usual" as a criterion. If it had been necessary to decide the point in Hannevig's case it might well have provided authority for the acceptability of "usual" bills - there were averments that the scarcity of wrapping materials in Egypt was such that if the goods were not acceptable as shipped there could be no trade at all - an excellent example of the prevailing conditions of the trade. Bankes L.J. (115) in considering the importance of "usual" bills quoted the example of a business disorganised by war. This is not an exceptional case, merely (116) another example of trade conditions at a given time.

The position has been complicated but not resolved by the judgment of Salmon J. in British Imex Industries v. Midland Bank. (117) The learned judge noted that the plaintiff's witness, a man of the "widest experience in the exporting and importing business", "had never heard of a bill of lading containing the clause in question being objected/

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(115) supra cit. at p.70.

(116) cf. Gutteridge & Magrah p.71: "each case must be decided on ..... the circumstances in which the credit has been established."

(117) [1958] 1 QB 542.

objected to on the ground that it did not contain a statement that such clause had been complied with". Salmon J. accepted this evidence of business usage. He goes on to say

"when a credit calls for bills of lading, in normal  
(118)  
circumstances it means clean bills of lading"

and approves Bailhache J. in Hannevig's Bank. I doubt whether this really takes us much further; he does not expand or contradict the judgments of Bankes and Scrutton L.J.J; he is obviously much impressed by the evidence led as to banking practice and this clearly had as much bearing on the judgment as the more celebrated dictum quoted elsewhere. It is certainly incorrect to assume that the difficulty is resolved  
(119)  
by this judgment.

It must also be pointed out that the two types of bill - clean and usual - do not necessarily conflict, nor have the judgments assumed them to. A clean bill has generally been taken to mean a bill which contains no reservation as to the apparent good order and condition of the goods or packing. This is undoubtedly "usual" in most cases; it is, however, with the exceptional that we must be concerned. The conflict is highlighted by Hannevig's Bank but not in the judgment of Salmon J. where the considerations of custom and cleanliness follow each other as if intended to be mutually re-inforcing. In Hannevig's Bank, on the other hand, Scrutton L.J./

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(118) *ibid* p.551.

(119) as Davis does - p.168.

Scrutton L.J. said:

"There were two views put, one that the credit calls for usual bills, the other that it calls for clean bills of lading",<sup>(120)</sup>

and answers this by envisaging a merger of the two:

"The question is whether clean bill of lading is usual bill of lading in the trade at the time".<sup>(120)</sup>

Similarly in National Bank of South Africa v. Banca Italiana di Sconto,<sup>(121)</sup> Bankes L.J. said:

"this bill is in so unusual a form that it cannot be treated as a good and sufficient tender of a clean bill of lading".

(122)

And in Westminster Bank v. Banca Nazionale di Credito,

London bankers gave evidence to the effect that clean bills were normally expected and that they would not without authority pay against any others. But the questions put to them did not appear to require them to consider the import of usual bills, only the possibility of dirty ones. The clauses in issue in this case disclosed that the wrappers were wet and blood-stained, clearly implying that the bills were neither clean nor usual.

"Cleanliness" of bills of lading may be re-defined in terms of what is usual. This is clearly what Scrutton L.J. had in mind in Hannevig's Bank.<sup>(123)</sup> The "usualness" of a bill is/

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(120) reported in Legal Decisions Affecting Bankers Vol.III at 213.

(121) (1922) 10 Ll L Rep. 531, at 534.

(122) (1928) 31 Ll.LR 306.

is not demonstrably unsuitable as a criterion of acceptability provided the protection of both buyer and banker is not prejudiced. The two standards may be merged on the basis that the broader should include the narrower. It is incorrect to restrict "usual" to mean "usual form" as Davis (123) appears to do; it also covers "usual terms" in the sense of those terms imposed as a usual condition of trade at any particular time. As Professor Miller says: (125)

"a 'clean' bill may yet be of any of the types in use in trade ..... closer examination of the transaction will be required to determine which of the various types may be regarded by the bank as sufficient tender".

If the definition of "usual" causes some difficulty, that of cleanliness appears to be well-settled. In Canadian and Dominion Sugar Co. v. Canadian National (W. Indies) S.S. Co., (126) a case concerned with a c.i.f. contract the term was taken to mean "that there was no clause or notation modifying or qualifying the statement as to the condition of the goods". On very similar lines the Uniform Customs and Practice, article 18 states "a clean shipping document is one/

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(123) supra cit.

(124) at p.157. See also Atkin L.J: (1922) 10 Ll LR 531 at 536.

(125) Casebook p.70.

(126) [1947] AC 46 at 54

one which bears no superimposed clauses expressly declaring a defective condition of the goods or packing". It is thought that the courts' practice of upholding the rejection of documents which merely indicate some particular risk or a circumstance creating an additional risk e.g. deck stowage can only be justified on the basis of the "usualness" or otherwise of the documents in question.

The importance of distinguishing the c.i.f. contract and the credit contract is underlined by Romariz Pistacchini (127) v. Zeyen and Co. where the seller tendered to the purchasers' bankers dock warrants which were marked "cases frail, not accountable for quantity of contents". These were not clean or usual: they indicated that the shipper was excluding his own responsibility for defective packing observed by him and also that the goods themselves might well be damaged or diminished. Bailhache J. appreciated why such documents were refused by the bankers but did not think that the actual contract (c.i.f.) called for clean warrants, in that they contained special provisions for dealing with defective goods. And while it is obvious from a practical point of view that the documents called for in the letter of credit will be those normally required in terms of the c.i.f. contract the interposition of the bank is crucial when the duty of investigation of documents is considered./



considered. It is submitted that in several areas the courts have clearly recognised the bank's duty to investigate the acceptability of documents tendered e.g. in cases of forgery, in cases where the type of bill may vary and where the question of "usualness" is raised.

The argument against involving the bank in such matters has, however, been forcefully stated by the courts, particularly in the leading case of Rayner v. Hambro's Bank,<sup>(128)</sup> a decision of the Court of Appeal. The facts were briefly that a credit was opened against the tender of documents covering a cargo of Coromandel groundnuts; the bills of lading in fact tendered related to "machine-shelled groundnut kernels", although the invoice was in order. Evidence was later led to show that the two were identical commodities and that a marginal note in the bills confirmed the goods were Coromandel groundnuts. The bank, however, refused to accept the documents. At first instance Atkinson J. held that the rejection was unjustified because of the "universal recognition" in the trade in question that the two descriptions related to the same goods. In overturning this decision the Court of Appeal emphasised that this "recognition" was restricted to the trade, and in rejecting the argument<sup>(128a)</sup> put forward for the plaintiffs that "if documents are presented in the form customary in the shipping trade ..... they/

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(128) (1942) 2 All E R 694; [1943] KB 37.

(128a) *ibid* at 39.

they are good and sufficient tender", gave a decision not only on the facts but also on the degree of knowledge which it is reasonable and proper to ascribe to a bank.

So far as the decision merely followed (as it stated itself to do) Lord Sumner's well-known dictum to the effect that "a banker acts at his peril if he departs from the strict terms of his mandate" no exception may be taken to it. (129)  
But Mackinnon L.J. went considerably further when he said:

"it is quite impossible to suggest that a banker is to be affected with knowledge of the customs and customary terms of every one of thousands of trades for whose dealings he may issue letters of credit ..... it would be quite impossible for business to be carried on, and for bankers to be in any way protected in such matters, if it were said that they must be affected by a knowledge of all the details of the way in which particular traders carry on their business".

It should be pointed out that the custom in this case was undoubtedly notorious in the trade. And it is therefore difficult to see how the situation differs from the tender of "usual" documents except to the extent that the description appears, at least on first inspection, to contradict the requirement of the credit. Does not Goddard L.J. (130) go too far when he says:

"It/

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(129) p.41.

(130) at p.43.

"It would be no answer for him (the banker) to say:

'Well, I got a receipt which in fact gives you all reasonable protection'? My answer would be:

'You are not concerned with the protection you have given me. You are concerned to carry out the orders which I give you and you have not done it'<sup>(131)</sup>".

Surely the banker is entitled to make a reasonable investigation of what its instructions in fact mean. If the bills in fact relate to the goods specified and the description can be justified by a universal usage in the trade, the banker would be entitled to interpret its instructions<sup>(132)</sup> reasonably. And Goddard L.J.'s comment that "for all the bank knows, the customer may have a particular reason for wanting "Coromandel groundnuts" in the bill" has obvious limitations in application: the credit stated the goods to which the bills must refer not the exact terms of the reference and a detailed invoice description would not normally and often could not conveniently be incorporated in the bill. The clearest support for the general proposition of principle in Rayner, as opposed to the decision itself, is to be found in the analogy used by Warrington L.J. in Stein v. Hambros Bank of Northern Commerce:<sup>(133)</sup>

"when two people are talking about a train leaving Paddington/

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(131) c.f. the view of Scrutton L.J. supra cit.

(132) Magrah: Gilbert Lectures 1951 at p.13.

(133) (1921) 9 LL LR 433.

Paddington at 5 o'clock, they are talking about something which is perfectly familiar to both, or assumed to be familiar. But in the present case the bank knew nothing whatever about the advertised sailings of the Caboto. All they knew about it was what they were told in their instructions".

Rayner, then, is certainly good authority for what it decides; <sup>(134)</sup> and the obiter dicta are unexceptional in so far as they justify the bank's entitlement to reject the documents in question. But where the bank's obligation is concerned the judgments must be tempered with the view subsequently adopted in Midland Bank v. Seymour by Devlin J, where correct particulars were given by the set of documents but not by the bill of lading itself, which omitted details of weight and cleanliness. The learned judge indicated that of two possible interpretations there was no way the bank could be bound to any one of them and that it was entitled <sup>(135a)</sup> to interpret its mandate reasonably. Nor did he feel that this was contradicting Rayner, clearly considering that decision to be restricted to a situation involving <sup>(135)</sup> contradiction rather than ambiguity. Unlike Rayner, however, the Midland Bank decision is consistent with Article 33 of the Uniform Customs and Practice which states that/

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(134) It does not settle the bank's obligation to accept or refuse documents.

(135) see particularly p.154 of the judgment.

(135a) See also Commercial Banking Co. of Sydney Ltd. v. Jalsard Pty. Ltd. [1972] 3 WLR 566 at 570.

that the description in the invoice must correspond with the description in the credit but that in the other documents, "description in general terms will be acceptable". (136)

It is not clear from the reports of the Rayner case that the documents required to refer in exact terms to "Coromandel groundnuts" although that is the interpretation which the court must be assumed to have adopted. And judicial support for the decision in Rayner, seen in British Imex Industries v. Midland Bank (137) and in the judgment of Scrutton L.J. in Hannevig's Bank, (138) is restricted to the ratio stated by Professor Gutteridge: (139)

"the real issue in the case was whether a banker should be required to take upon himself the interpretation at a moment's notice of ambiguous technical terms in the documents presented to him".

In the recent case of Soproma PA v. Marine & Animal By-Products Corporation (139a) Mr. Justice McNair considered whether bills referring to "Chilean fishmeal" were adequate where the goods were described in the credit as "Chilean Fish fullmeal" and followed the guidance of article 21. It may be suggested that where elements of "unusualness" and "custom" are in issue the courts may now be/

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(136) See also Guaranty Trust Co. of New York v. Van den Berghs (1925) 22 Ll LR 58, 286, 447.

(137) *supra cit per Salmon J.*

(138) *supra cit.*

(139) Journal of Institute of Bankers (1943) Vol. 64, p.66.

(139a) [1966] 1 Lloyd's Rep. 367.

be more inclined to follow the "Uniform Customs and Practice" and pre-1963 cases may require to be treated with care.

See also Guaranty Trust Co. of New York v. Van den Berghs (140b) where Mr. Justice Roche was prepared to accept evidence tending to show that "Manila cocoanut oil" and "cocoanut oil" were interchangeable.

Whatever the obligation on the bank, its entitlement in connection with "usual" or "ambiguous" documents has also been discussed in a series of cases dealing with insurance documents. In Wilson, Holgate and Company v. Belgian Grain and Produce Co., (140) Bailhache J. said:

"I am not satisfied that since Ireland v. Livingston was decided any custom has arisen which obviates the necessity for a tender by the seller of a policy of insurance if the buyer requires it ..... he is entitled to have a document of the very kind which he has agreed to take, or at least one which does not differ from it in any material respect".

(141)

This followed Manbre Saccharine Co. v. Corn Products Co.

where evidence of custom was rejected although it was recognised by McCardie J. that "inasmuch as the meaning of such a contract was created by custom, it may likewise, I presume, be altered by custom".

In the absence of custom, the right of rejection was explained in Diamond Alkali Export Co. v. Bourgeois (142) by McCardie J: /

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(140b) (1925) 22 Ll L R 58.

(140) [1920] 2 KB 1 at 8, 9 and 10.

(141) [1919] 1 KB 198 at 206.

(142) [1921] 3 KB 443 at 456.

McCardie J:

"I do not see how the buyer here could know whether the document he got was of a proper character unless he saw the original policy ..... I feel that a certificate of insurance falls within a legal classification, if any, different to that of a policy of insurance. The latter is a well-known document with clearly defined features ..... A certificate, however, is an ambiguous thing; it is unclassified and undefined by law".

It seems to be accepted in this judgment and in the judgment of Scrutton L.J. in Scott v. Barclays Bank <sup>(143)</sup> that it was the fullness of detail which dictated the need for a policy. And it must be considered very unlikely that any bank would be forced to accept a certificate even on the proof of custom so long as there is this absence of detail. This surely explains the attitude of Bailhache J. towards the <sup>(144)</sup> expert evidence led in Wilson Holgate and Co. to the effect that it was the common practice for sellers to tender, instead of a policy of insurance, a broker's cover note or a certificate of insurance:

"These witnesses, however, could give no instance in which there has been any contest as to the validity of a tender of a cover note or certificate ..... On the/

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(143) [1923] 2 KB 1.

(144) "witnesses of high standing ..... to whose evidence I give absolute credence" [1920] 2 KB at 7.

the contrary those witnesses were all very careful to explain that they were not prepared to say that the buyer was bound to take a cover note or certificate of insurance instead of a policy ... All that they would say was that so far as they know these cover notes and certificates were constantly (145) taken and never refused".

An onerous burden of proving custom was obviously envisaged by the learned judge as he accepted that the "practice" was one at least prevalent during war-time conditions. The acceptability of certificates in the United States is probably explained on the basis that certificates there do tend to contain terms more frequently only found in policies.

If the credit calls for "insurance policies" to be tendered, then on the basis of Rayner certificates would require to be rejected by the banker. It is only where an insurance document is stipulated for with the consequent ambiguity that the banker would be entitled to interpret his instructions as permitting a certificate, and only where the bank could justify its acceptance by showing a trade practice or custom or that the document contained more than selected details of the policy that it would be safe in so accepting.

We have been considering the effects of custom in modifying/

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(145) supra cit.



modifying or qualifying the bank's obligation to refuse documents not falling within the express terms of the credit. What of the converse situation where the documents are in strict compliance with the terms of the credit but those terms are understood in a special sense according to custom? It is submitted that in these circumstances, it is no part of the banker's duty to form and act upon an opinion as to the legal effect of the documents. Where the terms (146) are express and clear, custom can not qualify them.

The fact that the documents are not acceptable in terms of the letter of credit does not signify the end of the bank's involvement, at least since the development of the use of indemnities to cover discrepancies. The indemnity given by a party tendering unsatisfactory documents raises many distinct problems most of which may be considered on a straightforward contract basis quite independently of the letter of credit. This topic has been discussed elsewhere at some length. In considering the obligation and entitlement of the bank within the credit system there are two particular questions of special significance: the obligation of the bank to accept an indemnity and the obligation of the bank if it accepts an indemnity to advise the purchaser, its customer. The problem was raised in the American case, Dixon, Irmaos and Cia. Ltda. v. Chase National Bank of the City of New York (147) where the court held that the bank was obliged/

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(146) Midland Bank Ltd. v. Seymour supra cit. per Devlin J.

(147) 144 F 2d (1944) cert.denied 324 US 850,65 supra cit.687.

obliged to accept an indemnity on the basis of a uniform custom in New York banking circles. This indemnity was in respect of the inability of the tenderer to produce a complete set of bills of lading and the decision must be restricted to that situation. The basis of the decision was the importation of a custom into the contract between the seller and the bank. The effect of such a custom, if supported, would be to force the bank to enter a further contract the terms of which may vary and under which the bank may incur further expense in vindicating its rights. It also raises the questions of what is an acceptable indemnity and in respect of what defects must it be accepted. The difficulties are many and it is submitted that the courts in this country would not support any attempt to oblige a bank to accept an indemnity. Notwithstanding the practice of bankers in this country, Diamond Alkali Export Corporation (148) quite clearly shows that the courts will not enforce what is practised merely as a matter of courtesy or mutual convenience.

The second problem has not, as yet, been the subject of judicial decision. Gutteridge and Magrah state: (149)

"It is generally understood that where a bank takes up documents under indemnity, its principals should be/

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(148) supra cit.

(149) at p.117.

be advised. The paying banker has done something for which he has no authority, and, unless his action is ratified by the issuing bank, has to rely on the goods and the indemnity. While there may be no duty to advise that the indemnity has been taken, it is submitted that there is a duty to inform the principal that payment has been made against defective or inadequate documents, for the buyer ought to be put on guard".

An indemnity may, however, be given as a reassurance only, where, for instance the parties may not be prepared or inclined to insist on what they consider to be their entitlements to the extent of going to arbitration or the courts. An indemnity may be, and often is, the easy, convenient remedy. It is suggested that although the bank is authorised to accept only documents which are in strict accord with its mandate, in accepting the documents it is acting independently in terms of its contract with the seller, and it is submitted that the bank is not obliged to advise the purchaser either of the existence of the indemnity or, pace Gutteridge and Magrah, the fact that the documents are perhaps disconform to contract. If the documents were accepted without an indemnity and some discrepancy or disconformity in the documents later became apparent surely it is not for the bank to draw the purchaser's attention to his (the banker's) breach of contract./

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contract. And if this duty is not supportable, any other formulation of duty would seem fanciful being based only on the banker - customer relationship, which the courts have not been anxious to over-stress in the particular context of the tender of documents under the letter of credit. Moreover, the bank might insist on an indemnity or in fact obtain one where the documents were prima facie in order but there was some question as to the acceptability of the goods.<sup>(150)</sup> The bank might wish an indemnity to cover risks created by its reliance on the security of goods perhaps not in order. Is not the bank entitled to put the documents to the buyer without mentioning this fact - its right to recompense, after all, is based solely on the documents? And it is difficult to see any reason why the positions of the intermediary bank vis-à-vis the issuing bank and the latter vis-à-vis the customer should in any way be distinguished.

It is suggested that the device of the indemnity is intended as a practical remedy and much of its usefulness will be prejudiced if its use is hedged with a complicated network of further obligations and duties to those who are not parties to the indemnity agreement. The field of indemnities is clearly one where the distinction between the entitlement of the bank and its obligation is highlighted although/

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(150) *Moralice (London) Ltd. v. E.D. & F. Man* [1954]

2 Lloyd's Rep.526 shows that a party might well in practice obtain an indemnity where he was in any event bound to accept the documents without one.

although as in the other topics discussed in this Paper many of the most difficult questions remain unanswered with any certainty in the absence of clear judicial authority. If, however, the bank takes an indemnity to cover itself in accepting the tender of otherwise objectionable documents, it is thought that the bank can not claim to have correctly executed its mandate under the letter of credit.