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RELATIONS BETWEEN BANKER AND SELLER UNDER IRREVOCABLE LETTERS OF CREDIT

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The legal nature of the relationship which exists between banker and seller under an irrevocable letter of credit has long caused difficulty from a theoretical point of view. There is a tendency to regard this issue as one of academic significance only,[1] but as Gutteridge has pointed out[2] "it is always possible that the point might arise indirectly between the beneficiary and the buyer of the goods" whilst, in any case, to quote Cheshire and Fifoot:[3] "it is undesirable that established business practice should lack clear legal sanction."

The discussion of the legal problems involved has given rise to considerable confusion which, in the opinion of McCurdy:[4]

> is referable to a large extent, if not solely, to an imperfect understanding of the business transaction, and to an attempt to fit all letters of credit into one category both factual and legal.

To avoid confusion, therefore, it is necessary to state at the outset that the following discussion is confined to the position which arises under the irrevocable or confirmed acceptance documentary letter of credit.[5]

The transaction involved in the operation of such a credit, in so far as it is relevant to this discussion, and reduced to its simplest terms, may be put as follows: In a contract for the sale of goods there will be a term stipulating that payment is to be effected by means of an irrevocable credit. In compliance with this term the purchaser will approach his bankers requesting that they issue a letter of credit in favour of the sellers for the amount of the contract price. If the bankers are satisfied as to the financial integrity of the purchaser

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[1]Davies *Law relating to Commercial Letters of Credit*, 2nd ed. (1954) at p. 57.

[2]*The Law of Bankers' Commercial Credits* 2nd ed. (1955) at p. 16. He cites *Panoutsos v. Raymond Hadley Corporation of New York* [1917] 2 K.B. 473 as an instance of this. The Law Revision Committee in their Sixth Report (1937) also pointed out that the liquidation of a bank might be obliged to raise technical difficulties.

[3]*The Law of Contract* 4th ed. (1956) at p. 367.

[4]*Commercial Letters of Credit* (1922) 35 Harv. L.R. 539.

[5]For terminology see McCurdy, *op. cit.* pp. 542-545.

they will require him to sign a letter of request. This requests the opening of the credit and the advising of the seller thereof by air-mail or cable either direct from the issuing bank or through the bank's agents in the seller's place of business, and contains undertakings by the purchaser to re-imburse to bankers for all payments made under the letter, to pay all charged in relation to the goods, and to pay the bankers their commission.

The letter of credit thus issued, in the case of an irrevocable credit, will contain an undertaking by the bank to accept all drafts drawn under the credit in compliance with its conditions. These latter relate to the documents which must accompany the drafts, such as bills of lading, insurance certificates and invoices. On arrival of these documents the banker will take them up and, provided they comply with the description of the documents in the letter of credit, honour his promise to accept drafts drawn under that credit.[6]

One problem, although it is by no means the only one, which arises from this situation is that which concerns the relationship between the seller and the banker. What is the position of the seller *vis-à-vis* the banker if the latter, after issue and notification of the credit, fails to accept drafts drawn in accordance with the letter? The essential problem is whether the seller can sue the bank directly. He can, of course, sue the buyer on the original contract of sale, but to leave him with this remedy alone is largely to defeat the purpose of the whole operation. The system of banker's credits is based upon the idea of replacing the credit of individual firms, whose financial integrity will be unknown to other parties, by the credit of banking houses. Clearly, if the seller, under these circumstances, is left with his remedy against the buyer as his only redress then the justification for the whole system disappears.

That banks do in fact honour their obligations under letters of credit is obvious from the very small number of reported cases compared with the enormous number of transactions financed by this means. The problem remains, however, of determining the legal nature of the banker's liability. The theoretical difficulty experienced in formulating the basis of this liability is usually said to be that the seller has furnished no consideration for the banker's promise to make the credit available: *vis-à-vis* the seller the banker's promise is a *nudum pactum.*[7]

This theoretical difficulty seems to have been largely ignored by the English courts. Even as early as 1867 in *re Agra and Masterman's Bank ex p. Asiatic*

[6]For judicial exposition of the nature of the transaction see *Guaranty Trust Company of New York v. Hannay & Co.* [1918] 2 K.B. 623, *per* Scrutton L.J. at p. 659; *Equitable Trust Co. of New York v. Dawson Partners Ltd.* (1925) 25 L.L.R 90 per Scrutton L.J. at p. 93; *Pavia & Co. S.P.A. v. Thurmann-Neilsen* [1952] 2 Q.B. 84 *per* Denning L.J. at p. 88 and *Trans Trust S.P.R.L. v. Danubian Trading Co.* [1952] 2 Q.B. 297 *per* Denning L.J. at p. 304.

[7]This view was expressed by English counsel, including Sir Frederick Pollock, who gave evidence in *Russell v. Timothy Wiggin & Co.* (1842) 21 Fed. Cas. 68, No. 12, 165, cited by Trimble, the *Law Merchant and Letters of Credit* (1949) 61 Hav. L.R. at p. 992.

Banking Corporation,[8] Sir H. M. Cairns L.J. (as he then was) expressed the view that there was a binding contract between the seller and the banker from the date when the seller acted upon the letter of credit, a view which was also expressed by Rowlatt J. in *Urquhart, Lindsay and Co. v. Eastern Bank Ltd.,*[9] and followed by Greer J. (as he then was) in *Dexters Ltd. v. Schenker & Co.*[10] This view has, however, its difficulties and its limitations. In the first place it is difficult to identify the consideration which supports the alleged contract. In the second place this view of the matter only deals with the situation which arises after the seller has acted on the credit. It does not explain the position arising before that event.

Various alternative theories have been proposed to account for the bank's liability to the seller, but this is neither the time nor the place to examine them in detail.[11] Our purpose is rather to draw attention to one particular theory which, whilst it has often been advocated in the United States, seems to have attracted little attention elsewhere.[12] In the words of Hershey, who appears to have been one of the earliest writers to propose the theory:[13]

> all the requirements of the situation are met, and on the whole are better met, by treating the letter of credit as a self-sufficing instrument of the law merchant. In the end nothing will do so well as a frank and full recognition by law of the universal understanding of the commercial world.

This theory differs from all others which have been proposed in that it does not involve an attempt to fit letters of credit under the established categories of law or equity. It recognises that letters of credit are creatures of the commercial world whose justification is to be found in the practice of that world and not in the categories and concepts of the common law. In *Donald H. Scott & Co. v. Barclay's Bank,*[14] Bankes L.J. stated:

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[8](1867) L.R. 2 Ch. 391 at 396. His Lordship also expressed the view (at p. 397) that the principles of equitable assignment could be invoked.

[9][1922] 1 K.B. 318.

[10](1923) 14 Ll. L.R. 586 at p. 588. See also the view expressed in a dictum by Devlin J. in *Sinason-Teicher Inter-American Grain Corporation v. Oilcakes and Oilseeds Trading Corporation Ltd.* [1954] 1 W.L.R. 935. This case was actually concerned with a bank guarantee, but his Lordship, in comparing such guarantees with letters of credit, stated (at p. 941) "If it is an irrevocably confirmed letter of credit it creates a direct relationship between the bank and the seller and the bank becomes directly liable to the seller for the fulfilment of the obligation it has undertaken in the letter of credit." More recently the Court of Appeal, has expressed the same view in *Malas v. British Imex Industries* [1958] 1 All E.R. 262.

[11]The various theories are discussed by Gutteridge, *op. cit.* pp. 14-26 and Davies, *op. cit.* pp. 57-69 and *Relationship between Banker and Seller under a confirmed Credit* (1936) 52 L.Q.L. 225.

[12]It is remarkable that this theory is discussed by neither Davies nor Gutteridge. See, however, Baxter *Law of Banking and the Canadian Bank Act,* The Carswell Co. Ltd., Toronto 1956, at pp. 208, 209.

[13]*Letters of Credit* (1918) 32 Hav. L.R. 1 at p. 38.

[14][1923] 2 K.B. 1 at p. 10.

> The large and important part which letters of credit play in modern commerce restrains me from expressing my opinion on many of the points argued. The system should be kept as free as possible from technicalities, and from unnecessary judicial dicta which may embarrass business dealings in future.

Since all attempts to fit letters of credit under the established categories of law or equity inevitably result in the whole subject becoming embroiled in technicalities which have no real relevance so far as the commercial world is concerned, the essential merit of recognising letters of credit as self-sufficing instruments of the law merchant is that the development of the law on the subject is kept free from such technicalities.

This theory was, however, rejected by both McCurdy[15] and Thayer[16]. McCurdy, although he admitted that[17] "this is unquestionably the desirable solution for the irrevocable and confirmed types of letters of credit", nevertheless objected on the ground that there was no consideration to support the promise of the bank to the seller. He admitted that the courts have recognised mercantile customs such as that of negotiability but argued that they have rejected mercantile customs which require the enforcement of contracts which are unsupported by consideration. Thus he cited the failure of the attempt, made by Lord Mansfield in *Pillans v. van Mierop,*[18] to reduce consideration to the level of an evidentiary requirement, rather than as a point of substance. This he regarded as a fatal flaw in the theory that letters of credit could be recognised as self-sufficing instruments of the law merchant

Thayer took much the same view. Although he admitted that,[19] "at first glance this view seems both simple and efficient. It approximates very nearly to the mercantile understanding of the transaction", yet, after quoting the view of McCurdy, he continued:[20]

> Whether accidentally or otherwise, the doctrine of consideration has become an integral part of the Anglo-American law of contract, and for the present must be accepted as a fact. So far as the theory of a mercantile specialty fails to account for any consideration for the undertaking of the bank to the seller, it must accordingly be regarded as inadequate.

It is submitted that these objections, based upon a lack of consideration, raise unnecessary difficulties. The problem involved is not that of enforcing a promise which is unsupported by consideration, for the banker receives consideration for his promise from the buyer; the difficulty is that the consideration has not moved from the seller, or to put it in a slightly different form, the seller is not a party to the contract. Bearing this in mind it is submitted that the problem may legitimately be viewed as one which involves the question

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[15] *Op. cit.*

[16] *Irrevocable Credits in International Commerce: Their Legal Nature* (1936) 36 Col. L.R. 1031.

[17] *Op. cit.* at p. 564 n. 60.

[18] (1765) 3 Burr. 1663.

[19] *Op. cit.* at p. 1041.

[20] *Op. cit.* at p. 1042.

of enforcing a *jus quaesitum tertio* arising from a contract, which may be either enforced at common law or alternatively be recognised as a valid mercantile custom.

Two points, however, immediately arise. The first concerns the general position of a *jus quaesitum tertio* in the common law. The second concerns the extent to which such a mercantile custom could be recognised by the courts. Before we can discuss these, however, it is necessary to discuss a further problem as to the nature of a *jus quaesitum tertio* itself, for many legal systems seem to have some difficult in recognizing such rights and, so far as the common law is concerned, the difficulties in the way of recognising such rights are often formulated in two different ways:

a) consideration has not moved from the promisee;

b) the plaintiff is not a party to the contract.

It has been pointed out that these two formulations of the difficulty are not identical.[21] Thus Cheshire and Fifoot have emphasised that Roman law, although it did not possess a doctrine of consideration, nevertheless, did not normally allow third parties to enforce contracts made for their benefit. The learned writers go further, however, and argue that:[22]

> In England, therefore, if a third party seeks to sue on a promise, he is faced with two obstacles: the insular objection that he has given no consideration and the more comprehensive difficulty that he is a stranger to the contract.

That Roman law possessed a doctrine of third party contracts which in some cases prevented a *tertius* from enforcing a contract made for his benefit is indisputable; but that does not prove that the common law possesses a doctrine of privity independent of the doctrine of consideration.[23]

It may be pointed out that the Roman law, on this matter, rested on a very different basis from that of the common law. The Roman doctrine rested on the view that third party contracts were not only unenforceable at the instance of the *tertius* but were invalid even as between the parties to the contract. As Girard puts it:[24]

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[21]Law Revision Committee, *Sixth Report*, (1937).

[22]*Op. cit.* at p. 365.

[23]On the problem of third party contracts see Williston, *Contracts for the Benefit of Third Persons* (1902) 15 Hav. L.R. 768; Henning, *History of the Beneficiary's Action in Assumpsit* (1904) 43 A.L.R. (N.S.) 764, (1905) 44 A.L.R. (N.S.) 112, (1908) 47 A.L.R. (N.S.) 73 (reprinted in *Anglo-American Essays in Legal History* (1909) Vol. III 339) Corbin, *Contracts for the Benefit of Third Persons* (1918) 27 Yale L.J. 1008; Whittier, *Contracts Beneficiaries* (1923) 32 Yale L.J. 790; Corbin, *Contracts for the Benefit of Third Parties* (1930) 46 L.Q.R. 12; Finlay, *Contracts for the Benefit of Third Persons* (1930); Starke, *Contracts for the Benefit of Third Parties* (1948) 21 A.L.J. 382, 422,455,22 A.L.J. 67; Dold, *Stipulations for Third Parties* (1948) and Dorwick's, *A Jus Quaesitum Tertio by Way of Contract in English Law* (1956) 19 M.L.R. 374.

[24]*Manuel Elémentaire de Droit Romain* 8th ed. (1929) at p. 478. See also Monier, *Manuel Elémentaire de Droit*, Vol. II, 3rd ed. and Buckland, *Textbook of Roman*

> Les stipulations pour autrui sont nulles en ce double sens qu'elles ne font pas naître d'action pour le stipulant et qu'elles n'en font pas naître pour le tiers.

The common law seems never to have taken this view. In *re Schebsman,* du Parcq L.J. stated:[25]

> It is open to the parties to agree that, for a consideration supplied by one of them the other will make payments to a third person for the use and benefit of that third person... it cannot, I think, be doubted that the common law would regard such an agreement as valid and as enforceable (in the sense of giving a cause of action for damages for its breach to the other party to the contract) and would regard the breach of it as an unlawful act.

What then is the evidence which supports the view that the common law possesses a doctrine of privity which is independent of the doctrine of consideration? There are three factors which suggest, it is submitted, that in fact the common law possesses no such independent doctrine. The first is that, prior to the establishment of the doctrine of consideration in its modern form third party contracts were regarded as enforceable even at the instance of a *tertius,*[26] which they could not have been had there been, at that time, an independent doctrine of privity. Second, it was only after the decision in *Eastwood v. Kenyon*[27]

Law, 2nd ed. (1932) p. 426 *et seq.* A number of exceptions later mitigated the application of this principle, but the principle itself remained, see *Institutes* 3.19.3 It may be added that commercial credits give rise to problems even in countries that do not know the doctrine of consideration. Whether the concept of the *stipulation pour autri* provide a sufficient basis seems uncertain. See Brethe, *Le Crédit confirmé en Droit francais.*

[25][1944] Ch. 83. The only doubt would appear to relate to the question whether, in such cases, the plaintiff can recover substantial damages. This was denied in *West v. Houghton* (1879) L.R. 4 C.P.D. 197 but in *Lloyds v. Harper* (1880) L.R. 16 Ch. D. 290 Lush L.J. stated: "I consider it to be an established rule of law that where a contract is made with A for the benefit of B, A can sue on the contract for the benefit of B and recover all that B could have recovered if the contract had been made with B himself." If the opinion of Lush L.J. prevails the alleged common law rule regarding third party contracts seems to reduce to a narrow procedural rule. However, whichever view should prevail it seems clear that the validity of third party contracts is not affected by whether the damages recoverable are substantial or nominal.

[26]See *Lever v. Heys* (1599) Moore 550; *Provender v. Wood* (1630) Het. 30; *Hadves v. Levit* (1631) Het. 176; *Starkey v. Mill* (1651) Sty. 296; Thomas's case (1655) Sty. 461; *Sprat v. Agar* (1658) 2 Sid. 115; *Corny and Curtis v. Collidon* (1674) 1 Free. 284 ("he that hath the interest in the promise shall have the action"); *Dutton v. Pool* (1677) 2 Lev. 210; *Yard v. Eland* (1698) 1 Ld. Raym. 368. In the eighteenth century the principle was enunciated from time to time and even as late as 1787 (*Marchington v. Vernon* 1 B & P 101 n. (c)) the court stated "if one person makes a promise to another for the benefit of a third that third person may maintain an action upon it." For decisions to a contrary sense see *Bourne v. Mason* (1669) 1 Vent. 6, *Crow. v. Rogers* (1726) 1 Stra. 592 and *Price v. Easton* (1833) 4 B. & A. 433.

[27](1840) 11 A. & E. 438. The relationship between *Eastwood v. Kenyon* and third party contracts arise because a number of the earlier cases on third party contracts involved the problem of whether "moral obligation" could be regarded as sufficient consideration, as in *Dutton v. Poole* in which the court stated "the nearness of the relation gives the daughter the benefit of the consideration performed by her father."

had finally settled the modern doctrine of consideration that the courts set their faces against the enforcement of such contracts by a *tertius* which suggests that their attitude was related to, and even a consequence of, the development of consideration. Third, as Dowrick has demonstrated,[28] both *Tweddle v. Atkinson*[29] and *Dunlop v. Selfridge*[30] were based essentially upon the concept of consideration, rather than upon any independent doctrine of privity.[31] On these grounds it is submitted that the only difficulty that arises in connection with third party contracts at common law is a difficulty based upon the necessity for consideration flowing from the promisee, there is no further obstacle based on a lack of privity.

If we are correct in this assumption, we may turn to consider the general position of a *jus quaesitum tertio* in the common law. Until recently the position would appear to have been adequately summed up in the opinion of Lord Haldane in *Dunlop v. Selfridge* in which his Lordship stated:[32]

> In the law of England certain principles are fundamental. One is that only a person who is a party to a contract can sue on it. Our law knows nothing of a *jus quaesitum tertio* arising by way of contract.

Recent decisions, however, have suggested that the position is not quite so simple. In *Smith and Snipes Hall Farm Ltd. v. River Douglas Catchment Board*,[33] Denning L.J. (as he then was) was prepared to deny the proposition that English law does not recognise the existence of a *jus quaesitum tertio*. His Lordship stated that the principle enunciated by Lord Haldane in *Dunlop v. Selfridge* "is not nearly so fundamental as it is sometimes supposed to be" and he argned that it had not supplanted a more fundamental principle:[34]

> I mean the principle that a man who makes a deliberate promise which is intended to be binding, that is to say under seal or for good consideration, must keep his promise; and the court will hold him to it, not only at the suit of the party who gave the consideration but also at the suit of one who was not a party to the contract, provided that it was made for his benefit, and that he has sufficient interest to entitle him to enforce it, subject always, of course, to any defences that may be open on the merits.

Further, giving illustrations of the operation of this principle, he stated:

The point taken in both *Eastwood v. Kenyon* and *Tweddle v. Atkinson* was that "natural love and affection" could no longer be regarded as good consideration.

[28]*Op. cit.* at pp. 382-3.

[29](1861 1 B. & S. 393.

[30][1915] A.C. 847.

[31]Dowrick's conclusion (*op. cit.* at p. 384) is that "the principle obstacle to a third party rights doctrine is not that the leading cases preclude the possibility of a *jus quaesitum tertio* by way of contract, hut that on the authorities even a *tertius* must provide consideration to acquire a contractual right.

[32][1915] A.C. 847 at p. 853.

[33][1949] 2 K.B. 500. There are of course a number of recognised exceptions to the rule against a *jus quaesitum tertio* based on statute, e.g. Road Traffic Act 1930.s. 36 (4).

[34]At p. 515.

> It covers, therefore, rights such as the following which cannot justly be denied — the right of a seller to enforce a commercial credit issued in his favour by a bank under contract with the buyer...

His Lordship returned to this point in *Drive Yourself Hire Co. (London) Ltd. v. Strutt*[35] regarding the interpretation to be put on the Law of Property Act, 1925 s. 56.[36] In an opinion which was admittedly *obiter,* his Lordship stated:[37]

> I can think of no words more apt to do away with the rule in *Tweddle v. Atkinson,* leaving the courts free, in cases respecting property, to go back to the old common law whereby a third party can sue on a contract made expressly for his benefit.

Devlin J. likewise seems to have no difficulty with the idea of a *jus quaesitum tertio* arising by way of contract. In *Pyrene Co. Ltd. v. Scindia Navigation Co. Ltd.* his Lordship stated:[38]

> There is nothing novel about the idea of a third party coming in to enforce a contract either an undisclosed principal or as a beneficiary... The principle is very familiar in mercantile contracts.

Whilst this case was not concerned with letters of credit, it is worthwhile noting the comment of Cheshire and Fifoot:[39]

> The ready recognition of commercial interests which this case reveals suggests that, if the problem of Bankers Commercial Credits is presented to the courts, it may now be solved in the same way.

Adler v. Dickson[40] was yet another case in which the problem of third party contracts was raised. At first instance Pilcher J., although he accepted the principle enunciated by Denning L.J. in *Smith and Snipes Hall Farm Ltd. v. River Douglas Catchment Board,* nevertheless held that it was inapplicable in the case before him on the ground that the defendants did not have a sufficient interest to entitle them to rely on the exception clause in the contract alleged to have been made for their benefit.[41]

In the Court of Appeal Denning L.J. whilst he naturally adhered to the principle that he had enunciated in earlier cases, nevertheless held that it did not assist the defendant on the ground that the clause had not been made for their benefit, although he agreed that had the clause been appropriately worded

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[35][1954] 1 Q.B. 250.

[36]15 & 16 Geo. V. c.20. The section provided "A person may take an immediate interest in land or other property or the benefit of any condition, right of entry, covenant or agreement over or respecting land or other property, although he may not be named as a party to the conveyance or other instrument."

[37]At p. 274. This interpretation which has not commended itself to either Crossman J. in *re Foster, Hudson v. Foster (No. 2)* (1938) 159 L.T. 279 or Wynn-Parry J. in *re Miller's Agreement Uniacke v. A.-G.* [1947] 1 Ch. 615, is described by Cheshire and Fifoot, *op. cit.* at p. 375 as "attractive and generous."

[38][1954] 2 Q.B. 402 at p. 422.

[39]*Op. cit.* at p. 369.

[40][1955] 1 Q.B. 158.

[41]At p. 172.

the defendants would have been able to claim its protection.[42] Whilst Morris L.J. seems to have taken much the same view, Jenkins L.J. expressed himself in words which suggest that he was not prepared to accept even the general average and contribution.[43]

> Even if these provisions had contained words purporting to exclude liability of the company's servants non constat that the company's servants could successfully rely on that exclusion in proceedings brought against them by some third party injured by their tortious conduct, for the company's servants are not parties to the contract.

Finally reference must be made to the recent decision in *Shamia v. Joory*[44] in which the principle laid down by Lord Blackburn in *Griffin v. Weatherby*[45] was applied by Barry J. in circumstances which suggest that it may well prove useful in relation to the problem of commercial credits. This principle, which Lord Blackburn regarded as settled since *Walker v. Rostron*[46] was, in his Lordship's words, that:[47]

> Where a person transfers to a creditor on account of a debt whether due or not, a fund actually existing or accruing in the hands of a third person, and notifies the transfer to the holder of the fund, although there is no legal obligation on the holder to pay the amount of the debt to the transferee yet the holder of the fund may, and if he does promise to pay the transferee then that which was merely an equitable right becomes a legal right in the transferee, founded on the promise; and the money becomes a fund received or to be received for and payable to the transferee, and when it has been received an action for money had and received to the use of the transferee lies at his suit against the holder.

Provided only that the bank may be regarded as possessed of a 'fund' within the meaning of the above principle[48] it would appear that the issue of the letter of credit may be regarded as a sufficient promise on the part of the bank to the seller to found a right of action in the latter should the bank refuse to honour its promise contained in the letter.

The various decisions mentioned above seem to suggest that the concept of privity of contract as it arises in the common law, is undergoing considerable change. It is presumably too early to say just how far the changes will go, and since it must therefore be regarded as an open question just how far the common law does admit the possibility of a *jus quaesitum tertio* arising from contract,[49] we must turn to consider the problem from the point of view of

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[42]At p. 184.

[43]At p. 186.

[44][1958] 2 W.L.R. 84.

[45](1868) L.R. 3 Q.B. 753.

[46](1842) 9 M. & W. 411.

[47]At p. 758.

[48]In *Shamia v. Joory* Barry J. stated, with regard to the meaning of the term 'fund': "In my judgment all that the law requires is that there must be in the hands of or accruing to the third person, either a sum of money, or a monetary liability, over which the transferor has a right of disposal." (at p. 90).

[49]Dowrick, *op. cit.* p. 393 concludes that "Lord Justice Denning's general doctrine of *jus quaesitum tertio* in contract is not yet an established part of our positive law."

mercantile custom, i.e., even if, for the purpose of argument, it is assumed that Lord Haldane's opinion in *Dunlop v. Selfridge* represents an accurate statement of the common law today, to what extent could the courts recognise a mercantile custom by virtue of which a *jus quaesitum tertio* can arise from a contract?[50] This involves discussion of the extent to which mercantile customs can be recognised by the courts, and it is to this problem that we must now turn.

It would probably be true to say that there is no such thing in the common law as the *negotiorum gestio*. This has not, however, prevented the courts from recognising mercantile customs by which the claims of a *negotiorum gestor* are admitted. Thus in *Falcke v. Scottish Imperial Insurance Co.*[51] Bowen L.J. immediately after stating the above principle, noted three exceptions which were based on "maritime law" which, on these matters, his Lordship considered differed from the common law. The three exceptions were salvage, general average and contribution.[52]

Lord Goddard C.J. in *Sachs v. Miklos,*[53] using the terminology of implied agency of necessity, added two further exceptions, namely, the acceptance of a bill of exchange for honour, and the power of a ship's master to hypothecate his ship and cargo. The latter is quite clearly a matter of "maritime law" whilst for the former we have the opinion of Park B. in *Hawtayne v. Bourne*[54] that the exception to the general principle is based on the "law merchant."[55]

We may conclude that the fact that the common law has no concept of *negotiorum gestio*[56] has not prevented the courts from recognising mercantile customs which admit the claims of a *negatiorum gestor* and it is suggested that, by analogy, mercantile customs which admit of the possibility of a *jus quaesitum*

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[50]Mead, *op. cit.* considers that the "special theory" is unnecessary on the ground that, so far as American law is concerned, a *jus quaesitum tertio* is recognised. It is because, as we have submitted, this cannot yet be said of English law that we must give consideration to the "specialty theory".

[51](1886) 34 Ch.D. 234 at p. 248. See also Lord Kenyon in *Exall v. Patridge* (1799) 8 T.R. 308 and *Child v. Manley* (1800) 8 T.R. 610.

[52]In *Nicholson v. Chapman* (1793) 2 H.Bl. 254 Eyre L.C.J. explained the exception of salvage on the basis of "public policy and commercial necessity."

[53][1948] 2 K.B. 23. The courts have shown no disposition to extend these exceptions. See *Nicholson v. Chapman,* supra, *Hawtayne v. Bourne* (1841) 7 M. & W. 595; *Gwilliam v. Twist* [1895] 2 Q.B. 84; *Jebra v. Ottoman Bank* [1927] 2 K.B. 254 and *Munro v. Wilmott* [1949] 1 K.B. 295.

[54]*Supra*

[55]Pollock suggested that the right of a partner to indemnify from his co-partners constitued a further exception in that he regarded the right as going beyond the right of indemnity as derived from the law of agency. He considered that the right arose *quasi ex contractu* and suggested that it was analogous to salvage and average. (*The Law of Partnership* 15th ed. at p. 75. The learned editor has however doubted Pollock's opinion on this point — p. 76 n.3).

[56]A possible exception, even in the common law is to be found in relation to burial. See *Ambrose v. Kerrison* (1851) 10 C.B. 776; *Jenkins v. Tucker* (1788) 1 H.Bl. 90 and *Brashaw v. Beard* (1862) 12 C.B.N.S. 344.

tertio arising from contract, may likewise be recognised by the courts, despite the possible absence of such a conception from the common law.

Probably the best example of the recognition by the courts of mercantile custom was the recognition extended to the custom of negotiability. In this connection it is worthwhile recalling the words of Cockburn L.C.J. in *Goodwin v. Robarts,*[57] words which, in the opinion of Lord Chorley "should be inscribed in letters of gold in every court handling commercial litigation."[58] His Lordship stated:[59]

> The law merchant thus spoken of in relation to bills of exchange and other negotiable securities, though forming part of the general body of the *lex mercatoria,* is of comparatively recent origin. It is neither more nor less than the usages of merchants and traders, ratified by decisions of courts of law which, upon such usages being proved before them, have adopted them as settled law with a view to the interests of trade and public convenience... Why is it to be said that a new usage which has sprung up under altered circumstances, is to be less admissible than usages of past time? Why is the door to be now shut to the admission and adoption of usage in a matter of altogether cognate character, as though the law had been finally stereotyped and settled by some positive and premeptory enactment.

His Lordship somewhat limited the effect to these words, however, when he added:

> We must by no means be understood as saying that mercantile usage, however extensive, should be allowed to prevail if contrary to positive law, including in the latter such usages as, having been the subject of legal decision, and having been sanctioned and adopted by the courts, have become, by such adoption, part of the common law. To give effect to such a usage which involved a defiance or disregard of the law would obviously be contrary to a fundamental principle.

That there must be some limit upon the recognition that can be accorded to mercantile usage is obvious, what is not so obvious is the criterion to be applied. To say that a usage which is "contrary to positive law" will not be recognised is hardly very helpful. What is meant by "positive law" in this context? Negotiability was unknown to the common law, and such attempted assignments were, in one sense at least, contrary to positive law, yet they were recognised as valid, on the basis that they constituted mercantile custom.[60]

Without attempting to lay down any general rules for determining the limits of recognition in such cases, it is submitted that the recognition of the existence of a *jus quaesitum tertio* arising by way of contract is a mercantile custom

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[57](1875) L.R. 10 Ex. 76, aff'd (187 5) L.R. 10 Ex. 337.

[58]*The Conflict of Law and Commerce* (1932) 48 L.Q.R. 55.

[59]At p. 346.

[60]On the other hand the custom of the London Stock Exchange whereby the provisions of the Banking Companies' (Shares) Act 1867 are disregarded may clearly be regarded as a mercantile custom which is "contrary to positive law" and which may therefore be refused recognition by the courts on that ground. It was designated "unreasonable" by Lord Coleridge in *Neilson v. James* (1882) 9 Q.B.D. 546 and by Brett M.R. in *Perry v. Barnett* (1885) 15 Q.B.D. 388. See also Seymour v. Bridges (1885) 14 Q.B.D. 460 and *Coates, Son and Co. v. Pacey* (1892) 8 T.L.R. 351. That mercantile usage cannot prevail over a statute was made clear as early as 1612 in *Greenway & Barkers* case, God. 260.

which may be recognised by the courts without infringing the limitation laid down by Cockburn L.C.J. and this even if it be assumed that the common law, as such, does not recognise the existence of such a right.

Other examples in which the common law courts have recognised mercantile customs provide some support for this submission. Thus even the doctrine of consideration has been modified under the pressure of commercial needs, as is illustrated by the rules that an antecedent debt or liability is sufficient consideration to support a negotiable instrument[61] and that once value has been given for a negotiable instrument the holder is deemed to be a holder for value as regards the acceptor and all persons who became parties to the bill prior to that time.[62]

There is even some slender authority for the view that the courts have in fact recognised exceptions to the *jus quaesitum tertio* rule. One decision which has been recently claimed as constituting such an exception is that in *Elder Dempster & Co. v. Paterson Zochonis & Co.*[63] The interpretation of this decision as one involving an exception to the *jus quaesitum tertio* rule seems to stem from the remarks of Denning L.J. in *White v. John Warrick and Co. Ltd.*[64] in which his Lordship said of the *Elder Dempster* case, "It is one of those cases where a third party can take advantage of a contract made for his benefit",[65] a view which he later repreated in *Adler v. Dickson.*[66] In the latter case, however, Jenkins L.J. was inclined to interpret the *Elder Dempster* case rather more restrictively.[67]

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[61](1875) L.R. 10 Ex. 162.

[62]*Collins v. Martin* (1797) 1 B. & P. 648. Another good example of the recognition of mercantile custom is provided by the right of stoppage in transitu. On this see the remarks of Bowen L.J. in *Kendall v. Marshall Stevens* (1888) L.R. 11 Q.B.D. 356 at p. 368 and especially those of Lord Abinger in *Gibson v. Carruthers* (1841) 8 M. & W. 321 at p. 338. The right of undisclosed principals in agency are probably also to be explained on this basis.

[63][1924] A.C. 522. It has been pointed out that this case is not cited in the first three editions of Cheshire and Fifoot and even in the fourth edition it is only mentioned in a footnote. It is not mentioned by Corbin, Starke or Finlay.

[64][1953] 2 All E.R. 1021.

[65]At p. 1026.

[66][1955] 1 Q.B. 158. His Lordship stated: "it is one of those cases — by no means rare — where a third party is entitled to enforce a contract made for his benefit."

[67]At p. 195. The speeches or their Lordships in the *Elder Dempster* case, on this point, were as Denning L.J. pointed out in *Adler v. Dickson* very "compressed". Lord Cane appears to have relied on the concept of agency. In *Gibert, Stokes and Kerr Pty, Ltd. v. Dalgety & Co. Ltd.* [1948] S.R. N.S.W. 435 Owen J. (as he then was) claimed that the use of the concept of agency, in this context, introduced an unnecessary fictional element: "With all respect, I think that the notion that the grantor of a bill of lading makes it both as a principal and as an agent for those whom he may employ to perform the contract, with the result that all who take part in the performance of the contract becomes parties to it, and the converse proposition, that he acts as agent for the cargo owner to make contracts on the latter's behalf with all who may be

Another decision which is sometimes claimed as involving an exception to the *jus quaesitum tertio* rule is *Les Affréteurs Réunis Société Anonyme v. Leopold Walford (London) Ltd.*[68] in which the House of Lords allowed an action by a broker, who had negotiated a charter-party, for his commission which, by a clause in the charter-party, the owners had agreed to pay. Admitting that so far as the brokers were concerned the charter-party was *res inter alios acta,* Lord Birkenhead nevertheless held, following *Robertson v. Wait,*[69] that, "in such cases the charterers can sue as trustees on behalf of the broker", and further held that, although the charterers had not been made parties to the action, "the matter shall be dealt with as if the charterers were co-plaintiffs."

Even if the "cumbrous fiction"[70] of the trust concept be admitted (a view which is now difficult to reconcile with the subsequent decisions in *Vandepitte v. Preferred Accident Insurance Corporation of New York*[71] and *re Schebsman*[72]) there still remains the even more cumbrous fiction of allowing matters to proceed "as if" the charterers had been co-plaintiffs, which they were not.

Whilst the decision, which in fact gives effect to what would appear to be normal business practice, is doubtless desirable, it is surely deplorable that to reach a result the courts must indulge in games of "let's pretend". This decision indicates, however, that the courts are prepared to modify the common law concept of privity to meet commercial usage in certain cases. The fact that they are prepared to do so in some cases suggests that it is not unreasonable to argue that they should do so again in the case of letters of credit, although there would seem to be no need to resort to such methods to attain the desired result, since mercantile usage is a sufficient justification for allowing third parties to sue on contracts made for their benefit, quite apart from the technicalities of the common law.

It is thus submitted that there is no particular justification for the view that the number of such exceptions (if exceptions they really are) to the *jus quaesitum tertio* rule is now fixed. In this context it should be remembered that in *Edelstein v. Cchuler & Co.*[73] Bingham J. expressed the view that,

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employed to effect the contractual carriage introduces an unreal and fictional element into a commercial transaction, and for that reason alone does not appeal." (at p. 443). See also *Waters Trading Co. Ltd. v. Dalgety & Co. Ltd.* [1952] S.R. N.S.W. 4.

[68][1919] A.C. 801.

[69](1853) L.R. 8 Ex. 299. It is perhaps worth emphasising that this case was decided before *Tweddle v. Atkinson* (1861).

[70](1939) 55 L.Q.R. 208.

[71][1933] A.C. 70. Lord Wright stated: "the intention to constitute a trust must be affirmatively proved."

[72][1944] Ch. 83 Lord Green M.R. stated "It is not legitimate to import into the contract the idea of trust when the parties have given no indication that such was their intention."

[73][1902] 2 K.B. 144 at p. 154.

> It is also to be remembered that the law merchant is not fixed or stereotyped; it has not yet been arrested in its growth, by being moulded into a code; it is, to use the words of Cockburn C. J. in *Goodwin v. Robarts,* capable of being extended and enlarged so as to meet the wants and requirements of trade in the varying circumstances of commerce.

This view has been recently echoed in the Judicial Committee of the Privy Council, for in *Bank of Baroda Ltd. v. Punjab National Bank Ltd.*[74] Lord Wright stated:

> But the law merchant is not a closed book, nor is it fixed or stereotyped... Practices of business men change, and courts of law in giving effect to the dealings of the parties will assume that they have dealt with one another on the footing of any relevant custom or usage prevailing at the time in the particular trade or class of transaction.

If the law merchant has not in fact become stereotyped, and if the mercantile custom by which a banker is liable to a seller under an irrevocable letter of credit is well established, what need is there to look further for a justification for the banker's liability? It has been submitted that there is nothing in the nature of the custom itself to render it such that the courts could not recognise it, and further that the recent decisions tend to suggest that the common law itself is moving towards a position under which the concept of the enforceability of a *jus quaesitum tertio* may form part of the ordinary law of contract.

Our conclusion thus far is first, that the theory that letters of credit may be recognised as "mercantile specialties" is not invalidated by objections based upon the fact that consideration does not flow from the seller, and second that the seller's right to enforce the banker's promise may be regarded as a *jus quaesitum tertio* arising from the contract between the banker and the buyer which, even if not recognised by the common law may be recognised by the courts as a valid mercantile custom.

There remains, however, one difficulty which must be negotiated before this theory can be regarded as a possible basis for the operation of letter of credit. This difficulty relates to the question whether letters of credit have reached a sufficient degree of uniformity to warrant recognition as self-sufficing instruments of the law merchant. McCurdy, writing in 1921, argued that letters of credit had not in fact reached that degree of uniformity which would warrant such recognition, and he contrasted them with bills of exchange.[75]

At least two points may be made in connection with this objection. In the first place, in the forty years which have elapsed since Beale's article on the subject,[76] which McCurdy quoted in support of his argument, there has been a tremendous expansion in the use of such credits and standard forms are

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[74][1944] A.C. 176 at p. 182.

[75]*Op. cit.* at p. 564.

[76]*Utility of Letters of Credit in Export Trades: A Plea for Standard Forms* (1917) 95 Banker's Magazine 271.

commonly employed.[77] Thus Thayer, writing in 1936, referred to them as,[78] "one of the most important single instruments employed today in international commerce." Finkelstein, writing in 1930, whilst admitting that the argument based on a lack of uniformity had some force, nevertheless considered that the irrevocable credit was the one form of commercial credit which had reached a sufficient degree of uniformity to merit recognition as self-sufficing instruments of the law merchant.[79]

Finally it should be emphasised that commercial letters of credit, in one form or another, have been known to the courts for many years. As early as 1871, in *Banner v. Johnston,* the Lord Chancellor, Lord Hatherly, was able to say:[80]

> The transactions out of which this letter of credit arose are of a very ordinary character, as we have been able to learn from numerous cases brought before the courts with reference to mercantile engagements in the purchase of cotton abroad.

Again, in 1875, in *Morgan v. Lariviere,* Lord Cairns, after describing the nature of the transaction, stated, "Your Lordships are perfectly familiar with this, which occurs every day in commerce."[81]

Professor Davies has suggested that these cases involve a rather different form of the letter of credit than that encountered today. He states:[82]

> Both these decisions... turned on the older form of letter of credit which was given by a merchant or banker to his customer authorising the customer to draw on the merchant or the banker, it being the intention of the parties that the letter should be shown to third parties so that the customer might thereby obtain credit.

With respect it is submitted that this is not so. The facts of these cases, as reported, with which may be taken the fact situation of the earlier decision in *re Agra and Masterman's Bank ex. p. Asiatic Banking Corporation,* seem clearly to suggest that, in all essentials, the credit used was of the same nature as that encountered today. One decision which does, however, indicate that the type of credit mentioned by Professor Davies was employed, is *re Agra Bank ex. p. Tondeur.*[83] In this case the letter of credit was given by the bank to the

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[77]The International Chambers of Commerce has published *Uniform Customs and Practice for Commercial Documentary Credits,* the last edition of which appeared in 1951.

[78]*Op. cit.* at p. 1031.

[79]*Legal Aspects of Commercial Letters of Credit* (1930). It may be added that Thayer, *op. cit.* at p. 1041 n. 46 remarks, concerning the argument based on lack of uniformity, "This difficulty does not appear to be insuperable. Its (i.e. letter of credit) basic characteristics remain unchanged and are well understood commercially."

[80](1871) 5 H.L. Cas. 157 at p. 166.

[81](1875) 7 H.L. Cas. 423 at p. 432. It should perhaps be added that in *Prehn v. Royal Bank of Liverpool* (1870) L.R. Ex. 92 the buyer apparently felt it incumbent upon him to explain the nature of the transaction involved to his banker.

[82]*Op. cit.* at p. 9

[83](1867) L.R. 5 Eq. 160.

applicant, and upon which he was entitled to draw. In such cases the problem we are discussing here could hardly arise. The conclusion, is surely that, despite undoubted developments of commercial practice, the letter of credit, in its modern form, has been known to the courts for nearly a century.[84]

A second point which may be made with regard to McCurdy's argument is that whilst commercial practice regarding cheques and bills of exchange is undoubtedly uniform today, and has been so for many years, it can hardly be said that this was true at the date when the custom of negotiability was recognised by the courts. The recognition of the customs of negotiability by the common law courts would appear to date back to the beginning of the seventeenth century, but it was surely not until a good deal later that the practice with regard to such instruments became uniform.[85]

The mere fact that complete uniformity of pratice has not yet been obtained in regard to letters of credit cannot of itself therefore be regarded as a decisive objection to their recognition as self-sufficing instruments of the law merchant. Clearly some degree of uniformity is necessary before the courts would be justified in extending recognition to such instruments, but it is submitted that the degree of uniformity attained today is sufficient to warrant such recognition being accorded.

So far as the banks are concerned it would appear that the actual form and wording of the irrevocable letter of credit is uniform. The only point upon which there is lack of uniformity relates to the interpretation of the description of the documents which are required to accompany drafts drawn under the letter of credit. The principle was enunciated by Bailhache J. in *English Scottish and Australasian Bank Ltd. v. Bank of South Africa* thus:[86]

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

The problem remains, however, of determining when the documents are in "strict accord" with the terms of the letter of credit. Thus if the letter requires a clean bill of lading, the problem is to determine just what constitutes a clean bill of lading for this purpose, or to put it another way, the problem is to

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[84]The two earliest cases cited by Davies, *op. cit.* which involved transactions in the nature of letters of credit are *Pillans v. van Mieron, supra,* and *Mason v. Hunt.* (1778) 7 T.R. 350. In both these cases, however, as Professor Davies points out, the nature of the credit involved differed substantially from that involved in the modern letter of credit.

[85]See Holden, *History of Negotiable Instruments in English Law* (1955). He cites *Martin v. Boure* (1602) Cro. Jac. 6 as the first case in which negotiable instruments came before the courts of common law.

[86](1922) 12 Ll.L.R. 21 at p. 24.

determine just how strict the compliance must be.[87] It would appear that the practice in problems such as this may vary, but it is submitted that variation of practice on such points cannot necessarily be taken as excluding the possibility of the recognition of letters of credit as self-sufficing mercantile instruments, in the sense that the banker's liability is recognised as resting on a mercantile custom by virtue of which a *jus quaesitum tertio* arises, rather than on some principle of law or equity which has been pressed into service by way of analogy or fiction.

It may finally be remarked that there would appear to be some slight authority in favour of our submission. In *International Banking Corporation v. Barclay's Bank*[88] Atkin L.J. (as he then was) is reported as having said, of the position in relation to "cable credits", "the law relating to such transactions is not at the moment so crystallised that it is not dependent upon proof of custom." This would seem to imply that his Lorship was prepared to accept proof of mercantile custom in these matters, thereby implying that the matter was one of mercantile custom rather than of deduction from purely legal premisses. Thus his Lordship would appear to have been of the view that "cable credits" had not, at that time, reached the stage of development which e.g., debenture bonds had reached in *Edelstein v. Schuler & Co.*, in which Bingham J. felt himself able to hold that:[89]

> It is no longer necessary to tender evidence in support of the fact that such bonds are negotiable... the courts of law ought to take judicial notice of it.

We are not, of course, submitting that letters of credit have reached that stage, for no attempt appears to have been made judicially to establish the mercantile custom for whose existence we are contending, but the admission that the problems are such as must be solved by reference to mercantile custom is a long step in the direction which, we would submit, leads to a correct solution of these problems.

We would therefore suggest that on the score of uniformity irrevocable credits have reached that stage of development which would warrant the courts in accepting evidence of mercantile custom as a sufficient justification for the banker's liability to the seller. There would appear to be nothing in the decided case to rule out this course of action and it is therefore submitted that it constitutes a step that the courts can now justifiably take.

Thus we may note that the decisions of Devlin J. in *Sinason-Teicher Inter-American Grain Corporation v. Oilcakes and Oilseeds Trading Corporation*

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[87]It would appear that the English courts require "literal" compliance with the description. See *S.H. Rayner & Co. v. Hambro's Bank Ltd.* [1943] 1 K.B. 37 and *Moralice (London) Ltd. v. E.D. & F. Man* [1954] 2 Lloyds Reports 526 and see also *British Imex Industries v. Midland Bank* [1958] 1 All E.R. 264.

[88](1925) unreported, but available in *Legal Decisions Affecting Bankers* Vol. 5. (1955) cited by Gutteridge, *op. cit. at p. 14.*

[89]*Supra* at p. 55.

Ltd.,[90] suggests that the issue of a letter of credit does in fact create an obligation on the bank to meet drafts drawn under the credit without indieating the basis of that obligation. We would therefore submit that we are free to suggest that the basis of this obligation, which the courts would seem prepared to recognise, is in fact that of a *jus quaesitum tertio* arising from a contract by mercantile usage, a view which, more recently, has received some support from the decision of the Court of Appeal in *Malas and Malas v. British Imex Industries* in which Jenkins L.J. stated:[91]

> It seems to be plain that the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods which imposes on the banker an absolute obligation to pay, irrespective of any dispute which there may be between the parties on the question of whether the goods are up to contract or not. An elaborate commercial system has been built up on the footing that bankers' confirmed credits are of that character, and, in my judgment, it would be wrong for this court in the present case to interfere with that established practice.

It may be observed that American writers, basing themselves on the more abundant American material, appear to be prepared to go a good deal further than the English authorities seem to justify. Finkelstein stated:[92]

> The courts have adjusted the rights of the various parties to these instruments with surprising few differences of opinion. The approach in all types of problems has been that of the law merchant... The theory that the irrevocable letter of credit is a mercantile specialty has now for some time been acted upon and has been functionally adopted... its formal recognition as a mercantile specialty cannot be long delayed.

Trimble, writing in 1948, stated:[93]

> Not only is it historically clear that the irrevocable letter of credit is an old mercantile specialty but the present writer submits that the history of the irrevocable letter of credit, and the decided cases, establish that the basic principles of the law governing it are independent of the common law rules of consideration

In conclusion our submission is that the circumstances of the commercia world are such that it is now time that the irrevocable letter of credit was recognised as a self-sufficing instrument of the law merchant, or as a mercantile specialty, and that, in particular, there is no need to look further for the justification or sanction for the banker's liability, under such letters, to the seller. The custom provides its own justification.

It has often been pointed out that the law tends to lag behind the customs of merchants, indeed Trimble has stated that:[94]

> the attitude over nearly a millenium, of common law judges towards the law merchant should be classified as among the manifestation of the deficiencies of the human mind when it attempts to apply reason to social values and relationships.

[90] [1954] 1 W.L.R. 935.

[91] [1958] 1 All E.R. 262.

[92] *Op. cit.* at p. 294.

[93] *Op. cit.* at p. 1003.

[94] *Ibid.* at p. 981.

The fact of the matter is that if the constantly repeated assertion that the law merchant is part of the common law is to have any meaning at all, then surely the case presented by commercial letters of credit is one for its implementation.

The practice of merchants in regard to this matter is now sufficiently well developed to merit judicial recognition as a further development of the law merchant. There is no need further to torture the calcified contractual conceptions of the common law in an endeavour to reconcile them with developing business practice. The courts can, and it is submitted should, recognise that practice as it stands and enforce the normal expectations of business men on the simple basis of mercantile custom.