THE TENDER OF FRAUDULENT DOCUMENTS UNDER DOCUMENTARY LETTERS OF CREDIT*

INTRODUCTION

Documentary or commercial letters of credit are a commercial facility well established in practice and used by merchants all over the world. They play an important role in the finance of international commerce.

The nature of documentary credits is simple. It is best understood if one considers the two problems of furnishing security and of raising credit which arise in most overseas sales. In an inland sale these problems do not arise so acutely. Little time elapses between delivery to a carrier by a seller and receipt of the goods by the buyer. The goods can be paid for at the time of delivery. In an overseas sale, on the other hand, there is a longer period of transport. The seller would like to receive the price of the goods (or at least good security) when he parts with possession of them by delivery to the carrier. The buyer, on the other hand, would prefer to pay the price when he receives the goods. The problem is how to raise credit for the period of transport, or at least to arrange for security. The best solution is to be found in the documentary credit. Its operation is as follows. The buyer instructs his bankers to open a documentary credit in favour of the seller. The bankers thereupon send a documentary letter of credit to the seller. In it they promise the seller to pay him the price of the goods, or to accept a draft for the like amount, against the tender of certain documents (usually bills of lading, an insurance policy and an invoice). The seller thereupon obtains the required documents and ships the goods. He tenders these documents to the bankers and receives payment, or an acceptance of his draft to be followed by payment when the draft matures. The bankers obtain from the buyer reimbursement of the amount they have paid to the seller. The shipping documents are the bankers' security for their advances.

In this way the seller obtains security for the price of the goods. He is also assured of obtaining payment as soon as he tenders the shipping documents to the bankers. The buyer, too, is secured against loss. The price of the goods is paid to the seller only against the required documents. These usually include a document, *e.g.* a bill of lading, which confers on its holder a title to the goods. Moreover, the buyer can frequently arrange with the bankers to reimburse them only after the arrival of the goods. He thus obtains credit from his bankers. The

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bankers, too, find this arrangement profitable, since they earn a banking commission for the opening of the credit.

Documentary credits thus give rise to at least three relationships. First, there is the contract between the buyer and the seller, in which it is agreed that payment should be by a documentary credit.

Secondly, there is the contract between the buyer and the bankers. The buyer instructs the bankers to open a documentary credit in favour of the seller and promises to reimburse them for their advances to the seller, and pays them a certain commission. The terms of the contract between the buyer and the bankers appear in the "application-form", which is a document given by the bankers to the buyer for completion. It consists of two parts. The first, or front, part is meant for the instructions of the buyer regarding the details of the documentary credit to be opened. There are blank spaces in which the buyer should specify the name of the seller, the price of the goods, the list of the documents which should be tendered by the seller, the description of the goods and the date or period of shipment, as well as other specific terms. The second, or back, part of the application-form includes "small print" clauses which specify the general terms of the contract between the buyer and the bankers, *e.g.* the buyer's undertaking to reimburse the bankers, the pledge of the goods to the bankers, *etc.*

Thirdly, there is the relationship between the bankers and the seller. The details of this relationship are included in the documentary letter of credit sent by the bankers to the seller, which specifies the documents to be tendered by the seller (usually the ones specified in the application-form) and the other terms with which the seller has to comply. The documentary credit further includes an undertaking by the bankers, the nature of which depends on the type of the credit. If it is a "revocable credit" the bankers stress that it does not include a binding undertaking on their part. Such an instrument is therefore not a contract, and cannot confer on the seller any cause of action against the bankers.[1] On the other hand, if the documentary credit is "irrevocable", the bankers promise in it to pay a certain sum, or accept a draft, against the required documents and further promise not to revoke this undertaking. It has been indicated that such an instrument establishes a contract between the bankers and the seller.[2]

1. The seller is not even entitled to notice of revocation. See, *Cape Asbestos Co.. Ltd.* v. *Lloyds Bank, Ltd.* [1921] W.N. 274.

2. *American Steel Co.* v. *Irving National Bank* 266 F. 41 at p. 43 (1920); *Urquhart Lindsay & Co., Ltd.* v. *Eastern Bank, Ltd.* [1922] 1 K.B. 318 at pp. 321-322; *Donald H. Scott & Co., Ltd.* v. *Barclays Bank, Ltd.* [1923] 2 K.B. 1 at p. 14; *Lamborn* v. *National Park Bank of New York* 240 N.Y. 520, 148 N.E. 664 at pp. 665-666 (1925) ; *Asbury Park & Ocean Grove Bank* v. *National City Bank of New York* 35 N.Y.S. 2d 985 at p. 988 (1942); *Trans Trust S.P.R.L.* v. *Danubian Trading Co., Ltd.* [1952] 2 Q.B. 297 at pp. 304-305; *Midland Bank, Ltd.* v. *Seymour* [1955] 2 Lloyd's Rep. 147 at p. 166; *Malas (Hamzeh) & Sons* v. *British Imex Industries, Ltd.* [1958] 2 Q.B. 127 at p. 129. Although there are some theoretical objections to this concept, especially following from the lack of consideration moving from the seller to the bankers, it seems to have been clearly indicated by the courts. These objections might perhaps be overcome if one bears in mind that after receiving the irrevocable

Apart from these three parties, there is frequently a fourth participant, *i.e.* the correspondent or intermediary-banker. His interposition is both a matter of convenience for all parties and a measure of security for the seller. The buyer, it should be noted, will usually engage a banker in his own country. The seller, however, prefers to have an undertaking by a banker in his locality. First, he might find it difficult to present documents in the buyer's country. Secondly, he might not have complete trust in a foreign banker, of whose standing or reputation he might not know anything. In order to overcome this problem, the buyer usually engages the services of a banker in his own country — who is known as the "buyer's banker" or "issuing-banker" — and the latter employs a banker in the seller's country — who is known as the "correspondent banker" or "intermediary-banker". The employment of the correspondent-banker may assume one of the following three forms. Firstly, the issuing-banker may instruct the correspondent-banker to open the documentary credit in the latter's name. In such a case the issuing-banker[3] does not make any promise to the seller, who obtains only that of the correspondent-banker, and the latter in fact steps into the shoes of the issuing-banker. The correct designation of such a correspondent-banker is "correspondent-issuer". Secondly, the issuing-banker may open the documentary credit himself and instruct the correspondent-banker to notify it to the seller. The correspondent-banker, who in such a case is known as an "advising-banker", assumes no liability *vis-a-vis* the seller. The latter again obtains only one promise, *i.e.* that of the issuing-banker. Such an instrument is known as an "unconfirmed credit". Thirdly, the issuing-banker may open the documentary credit himself and instruct the correspondent-banker both, to notify it to the seller, and to add to it his own undertaking. In such a case the correspondent-banker notifies the seller of the undertaking of the issuing-banker and adds his own "confirmation". The seller here obtains two undertakings. The instrument is known as a "confirmed credit", and the correspondent-banker as the "confirming-banker".

The interposition of a correspondent-banker gives rise to various contractual relationships. In the case of a confirmed credit or a documentary credit opened by a correspondent-issuer, there is a contractual relationship between the correspondent-banker and the seller. This contract includes the same terms as those of the contract between the issuing-banker and the seller.[4] No such relationship comes into existence in the case of the "unconfirmed credit", *i.e.* a documentary credit opened by an issuing-banker and notified by an advising-banker. The interposition of a correspondent-banker also leads to a contractual relationship between the issuing-banker and the correspondent-banker. The

credit the seller must, in the first instance, claim payment from the bankers and thus forbears claiming from the buyer. See in this connection *Dexters, Ltd.* v. *Schenker & Co.* (1923) 14 Ll.L.R. 586 at p. 588.

3. In such cases the banker engaged by the buyer does not act as an "issuing-banker" at all. It has however been felt prudent to employ a uniform terminology, although in this one instance it might be slightly inaccurate.

4. See, *Courteen Seed Co.* v. *Hongkong & Shanghai Banking Corporation* 216 App. Div. 495, 215 N.Y.S. 525 at p. 529 (1926), *affirmed* 245 N.Y. 377, 157 N.E. 272 (1927), *reargument den.* 159 N.E. 641 (1927).

nature of this contractual relationship varies according to the role assumed by the correspondent-banker and will be discussed subsequently. There is no contractual or fiduciary relationship between the correspondent-banker and the buyer, who remain strangers.[5]

Issuing and correspondent-bankers participate in most documentary credit transactions. They are engaged for the purpose of carrying out the instructions of the buyer. Further bankers may participate in the transaction at the instruction of the seller. The latter might, on occasions, find it inconvenient to tender the documents to the issuing or correspondent-banker. He may, for example, want to obtain cash immediately, instead of waiting for the maturity of an after sight draft. He may therefore request his own banker to discount the draft. Such a banker is called a "discounting banker". There are other third party bankers such as "negotiation-bankers". All these classes will be discussed subsequently.

Although a documentary credit transaction gives rise to several relationships, only one mode of performance applies in all of them. It is by the tender of the documents specified by the buyer in the application-form and by the bankers in the documentary credit. The seller should tender these documents to the correspondent-banker, who should forward them to the issuing-banker who in his turn should tender them to the buyer. Thus, the performance of the different contracts involves the tender of documents and not of goods. This is of importance, because the parties to the documentary credit transaction (except the seller) cannot judge, before the delivery of the goods, whether these are up to contract and whether they comply with their description in the documents of title. The duty to pay, however, arises shortly after the loading of the goods, *i.e.* when the documents are tendered, and not at the time of delivery. It has therefore been held that in documentary credit transactions the parties are concerned solely with documents and not with goods.[6] The documents, however, must strictly comply with the terms of the documentary credit. Thus, on the one hand, if the documents comply with the specified terms, the party who tenders them is entitled to payment, even though the goods may be defective.[7] On the other hand, if the documents are faulty, payment should be refused,

5. As regards the absence of a legal relationship between the buyer and the advising-banker, see: *Kronman (Samuel) & Co., Inc.* v. *Public National Bank of New York* 218 App. Div. 624, 218 N.Y.S. 616 at p. 622 (1926). As regards the position of buyer and confirming-banker, see: *Equitable Trust Co. of New York* v. *Dawson Partners, Ltd.* (1926) 25 Ll.L.R. 90 (C.A.), (1927) 27 Ll.L.R. 49 (H.L.) ; *Distribuidora Del Pacifico, S.A.* v. *Gonzales* 88 F. Supp. 538 at p. 541 (1950) ; *Linden* v. *National City Bank of New York* 12 App. Div. 2d 69, 208 N.Y.S. 2d 182 at p. 184 (1960); *Dulien Steel Products, Inc., of Washington* v. *Bankers Trust Co.* 298 F. 2d 836 at p. 841 (1962).

6. *Old Colony Trust Co.* v. *Lawyers' Title and Trust Co.* 297 F. 152 at pp. 155-156 (1924); *Bank of East Asia, Ltd.* v. *Pang* 140 Wash. 603, 249 P. 1060 at pp. 1061-1063 (1926) ; *Maurice O'Meara Co.* v. *National Park Bank of New York* 239 N.Y. 386, 146 N.E. 636 at p. 639 (1925).

7. *Laudisi* v. *American Exchange National Bank* 239 N.Y. 234, 146 N.E. 347 at p. 350 (1924) ; *Continental National Bank* v. *National City Bank of New York* 69 F. 2d 312 at p. 315 (1934).

even if it is proved that the goods themselves are what has been bargained for.[8] This doctrine of strict compliance has been explained by Lord Summer in *Equitable Trust Co. of New York* v. *Dawson Partners, Ltd.*:[9]

> 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 accept are in the matter of the accompanying documents strictly observed. There is no room for documents which are almost the same, or which will do just as well. Business could not proceed securely on any other lines. The bank's branch abroad, which knows nothing officially of the details of the transactions thus financed, cannot take upon itself to decide what will do well enough and what will not. If it does as it is told, it is safe; if it declines to do anything else, it is safe; if it departs from the conditions laid down, it acts at its own risk.

These words are from a case in which the dispute was between banker and buyer, but the same doctrine applies in the relationship of banker and seller.[10]

Usually therefore the discharge of a documentary credit should not give rise to difficulties. Conforming documents should be accepted and paid for while non-conforming ones should be rejected and payment refused. However, difficulties arise when the documents, on their face, appear to be regular and in compliance with the terms of the documentary credit or application-form, but in fact are fraudulent. Two different types of fraud may be involved. First, the seller may have forged the documents or some of them, *e.g.* forged the signature of the master on a bill of lading. Secondly, the instrument may include false statement, *e.g.* a bill of lading which, due to false information supplied by the seller to the master, describes casks containing sea-water as containing beer. If the seller has succeeded in committing such a fraud, which of the innocent parties should suffer, if it is impossible to claim payment back from the fraudulent seller?

An attempt will be made in the course of this article to examine where such a loss should lie. Two main sources of law are applicable. First, the problem has been discussed in English, American, French and German cases. Secondly, the law and practice of documentary credits have been the subject of international codification. As early as 1933 the International Chamber of Commerce promulgated the Uniform Customs and Practice for Documentary Credits, which were revised in 1951 and again in 1962. The third revision of this code, of 1962,[11]

8. *Rayner (J.H.) & Co., Ltd.* v. *Hambro's Bank, Ltd.* [1943] 1 K.B. 37; *Overseas Union Bank, Ltd.* v. *Chua Teng Hwee* (1964) 30 M.L.J. 165.

9. (1927) 27 Ll.L.R. 49 at p. 52.

10. See, *e.g., Lamborn* v. *Lake Shore Banking & Trust Co.* 196 App. Div. 504, 188 N.Y.S. 162 at p. 164 (1921), *affirmed* 231 N.Y. 616, 132 N.E. 911 (1921); Moss v. *Old Colony Trust Co.* 246 Mass. 139, 140 N.E. 803 at p. 808 (1923); *Rayner (J.H.) & Co., Ltd.* v. *Hambro's Bank, Ltd.,* (*supra*).

11. *Brochure* 222. According to a list published by the International Chamber of Commerce on April 24th, 1964, the U.C.P. have been adopted in one hundred and twenty six countries.

(which will be referred to hereinafter as the U.C.P.) has been adopted by more than one hundred and twenty countries, including the United Kingdom and most Commonwealth countries. At present, modern application-forms and letters of credit contain an endorsement which incorporates the U.C.P. as part of the contract. It will be shown that some provisions of the U.C.P. are of importance in cases of fraudulent documents.

The effect of the tender of regular but fraudulent documents on each of the contractual relationships of the documentary credit transaction will now be discussed in detail.

THE RELATIONSHIP OF BUYER AND ISSUING BANKER.

The issuing-banker is not responsible and is entitled to obtain reimbursement from the buyer if documents, complete and regular on their face, are in fact forgeries or include fraudulent statements.[12] This is laid down in art. 9 of the U.C.P. which reads:

> Banks assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any documents, or for the general and/or particular conditions stipulated in the documents or superimposed thereon; nor do they assume any liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods represented thereby, or for the good faith or acts and/or omissions, solvency, performance or standing of the consignor, the carriers or the insurers of the goods or any other person whomsoever.

It follows that as long as the documents, on their face, comply with the terms of the documentary credit, the banker is not responsible if a fraud is involved.

A similar principle has been adopted by the courts. In *Woods* v. *Thiedemann*[13] the defendants ordered the plaintiff, a provincial banker, to arrange for the acceptance of a draft by his London Agents, provided the draft was accompanied by a bill of lading for wheat. The draft, with an apparently regular bill of lading attached to it, was accepted by the plaintiff's agents in London. The bill of lading was a forgery. It was held that the bankers were not responsible for and did not warrant the authenticity of the bill of lading, and the defendants were ordered to reimburse them.

In *Ulster Bank* v. *Synnott*[14] the defendant, a merchant, instructed the plaintiffs, who were his bankers, to accept a draft of one Linden, provided a bill of lading was attached. The plaintiffs accepted a draft of Linden, not knowing that the attached bill of lading was a forgery.

12. Gutteridge & Megarh, *The Law of Bankers' Commercial Credits,* (3rd ed., 1962), at pp. 108-112; Davis, *The Law Relating to Commercial Letters of Credit,* (3rd ed., 1963), at p. 146 *et. seq.;* Stoufflet, *Le Credit Documentaire,* (Paris, 1957), at p. 227; Marais, *Du Credit Confirme en Matiere Documentaire,* (2nd ed., 1953), at pp. 32-33; Wiele, *Das Dokumenten-Akkreditiv und der Anglo-Amerikanische Documentary Letter of Credit,* (Hamburg, 1957), at pp. 47-48.

13. (1862) 1 H. &C. 478, see also Davis, *op.cit.,* at pp. 146-147.

14. (1871) 5 Ir.R. Eq. 595. See also *Guaranty Trust Co. of New York* v. *Hannay & Co.* [1918] 2 K.B. 623.

The defendant refused to reimburse the plaintiffs. Chatterton V.C. held [15] that the plaintiffs only had to ascertain that the bill of lading was regular on its face. He said that the defendant was the person who introduced the drawer of the draft to the plaintiffs. The latter agreed to deal with the drawer solely on the authority of the defendant. Once the plaintiffs satisfied themselves that the bill of lading was regular on its face, the defendant bore the risk of its being a forgery. He was ordered to reimburse the plaintiffs.

In *Basse and Selve* v. *Bank of Australasia* [16] the plaintiffs ordered a German bank to open a documentary credit in favour of one Oppenheimer, of Sydney, from whom the plaintiffs purchased a consignment of cobalt ore. The German bank ordered the defendants to advise the credit to Oppenheimer and to add their confirmation. One of the documents called for in the documentary credit was a certificate of quality by an expert. Oppenheimer tendered a certificate which, on its face, complied with the requirements of the credit and obtained payment from the defendants. The defendants, on their part, tendered the documents to the German bank who accepted them and reimbursed the defendants. It was later discovered that Oppenheimer shipped worthless goods which were different from the sample examined by the expert. The plaintiffs brought an action claiming payment back from the defendants. Dismissing the action, Bigham J. held that it was not the duty of the defendants "to verify the genuineness of the documents".[17]

It should be noted that in this case the document in question was not a forgery, but was false in the sense that it described a worthless cargo as cobalt ore. The case, thus, lays down that the banker is not responsible for the genuineness or the truthfulness of the statements in the documents and the facts stated in them.

In the United States section 5-109(2) of the Uniform Commercial Code [18] and case law support the English view. In *Brown* v. *C. Rosenstein* Co.[19] the plaintiffs, at the request of the defendants, issued a documentary credit in favour of a Bulgarian exporter. The letter of credit required, *inter alia,* the tender of a bill of lading. The plaintiffs accepted a draft accompanied by a bill of lading. The defendants refused to accept the draft alleging, *inter alia,* that the bill of lading was a forgery. The Supreme Court of New York gave judgment for the plaintiffs. It was held that the plaintiffs were not responsible for the correctness or genuineness of the documents and that it was not the plaintiffs' risk whether goods were shipped or not.

15. *Ibid.,* at pp. 608-609.

16. (1904) 90 L.T. 618. See also Davis, *op. cit.,* at p. 147.

17. In point of fact the defendants were not issuing-bankers but correspondent-bankers. However, the court treated them as if they were issuing-bankers, and did not discuss their main defence, *i.e.* lack of privity between themselves and the plaintiffs.

18. The section is similar to art. 9 of the U.C.P.

19. 120 Misc. 787, 200 N.Y.S. 491 (1923), *affirmed* (no opinion) 203 N.Y.S. 922 (1924).

It follows that both in England and the U.S.A. the banker is not responsible if the documents are fraudulent. This rule may be based on a further ground as well. When the seller commits a fraud and the banker accepts the fraudulent or forged documents, believing them to be genuine, it is likely that an action against an insolvent or absconding seller will prove abortive. The loss therefore must be borne by one of two innocent parties, *i.e.* the buyer or the banker. If one of two such innocent parties must sustain a loss incurred due to the fraud of a third party, it should, it is submitted, be borne by the party who originally initiated the transaction with the fraudulent third party and who thus induced the other innocent party to enter into a contractual or other relationship with the fraudulent third party.[20] In the relationship of issuing-banker and buyer it is obvious that the latter induces the former to enter into a contract with the fraudulent seller. It follows that, in so far as the banker was not negligent, the buyer should sustain any loss resulting from the fraud of the seller.

The banker should not be negligent, since he owes a duty of care to the buyer. Thus, he should not ignore a "red flag", *e.g.* suspicious alterations or obliterations in a bill of lading. In such a case he should "scrutinize carefully all accompanying documents for all clues which would aid the [banker] to determine whether the terms of the letter of credit had been met."[21] This imposes on the banker a stricter duty of inspection than the usual one. Ordinarily, *i.e.* when no "red flag" is present, "the banker must examine all documents with reasonable care to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit."[22] Once a "red flag" appears the banker is not merely under a duty to inspect with reasonable care, but should scrutinize the documents. If, after such a careful examination, he is convinced that no fraud is involved, he should not be responsible if his view proves to be unjustified.

THE RELATIONSHIP OF BANKER AND SELLER.

In order to appreciate the effect of fraudulent documents on the relationship of banker and seller, one fundamental rule must be borne in mind. It is most clearly explained in General Provision *c.* of the U.C.P., which reads:

> Credits, by their nature, are separate transactions from the sales or other contracts on which they may be based and banks are in no way concerned with or bound by such contracts.

20. This principle appears to have been in the mind of Chatterton V.C. in *Ulster Bank* v. *Synnott* (1871) 5 Ir.R. Eq. 595 at pp. 608-609. See also *Lickbarrow* v. *Mason* (1787) 2 T.R. 63 at p. 70; *Mercantile Bank of India, Ltd.* v. *Central Bank of India, Ltd.* [1938] A.C. 287 at p. 297 *et seq.*

21. *Liberty National Bank & Trust Co. of Oklahoma* v. *Bank of America National Trust and Savings Association* 116 F. Supp. 233 at p. 240 (1953), *affirmed* 218 F. 2d 831 (1955).

22. Art. 7 of the U.C.P. A similar rule is laid down by authority: *National Bank of Egypt* v. *Hannevig's Bank, Ltd.* (1919) 1 Ll.L.R. 69, 3 *Legal Decisions Affecting Bankers* 211 at p. 213; *British Imex Industries, Ltd.* v. *Midland Bank, Ltd.* [1958] 1 Q.B. 542 at p. 552. The same view prevails in France and Germany. See Stoufflet, *op.cit.,* at pp. 212-213; Liesecke, "Das Dokumentenakkreditiv in der neueren Rechtsprechung des Bundesgerichtshofs", *Wertpapier Mitteilungen* 1960 210 at pp. 212-213.

Several English and American cases illustrate the importance of this rule. In *Urquhart Lindsay & Co., Ltd.* v. *Eastern Bank, Ltd.*[23] the plaintiffs contracted to manufacture and supply several shipments of machinery to a firm in Calcutta. An irrevocable credit in favour of the plaintiffs, covering all the shipments, was opened — at the order of the Calcutta firm — by the defendants, the Eastern Bank. The letter of credit promised the honour of several drafts to be accompanied by invoices and shipping documents. Two drafts were presented and honoured. The plaintiffs, however, included in these drafts sums payable for an alleged rise in the costs of production. These drafts did not exceed the amount of the letter of credit. The inclusion of the additional sums was, however, contrary to the terms of the contract of sale. At the order of the Calcutta firm, the defendants refused to accept a third draft drawn against the third shipment. This draft, too, did not exceed the amount of the credit, but, in the same manner as the earlier two drafts, was contrary to the terms of the contract of sale. The plaintiffs treated the defendants' dishonour of this third draft as a breach of contract, and brought an action for damages. The defendants argued, *inter alia-,* that the excess in the amount of the draft was a breach of the contract of sale, and that they were not, therefore, bound to honour the draft. This, it should be noted, was an attempt to read the terms of the contract of sale into the letter of credit. Allowing the action, Rowlatt J. said: [24]

> The answer to this [argument, *i.e.* that the draft conflicted with the terms of the contract of sale] is that the defendants undertook to pay the amount of invoices for machinery without qualification, the basis of this form of banking facility being that the buyer is taken for the purposes of all questions between himself and his banker or between his banker and the seller to be content to accept the invoices of the seller as correct. It seems to me that so far from the letter of credit being qualified by the contract of sale, the latter must accommodate itself to the letter of credit. The buyer having authorized his banker to undertake to pay the amount of the invoice as presented, it follows that any adjustment must be made by way of refund by the seller, and not by way of retention by the buyer.

It is submitted that the first part of this quotation is good law. An irrevocable credit should, indeed, be treated as independent of the contract of sale. It is, however, difficult to agree with the second part of the opinion, *i.e.* that the contract of sale must accommodate itself to the letter of credit. The two contracts are independent of each other. There is no reason why the documentary credit, which is opened after the making of the contract of sale, should qualify the latter any more than the documentary credit is qualified by it.

A similar rule was laid down in the American case of *Dulien Steel Products, Inc., of Washington* v. *Bankers Trust* Co.[25] The plaintiffs con-

23. [1922] 1 K.B. 318. See also *Malas (Hamzeh) & Sons* v. *British Imex Industries, Ltd.* [1958] 2 Q.B. 127 at p. 129. *Cf. Davis O'Brien Lumber Co., Ltd.* v. *Bank of Montreal* [1951] 3 D.L.R. 536 at p. 550.

24. *Ibid.,* at pp. 322-323.

25. 189 F. Supp. 922 (1960), *affirmed* 298 P. 2d 836 (1962). See also *Frey & Son, Inc.* v. *E. R. Sherburne Co.* 193 App. Div. 849, 184 N.Y.S. 661 at pp. 663-664 (1920); *American Steel Co.* v. *Irving National Bank* 266 F. 41 at p. 44 (1920); *Imbrie* v. *D. Nagase & Co., Ltd.* 196 App. Div. 380, 187 N.Y.S. 692 at p. 695

tracted to sell steel scrap to the European Iron & Steel Community. Messrs. Marco Polo Group Projects, Ltd. were entitled to a commission from the plaintiffs for having arranged this transaction. For the payment of this commission to Marco Polo, the plaintiffs procured an irrevocable credit from the Seattle-First National Bank. In accordance with the instructions of Marco Polo, this letter of credit was opened in favour of one Sica. The defendants confirmed this letter of credit. Subsequently, after further negotiations between the plaintiffs and the purchasers, the price of the goods was reduced. As a result the commission payable to Messrs. Marco Polo — for the payment of which the letter of credit was issued — should have been reduced respectively. However, Sica, the beneficiary of the credit, demanded payment of the full amount of the credit. Seattle Bank informed the defendants about the alteration in the underlying contract and asked them not to pay the full amount to Sica. It was, also, pointed out to the defendants that Sica was a mere nominee of Marco Polo and had no rights of his own. Sica, however, insisted on payment in full and the defendants finally complied with his request. The plaintiffs brought an action against the defendants for the recovery of the money paid to Sica. They based their action on two grounds. First, they argued that when the defendants were notified about the amendment of the contract of sale, they should have refused payment. It should have been clear to them that the reduction of the contract price affected Marco Polo's commission and that the original amount of the letter of credit should, therefore, have been reduced. This first contention was rejected by Bryan J. who said:[26]

> When a bank confirms a letter of credit the letter evidences its irrevocable obligation to honor the drafts presented by the beneficiary upon compliance with the terms of the credit. The letter is quite independent of the primary agreement between the party for whose account it is issued and the beneficiary, or of any underlying transactions. Neither the issuing nor the confirming bank has any obligation, and is not permitted, to go behind the terms of the letter and the documents which are required to be presented, and to enter controversies between the beneficiary and the party for whose account the letter was opened concerning any other agreements or transactions.

Secondly, the plaintiffs contended that Sica was a mere nominee or agent of Marco Polo. They proved that Marco Polo agreed to the amend-

(1921) ; *Rank of Italy* v. *Merchants' National Bank* 197 App. Div. 150, 188 N.Y.S. 183 at p. 185 (1921); *Border National Bank of Eagle Pass, Tex.* v. *American National Rank of San Francisco, Cal.* 282 F. 73 at p. 80 (1922), *cert. den.* 260 U.S. 701 (1922); *National City Bank* v. *Seattle National Bank* 121 Wash. 476, 209 P. 705 at p. 707 (1922); *Brown* v. C. *Rosenstein Co.* 120 Misc. 787, 200 N.Y.S. 491 at p. 496 (1923), *affirmed* (no opinion) 203 N.Y.S. 922 (1924); *Moss* v. *Old Colony Trust Co.* 246 Mass. 139, 140 N.E. 803 at p. 808 (1923) ; *Williams Ice Cream Co., Inc.* v. *Chase National Bank* 210 App. Div. 179, 205 N.Y.S. 446 at p. 447 (1924); *Bank of Taiwan, Ltd.* v. *Union National Bank of Philadelphia* 1 F. 2d 65 at p. 66 (1924); *Laudisi* v. *American Exchange National Bank* 239 N.Y. 234, 146 N.E. 347 at p. 350 (1924) ; *Huber (E.E.) & Co.* v. *Lalley Light Corporation* 242 Mich. 171, 218 N.W. 793 at p. 794 (1928); *Overseas Trading Corporation* v. *Irving Trust Co.* 82 N.Y.S. 2d 72 at p. 76 (1948); *Kingdom of Sweden* v. *New York Trust Co.* 197 Misc. 431, 96 N.Y.S. 2d 779 at p. 787 (1949); *Banco Nacional De Credito Ejidal S.A.* v. *Bank of America* 118 F. Supp. 308 at p. 310 (1954).

26, 189 F. Supp. at p. 927. See Ellinger, "The Autonomy of Letters of Credit", (1962) 4 Malaya L.R. 307.

ments in the contract of sale and raised no objections to the amendments suggested for the letter of credit. The plaintiffs argued that, therefore, payment to Sica should have been refused. This contention, too, was rejected, in the following words:[27]

> Whether or not Sica was a principal or a collecting agent was no concern of Bankers [the defendants]. Sica was unqualifiedly named as the beneficiary in the letter of credit by Dulien [the plaintiffs], at whose request and for whose account it was issued. Bankers [the defendants] [were] obligated to pay the beneficiary and no one else.

This case shows that the banker is concerned solely with the letter of credit and its requirements. The banker is not concerned with the contract of sale. Even if it is proved to the banker that the contract of sale is not fulfilled, he still has to accept a draft complying with the terms of the letter of credit. Alterations or amendments in the contract of sale, made after the opening of the letter of credit, do not affect the position of the banker.[28]

The letter of credit is independent not only of the contract of sale, but also of the contract between the buyer and the banker. General Provision *f.* of the U.C.P. reads:

> A beneficiary can in no case avail himself of the contractual relationships existing between banks or between the applicant for the credit and the issuing bank.

In *North American Manufacturers Export Associates, Inc.* v. *Chase National Bank of City of New York*[29] the plaintiff, the seller, failed to tender documents complying with the terms of the letter of credit issued by the defendant. It was argued that the documents complied with amended instructions, given by the buyer to the banker, and that accordingly they should be regarded as complying with the credit. Dismissing an action brought by the seller, the court said[30]

> If the Bank, in the formulation of the letter of amendment, failed to follow the instructions of its customer . . . this would not involve the Bank in any responsibility to plaintiff.
>
> The letter of credit, either in its original form or as amended must control; ...

Similarly, it was said in *Kingdom of Sweden* v. *New York Trust* Co.[31]

27. *Ibid.* These words were not discussed in the Circuit Court of Appeals.

28. See also, on this point, *Arctic Ice & Coal Co.* v. *Southgate* 287 F. 48 at p. 50 (1923). As to French and German law, which are similar, see Stoufflet, *op. cit.,* at pp. 312-321; Marais, *op. cit.,* at p. 35; Wiele, *op. cit.,* at pp. 57-61; Liesecke, *op. cit.,* at pp. 211-212.

29. 77 F. Supp. 55 (1948).

30. *Ibid.*

31. 197 Misc. 431, 96 N.Y.S. 2d 779 at p. 791 (1949). See also *Liberty National Bank & Trust Co. of Oklahoma* v. *Bank of America National Trust & Savings Association* 116 F. Supp. 233 at p. 237 n. (1953), *affirmed* 218 F. 2d 831 (1955); *Consolidated Sales Co., Inc.* v. *Bank of Hampton Roads* 193 Va. 307, 68 S.E. 2d 652 at p. 658 (1952). French and German law are similar. See Stoufflet, *op. cit.,* at p. 299 *et seq.;* Wiele, *op. cit.,* at p. 58.

that "the contract between a bank and the beneficiary of a letter of credit is completely independent from the credit agreement between the bank and its customer and from the sales contract between the buyer and seller."

Usually therefore the banker is under a duty to accept a complying tender of documents and should not enter into controversies between the buyer and the seller. This rule establishes the autonomy of letters of credit, and there is only one exception to it. The banker is not obliged to accept a set of conforming documents tendered by the seller if he knows that they are, in fact, fraudulent. Several cases support this rule.

In *Old Colony Trust Co.* v. *Lawyers' Title and Trust Co.*[32] a letter of credit called for a warehouse receipt. A document purporting to be a warehouse receipt was tendered by the seller. The bankers, however, knew — from examining the document — that the goods were not in the warehouse but still on board the ship, and accordingly refused to accept the documents. An action by the seller for the amount of the credit was dismissed. The court said:[33]

> 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 recognize such a document as complying with the terms of a letter of credit.

It should be noted that these words were *obiter.* The document, on its face, showed that the goods were not in the warehouse but on board the ship. It could, therefore, hardly be described as "regular"! It included a clearly false statement, *i.e.* that the goods were warehoused. In fact the court did not go further than to decide that a document, which includes on obviously false statement, is not regular.

A wider rule follows from an American case. In *Sztejn* v. *J. Henry Schroder Banking Corporation*[34] the plaintiffs contracted to purchase bristles from Indian sellers. At the instruction of the plaintiffs, the defendants opened an irrevocable credit in favour of the sellers. The sellers presented, through the Chartered Bank of India, a draft with apparently regular documents attached to it. But although the documents evidenced the shipment of bristles, the sellers, in reality, shipped crates containing rubbish. When the buyers discovered this fraud, they brought an action for an injunction to restrain the defendants from accepting the draft. The defendants brought a motion to dismiss the action on the ground that it did not disclose a cause of action. Refusing to strike out the action, Shientag J. said:[35]

> In such a situation, where the seller's fraud has been called to the bank's attention before the drafts and documents have been presented for payment,

32. 297 F. 152 (1924). *Cf.* Davis, *op.cit.,* at pp. 151-152.

33. *Ibid.,* at p. 158. *Cf. Higgins* v. *Steinhardter* 106 Misc. 168, 175 N.Y.S. 279 at p. 280 (1919); disapproved in *Frey & Son, Inc.* v. *E. R. Sherburne Co.* 193 App. Div. 849, 184 N.Y.S. 661 at p. 664 (1920).

34. 177 Misc. 719, 31 N.Y.S. 2d 631 (1941). See also Davis, *op.cit.,* at pp. 150-153.

35. 31 N.Y.S. 2d at p. 634.

> the principle of the independence of the bank's obligation under the letter of credit should not be extended to protect the unscrupulous seller. It is true that even though the documents are forged or fraudulent, if the issuing bank has already paid the draft before receiving notice of the seller's fraud, it will be protected if it exercised reasonable diligence before making such payment. . . . However, in the instant action Schroder [the defendants] has received notice of Transea's [the sellers'] active fraud before it accepted or paid the draft.

This "rule of the *Sztejn* Case" derives some support from English cases.[36] In France, too, it has been suggested that, whenever fraud is proved to the satisfaction of the banker, he is entitled to reject a regular set of documents.[37] The decision of the *Cour de Cassation* of March 4th, 1953[38] supports this view. In this case the seller tendered the banker documents for a consignment of Swiss watches. Although the documents were regular on their face, the consignment consisted of worthless goods. The buyer proved these facts to the satisfaction of the banker, who, accordingly, refused to pay against these documents. The *Cour de Cassation* stressed that the letter of credit and the contract of sale are independent of each other, but decided that, in view of the facts of the case and the maxim *fraus omnia corrumpit* the banker was entitled to reject the documents. The law is similar, though more clearly defined, in Germany. Wiele[39] explains that the banker should ignore any allegation against the quality or the nature of the goods. But, if it is proved to him that an entirely different commodity is shipped and that the documents contain fraudulent statements, the banker is entitled, under para, 242 BGB, to reject the tender. In a case decided by the *Bundesgerichtshof*[40] a banker opened an irrevocable credit for optical instruments. The seller shipped empty crates but managed to tender regular documents. It was held that the banker was entitled to reject the tender.

The rule that a banker need not accept a fraudulent tender even though regular on its face is, thus, widely accepted. It is, however, not an easy rule to apply. First, it is difficult to prove fraud. It is true that, on occasions, the facts might speak for themselves. If, for example, sea-water is shipped instead of "Pale Ale" it is obvious that some fraud is involved. If, on the other hand, "Stout" is shipped instead of "Pale Ale" this might be due to a genuine error (or difference in terminology) and not necessarily to fraud. In such a case it might be difficult to convince a court that a fraud was committed.

Secondly, it is not easy to decide what, on the part of the banker, amounts to sufficient knowledge of the fraud. Should he accept as true any allegation of the buyer? An affirmative answer could lead to unexpected results. The buyer would then be in a position to frustrate the

36. *Societe Metallurgique D'Aubrives & Villerupt* v. *British Bank for Foreign Trade* (1922) 11 Ll.L.R. 168 *per* Bailhache J. at p. 170; *Malas (Hamzeh) & Sons* v. *British Imex Industries, Ltd.* [1958] 2 Q.B. 127 *per* Sellers L.J. at p. 130.

37. Stoufflet, *op. cit.,* at pp. 326-328.

38. S. 1954 I 121 at p. 124 *(Ire espece).*

39. *Op. cit.,* at p. 59.

40. BGH in *Zeitschrift fuer das Gesamte Kreditwesen* vol. 55 at p. 615.

very purpose of the documentary credit by accusing the seller of fraud. It is obvious that such a position is undesirable. The fraud rule, it is submitted, must be read subject to several important limitations.

In the first place, the banker must know that the seller has *committed a fraud.* His knowledge that the goods are deficient, or do not exactly correspond to their description in the documents, is not sufficient. In *Maurice O'Meara Co.* v. *National Park Bank of New York*[41] the defendant bank opened an irrevocable credit in favour of the plaintiffs, the sellers. In this credit the defendant bank promised to accept a draft accompanied by documents covering a shipment of paper of a specified tensile strength. The plaintiffs tendered a set of complying documents, but the defendant bank rejected this tender. It argued that the plaintiffs did not furnish evidence that the paper was of the correct tensile strength and complained that the plaintiffs did not allow it to test the paper. The defendant bank further argued that the paper did not correspond to its description in the documents. The Court of Appeals of New York rejected these defences. Allowing the action, it said:[42]

> The [defendant] bank was concerned only in the drafts and the documents accompanying them. This was the extent of its interest. If the drafts, when presented, were accompanied by the proper documents, then it was absolutely bound to make the payment under the letter of credit, *irrespective of whether it knew, or had reason to believe,* that the paper was not of the tensile strength contracted for.

The court added that the defendant bank did not "even have a right to inspect the paper before payment, to determine whether it in fact corresponded to the description contained in the documents."[43]

This case shows that, even if the banker knows of a difference between the description of the goods in the documents and their true nature, he is not entitled to reject a regular tender. The banker must know that a fraud was committed. To prove fraud something more than a misrepresentation needs to be proved. It must be proved "that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false."[44] If a person makes a misrepresentation in the truthfulness of which he honestly believes, he is not guilty of a fraud. This shows that bankers should not make use of the "fraud rule" rashly. They should always consider whether they would be able to prove fraud if the seller brought an action. If the alleged fraud is, for example, that paper is of a wrong tensile strength, the banker may find it difficult to prove the fraud. The banker may be able to prove the "misrepresentation", *i.e.* that the goods were not of the specified tensile strength, but that is not proof of a fraud. The seller may have committed a genuine error. If, on the other hand, the banker knows that old newspapers have been shipped instead of "class

41. 239 N.Y. 386, 146 N.E. 636 (1925), *reargument denied* 240 N.Y. 607, 148 N.E. 725 (1925).

42. 146 N.E. at p. 639, (Italics supplied).

43. *Ibid.*

44. *Derry* v. *Peek* (1889) 14 App. Cas. 337 *per* Lord Herschell at p. 374.

I typing paper", he may safely decide to reject a tender of regular documents. The facts here speak for themselves. The description of old, worthless, newspapers as "class I typing paper" is inconsistent with anything but a fraud. But, if the goods shipped are not altogether worthless, the banker should be advised not to rely on the fraud rule.

Moreover, a banker should not reject a regular tender unless he *knows* that a fraud was committed. In *Dulien Steel Products, Inc., of Washington* v. *Bankers Trust Co.*[45] the plaintiffs argued, *inter alia,* that Sica's demand of the whole amount of the credit constituted a fraud. They relied on *Sztejn* v. *J. Henry Schroder Banking Corporation, (supra).* The Circuit Court of Appeals distinguished the cases:[46]

> But here Bankers [the defendants] never had notice of the type of fraud Sztejn seems to require. Dulien's [the plaintiffs'] own behavior was indicative more of one merely suspicious of then one certain of fraud.

It follows that mere suspicions should not be considered "knowledge". How, then, can a banker *know* that the seller has committed a fraud? This would usually depend on the evidence furnished by the buyer. Complaints of the buyer that the goods are of an inferior quality should be ignored.[47] If, on the other hand, the buyer furnishes evidence of the shipowner that the bill of lading is a forgery, or reliable evidence that sea-water has been shipped instead of beer, the banker may consider the fraud proved. He should not, however, accept such evidence without the greatest care.

It can, thus, be concluded that the banker should not refuse a tender of regular documents unless he has *positive knowledge* of a *fraud.* This is the first limitation to the rule of the *Sztejn* case.

Some London Bankers think the rule should, in addition, be limited to cases of forged documents.[48] The basis of this view is that bankers are not concerned with goods but only with documents. If the complaint is that the goods do not conform to their description in the documents, the complaint is against the goods. This, of course, is *prima facie* true. The shipment of worthless goods may, however, vitiate the documents. A carrier may be induced by a fraudulent shipper to issue a bill of lading for "beer" although the casks contain sea-water. The bill of lading is, therefore, not a forgery. It is, nevertheless, of no value. If it contains a clause "contents unknown", the holder has no action against the shipowner.[49] Yet, if the holder discovers the fraud, he can hardly transfer the bill of lading for value without facilitating a fraud. It should be noted that the documents are the banker's security for his advances to

45. 298 F. 2d 836 (1962), *affirming* 189 F. Supp. 922 (1960), facts discussed *supra.*

46. *Ibid.,* at p. 841.

47. *Laudisi* v. *American Exchange National Bank* 239 N.Y. 234, 146 N.E. 347 at p. 350 (1924); *Continental National Bank* v. *National City Bank of New York* 69 F. 2d 312 at p. 315 (1934); Stoufflet, *op. cit.,* at p. 321.

48. This was mentioned in a discussion with members of a leading banking house.

49. See Chorley and Giles, *Shipping Law,* (5th ed., 1963), at pp. 149-150.

the seller. The banker should not be forced to pay money against such a worthless security, even though it may not be a forgery. It is true that, despite the fraudulent statement in the bill of lading, the banker can claim reimbursement from the buyer. But, if the buyer becomes insolvent, this right of reimbursement would prove a broken reed. It may perhaps be said that, apart from the case of forged documents, the banker should be allowed to rely on the fraud rule whenever the fraud is connected with the documents, *e.g.* when the documents include a fraudulent misrepresentation. Subject to this modification, the view of the London bankers may be supported. The banker should certainly not be allowed to rely on the fraud rule when the alleged fraud is not connected with the documents, *e.g.* when it is alleged that the seller has, fraudulently, overcharged for the goods (but has not exceeded the amount of the documentary credit).

The case of *Dulien Steel Products, Inc., of Washington* v. *Bankers Trust Co.,* (*supra*), may support this view. One of the contentions of the plaintiffs was that the defendants should have refused payment on the "fraud principle" of the *Sztejn* case. The District Court held that no fraud was proved to the bank, and that —

> As far as Bankers [the defendants] [were] concerned the only information which [they] had was Dulien's [the plaintiffs'] claim transmitted by Seattle Bank [the issuing banker, who ordered the defendants to confirm the credit] that [their] obligation "under the letter of credit" was to Marco Polo and not to Sica and the amendments said to have been agreed to between Marco Polo and Dulien. The statement as to Dulien's obligation under the letter of credit flew directly in the face of terms and conditions of the letter [of credit] which had been issued at Dulien's own instance . . .[50]

It was, thus, held that the alleged fraud was contradicted by the terms of the credit and was therefore immaterial. This view was adopted by the Circuit Court of Appeals which held that "here Bankers never had notice of the type of fraud *Sztejn* seems to require."[51] The banker, it seems to follow, is not concerned with a fraud which is not connected with the documents.

The above limitations to the rule of the *Sztejn* case show that the banker should not reject documents on the ground of an alleged fraud without great care. The best advice that can be given to the banker is not to make use of the rule at all, except, perhaps, if the fraud is admitted by the seller. Instead of rejecting a regular but allegedly fraudulent tender, the banker should ask the buyer to bring an action for an injunction. This was the procedure adopted in the *Sztejn* case. Moreover, the Circuit Court of Appeals in *Dulien's* case indicated that the buyer is the person who should avail himself of the rule in the *Sztejn* case. It is for him to bring an action to restrain the banker from paying. An observation of Sellers L.J. in *Malas (Hamzeh) & Sons* v. *British Imex Industries, Ltd.*[52] shows that a similar view might be adopted by the English courts.

50. 189 F. Supp. 922 at p. 929 (1960).

51. 298 F. 2d 836 at p. 841 (1962). (Italics supplied).

52. [1958] 2 Q.B. 127 at p. 130.

If the banker asks the buyer to bring an action for an injunction he might avoid several difficulties. If no fraud were proved, the buyer — and not the banker — would have to pay the heavy costs of the litigation. There is, really, no reason why the banker should take the initiative by rejecting a regular tender without the sanction of the courts. This is so even if the buyer agrees to indemnify the banker for any expenses he might incur if the seller brings an action. There is no way of indemnifying the banker for the damage which might be done to his reputation if no fraud is proved.

Moreover, if the banker asks the buyer to bring an action for an injunction, he can be sure that unfounded accusations will not be pressed. A buyer might, as a result of a rumour, go to his bankers and raise accusations against the seller. If the market is falling, a suspicion as to a discrepancy in the quality of the goods might easily be represented to the banker as a fraud. The buyer would have to be more careful in his accusations if he were required to prove them in court. Furthermore, if the banker asks the buyer to bring an action for an injunction, and the latter refuses to do so, it can be assumed that the accusation is not to be taken seriously.

It is submitted that the banker should adopt this course even if the buyer produces *prima facie* evidence of a fraud. It is difficult, in English law at least, to prove fraud.[53] Moreover, the banker is not in a good position to assess the evidence produced to him. Statements that appear to him to be conclusive evidence, might — in court — turn out to be inadmissible, *e.g.* as hearsay. Witnesses who make a clear statement to the banker may be reluctant to testify in court. These difficulties may be partly overcome if there is enough time for referring the matter to the banker's solicitors. The banker should, however, bear in mind that whether a fraud has been committed or not is a question of fact. The banker is familiar only with the facts made available by the buyer and his representatives. There can hardly be a certainty that these are all the relevant facts. The seller's evidence may throw a different light on the whole matter. In the absence of exceptional circumstances, the banker should, therefore, not decide that he has positive knowledge of a fraud. His best course is to force the buyer to thrash out his disputes with the seller by bringing an action for an injunction.

This solution has been adopted in s. 5-114(2) of the Uniform Commercial Code (U.S.A.), which reads:

> Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (Section 7-507) or of a security (Section 8-306) or is forged or fraudulent or there is fraud in the transaction

53. See, *e.g., Woods* v. *Martins Bank, Ltd.* [1959] 1 Q.B. 55. In this case a bank manager made inaccurate and misleading statements as a result of which the plaintiff invested large sums of money in a "mushroom" company. The manager failed to disclose to the plaintiff that the company was heavily indebted to the bank itself. Salmon J., nevertheless, held that no fraud was proved since the bank-manager did "in his muddle-headed way, honestly believe in the advice which he gave the plaintiff" *(ibid.,* at p. 60).

> (a) the issuer must honor the draft or demand for payment if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course (Section 3-302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (Section 7-502) or a bona fide purchaser of a security (Section 8-203); and
>
> (b) in all other cases as against its customer, an issuer acting in good faith may honor the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honor.

The U.C.P., it should be added, are silent on this point. The rule of the Uniform Commercial Code (U.S.A.) is, it is submitted, a sensible one. It is to be hoped that courts of law outside the U.S.A. will give decisions in the same spirit.

THE EFFECT OF THE TENDER OF FRAUDULENT DOCUMENTS ON THE POSITION OF THE CORRESPONDENT-BANKER.

It remains to be considered what is the effect of a tender of fraudulent documents on the position of the correspondent-banker. Is the issuing-banker obliged to take up a set of such documents? The answer to this question depends mainly on the nature of the contractual relationship between the issuing-banker and the three different types of correspondent-banker, *i.e.* the correspondent-issuer, the advising-banker and the confirming-banker.

In the contract between the issuing-banker [54] (who in such a case may be more accurately described as "instructing-banker") and the correspondent-issuer, the former instructs the latter to open a documentary credit in favour of the seller, and promises to reimburse him for his advances to the seller against the tender of the specified documents.[55] The issuing-banker assumes *vis-a-vis* the correspondent-issuer a similar position to that of the buyer *vis-a-vis* the issuing-banker. Thus, the relationship of issuing-banker and correspondent-issuer is similar to that of buyer and issuing-banker. As has been shown, the issuing-banker is not responsible for the genuineness and truthfulness of the documents and is entitled to reimbursement in so far as the documents, on their face, comply with the terms of the documentary credit.

In the relationship of issuing-banker and advising-banker, the latter — at the request of the former — notifies the seller of the opening of the documentary credit by the issuing-banker, and usually requests the seller to tender the documents to himself. However, the advising-banker does not undertake to accept the documents. In this case the advising-banker is the agent of the issuing-banker.[56] An agent is, of course, under a duty not to exceed his mandate. But, if an agent carries out his instructions

54. See *supra n.* 3.

55. *Pan American Bank & Trust Co.* v. *National City Bank of New York* 6 F. 2d 762 (1925).

56. *Kronman (Samuel) & Co., Inc.* v.- *Public National Bank of New York* 218 App. Div. 624, 218 N.Y.S. 616 (1926).

with care and skill, he is not responsible for a defect he could not reasonably discover. In *Lamert* v. *Heath*[57] a principal ordered his agent to purchase certain scrip. The agent purchased scrip which subsequently turned out to be wrongfully issued. It was held that, since the agent bought what appeared to be genuine scrip, he was not negligent and was entitled to reimbursement. Since the advising-banker is the agent of the issuing-banker, he should not be liable if he accepts a fraudulent tender, provided it is regular on its face.

The relationship between the issuing-banker and the confirming-banker is more complicated. It has been held that the confirming-banker is the agent of the issuing-banker, but this view, it is submitted, is inaccurate.[58] The confirming-banker notifies the seller of the opening of the credit by the issuing-banker and, further, adds an independent undertaking of his own, *i.e.* the confirmation. In so far as the notification is concerned, he assumes a role similar to that of the advising-banker, and acts as an agent.. But, by adding his confirmation, he undertakes a contractual obligation *vis-a-vis* the seller. Thus, he not only brings into existence a contract between the issuing-banker and the seller, but also enters into the transaction as a party. It is therefore wrong to consider him a mere agent. In point of fact, the confirming-banker combines the roles assumed by an advising-banker and a correspondent-issuer. In so far as the notification is concerned, he acts as an advising-banker. In so far as the confirmation is concerned, he assumes the role of a correspondent-issuer. Since both, the advising-banker and the correspondent-issuer, are entitled to reimbursement against fraudulent documents, the position of the confirming-banker should not be different.

It is therefore submitted that a correspondent-banker is not responsible for the genuineness or truthfulness of documents tendered by him to the issuing-banker. In so far as the documents, on their face, comply with the terms of the documentary credit, he is entitled to obtain payment against them, even if they turn out to be forgeries. However, the correspondent-banker, like the issuing-banker, should not ignore a "red flag".[59]

As regards the position of the seller *vis-a-vis* the three types of correspondent-bankers, it is submitted that the correspondent-banker is entitled to reject regular but fraudulent documents tendered by the seller. The advising-banker is, in any event, under no obligation to accept a tender from the seller. The correspondent-issuer and the confirming-banker give the seller an undertaking similar to that given by the issuing-banker. They should therefore be in the same position as the issuing-banker, when the seller tendered fraudulent documents.

57. (1846) 15 M.&W. 486.

58. *Bank Melli Iran* v. *Barclays Bank D.C.O.* [1951] 2 Lloyd's Rep. 367 at p. 376. See also *Equitable Trust Co. of New York* v. *Dawson Partners, Ltd.* (1927) 27 Ll.L.R. 49 *per* Lord Shaw at p. 57 and Viscount Cave at p. 52. Their observations, however, were *obiter dicta.*

59. See *supra* at p. 31.

THE EFFECT OF FORGED OR FRAUDULENT DOCUMENTS ON THE POSITION OF THIRD PARTIES.

Ordinarily, a documentary credit transaction does not involve the participation of third parties. The seller tenders the documents to the issuing or correspondent-banker. But the seller is not always in a position to do so. If the documentary credit is opened by the issuing-banker in the buyer's country without the employment of a correspondent-banker, the seller might indeed find it difficult to tender the documents in person. He may, of course, tender the documents by mail, but this involves delay. The seller may find it more convenient to tender the documents through his own bankers. This is so not only in the case of the unconfirmed credit. A large mercantile firm may find it inconvenient to present each set of documents to a designated issuing-banker and may prefer to use the services of its own bankers for handling all its documentary drafts. The seller's bankers may in such a case assume one of two roles. First, they may act merely as the seller's agents for the presentment of the draft and documents. Secondly, they may give him credit or make an advance against the documents, and thus become discounters and holders for value of the draft.

The position and rights of a banker who becomes a holder of such a draft, *i.e.* becomes a "third party", depend mainly on the nature of the letter of credit. Documentary credits may in this connection be divided into "straight credits" and "negotiation credits."[60] The difference between these two types of credits is similar to the distinction between "special" and "general" *open* (or traveller's) letters of credit.[61] In a "special" or "specially-advised" open credit the issuing-banker asks the addressee to advance money to his customer. The addressee alone can rely on this promise. A third party is not entitled to act on it and cannot claim reimbursement from the issuing-banker.[62] In a "general" open letter credit, on the other hand, the issuing-banker asks the world at large to advance money to his customer. Any person, to whom such a letter is shown, is entitled to act on the offer included in it. If he advances money on the faith of it, he is entitled to reimbursement.[63]

Similarly, in a "straight" documentary credit, the issuing-banker engages himself only towards the seller, and promises him a certain sum for the tender of the documents. Such a promise to the seller is also given in a "negotiation credit". But the banker's engagement in the

60. This is essentially an American classification of documentary credits. See Ward and Harfield, *Bank Credits and Acceptances,* (4th ed., 1958), at p. 30. It should be noted that negotiation credits are far more common in the United States than in England. They are generally not in use on the Continent.

61. On the difference between these two types of open (or traveller's) letters of credit see Story, *The Law of Bills of Exchange,* (Boston, 2nd ed., 1860), para. 459.

62. *Birckhead & Carlisle* v. *Brown* 5 Hill (N.Y.) 634 at pp. 642-643 (1843), *affirmed* 2 Den. (N.Y.) 375 (1845) ; *Evansville National Bank of Evansville, Indiana* v. *Kaufman* 93 N.Y. 273 at p. 280 (1883).

63. *Northumberland County Bank* v. *Eyer* 58 Pa. St. 97 at p. 103 (1868).

negotiation credit is, at the same time, not confined to the seller. It is, usually, in the following words:

> We hereby agree with the drawers, indorsers, and bona fide holders of bills drawn and negotiated in compliance with the terms of this credit that said bills will be duly honored on presentation at our counter . . .[64]

The banker, in this type of credit, really makes two promises.[65] First, he undertakes an engagement towards the drawer, who is the seller. Secondly, he gives a promise to negotiators and *bona fide* holders of the seller's drafts.[66]

The position of a banker who takes a draft drawn under such a negotiation credit is different from the position of a banker who discounts[67] a draft drawn under a straight credit. The former — who will hereinafter be referred to as a "negotiation-banker"[68] — takes the draft on the faith of the credit of two persons, *i.e.* the issuing-banker and the seller. The "discounter" or "discounting-banker", who takes a draft drawn under a straight credit, on the other hand, relies mainly on the credit of the seller. Although negotiation is permitted under a straight credit, the discounter acquires no rights of his own against the issuing-banker.[69]

What then, is the position of a negotiation-banker who innocently takes up a set of fraudulent documents? The answer depends on the special contractual rights of the negotiation-banker.

The negotiation-banker has a contract both with the issuing-banker and the seller. It has been held that "[i]f the letter shows that it was written for the purpose of being shown in order to obtain credit, and the purchaser is within the terms of the letter, it amounts to an offer that, if he purchases the draft, it will be honored. That offer or promise

64. This was the undertaking included in the letter of credit opened in the case of *Banco National Ultramarino* v. *First National Bank of Boston* 289 F. 169 at p. 171 (1923).

65. In this he differs from the issuer of a general *open* letter of credit. The latter gives, in the credit itself, only one promise which is directed to any persons who would advance money to the issuer's customer.

66. The promise extends both to negotiators or indorsers of the drawer's draft as well as to *bona fide* holders who take it from them. One should bear in mind that, if the negotiator indorses the draft in blank, no subsequent party need indorse it.

67. The term "discount" is here used in a wide sense. Usually, bankers speak about "discounting" when they advance money against an accepted draft. When a banker advances money against an unaccepted draft he agrees to "negotiate" it. To avoid cunfusion between a "negotiation-banker" and a banker who *handles a draft* drawn under a straight credit, it was thought necessary to adopt a special terminology.

68. I have decided to use the term "negotiation-banker" and not "negotiating-banker" since the latter term is often used to describe a mere discounter, who takes a draft drawn under a straight credit.

69. *Banco Nacional Ultramarino* v. *First National Bank of Boston* 289 F. 169 at p. 175 (1923).

becomes a contract when the draft is negotiated."[70] Thus, when the negotiation-banker acts on the promise made to him in the negotiation credit, he becomes entitled to reimbursement under the contract which is established between himself and the issuing-banker.[71] However, the negotiation-banker does not participate in the transaction solely on the strength of the letter of credit. He acts not less at the request of the seller, who negotiates the draft to him. The negotiation-banker, thus, relies also on the instructions and the credit of the seller. This was most clearly explained by McAvoy J. in the case of *Courteen Seed Co.* v. *Hongkong & Shanghai Banking Corporation*:[72]

> When a bank buys a draft relating to a letter of credit, it acts solely for itself and at its own risk; its transaction is with the drawer, not with the drawee, except so far as it seeks to benefit from the drawee's commitment in its letter of credit; it owes no duty to the drawee, or to the drawee's customer. It is engaged in quite a distinct kind of a transaction from selling its credit. It is buying commercial paper, relying upon the credit of the drawer and any other security the drawer at the time may offer.

In point of fact there is a clear contractual relationship between the negotiation-banker and the seller which arises from the negotiable character of the draft. The negotiation-banker negotiates an unaccepted draft drawn by the seller on the issuing-banker. Thus, as against the seller, the negotiation-banker stands in the position of a holder *vis-a-vis* a drawer of a bill of exchange. He has, therefore, a right of recourse against the seller, which may be exercised in the event of the dishonour of the draft by the drawee, *i.e.* the issuing-banker.[73]

In view of these special rights of the negotiation-banker, what should be his position when he innocently accepted a tender of false or forged documents? Should he be given a right of recourse against the negotiation-banker? It has been shown, in the relationship between the issuing-banker and the buyer, that no warranty of genuineness is given by the issuing-banker who presents the draft, and that the buyer must reimburse the issuing-banker even if the documents are fraudulent. The position of the negotiation-banker *vis-a-vis* the issuing-banker should be similar. Just as the issuing-banker enters into the transaction at the request of the buyer, so does the negotiation-banker participate in it in reliance on a promise of the issuing-banker. The reasons for absolving the issuing-banker from liability *vis-a-vis* the buyer for the forgery or falsity of

70. *Ibid*., at pp. 173-174.

71. See, *Second National Bank of Toledo* v. *M. Samuel & Sons, Inc.* 12 F. 2d 963 at pp.965, 967 (1926).

72. 216 App. Div. 495, 215 N.Y.S. 525 at p. 529 (1926). These words were described to be an accurate statement of law by the New York Court of Appeals, 157 N.E. 272 at p. 273 (1927). See also *Scanlon* v. *First National Bank of Mexico, N.Y.* 249 N.Y. 9, 162 N.E. 567 at p. 568 (1928). This rule applies even if the credit is sent by the issuing-banker to the negotiation-banker.

73. S. 47(2) of the Bills of Exchange Act, 1882, (45 & 46 Vict., c. 61); *Courteen Seed Co.* v. *Hongkong & Shanghai Banking Corporation* 216 App. Div. 495, 215 N.Y.S. 525 at p. 529 (1926), *affirmed* 245 N.Y. 377, 157 N.E. 272 (1927); *Sassoon (M.A.) & Sons, Ltd.* v. *International Banking Corporation* [1927] A.C. 711 at p. 731.

documents presented by him, should equally apply for absolving the negotiation-banker from such responsibility *vis-a-vis* the issuing-banker. Moreover, the negotiation-banker, like the issuing-banker, does not give any warranty as to the genuineness of the documents. He should, therefore, not be liable if these turn out to be forgeries.

It remains to be considered what should the issuing-banker do when he knows, at the time of presentation, that the documents are fraudulent. Should he refuse to take them from the negotiation-banker and dishonour the draft? It has been shown that, as between the issuing-banker and the buyer, the latter has to take up the draft from the issuing-banker. One of the reasons for this is that the buyer is the person who launches the transaction, and between two innocent persons the one who initiates the transaction should bear the loss. A different reasoning has been applied to cases in which the seller presents a draft which, to the knowledge of the issuing-banker, is accompanied by fraudulent documents. It has been shown, on the authority of *Sztejn* v. *J. Henry Schroder Banking Corporation,*[74] that the issuing-banker is entitled to reject such a draft.

The position of the negotiation-banker *vis-a-vis* the issuing-banker resembles the position of the latter *vis-a-vis* the buyer, rather than that of the seller *vis-a-vis* the issuing-banker. The seller is the person who commits the fraud. The issuing-banker, and likewise the negotiation-banker, are innocent parties. The issuing-banker accepts the fraudulent draft only in reliance on and at the request of the buyer. It is true that the negotiation-banker does not rely solely on the credit of the issuing-banker but also on his own contract with the seller. Yet, partly at least, he acts at the request of the issuing-banker. The position of the negotiation-banker towards the issuing-banker should not be affected by the fraud of the seller. Since he relies on the negotiation credit, the negotiation-banker participates in the transaction at the request of the issuing-banker. It is therefore suggested that the fact that a fraudulent document is attached to a draft does not justify its rejection by the issuing-banker, provided the draft complies on its face with the terms of the letter of credit. This view derives support from an observation of Shientag J. in *Sztejn* v. *J. Henry Schroder Banking Corporation:*[75]

> On this motion only the complaint is before me and I am bound by its allegation that the Chartered Bank [the banker who presented the draft of the seller] is not a holder in due course but is a mere agent for collection for the account of the seller charged with fraud. Therefore, the Chartered Bank's motion to dismiss the complaint must be denied. If it had appeared from the face of the complaint that the bank representing the draft for payment was a holder in due course, its claim against the bank issuing the letter of credit would not be defeated even though the primary transaction was tainted with fraud.

A negotiation-banker is, indeed, a holder in due course of a draft drawn by the seller (provided the draft is complete on its face).

The negotiation-banker is thus not responsible for the genuineness

74. 177 Misc. 719, 31 N.Y.S. 2d 631 (1941).

75. *Ibid*., at .p. 635.

and truthfulness of the documents and is entitled to reimbursement against a tender of regular though fraudulent documents.

What is the position of a discounting-banker who takes a draft drawn under a "straight credit" which is accompanied by fraudulent documents? His position, generally, *i.e.* when there is no fraudulent document, needs to be first considered. Such a discounting-banker is the holder of a draft drawn by the seller on the issuing-banker, and unaccepted by the latter. Unlike the negotiation-banker, to whom a promise is made in the negotiation credit, the discounting-banker is not a promisee of the straight credit. Several cases indicate that, in the absence of an express undertaking, the courts are not willing to imply a promise of the issuing-banker *vis-a-vis* a discounting-banker. In S*assoon (M.A.) & Sons, Ltd.* v. *International Banking Corporation*[76] the defendants, merchants of Calcutta, agreed to sell goods to an English firm. That firm agreed to procure a confirmed credit in favour of the defendants. The defendants made an "exchange contract" with the plaintiffs, an English Bank operating in Calcutta, by which the plaintiffs agreed to negotiate "approved bills of exchange, drawn 3 M/St.[77] D/A[78] on London . . ." Subsequently, the English firm caused the Eastern Bank of Calcutta to open a letter of credit in favour of the defendants. It asked the defendants to attach the shipping documents to a draft drawn on the English firm (the buyer), and included an engagement to negotiate such drafts, if presented before the date of expiration. It contained the following sentence: "When offering drafts for negotiation under this authority, it is imperative that this letter be produced to enable the negotiating bank to note payments on the back thereof." The defendants shipped the goods and obtained the necessary documents. They attached these to drafts on the English firm and discounted them with the plaintiffs. They also handed the plaintiffs the letter of credit and a memorandum showing the conversion of the sum of the drafts into rupees. This memorandum described the drafts as "3 M/St. D/A drafts 2048 and 2048A on [the English firm]". This sentence in the memorandum had most unexpected results. Because of it the plaintiffs, instead of presenting the drafts for negotiation to the Eastern Bank, presented them for acceptance to the English firm. That firm accepted the drafts but failed to honour them upon maturity. The plaintiffs thereupon claimed recourse to the defendants. One of the defences raised was that the plaintiffs should have presented the drafts for negotiation to the Eastern Bank, against which the plaintiffs obtained rights when they "discounted" the drafts. Viscount Summer decided that, even if this were so, the plaintiffs were entitled to succeed. But he was by no means convinced that the letter of credit of the Eastern Bank contained a promise to a discounting-banker. He said:[79]

> It is contended that in spite of the words "when offering drafts for negotiation under this authority," which authorize negotiations to the Eastern Bank

76. [1927] A.C. 711.

77. Meaning "3 months sight."

78. Meaning "documents on acceptance."

79. [1927] A.C. 711 at p. 722.

> alone, the succeeding words "to enable the negotiation bank," convey that the authority advised in the letter of advice extends to transactions with other negotiating banks, and should not be construed as merely meaning "to enable us when we negotiate the drafts. . . ." Even if this be so (and it is a very summary way of converting the terms of a discount offer by one bank into an undertaking applicable to actual discounts by any other bank), it does not follow that, if a third party bank negotiates, all the undertakings and all the dealings referred to in this letter of advice will be or can be made applicable forthwith to such a substituted transaction.

In *Banco National Ultramarino* v. *First National Bank of Boston*[80] an American firm agreed to purchase from a Brazilian seller a shipment of Brazil white crystal sugar, to be shipped from Rio de Janeiro to New York. The defendants, at the request of the American firm, opened a negotiation[81] credit in favour of the seller and mailed it to him. It called, *inter alia,* for a set of bills of lading and for an invoice for "Brazil white crystal sugar". Apart from the written letter of credit mailed to the seller, the defendants sent him a cable through a correspondent, which read:

> Open credit $45,000 favour [Brazilian seller] account [American firm] drafts 15 days' sight drawn on us shipment about 100 tons Brazil white crystal sugar . . . expires September 15th number of credit 8451 notify beneficiary.

After receiving the cable, but before the arrival of the written letter of credit, the seller drew a draft on the defendants. He did not, at that time, attach any documents to it. The plaintiffs discounted this draft. On the following day the seller gave the plaintiffs a set of documents, including (1) bills of lading evidencing shipment from Bahia (and not Rio), and (2) a consular and a commercial invoice which did not describe the sugar in the words of the cable or the written letter of credit. Since these documents did not comply with the terms of the letter of credit, the defendants refused to accept them, whereupon the plaintiffs brought an action. One of the defences raised by the defendants was that the cable alone, and not the written document, contained the terms of the contract, and that this cable did not include a promise directed to the plaintiffs. Rejecting this argument,[82] Peters J. said that, while the cable constituted the contract, the written document could be used in order to "throw light on any obscurity in the cablegram as to the intent of the sender".[83] The learned judge then pointed out that "[i]f the letter designates a particular person to whom the promise is made, it has been held that no other can take advantage of it, on the principle that a person has the right to select his own promisee."[84] He added that the intent of the issuer "to confine his promise to the person addressed *is inferred from the fact of the address,* and sometimes from other circumstances supposed to throw light upon the intent."[85] As regards the case before

80. 289 F. 169 (1923).

81. See the engagement cited *supra* at p. 44.

82. Judgment was given for the defendants on a different ground.

83. 289 F. 169 at p. 173 (1923).

84. *Ibid*., at p. 174.

85. *Ibid*., (Italics supplied).

him, he said:[86]

> In the instant case there is no occasion to grope around to ascertain the intent of the issuing-bank. Its written letter of credit and cabled authority relate to the same transaction, and were written and sent the same day to the same person. The letter was full and explicit, and was an offer or promise to any bona fide holder of the draft. The cable message was an abridgment in terse language. Without the letter it might be reasonably argued that the intent of the sender of the cable message was to confine the offer to the adressee; but with the letter it is clear that any bona fide holder was intended, as is customary in such transactions.

These two decisions show that the courts are unwilling to turn a "straight credit" into a "negotiation credit" by implying a promise of the issuing-banker *vis-a-vis* the discounting-banker. It follows that, as against a discounting-banker, the issuing-banker is under no obligation to accept a draft drawn under a straight credit. In other words, the discounting-banker has no right to demand acceptance or payment from the issuing-banker under a straight credit.

The position where the draft, presented by the discounting-banker under a straight credit, is accompanied by a fraudulent document may now be considered. If in the absence of such a document the discounting-banker has no right to demand acceptance, it follows a *fortiori* that he has no such right where the draft is accompanied a fraudulent document.

A more complicated question is whether the issuing-banker, having taken up a draft accompanied by forged or false documents, has a right of recourse against the discounting-banker when the fraud is discovered. The answer may depend on the type of the draft, *i.e.* whether it is drawn on the issuing-banker or on the buyer.

When the draft is drawn on the issuing-banker, it is difficult to see any grounds for allowing him a right to claim payment back from the negotiation-banker if the documents prove to be forged or false. The Bills of Exchange Act, 1882 does not confer on a drawee a right of recourse against a holder who has obtained payment. Moreover, the falsity of the documents does not, in itself, entitle the issuing-banker to claim repayment. A person, who presents a documentary draft for payment or acceptance, does not warrant the genuineness or truthfullness of the documents attached to it.[87] This rule, which has been discussed in connection with the relationship of issuing-banker and buyer should apply even more forcefully in the relationship of discounting-banker and issuing-banker. Unlike the issuing-banker, who owes the buyer a duty to examine the regularity of the documents, the discounting-banker owes no duty and stands in no relationship of contract *vis-a-vis* the issuing-banker. There is, therefore, no reason whatsoever for suggesting that he warrants the genuineness or truthfulness of the documents.

However, a further problem arises. May the issuing-banker be

86. *Ibid.*

87. See authorities discussed in this connection *supra* at pp. 29-31.

allowed to recover money, paid to the discounting-banker against forged documents, as money paid under a mistake of fact? It is submitted that no such *quasi-contractual* action lies. First, it is to be presumed that in most cases the discounting-banker will change his position after obtaining payment, either by paying the balance of the amount received to the seller or by releasing a security. Such a change of position could, perhaps, defeat an action for money paid under a mistake of fact.[88] Secondly, it is to be doubted whether, in point of fact, the issuing-banker accepts the documents due to a mistake of fact. It should be emphasised that he is not concerned with the genuineness but only with the regularity of the documents and their compliance with the letter of credit. Thus, when the issuing-banker takes up the documents, he relies on the fact that, on their face, they comply with the instructions of the buyer, and not because he considers them to be genuine. It is therefore arguable that, by paying against regular but fraudulent documents, the issuing-banker does not rely on a mistake of fact. In other words, since his examination is not directed towards the genuineness of the documents, he should not be allowed to assert, when the documents prove to be fraudulent, that he has relied on a mistake of fact.

It appears, therefore, that, when the draft is drawn on the issuing-banker, he does not have a right of recourse against the discounting-banker when the documents prove fraudulent. Does he have such a right when the draft is drawn by the seller on the buyer? It should be noted that such drafts are not common in documentary credit transactions[89] and the question is not very likely to arise. It is submitted that, for the reasons given in connection with the discussion of drafts drawn on the issuing-banker, the latter should not, when the draft is drawn on the buyer, be allowed to claim the money back as paid under a mistake of fact or rely on an alleged warranty of genuineness of the discounting-banker.

However, the law of negotiable instruments prevents a definite exclusion of a right of recourse. When the draft is drawn on the buyer, the issuing-banker undertakes to negotiate it. Here, by taking the draft from the discounting-banker, the issuing-banker becomes a holder. If the discounting-banker is required to indorse the draft, he becomes an indorser. Accordingly, if the buyer refuses acceptance, the issuing-banker, as holder, is entitled to claim recourse to the discounting-banker, the indorser[90] In many such cases, however, this right is explicity excluded. When a letter of credit calls for drafts drawn on the Buyer, it usually stipulates that they be drawn "without recourse". The holder of such a draft has no right of recourse against the drawer or indorsers.[91]

88. This defence to an action for money paid under a mistake of fact is recognized by the American courts, but it is doubtful whether it is recognized in English law. See *Chitty on Contracts,* (22nd ed., 1961), Vol. I, para. 1579.

89. Except in South East Asia and the Far East.

90. The Bills of Exchange Act, 1882, s. 43(2).

91. *Ibid*., s. 16(1).

The right of recourse applies therefore only to cases of drafts drawn on the buyer, without the words "without recourse." It is obvious that such a right may lead to injustice. The discounting-banker may change his position after obtaining payment from the issuing-banker. If the issuing-banker is entitled to a right of recourse against the discounting-banker, the latter might not be able to recover his loss. It is true that he has a right of recourse against the seller, but a seller who presents fraudulent documents is most unlikely to be solvent. At the same time it is difficult to see on what grounds the courts may avoid this injustice by refusing the issuing-banker such a right of recourse. The answer may perhaps be found in an implied term. When the issuing-banker takes up the documents and draft presented by the discounting-banker, a contract is established. It is, obviously, mainly a contract for the sale of mercantile paper. But the courts may decide to read into it an implied term, by which the issuing-banker waives his right of recourse.

The justification for implying such a clause lies in the fact that the drawing of the draft is, in reality, incidental to the documentary credit transaction. Its main purpose is to finance a commercial sale in which payment is to be made against documents of title. In many Continental letters of credit the seller is not asked to draw a draft at all, and payment is promised against the tender of the documents. It may be argued that the participants in a documentary credit transaction do not arrange their business with a view to the law of negotiable instruments. The draft is requested only as a convenient means for making payment and not in order to regulate the rights of the parties. From the point of view of the mercantile transaction as a whole, it would be unsound to permit the issuing-banker to exercise a right of recourse against the discounting-banker, if the documents turned out to be forged or false. It is true that if, before taking up the documents, the issuing-banker comes to know that they are fraudulent, he is entitled to reject them if presented by a discounting-banker. Since the issuing-banker stands in no relationship of contract towards the discounting-banker, the former may not be forced to take up any tender. But it must be borne in mind that by issuing the documentary credit the issuing-banker has declared himself the "paymaster" of the transaction. Although the discounting-banker, who is not a party, cannot rely on the documentary credit in order to enforce payment, he is nevertheless entitled to assumed that, by taking up the documents, the issuing-banker recognizes that they comply with the letter of credit and acknowledges his duty, *vis-a-vis* the seller, to accept them. If follows that, by taking up the documents, the issuing-banker is most likely to lull the discounting-banker into security.[92] Moreover, by taking up the documents, the issuing-banker represents that they are up to his contract with the buyer. Since the issuing-banker negotiates the draft drawn on the buyer on the strength of the attached documents and not the draft itself, it may be possible to read into the

92. However, it is difficult to rest the matter on an estoppel. The right of recourse follows from the buyer's *(viz.* drawee's) dishonour of the draft and not from the forgery or falsity of the documents. Precluding the banker from raising the forgery or falsity will thus be of no avail.

contract (by which he negotiates it when presented by the discounting-banker) the words "without recourse".

It is therefore to be hoped that, even if the draft is drawn on the buyer, the courts will not permit the issuing-banker to seek recourse to the discounting-banker, even if the documents turn out to be fraudulent.

CONCLUSION.

The above discussion indicates that the effect of the presentment of a draft accompanied by fraudulent documents depends on the identity of the person who presents it. The issuing-banker who presents it to the buyer, as well as the correspondent-banker and negotiation-banker who present it to the issuing-banker, are entitled to obtain payment against it, provided that the documents, on their face, comply with the terms of the letter of credit. Moreover, the buyer who has taken such a draft from the issuing-banker, or the issuing-banker who has honoured such a draft when presented by the correspondent or negotiation-banker, is not entitled to a right of recourse against the party who has presented it. These principles are justifiable both at law and from a commercial point of view. At law, a person who presents a documentary draft does not warrant the genuineness or truthfulness of the documents. Moreover, the issuing-banker participates in the documentary credit transaction at the request of the buyer and, similarly, the correspondent and negotiation-banker are induced to participate by the issuing-banker. It is submitted that, if one of two innocent parties must sustain a loss as the result of the fraud of a third person, the loss should be borne by the party that induced the other to act by introducing the fraudulent person. From a mercantile point of view, it must be remembered that the bankers participate in the finance of a commercial sale. There is no ground for suggesting that by doing so they also assume a duty to prevent fraud. Their intervention is required for raising credit and providing a security against the insolvency of the buyer, and not as a means of guarding the seller's honesty.

The position differs when the seller presents fraudulent documents or has obtained payment against them. The seller is either the person who has committed the fraud or, if it has been committed by a supplier of his, the principal of the fraudulent party. Both from a mercantile as well as a legal point of view, he is responsible for the fraud. The issuing or correspondent-banker should therefore be entitled to reject a fraudulent tender, or if he paid against it, be entitled to claim the money back in an action in deceit.

As regards the discounting-banker, who negotiates a draft drawn under a straight credit, there is a dichotomy. Since he is not a promisee of the credit, the issuing-banker is entitled to reject a tender accompanied by fraudulent documents. Since the discounting-banker does not rely on the letter of credit but on his contract with the seller, the principle is commercially sound. But, if the issuing-banker accepts from the discounting-banker a tender accompanied by fraudulent documents, the issuing-banker is not entitled to a right of recourse. The discounting-

banker does not warrant the genuineness or truthfulness of the documents, and should not, therefore be liable in an action for money had and received. Moreover, he is an innocent party and the acceptance of the draft by the issuing-banker may well lull him into security. He should not, therefore, be liable once the issuing-banker had taken up the tender. This is sound from a mercantile point of view as well. The acceptance of the documents should constitute a final step in the transaction. Parties should be able to assume that, once a tender was accepted, there would be no further argument. If that were not so, the documentary credit transaction would lose its clear cut meaning. Thus, the issuing-banker should not be granted a right of recourse against the discounting-banker.

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