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of a petition for a rehearing in the case, in behalf of the Integrated Bar.

George Donworth then submitted the report of the committee on Law Enforcement, recommending the centralization of the police power by the state, and the abolition of many minor local enforcement agencies.

Alfred J. Schwappe of Seattle, made a short talk on the work of the Judicial Council.

The final committee report, and perhaps one of the most important was made by Tom S. Patterson, Chairman of the Legislative Committee. This report recommended the preparation and submission at the next Legislature of a new code for Justice Courts, embodying many new reforms in the number, qualifications, jurisdiction, and recall of justices of the peace; the abolition of the office of constable; an amendment creating a Washington State Patrol composed of local police officers drafted by executive order, and a return to the whipping post as a form of punishment for second felony offenders, and for crimes committed with force or violence. The recommendation of the whipping post as a form of punishment, evoked much comment from the floor, and resulted in a motion to submit the question to a referendum vote of the members of the bar.

Before adjournment, President Thorgrimson announced the appointment of Elmer Hayden of the Tacoma Bar as the president for the ensuing year, and after a short speech of acceptance by Mr. Hayden, the meeting was adjourned. Visiting members were then conducted through a garden tour of the Lake region, followed by an afternoon of golf and a buffet supper in the evening at the Tacoma Golf and Country Club.

NOTES AND COMMENTS

LIABILITY OF BANK ISSUING LETTER OF CREDIT WHEN GOODS FAIL TO COMPLY WITH DOCUMENTARY DESCRIPTION

The decision of the United States Circuit Court of Appeals (Ninth Circuit) in the case of *Continental National Bank v. National City Bank*¹ has reopened the question which received much attention in the legal and commercial periodicals following the writing of the opinions in *O'Meara v. National Park Bank* and

¹ 69 F (2d) 312 (1934).

Laudisi v. American Exchange Bank as to the liability of the issuing bank when the goods do not measure up to the description contained in the documents accompanying the draft drawn under the letter of credit. It seems that the problem can be best understood by examining the various situations which may arise under a letter of credit, proceeding from the simple to the more complex.

The letter of credit has been described as a contract between the buyer and his bank by which the bank in consideration of the buyer's promise to indemnify it, promises to pay drafts drawn on the buyer or his bank by the seller or his bank up to the purchase price of the goods sold by the seller to the buyer. Usually, the issuing bank will protect itself by providing in the letter of credit that only those drafts accompanied by certain designated documents, such as a bill of lading covering the shipment concerned, commercial invoices, warehouse receipts or delivery orders will be honored.³ Because the conditions to the bank's obligation are inserted for the protection of the bank, as well as for the protection of the buyer, it has been held that they must be strictly complied with, the bank being bound to pay the draft if the proper documents are presented, and bound to not pay the draft if the proper documents are not presented.⁴ Likewise, there is a multitude of authority to support the statement that the obligation of the issuing bank is separate and distinct from the contract of sale between the seller and buyer, its sole duty being to see that payments are made in accordance with the terms of the promise contained in the letter of credit.⁵

I. The simple situation is that presented by the cases involving the letter of credit calling for payment of a draft accompanied by shipping documents. The issuing bank to be protected in paying the draft or in refusing to pay the draft, has only to ascertain whether the documents are those required by the terms of the letter of credit. Such would be the case in which the letter of credit called for payment of a draft accompanied by an insurance policy of a certain type and the seller or his agent failed to present the insurance policy. In that case the issuing bank would be justified in refusing to honor the draft.

II. A slightly different problem is presented in the cases in which, while the necessary documents are presented, the form of

³ 239 N. Y. 386, 146 N. E. 636, 39 A. L. R. 747 (1925) 239 M. Y. 234, 146 N. E. 347 (1924).

⁴ See Mead, "Documentary Letters of Credit," 22 Col. L. Rev. 297 (1922) McCurdy, "Commercial Letters of Credit," 35 Harvard L. Rev. 539, 715. Also, 30 A. L. R. 1310.

Bank of East Asia, Ltd. v. Pang, 140 Wash. 603, 249 P. 1060 (1926) *Hibernia Bank & Trust Co. v. J. Aron & Co. Inc.*, 233 N. Y. S. 486 (1928) *Bank of Italy v. Merchant's National Bank*, 236 N. Y. 106, 140 N. E. 211 (1923) *Palmer v. Rice*, 36 Neb. 844, 55 N. W. 256 (1893) *Bank v. Griswold*, 76 N. Y. 472 (1878).

⁵ *Second National Bank v. Columbia Trust Co.*, 288 Fed. 17 (1923) *Bank of Taiwan v. Gorgas-Pierre Mfg. Co.*, 273 Fed. 660 (1921) *Lamborn v. Lake Shore Banking & Trust Co.*, 188 N. Y. S. 162, 132 N. E. 911 (1921) *Imbrie v. Nagase Co.*, 187 N. Y. S. 692, 196 App. Div. 380 (1921).

one of the documents is not as specified in the letter of credit. Thus in *National City Bank v. Seattle National Bank*⁶ the letter of credit read.

“We hereby authorize you to draw for invoice cost of 155 tons standard white granulated sugar at \$23.50 net per hundred pounds packed in double sacks f. o. b. cars Seattle, Washington. Railroad bills of lading issued to the order of the shipper and indorsed in blank, together with invoices, certificates of Hongkong Government and Lloyd’s covering quality, net shipping weights, inspection and analysis must accompany drafts.”

The documents accompanying the drafts presented to the issuing bank did not contain the words “standard white granulated sugar,” but did specify that the shipment consisted of “granulated white sugar, Java No. 24, direct polarization 98.5%.” The court in holding for the issuing bank in an action brought by the buyer against the bank, said, “in such a case as this it makes no difference whether the goods tendered were identical with the goods purchased, the only question being did the documents conform to the terms of the letter of credit? Not so conforming here, respondent (issuing bank) was in duty bound to refuse payment of the draft.”

III. Proceeding further, we have those cases in which, while the documents conform to the requirements set forth in the letter of credit, the goods themselves do not conform to the documentary description of them.

a. It is clear that the question of the defective quality of the goods does not concern the issuing bank when the only provision as to the quality is contained in the contract of sale between the seller and buyer. Thus in the case of *Bank of Plant City v. Canal-Commercial Trust & Savings Bank*⁷ where the letter of credit read

“We will honor sight draft of W J Hawkins, bill of lading attached, covering car of tomatoes on S. Segari & Co.”

it was held that the bank was liable for its refusal to pay the draft, regardless of the rejection by the buyer of the tomatoes as

⁶ 121 Wash. 476, 209 p. 705 (1922).

⁷ In *Manatee County State Bank v. Weatherly*, 144 Ala. 655. 39 So. 988 (1905) it was held that the bank was justified in refusing to honor the draft drawn under a letter of credit for oranges “provided each bill of lading be accompanied by a certificate that oranges were sound when shipped and loaded according to the signed contract” where the contract between the buyer and seller contained stipulations as to size, color and where the certificate accompanying the draft merely stated that the oranges were sound and merchantable when loaded. See also, *Lamborn v. Lake Shore Banking & Trust Co.*, note 5 *supra*.

⁸ 270 Fed. 477 (1921).

unmerchtable. Ordinarily, the sales contract between the buyer and seller is not part of the contract between the issuing bank and the buyer, nor is the performance of the sales contract a condition precedent to the letter of credit.⁹

But the New York court has said

“The sole obligation of a bank which issues a letter of credit is to see that the payments are made in accordance with the terms thereof, and subject to certain exceptions, it has no concern with any controversy between buyer and seller.”¹⁰

It is not stated what exceptions are meant, but it is reasonable to suppose that the court is referring to those cases in which the parties to the letter of credit stipulate in their contract that the terms of the contract of sale, or of a similar agreement relating to the quality of the goods shall be read into the letter of credit, conditioning the liability of the bank.

b. Since the letter of credit is a contract, the parties may include in its terms any conditions that they desire.¹¹ They may provide that the issuing bank shall ascertain the condition of the goods purchased by the buyer before paying the draft drawn by the seller for the purchase price. A search of the cases has not revealed a decision based on a letter of credit containing the express condition that the issuing bank determine whether or not the goods

⁹ In *Laudisi v. American Exchange Bank*, note 2, *supra*, the buyer brought suit against the issuing bank for damages suffered when the bank made payment of the draft knowing that the goods concerned were defective. The contract between the buyer and the bank made no mention of the quality of the grapes to be shipped, but provided.

“ It is understood and agreed that you may accept and/or pay the draft and/or drafts under said letter of credit on presentation of one copy of the bill of lading together with invoice and/or other documents required by the letter of credit.”

The grapes were not of the quality purchased. Before the bank had honored the seller's drafts, the buyer notified it of the breach of the buyer-seller contract and told the bank to dishonor the draft. The bank paid the draft on presentation, disregarding the notice. The court in expressing its approval of the conduct of the bank said.

“The contract between the customer and the bank is entirely distinct and apart from the contract between such customer and his vendor. The question between the customer and his vendor is one whether the goods comply with the contract.

The question between the customer and the bank which issues the letter of credit is whether the documents presented with the draft fulfill the specific requirements and if they do, speaking of such facts as exist in this case, the bank has the right to pay the draft no matter what may be the defects in the goods which have been shipped.”

¹⁰ *Williams Ice Cream Co. v. Chase National Bank*, 205 N. Y. S. 447. 210 App. Div. 179 (1924).

¹¹ *Bank of East Asia, Ltd. v. Pang*, note 4 *supra*.

are as ordered, paying the draft only if it should find in the letter of credit an express condition to that effect.¹²

In *American National Bank v. Pullman*¹³ the Missouri court was unable to find an agreement that the bank determine whether or not the peaches shipped to the buyer were of first quality before paying the drafts presented, nothing appearing in the letter of credit to indicate that the peaches sold were to be first class.

IV The difficult question is presented when the letter of credit describes the goods to be shipped with some degree of precision. The problem then before the court is one of construction. Is the description of the goods in the letter of credit to be read as requiring that the bank determine whether the goods shipped answer to the description given? This is the situation presented in the *Continental National Bank* case.

Plaintiff sues the issuing bank for damages suffered because of the alleged wrongful refusal of the bank to honor drafts held by plaintiff and drawn under a letter of credit issued by defendant. The buyer of cement to be shipped from Brussels arranged with the defendant bank for the issuance of the letter of credit providing for payment of drafts accompanied by commercial invoices, consular invoice and other documents against

“shipment of twelve thousand barrels Portland cement.

Cement to be of sound merchantable quality and standard of the same shall meet with the requirements of the American Society for testing materials.”

Plaintiff presented a sight draft accompanied by the commercial documents required and a document entitled “a certificate of quality” However, the bank refused to honor the draft, stating that the cement did not comply with the specifications in the letter of credit. Prior shipments of cement from the same seller having been found to be of inferior quality, the present shipment had been sampled and tested by a firm of engineers, who found it did not answer to the tests of the American Society for testing materials. The bank's course of conduct was based on the premise that the quality of the cement was to be ascertained before the bank became liable under the letter of credit. However, the court refused to find that the compliance of the goods with the standards of the society was a condition precedent, preferring to cite cases holding that the letter of credit is a payment against documents, the chief function of a letter of credit being to substitute bank credit for buyer's credit and to insure to the seller immediate payment for goods shipped regardless of the claims of the buyer that the goods are defective.

¹² *Continental National Bank v. National City Bank*, note 1 *supra*, *Laudisi v. American Exchange Bank*, note 9, *supra*; *Camp v. Corn Exchange National Bank*, 285 Pa. 337, 132 A. 189 (1926).

¹³ *American National Bank v. Pullman*, 176 Mo. App. 430, 158 S. W. 433 (1913).

The court devotes a good portion of the opinion to a discussion of the *O'Meara* case¹⁴ in which the New York court divided on this problem of conditions in the letter of credit. The letter of credit covered a "shipment of 1,322 tons of newsprint paper in 72½" and 36½" rolls to test 11-2, 32 lbs." Plaintiff presented the draft, the required documents, and an affidavit stating that the paper tested 12 points 32 pounds. Defendant refused to honor the draft, stating that the plaintiff was required by the terms of the letter of credit to furnish evidence reasonably satisfactory to the bank that the paper was as described. The majority of the court granted plaintiff's motion for a summary judgment, saying,

"The bank's obligation was to pay sight drafts when presented, if accompanied by genuine documents specified in the letter of credit. If the paper when delivered did not correspond to what had been purchased, either in weight, kind, or quality, then the purchaser had his remedy against the seller for damages. The bank was under no obligation to ascertain, either by personal examination or otherwise, whether the paper conformed to the contract between the buyer and seller. 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 definitely denied the existence of a condition as to the quality of the paper when it said.

"The defendant had no right to insist that a test of the tensile strength of the paper be made before paying the drafts, nor did it have the right to inspect the paper before the payment to determine whether it in fact corresponded to the description contained in the documents. The letter of credit did not so provide."

However, a dissenting opinion was written by Mr. Justice Cardozo and concurred in by Mr. Justice Crane. It is to the effect that while the bank was under no duty to inspect the goods shipped, yet if it did investigate and learned that the goods were not as required under the sales contract it could not be compelled to honor the draft.

*Old Colony Trust Co. v. Lawyers' Title & Trust Co.*¹⁵ has been cited as adopting Cardozo's minority rule. There the letter of credit called for payment against "negotiable delivery order or negotiable warehouse receipt invoice in triplicate." The plaintiff presented two drafts, both of which were dishonored by the issuing bank, the one because the goods were not in the warehouse although

¹⁴ Note 2, *supra*.

¹⁵ 297 Fed. 152 (1924).

the draft was accompanied by what purported to be a warehouse receipt, the other because the delivery order was not such as was contemplated by the letter of credit. In affirming the decision for the defendant bank, the Circuit Court of Appeals and later the Supreme Court of the United States¹⁶ declared that when the issuer of a letter of credit is tendered a document which he knows, although correct in form, to be in fact false, he cannot be compelled to accept the document as satisfying the terms of the letter of credit. It would seem that this is an application of the dissenting opinion in the *O'Meara* case to a set of facts involving defective documents rather than defective goods. This interpretation of the case is recognized by the court in the *Continental National Bank* case, but is discarded when the court attempts to distinguish the two cases on their facts, and then says that the court in the *Old Colony Trust* case did not intend to lay down the broad rule which would always permit the bank to refuse to honor drafts if the goods did not comply with the description of the documents. It is by this method that the court avoids calling the description of the goods in the letter of credit a condition which must be satisfied before the bank's obligation attaches.¹⁷

Just what language will be accepted by the courts as creating the condition that the goods concerned comply with the description in the letter of credit is not at all clear. However, it is clear that an issuing bank wishing to protect itself by the imposition of a condition to that effect must incorporate such into the letter of credit

¹⁶ 265 U. S. 285 (1920).

¹⁷ The court also attempts to distinguish *Lamborn v. National Bank of Commerce*, 276 U. S. 469, 48 S. Ct. 378, 72 L. Ed. 657 (1928) on its facts. Plaintiff sued the issuing bank for damages caused by the bank's refusal to pay a draft drawn under a letter of credit providing:

"Shipment to be made during Aug./Sept. 1920 at option of the sellers from Java by steamer or steamers to Philadelphia."

The basis of the bank's refusal to pay was that the ship on which the sugar was sent had not been continuously destined from Java to Philadelphia. The only reference to the quality of the goods was that given in the description of the goods covered by the letter of credit. The court, while holding for the plaintiff, made the statement that "Defendant is obviously not liable unless there was a tender of sugar which met the requirements of the letter of credit as to amount and quality of the sugar, as to time, and as to the manner of shipment." This has been cited as indicating that the court was in favor of Cardozo's rule. However, the court's only authority for the statement is a statement from *Norrington v. Wright*, 115 U. S. 188, 6 S. Ct. 12, 29 L. Ed. 366 (1885) that "A statement descriptive of the subject matter, or of some material incident, such as the time or place of shipment is ordinarily to be regarded as a warranty in the sense in which that term is used in insurance or maritime law, that is to say, a condition precedent upon the failure of which the party aggrieved may repudiate the whole contract." While this is very true when limited to the facts of the *Norrington* case (installment contract for iron, contest between the buyer and seller), it is submitted that it is not authority for the statement that the mere description of the goods in the letter of credit conditions the bank's obligation to pay the drafts drawn hereunder.

with such emphasis and clarity that its presence in its intended sense cannot be mistaken. A survey of what appears to be the available cases in the field leaves one very much in doubt as to what language other than that of express condition will be construed as giving the bank the right to reject the draft if the goods are not as ordered by the seller.

The mercantile policies in favor of avoiding delay in payment to the seller, in shifting the risk of defective goods from the accommodating bank, and the legal policy of avoiding circuitry of action are fostered by the court's attitude in stressing the fact that the letter of credit provides for prompt payment against documents. But it would seem that if the parties to the letter of credit wish to condition the obligation of the bank, as they seemed to be in the *Continental National Bank* case, they should be allowed to do so. And it would certainly appear that the language used in the letter of credit in that case was more the language of condition than was that used in the *O'Meara* case, from which it derived Cardozo's minority rule.

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