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The Legal Nature of the Irrevocable Commercial Letter of Credit

I. INTRODUCTION

Discussions of the nature of legal institutions are infrequent in contemporary legal literature. Pragmatic inquiries into the use and application of legal institutions, as well as their casuistic evaluation, seem to have displaced their analytic treatment. The nature of legal science is such, however, that empirical observation alone is insufficient when attempting to grasp the being of an emerging legal institution; one must not only appreciate its socio-economic role, but also acquire an awareness of its relationship to other legal institutions. It is difficult, for example, to understand the rules on the time of establishment of an irrevocable credit, on the limitation of the bank's powers to issue letters of credit, or on the extent of damages owed by the issuing bank to the beneficiary, unless one is able to distinguish between the promise embodied in a bilateral contract such as a sale or a suretyship and the promise in the commercial letter of credit.¹

Before examining the different theories on the nature of the irrevocable commercial letter of credit, it will be useful to review briefly its history.

A. The Twelfth and Thirteenth Century Letter of Payment

The instrument most frequently mentioned as the forerunner of the modern commercial letter of credit is an early Mediterranean form of the bill of exchange, referred to by some historians as the letter of payment.² The twelfth and thirteenth century letter of payment,

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¹ On the time of establishment of the credit see Boris Kozolchik, *Commercial Letters of Credit in the Americas: A Comparative Study*, Ch. 18; on the measure of damages owed by the issuing bank to the beneficiary upon wrongful dishonor of the letter of credit, see Ch. 19; on the power to issue letters of credit, Ch. 24, *ibid.*

Note: In the following, the abbreviation "C.C." is used for Civil Code, and "C. of C." for Code of Commerce.

² See, generally, Usher, 1 *The Early History of Deposit Banking in Mediterranean Europe*, Ch. 3, especially at 76 *et seq.* (Harvard Economic Studies, 1943); more specifically, see Huvelin, *Les Travaux Récents sur l'histoire de la Lettre de Change*, XV *Annales de Droit Commercial et Industriel Français, Étranger et*

either in its formal notarial or informal holographic form, was a four-party transaction. The parties were the remitter, the maker or drawer, the payor to whom the instrument was addressed, and the payee to whom it was sent by the remitter. It is doubtful whether the payee of the letter of payment could have forced the payor to pay the stated sum in the absence of a formal recognition of the remitter's or payee's right.³ In addition, it has not been clearly established whether the letter of payment was merely the result of a contract of exchange (*cambium*), or of both a contract of exchange and an extension of credit.⁴

Finally, an important albeit frequently disregarded feature of the letter of payment or letter of exchange was that it contained only an order of payment and not an explicit promise to pay.⁵ It was not until a series of consultations were given by the fourteenth century postglossators that the assimilation of the order of payment with the informal promise of payment took place.⁶

B. The Seventeenth Century Letter of Credit

During the seventeenth century, when the bill of exchange had begun to attain its formal status as a negotiable instrument in England and on the European continent, it was common to find other instruments referred to as "letters of credit," which were described as follows:

A merchant doth send his friend or servant . . . to buy some commodities or take up money for some purpose, and doth deliver unto him an open letter directed to another merchant requiring him that his friend, the bearer of that letter have occasion to buy commodities or take up moneys . . . that he will

International (Paris, 1901) 1; and the recent monograph by De Roover, *L'Évolution de la Lettre de Change XIV-XVIII Siècles* (Paris, 1953).

³ On this, see Usher, *op. cit. supra* n. 2 at 87 and also Huvelin, *op. cit. supra* n. 2 at 12, but *cf.* Freundt, 1 *Das Wechselrecht der Postglossatoren* (Leipzig, 1899) 108 *et seq.*

⁴ In favor of the theory that early letters of payment and bills of exchange were instruments intended merely for the remittance of exchange from one city to another, see Levin Goldschmidt's classic work, *Universalgeschichte des Handelsrechts* (Stuttgart, 1891) 403, but *cf.* Schaubé, "Studien zur Geschichte und Natur des ältesten Cambium," (1895) *Zeitschrift für Nationalökonomie und Statistik*, at 153-191 and 511-534, *cit.* by De Roover, *op. cit. supra* n. 2 at 13, wherein this author also takes issue with Goldschmidt's often quoted statements.

⁵ See Usher, *op. cit. supra* n. 2 at 88.

⁶ *Id.* at 88-89, and also Freundt, *op. cit. supra* n. 4 at 48-91 wherein the differing views of postglossators such as Johannes Andreae, Pierre de Bellperche, and Durantis are carefully contrasted to those of Jacobus de Arena, Cinus, and Alberto de Rosate, concluding with the famous consultation by Baldus in 1385, in which he explained the binding nature of the promise on the basis that delivery to a creditor of a document "for value received" was evidence of the maker's intention to be bound in earnest.

procure him the same and will provide him the money or pay him by exchange.⁷

As with the twelfth and thirteenth century letter of payment, this was a multiparty transaction; however, the letter of credit contained an express or implied promise to reimburse the payor. The Spanish *Ordenanzas de Bilbao* of 1737 acknowledged the circulation of these letters of credit (*Cartas Ordenes de Crédito*) and provided the basis for the statutory scheme that was later adopted by the nineteenth century Spanish and Latin-American commercial codes.⁸

Salient features of the nineteenth century code treatment of the *Carta Orden de Crédito* or *Carta de Crédito* were (1) the instrument could be issued only in favor of a designated person (*tomador, portador, preneur*) and never, as with bills of exchange, to the "order of" a given payee,⁹ and (2) the instrument had to contain a specification of a sum certain or of a maximum amount.¹⁰ Lacking these two requirements, the letter of credit was deemed a mere letter of recommendation.¹¹ These letters of credit could not be protested, even in the case of nonpayment. This meant that the nominee-payee acquired no right of action against the payor, and presumably would acquire a right of action in restitution against the issuer only upon proof of prepayment.¹² This principle found further support in the statutory rule that provided that the maker or issuer of the letter of credit could revoke his promise at any time merely by notifying the nominee-payee (*portador*) and the addressee.¹³

⁷ See Malynes, *Consuetudo vel Lex Mercatoria* or *The Ancient Law Merchant* (1629) at 104 *et seq.* and note the almost identical description of the seventeenth century French *lettre de crédit* quoted by Stoufflet, *Le Crédit Documentaire* (Paris, 1957) at 23-24 (attributed to Savary's *Le Parfait Commerçant*): *Un banquier ou un négociant donnera à une personne de ses amis qui a besoin d'argent dans une autre ville où il désire aller, une lettre adressée à son correspondant, par laquelle il lui mande de fournir à son ami, porteur de la lettre, une somme en deniers ou tout ce qu'il aura besoin.* (A banker or merchant will give to a friend who needs money in another city, where he wants to go, a letter addressed to his correspondent, by which he orders him to supply his friend, the bearer of the letter, a sum of money or whatever else he may need.)

⁸ See, *Ordenanzas de la Universidad y Casa de Contratación de la muy noble y muy leal Ciudad de Bilbao*, enacted by Phillip V in the Real Cedula de 2 de Diciembre de 1737, Capitulo, XIV (10, 11, 13) (1737), and compare with Articles 573 *et seq.* of the Spanish Code of Commerce of 1829; 567-572 of the Spanish C.of C. of 1885, and the Cuban C.of C. of 1886; Articles 564-575 of the Mexican C.of C. of 1889; 557-562 of the Peruvian C.of C. of 1902; 782-794 of the Chilean C.of C. of 1865; 464-469 of the C.of C. of San Salvador of 1906.

⁹ See the commercial code (C. of C.) provisions cited *supra* n. 8.

¹⁰ *Id.*

¹¹ See, for example, Article 568 of the Spanish C.of C. of 1885 and Article 558 of the Peruvian C.of C. of 1902.

¹² See, for example, Article 569 of the Spanish C.of C. of 1885 and Article 559 of the Peruvian C.of C. of 1902.

¹³ Article 570 of the Spanish C.of C. of 1885 reads as follows: "*El dador de una carta de crédito podrá anularla, poniendolo en conocimiento del portador y de*

The nineteenth century *Carta de Crédito* was, at best, an imperfect device for facilitating foreign purchases and although it involved several parties its liability structure was such that neither the payee nor his seller or financier could comfortably rely on it as the source of their respective rights and duties. Its use was confined to those cases where there was constant dealing between two or more mercantile houses that normally traded on an open account or credit basis. In the United States this type of letter of credit was commonly referred to as a "buyer's credit" and, as in Europe and Latin America, it was used until the middle of the nineteenth century mainly in domestic transactions and within a circumscribed area.¹⁴

C. *The Commercial Letter of Credit*

Shortly after the middle of the nineteenth century a new type of letter of credit, the "commercial letter of credit," issued by mercantile factors and banking houses, began to gain favor with Anglo-American and European traders.¹⁵ This letter was used as a means to

aquel a quien fuere dirigida." ("The issuer of a letter of credit may annul the instrument by notifying the bearer and whoever may be the addressee.") But *cf.* Article 786 of the Chilean C. of C. of 1865 restricting the issuer's power of revocation.

¹⁴ See Finkelstein, *Legal Aspects of Commercial Letters of Credit* (New York 1930) 23; McCurdy, "Commercial Letters of Credit," 35 *Harv. L. Rev.* (1922) 539 at 547, and also Thayer, "Irrevocable Credits in International Commerce: Their Legal Nature," 36 *Col. L. Rev.* (1936) 1031 at 1033.

¹⁵ The late Professor Karl N. Llewellyn concluded upon examining all the early nineteenth century United States letter of credit cases (such as *Robbins v. Bingham*, 4 Johns. 476 (N.Y., 1809), *Walsh v. Bailie*, 10 Johns. 180 (N.Y., 1813), *Edmonston v. Drake*, 5 Peters. 624 8 L.Ed. 251 (1831) and others) that not until the middle of the nineteenth century did the law of commercial letters of credit begin to develop. He found that the commercial letter of credit emerged in the United States from the competition of factorage houses for business, which led to the issuance of promises to accept drafts drawn against shipments. The specialization of banking activities to the point of becoming independent of factoring, the growth of manufacturers, and the use of the telegraph as a means of communicating the terms of contracts of sale at a fixed price were the main factors in the significant volume of issuances of letters of credit in the early eighteen-sixties. This is also the period when the first relevant commercial letter of credit decisions appeared, such as *Duncan v. Edgerton*, 6 Bosw. 36 (N.Y., 1860), *First National Bank of Chicago v. Pettit*, 41 Ill. 492 (1866), *Omaha National v. First National Bank of St. Paul*, 59 Ill. 428 (1871). (See Llewellyn's findings in a research paper reproduced in *Ward and Harfield, Bank Credits and Acceptances* [4th ed. New York, 1958] 146-150.) Professor Llewellyn's findings are borne out by independent sources such as the *Rand McNally Bankers' Directory* published annually in Chicago and containing the advertisements of United States banks engaged in the issuance of commercial letters of credit as far back as 1876. In addition, testimony in the case of *Victor v. National City Bank*, 200 App. Div. 557 at 572, 193 N.Y.S. 868 at 878-879 (1922) indicates that a leading United States inland bank had issued more than \$100 million worth of commercial and travelers' letters of credit during the period 1870-1913. Supporting Llewellyn's findings, see Trimble, "The Implied Power of National Banks to Issue Letters of Credit and Accept Bills of Exchange," 58 *Yale L.J.* (1949) 713 at 724. For further materials on the early history of the com-

finance and pay for international sales of the documentary variety. Its purpose was to enable an exporter to draw his draft or bill of exchange, not on the buyer-importer, but on a bank or factor of known solvency. The banking or factoring house issued a promise (revocable or irrevocable) to accept or pay the seller's draft or demand for payment, accompanying its promise with a specification of the documents that the seller or the seller's agent or bank was required to present. In the case of revocable credits the promise of the issuing bank was subject to revocation up until the moment of acceptance or payment. Irrevocable credits embodied a firm commitment by the issuing bank. The promise in the irrevocable credit was not subject to revocation and could be enforced not only against the issuing bank but also against another bank which acted as the confirming bank in the beneficiary's location; this enabled the beneficiary to discount or negotiate his draft against the issuing or confirming bank. It became clear to the bankers involved in issuing, accepting, discounting, and negotiating drafts emerging from commercial letters of credit that their function was to verify carefully the beneficiary's documentary compliance and not to judge the seller's performance under the underlying agreement. Otherwise the reliability of the bank's promise and the frequency of letter of credit transactions would suffer from the uncertainties in the buyer-seller relationship. The commercial letter of credit may therefore be defined as a formal promise by a bank or another party of known solvency to accept and pay, or just to pay, the draft or demand of payment by the beneficiary, whose compliance

mercial letter of credit in the United States see Finkelstein, *Legal Aspects of Commercial Letters of Credit* (New York, 1930) 1-13. This writer has not been able to find an adequate account of the history of the commercial letter of credit in England. Gutteridge and Megrah in their authoritative book, *The Law of Bankers' Commercial Credits* (London, 1962) deal only with twentieth century practices. Professor Davis' historical section in his book, *The Law Relating to Commercial Letters of Credit* (London, 1954) is extremely brief. Moreover, even in Lawson's *History of Banking*, published in London in 1855 and described as a "comprehensive account of the origin, rise and progress of the banks" there is no mention of commercial letter of credit practices, even though banking activities are covered until the year 1849. It is clear, however, from the information compiled by Professor Llewellyn that as far back as the eighteen-twenties there were large English banking and factoring houses engaged in letter of credit practices and handling an increasing amount of American credits. On this see Buck, *The Development of the Organization of Anglo-American Trade, 1800-1850* (New York, 1912) 154-158. For materials on the early French commercial letter of credit practices see Hamel, *2 Banques et Operations de Banque* (Paris, 1943) n. 1002-1004; Stoufflet, *Le Cr dit Documentaire* (Paris, 1957) 25-26; and also Brethe et Legal, "Le Cr dit Confirm  en Droit Fran ais et en Pays  trangers," (1924) *Revue de Droit Bancaire*, 289 *et seq.*; for early Italian practices see Brugi, "Contratto di apertura di credito bancario confermato," (1920) *Riv. Dir. Comm. II*, 541; Salandra, "Apertura di Utilizzabili da Terzi," (1926) *Riv. Dir. Comm. I*, 325; for early German practices see Stummer, *Das Bankakkreditiv nach Deutschem Recht* (M nchen, 1924) 2 *et seq.*; Wittrock, *Die Rechtsstellung der Bank beim Akkreditiv-Gesch ft* (Kiel, 1925) Ch. I.

with the terms of the credit is a prerequisite of the enforceability of the promise.¹⁶

II. BASIC DIFFICULTIES IN THE CHARACTERIZATION OF THE IRREVOCABLE COMMERCIAL LETTER OF CREDIT

The first effective work toward the development of a satisfactory theory on the nature of the irrevocable commercial letter of credit, particularly in United States law, was contributed by Omer F. Hershey in 1918.¹⁷ Mr. Hershey undertook a thoughtful analysis of the body of law then extant in order to find the legal basis upon which standardization could be built. This author noted that the development of the law on the subject was hindered, if not warped, on the European continent by preconceptions emerging from the law of contracts which led to the characterization of the letter of credit promise as one arising from the contract of *mandatum*. Similarly, Anglo-American attempts at characterization encountered difficulties in squeezing the letter of credit promise into the realm of contract law, due to the absence of privity of contract as well as of consideration.¹⁸

A. Civil Law Categories

The conceptual difficulties encountered by the early twentieth century civil law writings examined by Hershey were, at least in part, attributable to the fact that at that time the distinction between the "old," "traveler's," or "buyer's" letter of credit and the commercial letter of credit was not yet clearly established.¹⁹ Unable to escape the analogy with newer forms, civil law writers assumed they had to fit every form of letter of credit, including those arising from twentieth century practice, "into a legal theory of third century Rome."²⁰

The three-party transaction inherent in the "old" letter of credit (issuer, nominee, and correspondent or addressee) was conceptualized as a *mandatum* between issuer and correspondent and as a separate undertaking between the issuer and the "holder" of the instrument, amounting to a promise by the issuer to open a credit in favor of the nominee. By *mandatum* the Romans meant a transaction whereby one party known as the *mandans* gave to another known as the *mandatarius* a commission or order to do something. Having performed such commission, the *mandatarius* was entitled to be reimbursed for

¹⁶ The definition in the principal text serves a descriptive purpose; a more precise definition appears in section IV of this article.

¹⁷ See Hershey, "Letters of Credit," 32 Harv. L. Rev. (1918) 1.

¹⁸ *Id.* at 8 *et. seq.*

¹⁹ See Kozolchyk, *op. cit. supra* n. 1, Ch. 1.

²⁰ See Hershey, *op. cit. supra* n. 17 at 9.

his services.²¹ Between the issuer of the letter of credit and the nominee, the transaction was regarded as one of "opening of credit" (*ouverture de crédit*).²² An interesting comparison noted by Hershey with regard to the contract of opening of credit was that civil law writers defined the opening of credit agreement not as a loan, as in American practice, but as an agreement to lend up to a certain amount. This was attributed by Hershey to the Roman law distinction between the straight loan (*mutuum*) and the agreement to lend up to a certain amount (*pactum de mutuo dando*).²³ Since there was a Roman rule to the effect that a simple promise to make a loan, as a mere pact, was unenforceable (*ex pacto actio non nascitur*), the opening of credit agreement had to adopt the form of a *stipulatio de mutuo dando* to become an actionable promise.²⁴

The net effect of the double set of relations was that between the issuer and addressee of the irrevocable letter of credit the issuer's promise was revocable until the moment the addressee acted on it, as in the case of a *mandatum*, whereas between the issuer of the letter and the nominee the transaction was not revocable because it arose from a *pactum de mutuo dando*. The inapplicability of this category to modern letter of credit transactions is only too apparent. In the first place, each of the terms (nominee, addressee, and holder) could be applied to the party presently labeled "beneficiary." In the second place, even if a specified meaning were ascribed to the term "addressee" and it were applied only to the correspondent bank, its liability would need to be governed by the *mandatum* rules, such as Article 1984 of the French Civil Code. Under this provision, the "nominee," presumably the beneficiary, would not have a right of action on the letter of credit until the addressee (*mandatarius*) had accepted the mandate.²⁵ Conversely, if the seller-beneficiary (instead of the correspondent bank) were regarded as the addressee of the letter of credit, this would strain the facts considerably. There would have to be two sets of agents; first, the advising and confirming banks acting as legal agents for the issuer, and second, the seller-beneficiary, an agent implied in fact, whose liability to the principal (*mandans*) was supported by no legal relation whatever. The lack of a legal relationship between the issuing bank and the beneficiary could easily be seen from the fact that the beneficiary is under no duty to "perform"

²¹ On this topic, see generally, Buckland, *A Manual of Roman Private Law* (London, 1925) 299.

²² For a discussion of the characteristics of the Application Agreement and of the Contract of Opening of Credit (*Apertura de Crédito, Ouverture de Crédit*) see Kozolchik *op. cit. supra* n. 1, Ch. 3.

²³ See Hershey, *op. cit. supra* n. 17 at 7.

²⁴ *Id.* at 6.

²⁵ Article 1984 of the French Civil Code, 2nd par., may be translated as follows: "The contract [of *mandatum*] is not perfected until accepted by the agent."

under the credit; he may disregard the letter of credit without incurring any liability to the bank. In addition, the mandate theory would have to account for the presence of discounting and negotiating banks. Their inclusion in the original three-party transaction would have created such a theoretical bramble bush that the mandate would have lost all practical value as an explanation.

B. Common Law Categories

By comparison, Anglo-American theoretical difficulties arose because of the apparent absence in the letter of credit promise of elements essential to the formation of simple contracts. The case of *Pillans and Rose v. Van Mierop and Hopkins*²⁶ might have served as the starting point for a doctrine calculated to adapt certain promises to the realities of the business world. In this case, the plaintiffs, relying on defendant's affirmative answer to their letter inquiring whether defendants would accept bills drawn by the plaintiffs upon the credit of a certain White, extended credit to White and thereupon drew on the defendants. The defendants, having learned of White's bankruptcy, refused to pay the bills drawn on them by the plaintiffs in accordance with their prior correspondence. In an action for breach of contract, the defendants pleaded that there was no consideration in law for their promise, such consideration as there was being past consideration (this, because the plaintiffs had paid White before they wrote to defendants and, consequently, before they received defendant's promise). Lord Mansfield interpreted the words, "I will give the bill due honor" as an expression of acceptance of the bill, regardless of whether the acceptor had effects of White (who would presently be regarded as the bank's customer) in his hands.²⁷

Intuitively, this great judge disposed of the legalistic obstacle of past consideration to protect the enforceability of a type of mercantile promise that was later to become a commonplace in local and international trade. His major premise was that the *nudum pactum* did not exist in the usage and law of merchants. The necessity of consideration being merely a matter of evidence, if it were otherwise sufficiently proven that a promise was made, the defendants could not retract their undertaking. A few years after the *Pillans* case Lord Mansfield's attempt to do away with consideration in commercial promises was rejected in *Rann v. Hughes*.²⁸ In Professor Davis' words, "Lord Mansfield's novel proposition received a blow from which it has not yet recovered."²⁹

²⁶ (1765) 3 Burr. 1663.

²⁷ *Id.* at 1665.

²⁸ (1779) 1 Doug. 297.

²⁹ See Davis, *op. cit. supra* n. 15 at 7.

In brief, the widespread use of the irrevocable commercial letter of credit after the first world war forced civil law writers to search for a contractual justification other than *mandatum*, and the common law writers to resort to a rationale that would obviate the nullifying effects of lack of consideration.

III. THEORIES BASED UPON "SIMPLE" CONTRACT LAW

The term "simple" contract applies to certain common and civil law contracts whose enforceability is not dependent upon special formalities. The theories hereafter discussed are distinguished from theories that explain the binding effects of contracts under seal, or of instruments subject to certain formalities. The latter group of theories will be examined later.

A. Offer Resulting in a Simple Contract

Hershey set forth, as the orthodox theory on the nature of the commercial letter of credit, that the promise embodied in this instrument is a mere offer that becomes a contract by extension of the credit according to its terms.⁸⁰ Consequently, when the letter of credit was addressed to a specific person (at that time labeled a "special" letter of credit) it could not be accepted by anyone else. The letter of credit addressed generally to whomever may act upon it (at that time labeled a "general" letter of credit) was analogized to an offer to the world at large, which becomes a simple contract as soon as anyone accepts or performs according to its terms, as in the case of an offer of reward. The initial difficulties raised in Anglo-American law by the lack of privity between offeror and addressee were thus avoided and the procedural requirements of the action of special assumpsit were satisfied.

In comparison, the commercial letter of credit has been analogized to a firm or irrevocable offer in some civil law jurisdictions where this type of offer is admissible under the applicable commercial or civil legislation.⁸¹

Despite the sporadic reference to the "mere offer" theory in Anglo-American decisions,⁸² several basic questions remained unanswered by this theory. In the first place, in the absence of proof of an actual

⁸⁰ See Hershey, *op. cit. supra* n. 17 at 38.

⁸¹ See, for example, Varela Morgan, *El Acreditivo* (Santiago de Chile, 1960) 75, setting forth this point of view with regard to Article 99 of the Chilean C.of C.; see also, in connection with Chilean law, Varela y Varela, *Apertura de Crédito y Mutuo* (Santiago, 1959) 42.

⁸² For an English decision influenced by this view see *Urquhart Lindsay v. Eastern Bank* (1922) 1 K.B. 318 at 321; for a United States decision holding the letter of credit to be an offer to be accepted by the seller see *Moss. v. Old Colony Trust Co.*, 246 Mass. 139, 140 N.E. 803 (1923).

consideration flowing from the beneficiary (offeree) to the issuing bank (offeror), why is the latter bound as of the moment of reception of its "irrevocable" offer? In the second place, why should any sign of dissatisfaction with the terms of the letter of credit by the beneficiary not be interpreted as a conditional acceptance or counteroffer and thus be held to have constituted a rejection of the offer in accordance with elementary contract law?³³ In the third place, why should the normal power of revocation of unaccepted offers be deemed as having been waived by the offeror in the absence of consideration therefor?

From a civil law standpoint and especially as it affects Inter-American commercial laws, an additional objection may be directed against this theory. As admitted by some of its civil law proponents, the irrevocable offer necessitates an acceptance by the beneficiary to become binding on the bank-offeror. Admittedly, also, the beneficiary's acceptance may be one implied from his acts subsequent to the reception of the letter of credit; as stated by Varela Morgan in Chile, "Any act that imports the beneficiary's exercise of his right will be tantamount to the tacit acceptance of the offer and will complete the contract" ("*Cualquier hecho que importe el ejercicio del derecho por parte del beneficiario, significará aceptación tácita de la oferta y perfeccionará el contrato*").³⁴ This would imply (a) that the meaning of the word "act" can be easily established, and (b) that after having "acted" by accepting the contract, regardless of its unilateral or bilateral nature, the offeree is bound to carry out his part of the bargain.

The diversity of rules in Inter-American commercial contract law and the facts of the letter of credit transaction stand in the way of these inferences. If by "act" is meant an express or implied acceptance, one would need to cope with several conflicting Inter-American rules on the time of consummation of contracts entered into through the mails or more generally *inter ausentes*. The beneficiary's acts in reliance on the credit, such as ordering or manufacturing the merchandise, may be deemed to perfect his acceptance or it may be validly asserted that the bank is bound as of the moment (a) the beneficiary voiced his acceptance,³⁵ (b) mailed it to his offeror,³⁶ (c)

³³ See *Moss v. Old Colony Trust Co.*, *loc. cit. supra* n. 32.

³⁴ See Varela Morgan *op. cit. supra* n. 31 at 75.

³⁵ For provisions which adhere to the "voicing" of the acceptance rule, see Article 101 of Chilean C.of C. (1865); Article 54 of the Spanish and Cuban C.C. (1885); Article 80 of the Mexican C.of C. (1889); Article 145 of the Ecuadorian C.of C. (1906); *in fine* Article 225 of the Guatemalan C.of C. (1943).

³⁶ Following the "remission" view, see Article 1154 of the Argentine C.C. (1869); Article 188 of the Colombian C.of C. (1870); Article 1086 of the Brazilian C.C. (1916); Article 190 of the Costa Rican C.of C. (1853). Section 64 of the Restatement of the Law of Contracts in the United States provides that ". . . an acceptance is operative and completes the contract as soon as put out of offeree's possession." For contemporary qualifications on the landmark case of *Adams v. Lindsell* (1818) 1 B & A 681, see Hodel, "Communications of Acceptance between Parties at a

the acceptance was received by the offeror, or (d) he became aware of its receipt.³⁷ Obviously, such a diversity of rules impedes certainty at the time of establishment of the credit, which means that the entire credit transaction would be subject to unnecessary uncertainty.

B. A Promise for which Consideration is Supplied by the Buyer, and Third Party Promises

Attempting to overcome the obstacles of the mere offer theory, Professor McCurdy³⁸ distinguished between two situations. One involves a contract of sale entered into between customer and beneficiary in which the buyer promised to procure a letter of credit and the seller's obligation was conditioned on such procurement. In this case, the issuing bank's promise directed to the seller, a designated person, was to pay or to accept and pay drafts drawn by the seller. According to McCurdy, this promise was supported by consideration moving from the buyer, hence giving rise to an immediate obligation. The obligation, however, was conditioned by the beneficiary's tender of specified documents. The other situation was that of the opening bank requesting the issuing or drawee bank to accept or pay beneficiary's draft. The purchase of the draft would be deemed the acceptance of the bank's implied offer in a negotiation credit and was supported by the consideration of buyer's executory promise to the opening bank.³⁹

Professor McCurdy's explanation solved the problem of the revocability of the offer by asserting that the contract was completed the moment the letter of credit was issued. The problem of lack of consideration was obviated by reasoning in the following manner. Since the main test for finding the existence of consideration for most United States courts was the detriment of the promisee, it was necessary only to broaden and modify the common law conception, as originally found in the action of deceit, in order to find consideration

Distance," 15 Cornell L. Q. (1930) 273. For cases conceptualizing on the nature of an acceptance issued by wire, see *Cheseborough v. Western Union Tel. Co.*, 76 Misc. 516, 135 N. Y. S. 583 (1912), wherein the acceptance was deemed effective as of the moment it was sent; for an English case involving an acceptance by teletype, see *Entores Ltd. v. Miles Far-East Corp.* [1955] 2 Q.B. 327, and comment thereon in 72 L.Q.R. (1956) 10.

³⁷ See the following provisions adhering to the moment of receipt rule: Article 84 of the C.of C. of Nicaragua (1916); Article 210, C.of C. of Panama (1916); Article 204 of the C.of C. of Uruguay (1866); requiring the offeror's knowledge of the acceptance, see Article 115 of the C.of C. of Venezuela (1919). For an evaluation of the different views as they impinge on the Latin-American law of sales, see Barrera-Graf, *Estudios de Derecho Mercantil* (Mexico, 1958) 5 *et seq.*; more generally, see Cueto Rua, "Administrative, Civil and Commercial Contracts in Latin-American Law," 26 Fordham L. Rev. (1957) 15.

³⁸ See McCurdy, "Commercial Letters of Credit," 35 Harv. L. Rev. (1921) 539 at 574.

³⁹ *Id.*

in a situation where the detriment is to one other than the promisee. In the hypothetical situation where A makes a promise to B in exchange for B's promise, not to A but to C, or to both A and C, A's promise was said to be supported by valuable consideration. A's promise was distinguished from that in a third-party beneficiary situation because "the reason why a beneficiary should not be able to sue is not that he is a volunteer. The reason is that he is not a party to the contract."⁴⁰

Assuming, *ex arguendo*, that the problems of revocability and lack of consideration were solved by McCurdy's explanation, it does not follow that the line of separation between a promise by the bank with consideration moving from the buyer and a third-party promise was clearly drawn. This is an important distinction because the answer to the question of what are the bank's admissible defenses against the beneficiary and third parties depends upon the characterization of the bank's promise. If, as it seems, the party referred to as "C" in McCurdy's hypothetical situation is the same party described by Section 133B of the United States Restatement of the Law of Contracts as a "third-party creditor beneficiary,"⁴¹ then the bank's promise is subject to underlying equities. A's supervening insolvency or his fraud, as well as the lack, insufficiency, or inadequacy of considerations affecting the underlying agreement may be raised as defenses by B against C. As stated in the United States case of *Adams v. Republic Steel Corp.*,⁴² "If he (the third-party creditor beneficiary) claims the benefits, he also assumes the burdens. . ." Consequently, the third-party promise theory would support the issuing bank's allegation that its irrevocable letter of credit is not binding because it had not received value from the buyer or the seller.⁴³

Another difficulty with the third-party promise theory in Anglo-American law is that British courts still reject the *jus quaesitum tertio* as a valid ground for bringing an action on contract. As stated by Lord Haldane in *Dunlop Pneumatic Tire Co. v. Selfridge*, "In the law of England certain principles are fundamental. One is that only a person who is a party to a contract can sue on it. Our law knows nothing of a *jus quaesitum tertio* arising by way of contract."⁴⁴

Professor Bartholomew has recently pointed out that the rule in the *Dunlop* case is no longer regarded as the prevailing rule on the

⁴⁰ See McCurdy, *op. cit. supra* n. 38 at 575.

⁴¹ Section 133 of the Restatement of the Law of Contracts in the United States reads as follows ". . . a creditor beneficiary if no purpose to make a gift appears from the terms of the promise, in view of the accompanying circumstances and performance of the promise, will satisfy an actual or supposed or asserted duty of the promisee to the beneficiary. . ."

⁴² 254 Ala. 620, 49 So. 2d 214 at 217 (1914).

⁴³ In this connection, see the defenses raised in *Viotor v. National City Bank*, 200 App. Div. 557, 193 N.Y. Supp. 868 (1922).

⁴⁴ [1915] A.C. 847.

recognition of third-party promises.⁴⁵ His historical analysis reveals that the difficulties encountered in English law with regard to recognizing third-party rights have been formulated in two different ways: (1) that consideration has not moved from the promisee; (2) that the plaintiff is not a party to the contract. Bartholomew concluded that the English common law does not possess a doctrine of privity that is independent of that of consideration. This he proved by pointing out that prior to the time of adoption of the doctrine of consideration in its present form, third-party promises were regarded as enforceable even at the instance of a third party. The *Dunlop* decision,⁴⁶ he submitted, was based essentially upon the concept of consideration rather than upon the doctrine of privity. The only obstacle in admitting the *jus quaesitum tertio* in English law, therefore, is the need for proof of consideration flowing from the promisee. In Professor Bartholomew's words, "There is no further obstacle based on lack of privity."⁴⁷

Professor Bartholomew's suggested analogy between the letter of credit promise and the third-party beneficiary promise is of little value as an explanation of the abstract nature of the former. Indeed, the same decision advanced by Bartholomew in favor of the present recognition of the *jus quaesitum tertio*, *Smith and Snipes Hall Farm Ltd. v. River Douglas Catchment Board*,⁴⁸ warns that the third-party beneficiary's rights would be "subject always, of course, to any defences that may be open on the merits." These words by Judge Denning obviously leave the door open for the bank's raising defenses that arise from the underlying agreements.

Civil law writers have also attempted to go beyond the shortcomings in the "mere offer" theory and have proposed third-party promise theories in terms similar to those used in the Anglo-American legal world by McCurdy and Bartholomew. The issuing bank's promise in an irrevocable letter of credit has been compared to a "promise of performance by a third party" (*promesa del hecho de un tercero*),⁴⁹ or to a straight third-party promise.⁵⁰

⁴⁵ See Bartholomew, "Relations between Banker and Seller under Irrevocable Letters of Credit," 5 McGill L.J. (1959) 89 at 95 *et seq.*

⁴⁶ *Loc. cit. supra* n. 44.

⁴⁷ See Bartholomew, *op. cit. supra* n. 45 at 95.

⁴⁸ [1949] 2 K.B. 500 at 515.

⁴⁹ See Varela Morgan of *cit. supra* n. 31 at 71 and civil law writers cited therein. In a well-reasoned and documented study by Thayer, "Irrevocable Credits in International Commerce," 36 Col. L. Rev. (1936) 1031 at 1050, he drew attention to German attempts to explain the nature of the irrevocable letter of credit by resort to the concept of *Anweisung* first and *Schuldversprechen* later. The *Anweisung* explains the operation of the *Kreditbrief* (old letter of credit) but not of the modern irrevocable letter of credit (*Akkreditiv*). As described in Article 783 of the German Bürgerliches Gesetzbuch (1900), the *Anweisung* consists of the remittance of a document whereby the recipient (third party) is authorized to receive payment in money, securities, or other fungible objects, from the payor

In Latin-American codes the enforceability of a promise of performance made by a party other than the original debtor requires an express or implied ratification by the creditor, presumably the beneficiary.⁵¹ In addition, the terms of the original obligation, presumably the documentary sale, are deemed incorporated in the assumed promise and the original debtor is thereafter liberated from his previous obligation.⁵² These features disqualify the analogy between the promise of performance by a third party and the promise in the irrevocable letter of credit.

The straight third-party promise (*estipulación por otro*) is a valid promise under most Latin-American civil codes.⁵³ In attempting to fit the irrevocable letter of credit within the mold of a third-party promise in the civil law and especially in Latin-American jurisdictions, one finds, however, that, similarly to the rules in Anglo-American cases, the code provisions set forth an obligation that remains subject to previous equities. A failure by the stipulator (buyer) to perform his obligation to the promisor (bank) is a valid defense against the third-

named in the instrument; but as stated in Article 784 of the BGB, the recipient (assignee) could not enforce his right against the delegee-payor unless the latter accepted such an obligation. The *Anweisung* mechanism probably influenced another civil law theory, the "multi-lateral transaction." The multilateral transaction (*negocio jurídico pluri-lateral*) is defined as one where more than two parties having different and conflicting interests bring about a single result achieved through successive agreements. See for example, Messineo, "El Negocio Jurídico Pluri-lateral," Part 72, 13 Jus. 520 (Mexico 1941). Yet, criticism to the delegation and *Anweisung* analogies is equally applicable to this view, the necessity of the beneficiary's (third party) acceptance, and the corresponding contractual nature of the undertaking are foreign to letter of credit law. Regarded as a *Schuldversprechen*, the letter of credit was an abstract promise in writing whose cause was presumed and thus the burden of proving the lack of cause was shifted to the defaulting promisor. However, as pointed out by Thayer (*loc. cit.* n. 14, at 1052) such a proof of absence or lack of consideration would void the *Schuldversprechen*. For a detailed discussion of the different theories advanced in Germany until 1925, see Sieckman, *Das Akkreditiv*, (1925) at 17 *et seq.* For a recent German decision that still uses the *Anweisung* rationale, see Bundesgerichtsof, Urteil vom 23, 3, 1955, reported in *Der Betriebs-Berater*, May 30, 1955, case n. 862 p. 462 at 463.

⁵⁰ See Pierre Marais, *Des ouvertures en banque de crédits confirmés et non confirmés* (Paris 1925) 25 and authorities cited therein. See also for more recent French and Belgian decisions following the same line of thought, Stoufflet *op. cit. supra* n. 15 at 374 n. 1.

⁵¹ See, for example, Article 1450 of the Chilean C.C. (1855).

⁵² For a commentary on the effects of Article 1450 of the Chilean C.C. as applied to the letter of credit transaction, see Varela Morgan *op. cit. supra* n. 31 at 71.

⁵³ The model provisions were the French Civil Code, Articles 1119 and 1121, which provide that in general one may not stipulate in one's own name except for one's own self, but allow the stipulation for the benefit of a third person when such was the condition of the stipulation made for one's own benefit or as a result of a donation favoring another. Accordingly, see, among others, Article 1257 of the Cuban C.C.; Articles 503-505 of the Argentine C.C.; Articles 1098-1100 of the Brazilian C.C.; compare with Article 1164 of the Venezuelan C.C. and Article 1449 of the Chilean C.C.

party beneficiary's claim, regardless of whether the beneficiary is the seller, his assignee, or the purchaser of his draft.⁵⁴ In addition, under some codes the stipulation in favor of a third party is an essentially revocable promise until the moment the beneficiary has clearly manifested his intention to rely thereon.⁵⁵ Clearly, then, the third-party promise theory is an inadequate explanation of the validity and effects of the irrevocable letter of credit.

C. A "Special" or "Implied" Agency, Novation, and a Delegation of Debt

As originally stated by Professor Gutteridge⁵⁶ and now restated by Maurice Megrah,⁵⁷ when a buyer, at the instance of a seller, procures the issuance of an irrevocable credit in favor of the seller, the former may be deemed to have acted as the latter's agent for this purpose. A new contract comes into existence, which is ancillary to the contract of sale. This contract contains a promise by the banker to pay the price to the seller, in consideration of a promise by the seller to place him in possession of the documents of title to the goods. Assuredly, this view takes into consideration the fact that payment by a third party is sought by the seller not only to obviate the possibility of buyer's insolvency but also of buyer's chicanery in delaying or defeating payment.⁵⁸ Thus an "independent promise of payment" by a party of known solvency comes into existence.

The "independence" of the promise of payment, as well as the impossibility of resort to chicanery, can hardly be said to have been accomplished if the buyer acting as the seller's implied agent could defeat the latter's right to payment upon commission of a tort. For example, if the buyer, deemed as seller's agent, fraudulently misrepresented the state of his solvency to the issuing bank, there would be no reason to forbid the bank's raising misrepresentation as a defense against the claim of the buyer's principal. Hence, in Professor Davis' words, the agency view does not "obviate, but rather encourages resort to chicanery."⁵⁹ Furthermore, Gutteridge's and Megrah's assertion that there is a binding contract between the banker and the seller once the credit is communicated⁶⁰ ignores the fact that the seller's liability to the bank is not necessarily a contractual one. As stated

⁵⁴ On the possibility of the bank raising the stipulator's defenses under Article 1449 of the Chilean C.C., see Varela Morgan *op. cit. supra* n. 31 at 72.

⁵⁵ See, for example, Article 1257 of the Cuban C.C.

⁵⁶ See Gutteridge, *Bankers Commercial Credits* (London, 1932) 24 *et seq.*

⁵⁷ See Gutteridge and Megrah *op. cit. supra* n. 15 at 21.

⁵⁸ *Id.* at 22.

⁵⁹ See Davis, *op. cit. supra* n. 15 at 63; see also McCurdy, *op. cit. supra* n. 38 at 583.

⁶⁰ See Gutteridge and Megrah *op. cit. supra* n. 15 at 21.

previously, such a liability is nonexistent when the seller-beneficiary decides to disregard the issuance, and it arises only when the bank mistakenly, or as a victim of beneficiary's fraud, pays the credit. Yet, even in cases of mistake or fraud, the bank's right of recourse against beneficiary, when granted, is not necessarily predicated upon a contractual relationship.⁶¹

Conceivably the letter of credit could be regarded as a bilateral contract between the issuing bank and the buyer, coupled with a simultaneous assignment by the buyer to the seller. However, the practice of letters of credit that are addressed to the seller-beneficiary and that are sent to him directly or through an intermediary bank strains the factual application of this view. Furthermore, any view that confers upon the beneficiary only an equitable or derivative right must be discarded because it is inconsistent with the nature of the beneficiary's right. As pointed out by Professor McCurdy, any defense that the bank may have against the buyer prior to notice of the assignment could be set up against the seller.⁶²

It should also be noted that the issuance of an irrevocable letter of credit does not operate a novation in the buyer-seller relationship. The buyer continues to be liable under the terms of the sale or any other underlying agreement, and the letter of credit, although a means of payment, cannot be regarded as "absolute payment."⁶³

The difficulties with the agency, assignment, and novation views have prompted a significant number of civil law writers in Europe and Latin America to adopt the view that the issuance of an irrevocable letter of credit constitutes an "imperfect delegation of buyer's debt."⁶⁴

In classical Roman law, the delegation of a debt was regarded as a species of novation whereby the debtor absolved himself of liability by having a third party assume the debt, in agreement with the creditor

⁶¹ On the problems of recourse against the beneficiary, see Kozolchik *op. cit. supra* n. 1, Ch. 22.

⁶² An example of one such defense is fraud in the inception of the instrument.

⁶³ For a United States decision where the mere issuance of a letter of credit was not deemed absolute payment to the beneficiary once the issuing bank became insolvent, see *Greenough v. Munroe*, 46 F.2d 537, 53 F.2d 362 at 364 (C.A.2d 1931).

⁶⁴ See, for example, Asquini, "Pagamenti Mediante Rimborso di Banca," 20 Riv. Dir. Comm. (1922) 225 *et seq.*; Hamel, note in D.P. 1926. 1.201, especially at 203; Latin-American jurists following this view form an impressive list, see Satanowsky, *Estudios de Derecho Comercial* (Tomo 2, Buenos Aires, 1950) 14; Torres, *El Credito Documentado*, (Buenos Aires, 1942) 39; Varela Morgan *op. cit. supra* n. 31 at 75 and 76; Barrera Graf *op. cit. supra* n. 37 at 148. In addition, there have been a number of European and Latin-American decisions adopting the imperfect delegation theory. See, for example, for French decisions, D.P. 1926. 1.201 at 203. For a Belgian decision, see Bruxelles, C.A. 28 juin 1922, reported in 1922 *Belgique Judiciaire*. For Argentine decisions see Torres, *op. cit.* at 41.

or with another party designated by the latter.⁶⁵ In the nineteenth century a few civil law writers distinguished between the "perfect delegation" (as just described) and a variety known as "imperfect delegation," derived from the Roman notion of *adpromissio*. *Adpromissores* were those accessory debtors on the side of the principal who, either as *sponsores*, *fideipromissores*, or *fideiussores*, could be sued by the creditor without suing the principal first.⁶⁶

Professor Asquini in Italy and Professor Hamel in France, among other contemporary letter of credit writers, perceived the analogy between a variety of the Roman *adpromissio* and the irrevocable promise of one other than the principal debtor, as found in the commercial letter of credit. These authors described the "imperfect delegation" of a debt as a transaction whereby the buyer as an assignor stipulated the insertion of a third party, the bank, as delegee. The imperfect delegation, therefore, neither results in a suretyship nor in a joint and several liability situation. It is not a suretyship because it is intended as a primary obligation of the delegee bank, not ancillary or subordinated to the validity of the principal obligation as it occurs with suretyship agreements.⁶⁷ It is not an instance of joint and several liability, either, because each debtor "is subject to a different cause of action, only interrelated by the same subject matter; upon payment by one, the other is liberated."⁶⁸ The imperfect delegation theory has explained the separation between the rights and duties that emerge from the letter of credit promise by the bank and those that arise from the underlying transactions (abstraction). Where it has failed is in supplying an explanation for the rules on the time of establishment of the credit.

The certainty of the promise in an irrevocable letter of credit may be said to arise at the moment the beneficiary learns of the bank's willingness to issue the credit, or at the moment of issuance, communication, or reception of the credit instrument. Depending on which moment is chosen, the certainty of the promise will be deemed established. Of the four possible moments, the time of receipt of the credit instrument by the beneficiary is the one most consistent with banking needs and practice. Frequently upon approving the customer's application agreement or upon deciding to issue a letter of credit, a bank may learn some unpleasant facts about the customer's or the benefi-

⁶⁵ On the *delegatio debitoris* and *novatio* in Roman Law, see generally, Buckland, *Manual of Roman Private Law* (London, 1925) 344.

⁶⁶ See Arangio Ruiz, *Istituzioni di Diritto Romano* (Rome, 1947) 403 and also, Buckland, *Roman Law* (2nd ed. London, 1932) 445 *et seq.*

⁶⁷ See Asquini and Hamel, *loc. cit. supra* n. 64. For a discussion of the similarities and differences with suretyship agreements in United States law, see Campbell, "Guaranties and Suretyship Aspects of Letters of Credit," 85 U.Pa. L. Rev. (1936-37) 191.

⁶⁸ See Asquini, *op. cit. supra* n. 64 at 239 *et seq.*

ciary's solvency and may then prefer not to issue the credit or, if possible, may wish to recall one already issued but not yet received by the beneficiary.⁶⁹ Under the imperfect delegation theory, the beneficiary must express his consent as creditor before the delegation of the debt could be effective and the credit be deemed as established. If the consent were expressly given, it would be pertinent to inquire, as in the agency theory, what is the beneficiary's obligation? If, on the other hand, the beneficiary's consent were implied in fact, the situation is similar to that already examined and discarded under the "mere offer" theory.

IV. THEORIES BASED UPON RULES ON MERCANTILE SPECIALTIES

The use of the expression "specialty" as applied to mercantile instruments probably goes as far back in the Anglo-American world as Lord Holt's decision in *Cramlington v. Evans*.⁷⁰ It was used at that time to denote exceptions to the traditional rules on common law simple-contract obligations. These exceptions were justified by proof of the customs of merchants. Thus, the bill of exchange first, the promissory note later, and eventually the check emerged as mercantile specialties in the common law world.

In comparison, the separation between civil and commercial codes which characterized early nineteenth century European codification, presupposed the separate treatment of negotiable instruments as part of the commercial codes. The autonomous nature of the rules governing the issuance and circulation of these instruments was, in a sense, taken for granted. Hence a special variety of the innominate contract of third century Roman law, *cambium*, was in time transformed into the bill of exchange; a commercial instrument so easily transferable and convertible into money that it was equated to money itself by the proponents of the *Wertpapiere* theory.⁷¹

Both major legal systems have, therefore, allowed the creation and development of instruments which, although partaking of the nature of existing institutions, were, as individual entities, not equal to their component parts. The irrevocable letter of credit may be regarded as one such instrument; it partakes of the nature of a contractual offer as much as it resembles an agency, third-party promise, delegation of debt, or suretyship arrangement, but under the influence of commercial practices these contractual ingredients have been mixed so

⁶⁹ For a discussion on the different rules on the time of establishment of the letter of credit promise, see Kozolchuk *op. cit. supra* n. 1, Ch. 18.

⁷⁰ (1689) 1 Show 5, Holt K.B. 108, 2 Vent. 30, cit. by Aigler and Steinheimer, *Cases on Bills and Notes* (St. Paul, Minn., 1962) 26.

⁷¹ See, for example, Einert's influential treatise, *Das Wechselrecht* (Leipzig, 1839). For later versions of the *Wertpapier* theory, see Cossack, *Lehrbuch des Handelsrechts* (7th edition, 1909) at section 79.

thoroughly that the end product looks indeed *sui generis*. As a *sui generis* transaction it is still necessary to determine the reason for its binding effects.

A. *The Acceptance in Advance*

Unquestionably there is a strong kinship between a promise to accept a bill of exchange incorporated either in the draft or in a separate document, and the promise embodied in the irrevocable letter of credit. The drawee acceptor of a bill of exchange promises to pay money to the payee named in the bill. Similarly, under the commercial letter of credit the bank promises to pay money to the drawer of the draft or of the demand for payment, or if no draft or demand is required, to the presenter of the letter of credit. This analogy has prompted the conclusion that the commercial letter of credit is like a trade acceptance issued by the bank in advance of the drawing of the draft.

The task of tracing the evolution of trade acceptances in the common law from the time of Lord Mansfield to the first quarter of the twentieth century was undertaken by Dr. Finkelstein.⁷² He concluded that the cases involving actions on the promise to accept, whether virtual or extrinsic, revealed that questions of reliance and consideration were two aspects of the same problem.⁷³ Where there was reliance, courts, in their attempt to fit the action on the credit-promise into the usual contract forms, were likely to find consideration and would mention the fact of reliance, the forbearance to sue, and the giving of value. The real basis for this attitude was the courts' recognition of widespread commercial customs such as those found in the field of letters of credit.

Since merchants regarded the letter of credit not as a representation but as a promise, the recognition of the letter of credit as a mercantile specialty was, according to Finkelstein, amply supported by the close analogy between the liability of a bank as issuer of the credit instrument and as an acceptor of a bill of exchange.⁷⁴ This analogy, incidentally, had already been perceived in France by Dean Rousseau. Commenting on two French decisions rendered in 1922 and 1926, this author suggested the convenience of treating the letter of credit as an "acceptance issued in advance" ("*une acceptation anticipée*").⁷⁵

Several objections have been raised in the United States against

⁷² See Finkelstein *op. cit. supra* n. 15 at 1-144, see also Trimble, "The Law Merchant and the Letter of Credit," 61 Harv. L. Rev. (1948) 981.

⁷³ See Finkelstein *op. cit. supra* n. 15 at 289.

⁷⁴ In connection with this view, see also, Second National Bank v. Samuel & Sons, 12 F.2d 963 at 968, 53 A.L.R. 49 (C.C.A.2d 1926).

⁷⁵ Cass. Req., January 26, 1926, Banque de Marseille c. Delamare *et al.*, S.1926. 1.353, Note Henri Rousseau.

the unqualified admission of the "mercantile specialty" view as tentatively suggested by Hershey and fully elaborated by Finkelstein. In the first place, the close analogy found by the proponents of this view between the position of the promisor under a commercial letter of credit and under a bill of exchange is clouded by the impossibility of regarding the bank's promise to pay or accept as a negotiable undertaking. In effect, the Negotiable Instruments Law in Section 135 provides that ". . . an *unconditional* promise in writing to accept a bill before it is drawn is deemed an actual acceptance in favor of every person who upon the faith thereof receives the bill for value." The bank's undertaking in an irrevocable letter of credit, it is argued, may not be considered as an "unconditional promise in writing" since it is conditioned upon the presentation of documents or on the occurrence or non-occurrence of certain events.⁷⁶

In the second place, it has been objected that in contrast with negotiable instruments, the letter of credit itself at times need not be shown to the drawee.⁷⁷ It suffices that he or his predecessor in title is informed of the contents of the credit and on the faith thereon receives the bill for value. A third objection was raised on behalf of the inevitable presence of consideration: "the tendency of the law is toward requiring consideration, not away from it, even bills and notes require consideration as between the immediate parties; the effect of the law merchant on the common law is to make bills and notes negotiable but not to make promises binding without consideration."⁷⁸

Rousseau's theory has been criticized in France on the basis that the "anticipated acceptance" of a bill of exchange would only apply to the case of a letter of credit calling for a bill of exchange to be drawn. Thus, the nature of letters of credit that are payable upon presentation of the letter of advice or notification would remain unexplained.⁷⁹ In addition, the more substantive objection was raised that since in French law the bank's promise to the purchaser of beneficiary's unaccepted draft is, more often than not, subject to the same defenses that may be raised against the beneficiary, the notion of an anticipated acceptance would run contrary to existing commercial letter of credit laws.⁸⁰ Finally, the adoption in France and other civil law jurisdictions of the Geneva Convention on bills of exchange, which provides that the acceptance must be found in the text of the bill of exchange,

⁷⁶ For the application of the concept of condition as used in Roman law, civil law, and common law to contemporary letter of credit law, see Kozolchyk, *op. cit. supra* n. 1, Ch. 18.

⁷⁷ See Campbell, *op. cit. supra* n. 67 at 191.

⁷⁸ See McCurdy, *op. cit. supra* n. 38 at 563-566.

⁷⁹ See Stoufflet *op. cit. supra* n. 15 at 388 *et seq.*

⁸⁰ *Id.*

contributes an important ground in these countries for the rejection of the anticipated acceptance view.⁸¹

B. *A New Type of Mercantile Currency*

It is here submitted that the legal nature of bills of exchange as well as of commercial letters of credit can best be understood if they are viewed in the light of formal legal transactions. The enforceability of these instruments can be traced to the use of rigorously formal institutions at different stages of the development of the civil or common law. Thus, while the German law of the eighteenth century knew already of the formal bill (*formelle Wechsel*), an English seventeenth century judge had compared the bill of exchange to a formal contract under seal.⁸²

Underlying the use of formal and abstract promises is a fundamental economic need—facilitation of the flow of goods and services. As an answer to some of the problems posed by the circulation of property, in a century characterized by massive industrial production and by the shrinkage of distances, commercial law has provided an instrument that serves both as a means of payment and of credit. At times the “liquidity” of this instrument is such that it can provide its holder with local currency more quickly than if he were to exchange weak or unstable foreign currency. In its prevailing use, however, the letter of credit transaction sacrifices a maximum of liquidity for a modicum of certainty, mutually enjoyed by the parties to the underlying transaction. In other words, the primary function of the letter of credit is not to become the international means of payment; it is to assure the parties of formal compliance with the terms stated in the instrument. The speed with which it may be converted to cash is reduced while the party of known solvency is given the opportunity to perform his duty of verification. In this context, Einert’s observation, ascribing to the early nineteenth century German bill of exchange the nature of *Wertpapiere* or of a “moneyed” instrument, is particularly applicable to the contemporary letter of credit.⁸³

As a new type of mercantile currency, the commercial letter of credit is not the legal equivalent of money. Money, as aptly described by Professor Nussbaum, performs a threefold function: it is (1) the common medium of exchange, (2) a common denominator of value, and (3) the standard of deferred payments. From a legal standpoint,

⁸¹ See Article 25 of the Geneva Convention of June 7, 1930, on bills of exchange and promissory notes, and in connection therewith, see Article 122 of the French C.of C.

⁸² See Holt C. J.’s opinion in *Clerke v. Martin* (1702) 2 Ld.Raym. at 578 (cit. by Holdsworth 8, *A History of English Law* at 168 (1920)).

⁸³ See Einert, *op. cit. supra* n. 71 at 102.

money is a physical and fungible object that is given or accepted as a "fraction, equivalent, or multiple of an ideal unit."⁸⁴ The commercial letter of credit, while always stating the amount of the obligation in relation to a monetary unit, is not in itself the fraction, multiple, or equivalent of such a unit. In the first place, it definitely requires a certain compliance with its terms, thus making it less abstract an instrument than money, whose "beneficiary" may be any holder, including a thief. In the second place, its circulation is much more restricted than that of currency since it does not constitute legal tender and it is neither freely transferable nor negotiable.⁸⁵ Consequently, the negotiating bank or the bona fide purchaser of a letter of credit draft or acceptance must take into consideration factors such as the issuer's solvency as well as the time and place of payment, and in addition, determine whether it is a straight or negotiation credit. Finally, one may agree with Professor Stoufflet's observation concerning the different effects of the destruction of money as compared to the destruction of the letter of credit instrument. In the former case, the physical disappearance of the object entails the inability to exercise the right of payment or convertibility; in the latter case, more frequently than not, a duplicate instrument will be issued.⁸⁶

Yet, the fact that from a technical legal standpoint the letter of credit is not the equivalent of money should not deter the perception of their strikingly similar economic functions. Indeed, as pointed out by a reviewer of Nussbaum's classic work, *Money in the Law*,⁸⁷ there are different kinds of objects with varying degrees of "moneyness" along a continuous scale of economic value. For an economist it would seem artificial to distinguish on a qualitative basis of moneyness between a commercial letter of credit in Swiss Francs issued by a reputable Swiss bank and Swiss Francs themselves. He might find a difference in the degree of moneyness, but not in its intrinsic monetary quality, both being forms of money. To a jurist, however, as pointed out by Nussbaum, it is important to establish the distinction because many important legal consequences flow from the proper characterization of the term, whether it is in the context of determining what is a pecuniary obligation or what is a monetary crime.

The commercial letter of credit has in common with money the fact that there is no direct agreement between the holder and the issuer of currency, since there is no contract between the issuing and confirming

⁸⁴ See Nussbaum, *Derecho Monetario Nacional e Internacional* (Buenos Aires, 1954) 19.

⁸⁵ For a discussion of the transfer and negotiation of the commercial letter of credit see Kozolchyk, *op. cit. supra* n. 1, Chapters 21 and 22.

⁸⁶ See Stoufflet *op. cit. supra* n. 15 at 392 *et seq.*

⁸⁷ See the review to Nussbaum's *Money in the Law* in 7 *U. of Chicago L. Rev.* (1940) 195 at 196.

bank and the beneficiary. In both cases, the issuance of a "moneyed" instrument has taken place as a result of a social consensus that delegated the function of creating these instruments to either public or private entities. In addition, in both cases the form in which the promise is couched plays a predominant role—in the case of money, for reasons not yet clear even to the keenest legal minds,⁸⁸ in the case of the commercial letter of credit, due to the mercantile habit of relying on paper and ink, or on writings obligatory, in order to evidence and record obligations.

The irrevocable letter of credit can therefore be said to be a mercantile specialty embodying a formal monetary promise. The degree of moneyness of this promise depends on factors such as the type of letter of credit, the stage of the transaction, the type of defense raised, and so on. Accordingly, the commercial letter of credit may be defined as *a formal and certain promise embodying an abstract obligation to accept a draft or demand for payment upon literal compliance with its terms*. Thus defined, the commercial letter of credit does not belong to the realm of simple contract law but squarely within the field of negotiable instruments, despite the fact that its promise may not necessarily meet the requirements of unconditionality as specified in certain jurisdictions.⁸⁹

Very little information is available on the meaning of the "unconditionality" requirement of the Negotiable Instruments Law in the United States. While the reason for the rule was apparently a desire to preserve the definiteness or certainty of the negotiable promise at the time of issuance,⁹⁰ the silence of the Negotiable Instruments Law on the meaning of a conditional promise may lead to three or possibly more interpretations of the term: (1) condition as defined in the law of simple contracts, including such terms as precedent, subsequent, implied, constructive, etc., (2) condition as expressly stated in the instrument, i.e. "upon the following *conditions*," coupled with a general presumption of unconditionality, and (3) a new meaning for condition as derived from the entire context of the Negotiable Instruments Law.⁹¹

The Negotiable Instruments Law, in contrast with the English Bills of Exchange Act, adopted a *numerus clausus* approach with regard

⁸⁸ See Savigny, 1 *Obligationenrecht*, (1851) 406-408 cit. by Nussbaum *op. cit. supra* n. 84 at 13. Since Savigny's time a number of explanations have been advanced for the form and validity of currency. Nussbaum enumerates the following: the metallistic, state function, medium of exchange, ideal unit, and nominalistic theories. See Nussbaum at 2-25.

⁸⁹ See, for example, section 1 of the United States Negotiable Instruments Law.

⁹⁰ See, for example, Crawford's Annotated Negotiable Instrument Law (New York, 1918) 11 *et seq.*, where nothing appears on the meaning of conditionality. This source is particularly relevant inasmuch as Crawford drafted the Negotiable Instruments Law; see also, Britton, Bills and Notes (St. Paul, Minn., 1962) 34.

⁹¹ See Britton, *loc. cit. supra* n. 90.

to admissible negotiable instruments. Indeed, the word "must" was used in order to qualify the elements of a negotiable instrument.⁹² Thus, United States courts were forced to resort to the interpretations listed above under (2) and (3) in order to bestow negotiability upon "new" instruments which apparently would not have qualified under the simple contract law test as unconditional promises to pay a sum certain.

Whether the commercial letter of credit will ever need to attain the same degree of negotiability already reached by other specialties of recent vintage, such as certificates of deposit, government and municipal bonds, etc., is very much open to question.⁹³ What cannot be disputed is that the trend to regard the commercial letter of credit as a mercantile specialty and thus belonging to the realm of negotiable instruments law has by now been perceived by courts and legislatures alike.⁹⁴

In 1926, a United States court was asked to decide whether a bank that had discounted a seller's draft drawn under an irrevocable credit which, due to delay in the mail, had not been presented to the issuing

⁹² See Article 1 of the United States Negotiable Instruments Law and in connection therewith see Cardozo's opinion in *Directors of Manhattan Co. v. Morgan, et al.*, 242 N.Y. 38, 150 N.E. 594 at 597, (1926) wherein this liberal-minded judge was forced to conclude as follows: "We are satisfied, however, that the law merchant is without capacity to make instruments negotiable against the express provisions of a statute which says they are not negotiable." The United States rule contrasts with the one under the English Bill of Exchange Act. Under this statute, it is possible for the courts to grant negotiable status to new types of instruments whenever the commercial practices demand such treatments. On this point see Aigler and Steinheimer, *op. cit. supra* n. 70 at 28. It is interesting to note the attitude adopted in recent times by Latin-American legislatures with regard to the requisite of unconditionality. Article 5 of the *Ley General de Títulos y Operaciones de Crédito* (1932) (L.T.O.C.) in Mexico defines credit instruments as those necessary to exercise the literal right incorporated in the instrument; the same approach is found in Article 449 of the Honduran C.of C. (1950). Yet, when enumerating the requirements of specific instruments such as the bill of exchange, the Mexican legislature required an unconditional promise to pay a sum certain. See, for example, Article 76 (III) of the Mexican L.T.O.C.

⁹³ See with regard to the characterization of municipal bonds as negotiable instruments, *Keck v. Yakima Sav. Loan Ass'n*, 160 Wash. 430, 295 P. 483 (1931), *Comm'rs of Cleveland County v. Citizens Nat'l Bank*, 157 N.C. 191, 72 S.E. 996 (1911); on certificates of deposit, see *Nelson v. Citizen's Bank*, 191 App. Div. 19, 180 N.Y.S. 747 (1929) *cit. by* Aigler and Steinheimer, *op. cit. supra* n. 70 at 30. See also Professor Aigler's excellent article, "Conditions in Bills and Notes," 26 *Mich. L. Rev.* (1928) 471, where at 501 he concludes, "Let the act be amended so as to make it read that promise or order is conditional only by virtue of the express terms contained in the instrument itself or in such other papers as are expressly made a part thereof."

⁹⁴ See the decision in *Second National Bank v. Samuel & Sons*, 12 F.2d 963 at 965-66 (C.C.A2d, 1926), see also Section 5-105 of the U.C.C. abolishing the need for consideration for establishing or modifying a credit. This trend was forecast by Finkelstein in 1930 when he finished his book by concluding, "Its formal recognition as a mercantile specialty cannot long be delayed." See Finkelstein *op. cit. supra* n. 15 at 295.

bank until one day after the expiration date of the credit, had any rights against the customer.⁹⁵ Faced with the customer's refusal to consent to late payment, the issuing bank refused to honor the draft. The court dealt with the letter of credit draft in the same manner as it would have considered the question had it arisen under an ordinary, not letter of credit, draft. The question was asked whether presentment of a bill of exchange might not in some cases be sufficient to charge the party secondarily liable under the instrument, although such presentation was made after the date of maturity. If so, why not apply the same rule to drafts emerging from a letter of credit? Especially if, as the court stated, "It (the letter of credit) partakes of the nature of a negotiable instrument."⁹⁶

The text of the Uniform Commercial Code has added strength to this court's opinion. Section 5-105 of the U.C.C., in doing away with the necessity of proving consideration for the issuance or modification of a credit, removed one of the traditional objections to admitting the letter of credit as a mercantile specialty.⁹⁷ It is also highly significant that the only two statutory sources of commercial letter of credit law in Latin America, the Mexican *Ley General de Títulos y Operaciones de Crédito* (L.T.O.C., 1932) and the Honduran Commercial Code of 1950, placed the commercial letter of credit squarely within the realm of negotiable instruments and banking transactions law.⁹⁸

V. CONCLUSIONS

The present stage of letter of credit law requires more than a mere awareness of its basic features. At the end of the first world war it was important to establish the distinction between the "old" buyer's or traveler's letter of credit and the "new" commercial or documentary letter of credit to be able to bestow certainty and enforceability on the promise by the issuing bank. In the ensuing years it became equally important to isolate the effects of the irrevocable letter of credit from those produced by revocable credits and authorities to purchase and pay. At the same time, the requirements of form as well

⁹⁵ See the Second National Bank case *cit. supra* n. 94.

⁹⁶ *Id.* at 966.

⁹⁷ The two basic objections as of the time of Finkelstein's writing (1930) were (1) the necessity to prove consideration, (2) the lack of uniformity of letter of credit forms. (See Finkelstein, *op. cit. supra* n. 15 at 290.) More than thirty years of letter of credit practice prove how insignificant these objections have been. The asserted lack of consideration has not influenced banks in disclaiming their liability or courts from enforcing it. The form of the irrevocable letter of credit has attained greater uniformity than diversification. On the formal requirements of the commercial letter of credit see Kozolchik *op. cit. supra* n. 1, Ch. 17.

⁹⁸ The commercial letter of credit regulations are found in Book IV, Ch. VIII (Banking and Credit Transactions) of the Honduran C.of C. (1950) and in Title 2 (Credit Transactions), Ch. 4, Section 4 of the Mexican L.T.O.C. (1932).

as the rules on the certainty, literality, abstraction, and transferability of the letter of credit promise began to acquire their present meanings.⁹⁹ The internationally widespread use of the instrument has in our day brought about conflicting rules in different jurisdictions; hence the need for uniformity. In the years that lie ahead, much of the legal effort will have to be directed to working out solutions for the conflicts created by the opposing rules arising from two or more countries, and by the inconsistencies between municipal statutory or case law and international banking customs. By way of example, the following areas of conflict may be mentioned: (1) the liability of the opening and issuing bank to the customer for negligence in the transmission of the terms of the credit;¹⁰⁰ (2) applicable presumption when the credit is silent on its revocable or irrevocable nature and time of establishment of an irrevocable credit;¹⁰¹ (3) the nullity of the underlying agreement as it affects the validity of the letter of credit;¹⁰² and

⁹⁹ For a comparative discussion on the form, certainty, literality, abstraction, and transferability of the commercial letter of credit promise, see Kozolchyk, *op. cit. supra* n. 1, Chapters 17, 18, 19, 20, 21 and 22.

¹⁰⁰ Compare, for example, the rules on the issuing bank's liability when utilizing the services of another bank in Article 12 of the Uniform Customs and Practice of Documentary Credits (U.C.P., 1962 Paris revision); Section 5-107(4) of the Uniform Commercial Code (U.C.C. 1962 Official Text); and Article 319 of the Mexican L.T.O.C. (1932). Article 12 of the U.C.P. denies to the customer a right of action against the issuing banks which are said not to "assume liability or responsibility should the instructions they transmit not be carried out, even if they have themselves taken the initiative in the choice of such other bank . . ." Almost the same disclaimer appears in Section 5-107(4) of the U.C.C. which can be read as imputing liability to the issuing bank only when fault is directly attributable to its acts. Article 319 of the Mexican L.T.O.C., however, makes the issuing bank (*acreditante*) responsible for the acts of the party "substituted in the performance of the obligation assumed by the issuing bank" (Author's translation). On the other hand, the combination of Article 12 of the U.C.P. or Section 5-107(4) of the U.C.C. with Article 908(c) of the Honduran C.of C. does not result in conflict but in a denial of a right of action to the customer against any bank, regardless of fault. Article 980(c) of the Honduran C.of C. states that advising banks are not liable for the "exactness of the translation of the terms of the credit." Thus, when an issuing bank in the United States selects a correspondent in Honduras which negligently translates the credit, neither the issuing nor the advising bank can be sued.

¹⁰¹ Compare, for example, the rule in Article 1 of the U.C.P. (1962 revision) which establishes the presumption that in the event of silence the letter of credit shall be deemed revocable, with the holdings by the Supreme Court of New York in *Fogliano v. Webster*, 217 App. Div. 282, 216 N.Y.S. 225 (1926), Lord Atkin in the English case of *International Banking Corp. v. Barclays Bank*, 5 Legal Decisions Affecting Bankers (1955) 1, and the German *Bundesgerichtshof*, in *Urteil vom 28/3/1955*, reported in *Der Betriebs-Berater*, May 30, 1955, case n. 862 p. 462. In these decisions the presumption used by the courts was the opposite than in Article 1 of the U.C.P.

¹⁰² Compare, for example, the holding in the Belgian decision *Société Fioriani Dante et Fratelli v. Banque X.*, 10 juin 1952, reported in 7-8 *Revue de la Banque* (1952) 583, in which the nullity of the underlying agreement was held not to affect the rights of a beneficiary of a transferable letter of credit, with Article 320 of the Mexican L.T.O.C. This article provides that the issuing bank may raise

(4) fraud and the bona fide purchaser of beneficiary's draft.¹⁰³

It is submitted that by regarding the irrevocable letter of credit as a new type of mercantile specialty, formal and monetary in nature, solutions to the above problems are bound to gain consistency and uniformity. So regarded, the parties to the letter of credit transaction, as well as legislatures and courts, will need to pay more attention to the following factors:

- (1) As a formal promise, the letter of credit may no longer be treated as an instrument whose form is immaterial and whose requisites are to be determined by random considerations. On the contrary, it will be necessary to place the burden of surveillance of formal adequacy in the letter of credit transaction upon the bank acting as the pivotal party.
- (2) As an instrument whose usefulness is directly proportional to its certainty, the letter of credit cannot render an adequate service if plagued with presumptions in favor of revocability. Its time of establishment will inevitably have to be geared to the receipt and possession of the instrument (a negotiable instrument rule, rather than a simple contract solution).
- (3) As an abstract promise, only the most extreme cases of illegality should be allowed to affect its validity.
- (4) As an instrument of limited transferability it should nonetheless be allowed to become highly negotiable, once it has reached the stage of a banker's acceptance.

against the beneficiary defenses arising from the letter of credit as well as from the relationship between the beneficiary and the customer.

¹⁰³ The problem is twofold, it involves the question of admissible defenses against the purchaser of beneficiary's drafts and recourse against him in the event of payment. What little law there is in this area (statutory and decisional) could not be more confusing. For a comparative discussion of the problem, see Kozolchyk, *op. cit. supra* n. 1, Ch. 22.