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Bank Security in Letters of Credit: Mere pledgee or something more?

Abstract

Banks acquire security rights under letters of credit through two methods, as pledgees of shipping documents and as lawful holders of bills of lading under The Carriage of Goods by Sea Act 1992. This article seeks clarity in what exact rights these methods transfer, how they operate together and argues that the most secure position for a bank is to be a lawful holder. As such, this article proposes a two-tier system for the transfer methods, with the Act as the primary method and the pledge as the secondary provision.

A. Introductory Matters

1. International Trade and Banks

If one wants to evaluate whether international trade is flourishing, then the best indicator to consider is the Baltic Dry Index[1] (BDI). This measures demand for shipping capacity (i.e. the amount of cargo requiring shipment) against the supply of carrying vessels. If the value is high, it means there is plenty of cargo being traded and if the value is low, it means that we have empty vessels floating on the ocean with nothing to carry. Since the 2008 financial crisis, this index has seen very dramatic changes, including a 94% drop in value from May to December 2008 and an historic low on 10 February 2016 of 290 points. Today[2], the index is at 3255 points, but it was particularly volatile in 2019 and of course 2020, hovering around 400 points in the first half of the year. The BDI is particularly significant as an economic indicator because it indirectly measures the supply and demand of commodities; things like coal, iron ore and grain. This type of cargo is required to feed us, heat our homes and help us survive. So if demand for this is low, then it is a good indicator that manufacturing and production is also low, with future economic growth likely to be slow.

In this climate, banks have been very apprehensive about offering credit[3], whether it be to companies looking to purchase vessels through shipping loans, or traders looking to open a letter of credit to finance an international sale of goods. The most important element for a bank in this environment is security. If the customer fails to pay back the loan or fails to reimburse the bank under a letter of credit, then the bank will want to enforce its security. For the shipping loan, the mortgage on the vessel. For the letter of credit, the right to sell the cargo. It is therefore incredibly significant, that in this financial climate, banks are in a strong position to enforce appropriate security rights. Security

[1] This is issued by the Baltic Exchange based in London. Every business day a panel of international shipbrokers submits their assessment of current freight (shipping) costs of dry bulk goods on twenty shipping routes and the BDI is a composite of these assessments. For more information and the values quoted above, see https://www.bloomberg.com/quote/BDIY:IND

[2] 25 June 2021

[3] For example, the European Central Bank has been reviewing the shipping loan portfolios of several banks with a view to add pressure for the sale of non-performing contracts. See further ECB Banking Supervision, *ECB Banking Supervision reviews lending to troubled shipping sector*, Newsletter 17 May 2017 available at https://www.bankingsupervision.europa.eu/press/publications/newsletter/2017/html/ssm.nl170517_1.en.html

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rights which give them the best chance of recouping losses. This article looks at the crux of the matter. Namely, security rights for banks in letters of credit.

2. Arguments in this article

This articles focuses on letters of credit. These are payment mechanisms issued by banks to finance international trade transactions. We shall look at the mechanism in a little more detail in part B but at the moment it is important to note that in essence, the bank is providing finance to the trading parties for the sale of goods contract[4]. The primary security it seeks is in the cargo itself – the ability to sell the goods and recoup losses. From a practical perspective however, neither the bank, nor the trading parties will have physical possession of these goods. Instead, they will be on a vessel bound for the destination port and thus in the physical possession of a third party, the carrier. The bank will therefore seek security in the documents which *represent* the goods and the stronger these documents are, the stronger security rights the bank will possess.

This article argues that:

i) The best security for the bank is being lawful holder of a bill of lading[5];
ii) The bank must therefore demand from sellers an order bill indorsed in its name or a bearer bill indorsed in blank[6];
iii) The way to acquire these security rights is under The Carriage of Goods by Sea Act 1992 (COGSA) and these rights are in combination stronger than rights acquired as pledgee;
iv) The law and scholars should make a clear division between which rights the bank could acquire as pledgee and which it could acquire as lawful holder;
v) As the bank acquires stronger rights as lawful holder, we should not confuse their primary position by mixing pledgee rights;
vi) Instead, the article suggests a two-tier system: the COGSA transfer operates first and the pledge transfer operates second to give banks complete security rights.
vii) The importance of this lies in issues of timing: if goods are lost or damaged, it will be central for the bank to establish what rights it had at any given time, hence the necessity of clarifying *what* rights it acquires, *how* it acquires them and *when*.

[4] For the operation of letters of credit in general and the law in this area see Ellinger and Neo, *The Law and Practice of Documentary Letters of Credit*, 2010, Hart Publishing, ISBN: 978-1841136738 and Malek et al, *Jack: Documentary Credits*, 4th Edition, 2009, Tottel Publishing, ISBN: 978-1845923471.

[5] Bills of lading are documents signed by the shipowner acknowledging that certain specified goods have been shipped on a particular vessel and the contractual terms upon which he will deliver those goods at destination: see generally *Sewell v Burdick* (1884) 10 App Cas 74 and Aikens et al, *Bills of Lading*, 3rd Edition, 2020, ISBN: 978-0-367134372 Chapters 1 and 2.

[6] Commercial usage confirms that these specific types are transferable and represent symbolic possession of the goods, meaning that their transfer is symbolic delivery of the goods. Order bills name a consignee and delivery of the goods is to him or his order, requiring indorsement and delivery of the bill for the transfer to operate. Bearer bills do not name a consignee and delivery is to the bearer. *Lickbarrow v Mason* (1794) 5 Term Rep 683; *Cole v North Western Bank* (1875) LR 10 CP 354; *Burdick v Sewell* (1883) 10 QBD 383.

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To reach the above conclusions, we must consider the transfer methods in turn, and evaluate what is more favourable to the bank based on its security needs. This article therefore proceeds as follows. We look at the legal background first, to give us the foundation upon which this article is based and the inspiration of the issues posed. We then proceed to evaluate the two methods of transfer first, a discussion of what rights the bank wants to acquire second and third, our proposal on how these methods can work in tandem. We end with a further two sections, firstly an acknowledgement that along with acquiring security rights, banks may of course also acquire obligations under these contracts and in light of this, a small discussion of what other types of documents representing goods the bank may choose instead. We then end with the conclusion, bringing together the above arguments and articulating the answer to the questions, *what* rights the bank acquires, *how* it acquires them, and *when*. The article provides the two-tier proposal of how these transfer methods should operate, to give the bank maximum security.

3. Significance of the issues and answers given

As we shall see in part C, when discussing bank security rights in letters of credit, the law and academics mix together both rights acquired by the bank as pledgee and rights acquired by banks as lawful holders of bills of lading[7]. The main reason for this mix is that there are in operation two primary[8] methods of transfer[9]. The first is the pledge of the shipping documents representing goods. The seller pledges the documents and the goods to the bank until payment has been made. The second is transfer of the bill of lading to the bank as lawful holder of the bill under The Carriage of Goods by Sea Act 1992. Although the Act was drafted having in mind the transfer of documents between sellers and buyers in sale contracts[10], the wording itself is wide enough to apply to the transfer of documents from seller to bank in a letter of credit. Nothing has repealed the pledge method (in fact, as we shall see in part E, this method needs to remain for specific rights), and no research has fully investigated what it now means that transfer is possible under the 1992 Act for banks.

[7] As defined by s5(2) of The Carriage of Goods by Sea Act 1992. See for example Popplewell J. in *Sea Master Shipping Inc v. Arab Bank (Switzerland) Ltd* EWHC [2018] 1902 (Comm) at para. 12 who states as fact that the bank held presented documents under a letter of credit as lawful holder, whilst also having a pledge agreement assigning all rights in relation to the goods and therefore the bank "held the bills of lading for its security interest in the usual way".

[8] Banks can have other causes of actions against the carrier as well, though outside the scope of this article. Here we confine ourselves to issues concerning the pledge and bills of lading under the Carriage of Goods by Sea Act 1992. For other methods of protection outside the 1992 Act see Adodo, E. *Bank's title to sue on a bill of lading taken up under an ill-fated letter of credit* J.I.B.L.R. 2015, 30(1), 40-48.

[9] This is in law but also in practice, two transfer methods may be in operation. See for example *Sea Master Shipping Inc v. Arab Bank (Switzerland) Ltd* EWHC [2018] 1902 (Comm) where the bank paid against documents including a bill of lading, presented to it under a letter of credit and became lawful holder of the bill, along with having a pledge agreement which pledged and assigned to the bank all rights arising from the bill in relation to the goods financed.

[10] For a review of the purpose of the Carriage of Goods by Sea Act 1992 see *The Berge Sisar* [2001] 1 Lloyd's Rep 663 at 672-674.

There is no clarity on how these transfer methods operate together, nor is there clarity on what *specific* security rights the pledge method transfers compared to the *specific* security rights the 1992 Act transfers. This article seeks to provide this clarity. As we shall see, it is argued that the 1992 transfer gives banks *more* security rights, *stronger* security rights and puts it in the best possible position to recoup losses. It is also argued that it is fruitless to mix this transfer with the pledge transfer. Although it operates simultaneously, it operates separately and gives different rights to the bank. Instead, this article proposes a two-tier system. COGSA should be considered the primary transfer method for banks that hold bills of lading. The pledge will then support this primary transfer with additional rights. This is the first article to compare *how* security rights are transferred under the two methods and *what* specific security rights are transferred by each. It is also the first article to resolve the operation of these two methods together, by proposing the two-tier system thus answering the question *when* the transfers should operate.

The research presented in this article provides two significant results, one for the law and one for the parties involved in the credit transaction. For the law, clarity in how credits operate, including what rights are transferred between the parties and when they are transferred, means that the legal framework better supports the transaction. It is the opinion of this article that the law in international trade finance, must serve the parties. The more certainty the law provides, through clear legal provisions, the more secure the parties feel to trade. Although perhaps an unpopular view in other areas, the primary party that should feel secure is the bank. Without finance, goods will not move, no matter the efforts of the sale parties. If the bank feels secure, the more likely it is to agree to finance the sale and thus the increase is trade transactions. The legal support this article considers, is clarity in the security rights banks obtain in letters of credit. For the banks themselves, this article acts as a blueprint of what documents they should seek to obtain the strongest security. If these cannot be obtained, then the commission charged by banks under the credit should be adjusted accordingly. Both results are significant because they can only lead to more credits being issued, more trade transactions being financed and more goods being transported. International trade flows only, with secure finance.

Despite COGSA being close to thirty years old the position of the bank as holder of a bill of lading has not been fully analysed[11]. When drafted, COGSA was meant to deal with the trading parties to the carriage contract, not with the financing banks, so of course the primary commentary on the Act has been dealing with pure carriage matters rather than related finance matters. Also, letter of credit disputes seldom reach the courts. This is mainly because banks use alternative resolution methods and prefer to keep their issues private to maintain a good reputation. However, in 2014 the Court of Appeal was offered the opportunity to examine letters of credit and the Carriage of Goods by Sea Act 1992 in *Standard Chartered Bank v. Dorchester LNG (2) Limited*[12] (*The Erin Schulte*). The case brought

[11] Note that the issue of what rights the bank has against the carrier upon failure of the credit is discussed by Professor Todd prior to the 1992 Act in Todd, P. *Actions by banks against carriers* J.I.B.L. 1986, 1(1), 11-15. The bill of lading as security as to rights of suit is also discussed in Olawoyin, A. *The bill of lading as security for credit advances: deconstructing a misapplication of common law principles in Nigeria* J.I.B.L.R. 2003, 18(2), 61-68 but with a specific perspective on Nigeria.

[12] *Standard Chartered Bank v. Dorchester LND (2) Limited* [2014] EWCA Civ 1382

to the forefront the issue of bank security in shipping documents and this article, drawing inspiration from statements within the case, seeks to clarify the position of banks. Issues concerning the position of banks within the matrix of the carriage contract have also been highlighted in relation to arbitration agreements and COGSA in the 2018 case *Sea Master Shipping Inc v. Arab Bank (Switzerland) Ltd*[13]. Arbitration agreements are outside the scope of this article where we focus on the financial aspect, but it is interesting to note that the *Sea Master* case evidences how complex the position of a bank can be when part of an international trade transaction and how the carriage contract regulated by COGSA, can affect the ancillary contracts which surround it, whether dealing with finance or arbitration. This is a web of contracts. The position of the bank under contract A, will affect its position under contract B, whether an original party to it or not. Therefore, banks should take note that security rights may also come with unexpected liabilities, as evidenced by *Sea Master.*

Solving this issue of how, what and when security rights are transferred provides a clear benefit to the parties involved – when goods are lost or damaged, party positions under the contracts are clearer, further losses can be mitigated, swift actions can take place to minimise costs, and commercial contracts can thus operate more smoothly when parties are aware of what rights they have at any given time. Bank efficiency can only lead to more trade and simplicity in its security rights is crucial to how effectively it can operate in a credit transaction.

B. Legal Background

Perhaps without realising, Lord Justice Moore-Bick in *The Erin Schulte*[14] raised an important issue regarding a bank's position in a letter of credit when it has in its possession a bill of lading[15]. Although the judge's statement has been overlooked by commentators, this is not surprising given that the judge himself did not expand on his thought. The point he raised is something which has not been reconciled in trade finance and with the decline in letter of credit numbers[16], it is certainly something worth discussing.

Lord Justice Moore-Brick stated[17]:

"When a bank takes possession of a bill of lading under a letter of credit…it does so with the intention of holding it as security for the recovery of the funds that it becomes obliged to pay to the [seller]. Normally it obtains a special property in the goods as a pledgee and a right to sue under the contract of carriage."

The first point the judge noted in that sentence is that when the bank accepts the bill of lading under a letter of credit, it is holding that document as security for the funds it has paid to the seller. Although the judge then goes on to note the bank obtaining rights as pledgee, the rest of the case deals entirely

[13] *Sea Master Shipping Inc v. Arab Bank (Switzerland) Ltd* EWHC [2018] 1902 (Comm).
[14] *Standard Chartered Bank v. Dorchester LND (2) Limited* [2014] EWCA Civ 1382
[15] For a comprehensive overview of the case and the base upon which the bank can sue the carrier see Adodo, E. *Bank's title to sue on a bill of lading taken up under an ill-fated letter of credit* J.I.B.L.R. 2015, 30(1), 40-48.
[16] See further *Documentary Credit World* Volume 23 (8) September 2019 published by The Institute of International Banking Law and Practice, USA.
[17] *Standard Chartered Bank v. Dorchester LND (2) Limited* [2014] EWCA Civ 1382 at para [17]

and exclusively with rights the bank obtains as lawful holder under the Carriage of Goods by Sea Act 1992. It is almost as if this statement has been thrown in out of nowhere, acknowledging that these documents normally give rise to a pledge but then completely side stepping the bank's rights as pledgee to deal with the bank's rights under COGSA. There is no explanation of what has happened to the pledgee rights, whether they have any bearing on the bank's position, or whether they are superfluous given the rights obtained under COGSA.

To put this statement into perspective, it is prudent here to briefly explain how a credit works[18].

The biggest obstacle to concluding an international sale transaction is trust and risk. The seller does not want to ship goods until he has received payment and the buyer does not want to pay in advance unless he has received goods. Put simply, the parties do not trust each other and they do not want the risk of losing goods and/or money. They engage the help of a bank who under a letter of credit has the responsibility of examining documents evidencing the shipment of goods and if it is satisfied that they comply with the credit requirements, it will pay the seller. This provides the sale parties with a trustworthy financial institution to handle the monetary transfer and in exchange, should provide the bank with a security measure should there be a failure for it to be reimbursed. Within this bundle of documents, the most important is the bill of lading. A transferable bill of lading is a document of title and as such carries certain important rights relating to the goods within it. Physical possession of the document is important[19]. Under the Sale of Goods Act 1979 the parties usually intend the transfer of the document to transfer property and title to goods[20] and under the Carriage of Goods by Sea Act 1992 rights of suit are transferred by statute to those in possession of the bill[21]. Rather than transfer these rights to the buyer directly and await payment, sellers would prefer to present these documents to a trusted financial institution, usually a bank, who will examine them according to instructions it has been given by the buyer and if satisfied they comply, will honour the credit and pay the seller. The bank in turn presents the documents to the buyer and is reimbursed. What the credit achieves is the transfer of rights and money being secured via a financial institution – seller feels comfortable enough parting with the goods knowing that he will be paid by a bank and the buyer in turns uses the bank as a buffer, requiring it to check the documents evidencing the shipment before payment is made.

It is accepted that a bank is pledged the documents for an international sale when the seller presents these to it under the letter of credit. The first point upon which this article seeks clarity is exactly what the pledged rights entail. As seen above, Lord Justice Moore-Bick acknowledged the special property in the goods, but then continued with the right to sue [the carrier] under the contract of carriage. Yet, this right is one transferred through the Carriage of Goods by Sea Act 1992 and indeed what the judge himself examined in *The Erin Schulte*. This raises the question of whether the pledge transfer gives different rights to the COGSA transfer. Therefore, the second point upon which this article seeks clarity, is what rights the COGSA method transfers. If the rights transferred are the same, then would it not be clearer for the law to settle on one mode of transfer? If the rights are different, which is the

[18] For the operation of letters of credit in general and the law in this area see Ellinger and Neo, *The Law and Practice of Documentary Letters of Credit*, 2010, Hart Publishing, ISBN: 978-1841136738 and Malek et al, *Jack: Documentary Credits*, 4th Edition, 2009, Tottel Publishing, ISBN: 978-1845923471.

[19] See discussion under C.1. for an explanation of bills of lading as documents of title.

[20] See section 17 of The Sale of Goods Act 1979. See also *Barber v Meyerstein* (1870) LR 4 HL 317.

[21] See sections 2(2) and 5(2) of The Carriage of Goods by Sea Act 1992.

argument suggested here, then one must be able to determine which method operates under any given circumstance and from the bank's perspective, which method gives better security. It is plausible, that both methods operate together, but it would be wise to clearly articulate what rights each transfers to the bank and which operates first. Only then can it make a sensible decision of what requirements as to security it needs. Above all, commercial contracts of this kind require certainty for the parties involved and the most important reason for establishing how the pledge and COGSA interact is timing. At any given moment the goods can be lost or damaged[22]; they are, after all on board a vessel in the middle of the ocean. At the point of that loss, the question that arises is "who has suffered the loss, and in this matrix of contracts, to whom do they turn seeking damages?". We can only answer this question if the law pinpoints at what time each party acquires rights against the goods and what exact rights these are. It is therefore necessary to thoroughly examine the transfer methods of these rights, and intrinsic to that examination must also be how these methods interact What rights to each give and at what point? The bank is a third party to the sale contract and so its position is more complex than the buyer and seller; its rights are not regulated by the initial sale. It is crucial that a bank can establish what rights in the goods it has at any given time, to know how it can reclaim losses.

C. Pledge vs. Lawful Holder

1. The Pledge

A pledge at common law is a bailment of goods by a debtor to his creditor, to be retained by the creditor as security until the debt is paid[23]. Although general property in the goods is retained by the pledgor, a special property passes to the pledgee in the form of a right to possession and power to sell the goods in the case of default[24]. Delivery of the goods is essential for the pledge to operate though this can be constructive rather than actual[25]. In international trade, delivery of a bill of lading representing the goods which is a document of title is enough to create the pledge. Bills of lading that are documents of title are a symbol of the goods specified within them[26]. As such, possession of the bill equates to possession of the goods themselves[27] and so transfer of it is symbolical delivery of the goods[28] which commercial usage[29] has acknowledged as having the same effect as actual delivery[30].

[22] Or indeed the vessel upon which the goods are being carried could be incurring demurrage, which the owners may seek to claim from the bill of lading holder, as occurred in *Sea Master Shipping Inc v. Arab Bank (Switzerland) Ltd* EWHC [2018] 1902 (Comm).
[23] See further Chitty on Contracts 33rd Edition at para 33-121; *Donald v Suckling* (1886) L.R. 1 Q.B. 585.
[24] *Ex p. Hubbard* (1886) 17 Q.B.D. 690; *The Odessa* [1916] 1 A.C. 145; *Rosenberg v. International Banking Corporation* [1923] 14 Lloyd's Rep. 344.
[25] *Dublin City Distillery Ltd v Doherty* [1914] A.C. 823; *Kum v Wah Tat Bank Ltd* [1971] 1 Lloyd's Rep. 439, PC.
[26] *Barber v Meyerstein* (1870) LR 4 HL 317.
[27] *Cole v North Western Bank* (1875) LR 10 CP 354.
[28] *Burdick v Sewell* (1883) 10 QBD 383.
[29] *Lickbarrow v Mason* (1794) 5 Term Rep 683.
[30] *Cole v North Western Bank* (1875) LR 10 CP 354.

Commercial custom dictates that these bills are transferable[31] and the form in which they are drafted determines their transferability[32].

The question that concerns us in this article, is whether this pledge gives merely a right to possession and power to sell, or whether it gives title to the goods and rights of suit under the contract of carriage. Professor Beale, the author of *Chitty on Contracts*[33] states that "delivery for the purpose of pledging the goods may be effected by indorsement or transfer of the bill of lading" [34]. What Beale is indicating is that the delivery characteristic required by the pledge can, in the case of bills of lading, be satisfied by the indorsement *and*[35] transfer of an order document, or by mere transfer of a bearer document. It should be noted here, that this is terminology used in the Carriage of Goods by Sea Act 1992 which deals with the transfer of *rights of suit* in bills of lading. It is curious therefore, that Beale uses these words when talking about the *right to possession* and *power to sell* under a pledge.

Beale goes on to state that "it is a question of fact whether a particular transaction was intended to pass the title in the goods, or only to create a pledge"[36]. Here Beale is indicating that there may be circumstances where the delivery of the bill has created only a pledge, and others where it has also passed title to goods[37]. Combining this statement with the above, Beale has mixed three different rights[38]:

i) A right to possession and power to sell goods through pledging of a bill of lading;
ii) Title to goods through delivery of a bill of lading *and*
iii) Rights of suit relating to the carriage of those goods through indorsement and delivery of a bill of lading.

[31] *Evans v Marlett* (1697) 1 Ld Raym 271*; Lickbarrow v Mason* (1794) 5 Term Rep 683; *Burdick v Sewell* (1883) 10 QBD 383.

[32] Order bills name a consignee and the bill is drafted so that delivery of the goods is to him or his order, requiring indorsement and delivery of the bill for the transfer to operate. Bearer bills do not name a consignee and instead leave the consignee name as blank or state 'bearer'. *Lickbarrow v Mason* (1794) 5 Term Rep 683; *Cole v North Western Bank* (1875) LR 10 CP 354; *Burdick v Sewell* (1883) 10 QBD 383.

[33] Beale, H. *Chitty on Contracts* 33rd Edition, 2018, Sweet & Maxwell, ISBN: 978-0414065130.

[34] *Ibid* at para. 33-123.

[35] With respect, a minor correction to the terminology used by Professor Beale – order bills require indorsement *and* transfer to be effective, bearer bills require only transfer; it is not one or the other. As we shall see below in section 2, the terms used in the Carriage of Goods by Sea Act 1992 are indorsement and *delivery*.

[36] *Ibid*

[37] Note that under section 17 of the Sale of Goods Act 1979 ownership of the goods transfers when the parties intend it to do so. In international sales this usually coincides with the transfer for the bill but it is not always necessarily so.

[38] It is important to note that this is something done by the courts themselves, as indeed the authority used for Beale's statements is *Burdick v Sewell* (1883) 10 Q.B.D. 363 and indeed something this article noted in part B with Lord Moore-Bick's statement in *The Erin Schulte* [2014] EWCA Civ 1382.

It is interesting to note that Professor Bridge in *Benjamin's Sale of Goods*[39] also mixes these rights. After explaining that in an international sale the seller transfers possession of the goods to a bank with the intention to grant security in the form of a pledge[40], Bridge goes on to state

"the seller will indorse the bill in favour of the…bank or in blank…the bank through possession of the bill of lading as a document of title will now be identified as the party to whom the carrier will deliver the goods and thereby will obtain constructive possession of the goods, a possessory interest sufficient to sustain a right of pledge"[41].

Bridge himself ties the right to delivery of the goods (and thus rights of suit[42]) to the right of pledge by stating that it is the constructive possession through the bill of lading which is the interest satisfying the right of pledge. He goes on to explain that if a bill is consigned to the buyer, then possession of the bill by the bank does not amount to constructive possession of the goods and thus there is no pledge[43]. Similarly, that only bills of lading which are documents of title can give rise to a pledge as they are the only documents with the ability to transfer possession of the goods[44]. Lastly, that the right of the pledgee bank is to sue in conversion any carrier who breaches the carriage terms contained in the bill.

The confusion that arises from the above is this: if it is possession of a document of title, whether indorsed to the bank if an order bill or blank if a bearer bill, that gives rise to the right of pledge, how is this different to the bank being a lawful holder under the Carriage of Goods by Sea Act 1992? Bridge has stated that the right of the bank as pledgee is to sue the carrier in conversion – why would this be necessary if the bank is already lawful holder of the bill? The bank's rights of suit against the carrier would be obtained under the Carriage of Goods by Sea Act 1992 and the pledge would not be needed. As we shall see, this article argues that pledgee rights are not necessary unless the bank wants to sell the goods. The bank's right to sue the carrier and its right to delivery is irrespective of the pledge. These rights are transferred under the Carriage of Goods by Sea Act 1992 and operate separately to the pledge. With respect therefore, this article disagrees with the authors of *Benjamin* that the right of the of the bank to sue the carrier in conversion rests on its pledgee position. The bank's right to sue the carrier rests on its position as lawful holder under COGSA. Once this transfer has taken place, the bank then obtains *in addition* pledgee rights. These rights are different. They are a right to possession of the goods and a right to sell upon default of the buyer. The transfer of a bill of lading gives rise to

[39] Bridge, M. *Benjamin's Sale of Goods* 11th Edition, 2020, Sweet & Maxwell, ISBN: 978-0414080249.

[40] *Ibid* at para. 23-309; *Ross T Smyth & Co v Bailey and Son & Co* (1940) 67 Ll. L.R. 146 and *The Future Express* [1993] 2 Lloyd's Rep. 542

[41] *Ibid* at para. 23-310. Bridge supports this statement with several cases including *Glyn, Mills, Currie & Co v East & West India Dock Co* (1882) 7 App. Cas. 591; *Sewell v Burdick* (1884) 10 App. Cas. 79 and *The Stone Gemini* [1999] 2 Lloyd's Rep. 255.

[42] See further Debattista, C. *Bills of Lading in Commodities Trade,* 4th Edition, 2021, Tottel Publishing (Bloomsbury Professional), ISBN: 978-1784510350 pgs. 30-32.

[43] Though see Quest, M. *Jack: Documentary Credits* 4th Edition, 2009, Tottel Publishing (Bloomsbury Professional), ISBN: 978-1845923471 at pg. 326 who suggests that the bank still obtains a pledge which can be enforced by bringing a claim for delivery of the goods against both the consignee and the carrier. This indicates again rights of suit.

[44] See also Brindle, M. and Cox, R. *Law of Bank Payments* 5th Edition 2017, Sweet & Maxwell, ISBN: 978-0414051706 at para. 7-115.

the pledge, and this pledge give rise to the right of possession and power to sell but this is secondary to the initial transfer under COGSA. Hence, we shall conclude, on the two-tier system.

Lastly, Brindle and Cox in *Law of Bank Payments*[45] discuss the security afforded to a bank in a letter of credit where it has in possession a bill of lading. The authors advise that "a bank that wishes to exercise its rights as pledgee should ensure that it…procures…[a] bill of lading…drawn, or indorsed, to its order, or drawn to order and blank indorsed". Again the authors tie the right of pledge to possession of a document of title, which under the Carriage of Goods by Sea Act 1992 could mean that the bank is considered a lawful holder. Is there a difference? And if so, which is a stronger position to be in? It is an appropriate time therefore to turn to the Act itself.

2. Lawful Holder under COGSA 1992: essential provisions

We are confining ourselves to the sections of the Carriage of Goods by Sea Act 1992 that relate directly to bills of lading and thus it is prudent to start with the definition of such documents given in s1.

A document which is "incapable of transfer either by indorsement or, as a bearer bill, by delivery without indorsement" is not a bill of lading under the Act. We are therefore talking only about order bills of lading and bearer bills of lading as these are the only ones that can be transferred[46].

The rights a transferee obtains are provided in section 2 and under sub-section 2(a) "a person who becomes the lawful holder of a bill of lading…shall…have transferred to and vested in him all rights of suit under the contract of carriage as if he had been party to it".

The next definition required is that of "lawful holder" which for bills of lading is found in s5(2)(a). A lawful holder of an order or bearer bill is "a person with possession of the bill as a result of completion, by delivery of the bill, of any indorsement of the bill or, in the case of a bearer bill, of any transfer of the bill".

If this sentence was to be divided, one could say that the following essential elements are required for someone to become a lawful holder of an indorsed bill:

i) possession of that bill
ii) that has been indorsed
iii) and that indorsement has been completed
iv) by delivery of the bill.

For a bearer bill, the position is simpler. Possession is still required but this time it is a result of the simple transfer of the bill. There are no discussions about indorsement or completion thereof.

[45] Brindle, M. and Cox, R. *Law of Bank Payments* 5th Edition 2017, Sweet & Maxwell, ISBN: 978-0414051706.

[46] Commercial usage confirms that these specific types are transferable and represent symbolic possession of the goods, meaning that their transfer is symbolic delivery of the goods. Order bills name a consignee and delivery of the goods is to him or his order, requiring indorsement and delivery of the bill for the transfer to operate. Bearer bills do not name a consignee and delivery is to the bearer. *Lickbarrow v Mason* (1794) 5 Term Rep 683; *Cole v North Western Bank* (1875) LR 10 CP 354; *Burdick v Sewell* (1883) 10 QBD 383.

The essence is that banks which would not have been original parties to the carriage contract, obtain rights of suit against the carrier for breach of its terms, if they become lawful holders. This is a similar outcome to the rights of pledgee discussed above. Namely, being able to sue the carrier in conversion for incompatibility with the carriage contract terms.

2.1. *Interpreting section 5(2)(a) COGSA 1992*

The Court of Appeal has relatively recently been afforded the chance to interpret s5(2)(a) of COGSA 1992 in *The Erin Schulte*[47]. The case involved quite complicated facts but what follows is a summary of key points required for our discussion.

The case involved the sale of gasoil to be paid for via letter of credit with the United Bank of Africa (UBA) acting as issuing bank and Standard Chartered Bank (SCB) acting as confirming bank. The gasoil was sent on two different vessels and when the first arrived it was found to be below contract quality. The buyer agreed to take the cargo from the first vessel at a lower price, but rejected the cargo on the second vessel, The Erin Schulte.

Amendments to the credit were therefore necessary so that it now covered only the cargo on the first vessel at the new lower price and did not cover the cargo on The Erin Schulte at all. The buyer obtained agreement to the amendment from UBA and UBA in turn obtained agreement from SCB. However, SCB failed to obtain agreement from the seller. When the seller presented documents for the full cargo at the full price, SCB found itself liable for payment. The situation became further complicated by the fact that the seller had arranged new buyers for The Erin Schulte cargo and although the carrier was legally bound not to discharge the goods to anyone but the bill of lading holder, upon letter of indemnity from the seller the carrier handed the goods over to the two new buyers.

Although SCB initially rejected the documents stating that they did not comply with the credit (no doubt to avoid paying for something it could not now pass on to UBA) the bank did eventually pay the seller after realising that there were no contractual grounds upon which it could deny payment. It was now stuck with documents, including an order bill of lading indorsed in its favour, which represented goods but was not in physical possession of them. If SCB did have physical possession of the goods, it could sell them and recoup losses. It decided to sue the carrier claiming that as lawful holder of the bill, it had a right to physical delivery of the cargo and since the carrier delivered to third parties, it had breached the carriage terms in the bill.

Both the High Court[48] and the Court of Appeal[49] decided that SCB was holder of the bill under the Act, though they decided this right was acquired at different times and with different reasoning.

2.2. *Reasoning in The Erin Schulte*

The discussion in the case centred around the definition of "delivery" in s5(2)(a). As a reminder the lawful holder of an indorsed bill is a person who has "possession of the bill as a result of the completion, by delivery, of any indorsement of the bill".

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[47] *Standard Chartered Bank v. Dorchester LNG Ltd (The Erin Schulte)* [2014] EWCA Civ 1382

[48] *Standard Chartered Bank v. Dorchester LND (2) Limited* [2013] EWHC 808 (Comm).

[49] *Standard Chartered Bank v. Dorchester LND (2) Limited* [2014] EWCA Civ 1382.

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Both Mr Justice Teare in the High Court[50] and Lord Justice Moore-Bick in the Court of Appeal[51] turned to dicta of Thomas J. in *The Aegean Sea*[52] to define delivery and were in agreement that delivery required both the *receipt* of the bill but also *acceptance* of the bill. Receipt is easy enough, clearly SCB had possession of the document so therefore it was now a question of what constituted acceptance that the judges turned to. In the High Court, Teare J. stated[53] that the possession of the bill by SCB and the fact that it *retained* possession, infers acceptance of the bill. Unfortunately, this was an inference from the facts rather than a definition of acceptance. On this basis, the judge decided that since possession of the bill took place on the day the seller presented the documents to the bank, SCB became holder from the day of presentation.

Moore-Bick L.J. however took a different approach. The judge did attempt a definition and took the view that completion required a "voluntary and unconditional transfer of possession by the holder to the indorsee and unconditional acceptance by the indorsee"[54]. This unconditional acceptance did not happen on presentation day – indeed SCB rejected the documents as non-compliant five days after presentation and thus gave no such acceptance despite the bank retaining possession.

Before continuing, it is interesting to note that neither judgment gave a clear definition of what constitutes acceptance of the bill for delivery to have taken place and complete the indorsement. Is it simply a decision based on the fact that if the document is refused, it cannot therefore be accepted? So it is a matter of eliminating possibilities rather than listing them. As we shall see below, Moore-Bick L.J. decided that the bill was accepted when payment was made. Is the definition of acceptance therefore payment? If SCB did not initially refuse payment but instead determined it would pay and communicated as much to the seller, would acceptance take place on the day of the bank's determination of compliance? On the day it communicated this to seller? On the day payment was made? Or on the day payment was received? One must remember that the day on which SCB became holder of the bill is the day that SCB obtained rights against the carrier – it will be vital to pinpoint this day to determine the exact rights the bank has if cargo is lost, damaged or misdelivered. Therefore, with respect, it would have been helpful for a clear definition of acceptance to be given as even Moore-Bick's L.J. statement defines completion as "unconditional acceptance by the indorsee" rather than defining "acceptance" itself.

Both judges then turned their attention to the possibility of SCB becoming holders of the bill on payment day; the day SCB paid the full amount under the credit to seller. Teare J. in the High Court saw this simply as an alternative and again, through inference of the facts, stated[55] that delivery could occur on the payment date because the documents were compliant, they were taken up by the bank and the letter of credit was thus honoured. From these actions, delivery can be inferred. Moore-Bick L.J. in the Court of Appeal again differed in his reasoning. His position was that the wrongful rejection of the documents by SCB gave rise to a debt (not a claim for damages, as the documents remained with SCB). This debt meant that the only way for the seller to receive payment was to surrender the documents to the bank[56]. Indeed, the seller not only presented these to the bank, they also insisted on payment and did not demand the documents returned. There was, on their part, a voluntary

[50] *Standard Chartered Bank v. Dorchester LND (2) Limited* [2014] EWHC 808 (Comm) at para. 38.
[51] *Standard Chartered Bank v. Dorchester LND (2) Limited* [2014] EWCA Civ 1382 at para. 28.
[52] *Aegean Sea Traders Corp v Repsol Petroleo SA (The Aegean Sea)* [1998] 2 Lloyd's Rep. 39.
[53] *Standard Chartered Bank v. Dorchester LNG Ltd (The Erin Schulte)* [2013] EWHC 808 at para. 38.
[54] *Standard Chartered Bank v. Dorchester LNG Ltd (The Erin Schulte)* [2014] EWCA Civ 1382 at para. 28.
[55] *Standard Chartered Bank v. Dorchester LNG Ltd (The Erin Schulte)* [2013] EWHC 808 at para. 63.
[56] *Standard Chartered Bank v. Dorchester LNG Ltd (The Erin Schulte)* [2014] EWCA Civ 1382 at para. 52.

transfer of possession and this action amounted to an acceptance that SCB was entitled to take them, thus making the bank holder once payment was made.

2.2 Conclusion

The position therefore seems to be, that under COGSA a bank becomes lawful holder of an indorsed bill when it has paid for the documents. Only then has it unconditionally accepted the completion of the indorsement. At this stage, the bank obtains rights of suit against the carrier and with the bill, the right to physical delivery of the goods. The situation is much simpler for bearer bills. No indorsement is required and thus we need not consider completion of the indorsement by delivery. This time, the mere transfer of the bill gives possession to the bank and that is enough to make it lawful holder. This has clarified what rights are obtained via COGSA and when they are obatained.

D. Rights the Bank wants to acquire

We have looked at the two methods that transfer security rights to banks. In order to decide which of the two methods is most desirable for the bank it is a convenient time to ascertain what rights the bank is seeking. We can then decide how the two methods are reconciled and how they can operate together.

1. Overall Bank Position

The purpose of a bank in a letter of credit is to provide finance for the international sale transaction. Its role is limited to examination of documents relating to the sale, to decide whether, under the credit terms and the Uniform Custom and Practices 600 (UCP 600)[57], those documents are compliant and if so, to pay for them. It is not in the bank's interest to get involved in the actual sale transaction, and this is clearly evidenced in Articles 4 and 5 of the UCP600 which enshrine the Principle of Autonomy: banks deal with documents and not with goods.

The starting point therefore is to acknowledge that the bank never wants to become a lawful holder of the bill – it doesn't want to reach the point where it must chase the carrier for the goods, nor indeed does it want liabilities under the shipping documents which it would obtain if it enforced its rights[58]. The situation is much like a bank loan for a house – the bank wants to provide the finance and obtain interest, it does not ultimately want to own the house and get involved in real estate.

However, it does want security for the finance it provides. For the bank loan, the mortgage is the bank's ultimate protection. It is the last option for recouping the money it has given if payments under the loan are not made. Similarly, security is what the bank seeks in a letter of credit. So that if the finance it provides cannot be reimbursed from the parties involved in the credit, the bank does have a route to recouping losses. The route is provided by the shipping documents so that the bank can

[57] Uniform Customs and Practices for Documentary Credits, 2007 revision, published by the International Chamber of Commerce, ICC Publication no.600 ISBN: 978-9284212576. These are international rules governing letters of credit and are incorporated into the credit contract by using SWIFT messages (Society for Worldwide Interbank Financial Telecommunication).

[58] Section 3 Carriage of Goods by Sea Act 1992.

ultimately sell the goods should it need to. Of all the documents, the bill of lading is the most important because only this acts as a document of title which by law, can transfer rights relating to the goods. On the assumption that the goods arrive safely, and that the bill of lading is indorsed in the bank's name or is a bearer bill, presentation of that document to the carrier means that physical delivery of the goods is given to the bank. If the goods do not arrive safely, then possession of the same bill gives the bank rights of suit against the carrier.

2. Security Rights in Documents

a. Right to physical delivery of goods and the transfer thereof

It is quite possible that the bank receives the documents at a time when the goods are in transit. As the goods usually move a lot slower than the documents, it is possible that the bank is in possession of the bill long before the goods will reach their destination. Where the bank is selling those goods, the person buying will want and need the right to physical delivery of goods from the carrier. That person may also wish to sell the goods, in which case he will also want the ability to transfer the right to physical delivery. These two rights are enshrined in bills of lading which are transferable, bills of lading that through their own physical transfer also transfer rights in the goods[59]. Debattista convincingly argues[60] that the right to delivery "is a logical and practical precondition" to the rights of suit given to bill of lading holders under COGSA. Thus, when COGSA confers rights of suit to the bank, it also confers the right to delivery. Although Debattista refers to the position of "the buyer" throughout his analysis, the Act applies to banks equally as the Act itself uses the terminology "lawful holder" that we examined above, rather than "buyer". The definition is thus wide enough to include the bank.

Therefore, the right to physical delivery of the goods which the bank needs transfers to it when it becomes lawful holder of the bill of lading[61]. On this basis, under *The Erin Schulte*, the point in time at which a bank becomes a lawful holder, which is the time it makes payment, is the point in time the bank obtains rights of suit and the right to physical delivery of the goods. This is positive news for the bank; with the acceptance of one document, it obtains not just a pledge of the goods, but in fact rights to delivery and rights of suit.

b. Right to sue carrier for damage and loss

[59] As a reminder these are order bills which name a consignee and delivery of the goods is to him or his order, requiring indorsement and delivery of the bill for the transfer to operate. Bearer bills do not name a consignee and delivery is to the bearer. Both are documents of title that are considered symbolic representation of the goods. *Lickbarrow v Mason* (1794) 5 Term Rep 683; *Cole v North Western Bank* (1875) LR 10 CP 354; *Burdick v Sewell* (1883) 10 QBD 383.

[60] Debattista, C. *Bills of Lading in Commodities Trade,* 4th Edition, 2021, Tottel Publishing (Bloomsbury Professional), ISBN: 978-1784510350 at pages 30 -32.

[61] It is likely of course, that the bill of lading itself contains within it terms that require delivery to the lawful holder. See for example Page 1 of BIMCO's CONLINEBILL 2016 (available by registration at www.bimco.org).

The right to sue the carrier needs to be acknowledged separately to the right to physical delivery of the goods. It could be the case that the goods have been lost at sea whilst the documents are with the bank. Physical delivery in this scenario is obviously not possible and the right to this will give no security to the bank as it will not be able to sell the goods. However, the right to sue the party responsible for the loss (goods are in possession of the carrier) is incredibly useful and necessary[62] as the only way the bank can recoup losses will be in the form of damages from the carrier[63]. As established by *The Erin Schulte*, the bank, if indorsee on an order bill, can sue the carrier when it becomes lawful holder of that bill on the payment date under the credit. This right gives the bank added security. If it only had the physical delivery right, any loss to the goods would not be protected. The situation is of course similar in the case of damage or part loss. Any remaining goods could be sold at a lower price and the carrier would be liable for the outstanding damage. Lastly, as was the case in *The Erin Schulte*, if the carrier has neither lost nor damaged the cargo but instead delivered to a different party altogether, then by asserting a combination of the bank's right to physical delivery and its right to sue, the bank can claim damages for misdelivery from the carrier[64].

c. Right to sell

Where reimbursement from the buyer fails and the bank is lawful holder of the bill it will look to recoup losses through the sale of the goods. It was never party to the sale contract so the only way to do this is if it obtained a right to sell through another means. This is necessary for the bank because this is the easiest and most effective way of recovering the money it paid under the credit quickly. The value of the goods may have decreased, and this is a loss it may have to suffer but none the less selling the goods is the quickest way to receive funds. Legal proceedings against any of the parties will take much longer to resolve. The purpose of the pledge at common law is exactly that, to give the bank power to sell.

The right to sell is also tied to title of the goods and this is dealt with through the Sale of Goods Act 1979 section 17. Property in goods passes when the parties intend it to pass. With international sales on shipment terms, the intention is usually for property to pass with the bill of lading[65]. Again therefore, the right to sell is tied to possession of the bill. One could argue that the time at which the bank becomes lawful holder of the bill is also time for the right to sell to pass – this is the point at which the intention of the parties is clear, the seller has transferred possession of the bill to the bank and the bank accepts the bill upon payment.

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[62] If goods are delivered in a damaged condition or not delivered at all, the shipowner is liable to consignee or indorsee for all damage sustained whilst the goods are in his custody: *Diederichsen v Farquharson Bros* [1898] 1 QB 150 unless there are an exclusions or limitations under The Carriage of Goods by Sea Act 1971.

[63] It is of course likely that the goods are also insured for specified risks, in which case the bank may want to claim on the insurance policy. Whether it can is a matter outside of this article but will likely require assessment of assignment of insurance policies as the transfer of insurance contracts does not operate in the same way as the transfer of bills of lading which are documents of title.

[64] Physical delivery of the goods should only be given to the bill of lading holder who presents the bill to the carrier at the discharge port and if delivery without presentation of the bill is a breach of contract by the carrier: *London Joint Stock Bank Ltd v British Amsterdam Maritime Agency Ltd* (1910) 11 Asp MLC 571 and *The Sormovskiy* [1994] 2 Lloyd's Rep 266.

[65] *Bayer v Meyerstein* (1870) LR 4 HL 317, *Sewell v Burdick* (1884) 10 App Cas 74 and *Wright v Campbell* (1767) 4 Burr 2046.

The crucial problem that arises however is that the bank was never party to the sale contract. So when the Sale of Goods Act talks about the "parties" intending property to pass it can only mean parties to the sale, the original sale. When the seller presents the documents to the bank for payment it is not part of the sale transaction, it is part of the credit transaction and as such s17 of the Sale of Goods Act cannot apply. In fact, section 17 of the Sale of Goods Act 1979 specifies that property passes *to the buyer.* Unlike COGSA, which is worded wide enough to consider banks as parties to contracts of carriage which can become lawful holders, the Sale of Goods Act specifies that property passes between the two parties of a sale contract, from seller to buyer. It does not envisage banks as parties and is not drafted to allow banks to obtain property through the bill of lading. It is perhaps therefore here, that we find the necessity of the pledge method. The transfer of the bill by way of pledge, shows intention to pass at least qualified property in the goods to the bank and along with this, the right to sell to realise its security[66].

3. Concluding thoughts

We can therefore conclude that what the bank seeks in terms of security and protection through the documents is three essential rights: the ability to take physical delivery of goods from the carrier[67], the ability to sell those goods to recoup losses, and the ability to sue carrier if goods are lost, damaged or misdelivered. It is COGSA that gives banks the right to delivery and right to sue and it is the pledge that gives the bank the right to sell. The two transfer methods are both therefore essential for the bank to obtain full security rights.

E. How Pledge and COGSA work together

The above two sections, discussing the two transfer methods and the rights the bank wants to acquire, have answered the *what* rights are transferred and in part, *how* they are transferred (specifying what right each method transfers). We must now complete the issue of *how* and deal with the issue of *when* the rights transfer. The proposal below, suggesting a two-tier system evaluates how the methods can work together, and at what point each one transfers rights.

If one brings all of the analysis in the above sections together then we can conclude that although judges and academic scholars often tie a number of rights relating to the goods under the pledge method[68], it is in fact a method that should be understood as dealing only with the right to possession

[66] Note here also, that when discussing pledgee rights, Professor Bridge in Bridge, M. *Benjamin's Sale of Goods* 11th Edition, 2020, Sweet & Maxwell, ISBN: 978-0414080249 at para. 23-310 states, that although the bank obtains constructive possession of the goods when it acquires a bearer bill or a bill indorsed in its favour, ownership of the goods passes to the buyer. This evidences the clarity required in what rights are transferred and by which method.

[67] Readers should also assume included within this is this the right to transfer the right to take delivery as discussed above in this section at 2.a.

[68] Even Halsbury's Laws of England in *Carriage and Carriers,* Volume 7 (2020) at para. 465 and footnotes 1-3, states that "A pledgee or other person holding a bill of lading as security has contractual rights directly against the carrier where [he] holds…a bill of lading…by virtue of the Carriage of Goods by Sea Act 1992". Again, this confuses the bank's position as pledgee with that of lawful holder. It may indeed be simultaneously pledgee, but

and power to sell goods – it transfers a special property in the goods which gives the bank a right to sell the goods if there is a default in the letter of credit. It also gives a right to possession tied to that right to sell and for international sales on shipment terms, it is the bill of lading as a document of title that gives that constructive possession.

Simultaneously, though quite separately, where the bill of lading is an order bill indorsed to the bank, or a bearer bill indorsed in blank, it will also transfer rights of suit and the right to physical delivery of the goods. The point in time that a bank obtains these rights is the point at which it becomes a lawful holder under the Carriage of Goods by Sea Act 1992.

Under *The Erin Schulte* interpretation, for order bills this is the day that the bank pays for the documents; the day it honours the credit the bank becomes lawful holder. At that point it has unconditionally accepted the documents and the indorsement has been completed by delivery.

For bearer bills the situation is different, only transfer of possession is required and this happens on the day of presentation.

To be clear, the pledge arises because the bill of lading is a document of title which is symbolic possession of the goods. The fact that the bank is a pledgee because it has symbolic possession of the goods does not mean that the rights against the carrier (delivery and suit) are derived by its position as pledgee. They are not. They are derived by its position as lawful holder under the Carriage of Goods by Sea Act 1992. In fact, the rights transfer at different times. As noted above, the bank becomes lawful holder of a bearer bill on the day the document is presented to it. It becomes lawful holder of an order bill upon payment to the seller. In contrast, it obtains a pledge, when the buyer fails to reimburse the contract price. This is necessarily after the time at which the bank becomes lawful holder. The pledgee right of sale is therefore obtained after the holder rights of suit and delivery. They therefore cannot be the same set of rights and cannot be mixed together. It is suggested that they operate on a two-tier system. Both, in terms of time because the pledge comes after COGSA, but also because the right to sell necessarily requires as a precondition the right to delivery of the goods and as argued by Debattista above, this is derived under COGSA.

A further argument for the pledge method encapsulating only the power to sell is its consideration in *The Erin Schulte.* If the pledge method transferred something more than the power to sell, then why was this transfer not considered in the case? Council for SCB did not argue that they had obtained rights of suit through a pledge; they argued that they obtained rights of suit under COGSA 1992. Similarly, both Judge Teare and Lord Justice Moore-Bick turned to the position of the bank as bill of lading holder, not as pledgee, to consider its right to delivery and its right to sue the carrier. We can therefore assume that what takes precedence, is the position of the bank as lawful holder. There is no need to turn to the bank as pledgee. The rights of suit are instead entirely enshrined in the Carriage of Goods by Sea Act 1992. Here the bank finds an unequivocal right to sue the carrier and therefore also a right to delivery of the goods. If the carrier breaches his obligation, then it is the bank who is considered lawful holder of the bill and thus sues the carrier for damage to the goods or misdelivery. This is upon the basis of the carriage contract, to which the bank has become party through the

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the rights of suit are derived by its position under COGSA and it doesn't need to be pledgee to obtain those rights.

operation of COGSA. It is argued that these rights are in fact superior and stronger to the right to sell. Rights of suit and rights to delivery *control* the goods and seek control over the party who has possession of them. The power and right to sell the goods can only operate in practice if a party also has possession of goods themselves – and possession will always ultimately rest with the bill of lading holder. Only with it can physical delivery of the goods be obtained.

It is for this reason that one can argue that the pledge method is the second tier. Although it confers upon the bank the necessary right of sale (which as we discussed above is not transferred by COGSA) it is none the less secondary.

Based upon this analysis, we have therefore now also answered the question of *when* the security rights are transferred, and completed the issue of *how.* Both transfers are necessary, both are based on possession of a document of title but the intricacies of how they work together have been clarified by the proposal of the two-tier system. This provides simplicity to give the parties a more transparent picture of the web of contracts.

F. Ancillary matters

Before we reach our final conclusion we must acknowledge a few matters closely related to the issues presented in this article and the confines of our current investigation. This article restricted itself to security for banks through possession of bills of lading that are documents of title. This is because such bills are considered the strongest form of security. We should however at least acknowledge the existence of other types of transport documents[69]. None of the rest are considered documents of title[70] and cannot therefore create a pledge, nor can they transfer rights to the bank under COGSA unless it has been named as consignee[71]. COGSA does acknowledge other transport documents[72]. The most significant are seawaybills[73] which are transport documents made out to a named consignee and delivery of the goods by the carrier can only be made to that consignee. These documents still give rights of suit against the carrier and rights to delivery[74], but these rights cannot be transferred to a third party. In the hands of the bank, assuming the consignee name is the buyer, these documents are useless as security. The rights contained within them belong to the consignee alone and possession of the document does not give any rights to the bank[75]. It will not be considered lawful holder of the

[69] For further details on these other types see generally Bridge, M. *Benjamin's Sale of Goods* 11th Edition, 2020, Sweet & Maxwell, ISBN: 978-0414080249 at Chapter 18 Section 2.

[70] The only documents considered bills of lading under the Carriage of Goods by Sea Act 1992 are those that are transferable as per section 1(2)(a).

[71] The person to whom goods have been consigned and therefore the person to whom they will be delivered.

[72] Section 1(1)(a) seawaybills and section 1(1)(c) ship's delivery order. Straight bills of lading are considered seawaybills for the purposes of the Carriage of Goods by Sea Act 1992. The position is different for the Carriage of Goods by Sea Act 1971 as determined by *The Rafaela S* [2005] UKHL 11.

[73] Under section 1(3) these act as a receipt for goods and contracts of carriage but identify the person to whom delivery is to be made

[74] Section 2 (1) (b) Carriage of Goods by Sea Act 1992.

[75] The bank may still have an interest in the goods and if it suffers loss due to a breach of the carriage contract, then by virtue of s 2(4) of The Carriage of Goods by Sea Act 1992, the named consignee can exercise his rights under the Act for the benefit of the bank.

seawaybill and it will not have any rights in the goods including the right to sell. A pledge cannot be created because possession of this type of document is not constructive possession of the goods. The bank obtains no special property right. The only way for the bank to obtain any rights in the goods is by requiring the sale parties to name itself as consignee. This is unlikely; one must remember that banks do not in fact want to be involved in sale contracts – they wish to avoid any obligations or liabilities relating to the sale. That is why the preferred position would be to utilise an order or bearer bill that would grant rights *if* and *when* the bank required them[76]. However, it would also be irresponsible if this article did not recognise that as well as acquiring rights in the goods when a bank becomes a lawful holder of a bill of lading under COGSA, it may of course also acquire obligations and liabilities. This was most recently highlighted by the case of *Sea Master Shipping Inc v. Arab Bank (Switzerland) Ltd* EWHC [2018] 1902 (Comm). The issue there, inter alia, was whether a bank as holder of the bill and thus with rights of suit under section 2 of COGSA was also bound by the arbitration clause in the bill, and if so, whether disputes relating to its potential liabilities also had to go to arbitration. The details of the decision do not concern us here[77], but the case itself serves as a warning to banks that along with acquiring rights, obligations may be acquired too and that these may not be limited to the carriage contract but could instead extend to issues such as arbitration agreements. The issues in this section are also well worth investigating, to determine what security rights other transport documents can provide, if any, and what the overall position of the bank may be if it also acquired obligations and liabilities under the web of contracts. For now however, we move on to the concluding remarks of our current analysis.

G. Conclusion

We commenced this investigation to seek security rights for banks in letters of credit with the objective of protecting their position in the event of default by the parties. The default would mean that although the bank has paid seller for the price of goods, it is now unable to be reimbursed from the buyer. This could be due to its own fault, as in *The Erin Schulte* or it could be because of unpredictable events such as the insolvency of the buyer. In either case, the bank has lost money. To protect its position, it must seek security in the underlying sale contract upon which the credit is based. Security rests primarily not with the goods themselves, as these are in the possession of a third party, but instead in the bundle of documents the seller presented that represent the goods. The most important of which is the bill of lading because as a document of title, it is symbolic possession of the goods. The rights the bank wants and needs to secure its position are:

i) The right to sell the goods;

[76] It is also clear that if a bank obtained an order bill of lading that was not indorsed in its name it would not have any rights as pledgee nor any rights under the Carriage of Goods by Sea Act 1992. Although this is a document of title, it cannot operate as such in the hands of the bank because it is neither named as consignee, nor has the document been indorsed in its name.

[77] For a discussion on these details see Lista, A. *International commercial contracts, bills of lading, and third parties: in search of a new legal paradigm for extending the effects of arbitration agreements to non-signatories*. J.B.L. 2019, 1, 21-42.

ii) The right to physical delivery of the goods and transfer thereof;
iii) The right to sue the carrier for damage, loss or misdelivery of goods.

If the goods reach the destination in good order and condition, the bank will want to sell them to recoup the price. We have concluded that its right to do this is transferred to it as pledgee. When the bank obtains a bill of lading and the parties default on payment, the right of sale arises due to the bank's possession of a document of title that give rise to a pledge.

If the goods do not reach the destination at all or are damaged, the bank will want to sue the party responsible and that is the carrier. We have concluded that the right to delivery[78] and the right to sue for misdelivery or loss and damage is transferred to the bank as lawful holder under the Carriage of Goods by Sea Act 1992. We have clarified that this is a separate transfer and although the document that gives rise to the rights is the same document that is required for the pledge to operate, this transfer is separate, both in time and in the rights conferred. This has answered our questions of *what* rights are transferred (listed i-iii above) and *how* they are transferred (which method).

We must therefore conclude that the bank obtains both rights as pledgee and rights as lawful holder and that both methods are required to give the bank utmost security. It is not possible to predetermine what rights the bank may need to utilise so it must be ready for all scenarios. To give it a clear understanding of what security rights it could possess, we have clarified what it obtains as pledgee and what it obtains as lawful holder. Also, *when* it obtains these rights. We have suggested that along with the law clarifying which rights are obtained by either method, it should clarify how the two transfer methods operate together and, on this basis, suggested the two-tier system:

i) The Carriage of Goods by Sea Act 1992 operates first both in time and in importance to give the holder rights to delivery of the goods and rights to sue the carrier upon bank payment of an order bill or presentation of a bearer bill;
ii) The pledge operates second arising upon default of buyer payment to give the bank right to sell the goods.

This clearly answers the *when* issue of the bank obtaining security rights. The significance of these findings and the proposals made will result in a simplified structure of security rights for banks, providing the parties with a more transparent view through the web of contracts. Banks should demand order bills indorsed in their names, or bearer bills indorsed in blank so that if the credit fails, they can recoup losses no matter the state of the goods. Only then can banks really feel secure enough to continue financing international trade transactions. As noted in the introduction, without finance, goods will not move and prosperity for all is dependent on efficient trade mechanisms. With the answers provided in this article both the law would be improved and certainty afforded to the parties involved in such high value transactions.

[78] Again readers should note that this includes the right to transfer the right to delivery, so that the a new buyer can take physical possession of goods.