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WHAT IS A "CLEAN" BILL OF LADING?—A PROBLEM IN FINANCING INTERNATIONAL TRADE

*Daniel C. Draper**

United States exporters are frequently unwilling to ship to foreign importers against payment on delivery in the foreign country, and require that the foreigner pay when the goods are delivered for shipment to the carrier in the United States.¹ In order to do this, the importer usually makes a contract with his foreign bank by which that bank agrees to induce its United States correspondent to issue its own letter of credit or confirm the foreign bank's letter of credit in favor of the United States exporter. By this letter of credit, the United States bank obliges itself to pay the United States exporter the amount due for the goods if he presents to the bank documents, such as commercial and consular invoices, a marine insurance policy, and a "clean" bill of lading evidencing delivery to the carrier for shipment.² Such a credit is known as a documentary letter of credit and is distinguished from a clean letter of credit where the issuing bank agrees to pay unconditionally and thus where no documents are required. The documentary letter of credit device allows the United States exporter to collect his money when the documents are presented at a time on or before shipment is made, and thus the exporter gets the use of the money during the pendency of any dispute and avoids both the risk of fluctuating exchange and the difficulty of establishing the credit standing of a foreign importer. In fact the goods shipped, however, may be defective, but even where defects are not visible, the foreign buyer must rely on the carrier noting the defect on the printed form of the bill. The sole duty of the bank issuing the letter is to see that, on paying, it receives proper documents. In the letter of credit situation, the crucial question, therefore, upon which the respective rights and liabilities of the exporter, importer and banks turn is the status of the documents, and the requirement of a "clean" bill of lading presents perhaps the chief problem in determining that status.

*See Contributors' Section, Masthead, page , for biographical data. The writer wishes to acknowledge his indebtedness to his colleagues Messrs. Albert J. Walker and Richard C. Packard, whose assistance made this study possible.

¹ The reverse transaction of an exporter in a foreign country and a U.S. importer also takes place, but *usually* in that case the foreign bank that makes payment passes on the "cleanliness" of the bill of lading and thus in such a case litigation would not arise in the United States. This might not be the case where credits were issued here and confirmed abroad.

* See Contributors' Section, Masthead, page 69, for biographical data. The writer wishes City Bank of New York, 69 F.2d 312 (9th Cir. 1934).

Since the letter of credit-bill of lading device is of relatively recent development,³ and for other reasons to be discussed, the courts have had little occasion to treat the problem. The question of what notations superimposed⁴ on a bill of lading will render it "foul" has, curiously enough, in view of the importance of the problem to the daily transaction of large scale commercial banking, excited only passing and inconclusive comment on the part of text writers. Ward and Harfield's well-known work⁵ raises the problem without reaching any solution. In his work on *Sales*⁶ Professor Williston confined himself to citing an earlier edition of Ward and the following general statement:

A bill of lading is called "foul" if there is any notation thereon indicating that the goods are in bad condition. A buyer who is bound to pay cash against bills of lading is clearly entitled to a clean bill of lading; that is, one which does not indicate any defect in the goods. A question might be raised whether the defect indicated in a foul bill of lading might not be so slight as not to amount to such a breach of contract as would justify the buyer in refusing the goods. As to this matter, banks were unwilling to take any risks and insisted on regarding notations of the carrier with reference to the condition of merchandise or its container as an irregularity justifying the rejection of the merchandise.

Williston does not discuss precisely what notations should be taken as indicating that the goods are in "bad condition." In the last part of the quotation, he seems to indicate that, at one time at least, any "notations of the carrier with reference to the condition of the merchandise or its container" justified the bank in rejecting a bill of lading. Apparently Williston derived this view from a consideration⁷ of the practice of rejecting bills of lading containing any notation which the litigation resulting from the 1920 commodity price debacle temporarily forced upon the banking community. The pressure of rapidly falling prices encour-

³ FINKELSTEIN, *LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT* 4-7 (1930). The Federal Reserve Act of 1914 explicitly authorized National Banks to accept time drafts or to issue letters of credit. See WHITTAKER, *FOREIGN EXCHANGE* 134, n. 1 (1922); YORK, *INTERNATIONAL EXCHANGE* 298 *et seq.* (1923); WARD, *AMERICAN COMMERCIAL CREDITS*, c. 1 (1922). Letters of credit were in use, however, during the nineteenth century. See WARD AND HARFIELD, *BANK CREDITS AND ACCEPTANCES* 68-70 (1948).

⁴ By "superimposed" something more is meant than the filling in of blanks on the printed form of the bill. See *The Idefjord*, 114 F.2d 262 (2d Cir. 1940), *cert. denied sub nom* Norske Amerikalijnje v. Blumenthal Import Co., 311 U.S. 707 (1940). (These words printed in small capitals appeared on the bill of lading: "Subject to all terms appearing in the bills of lading at present in use by Messrs. ————." The blank was filled in: "The oncarrying line of steamers." The Court properly considered this a "clean" bill of lading.)

⁵ WARD AND HARFIELD, *op. cit. supra* note 3.

⁶ WILLISTON, *SALES* § 405c (rev. ed. 1948).

⁷ See WARD, *op. cit. supra* note 3.

aged buyers to seize upon any pretext that might suggest that the goods were in unsatisfactory condition and thus permit an escape from a promise to purchase at prices higher than those then prevailing. Under these circumstances some banks tended, as Williston states, to reject bills containing any notation.⁸

Recurrent dicta originating in the earlier cases and authorities tended to support the banks' view. In *The Isla de Panay*, a case where the defect in the goods was not noted on the bill, the court stated:

The bills of lading which were issued in these cases were what are known as "clean" bills. A clean bill of lading is one which contains nothing in the margin qualifying the words in the bill of lading itself.⁹

More recently in *Roberts v. Calmar S.S. Corporation*, the court reiterated the formula but indicated that it only applied "broadly speaking":

However, broadly speaking, it may be said that a "clean" bill of lading is one which contains nothing in the margin qualifying the words of the bill of lading itself.¹⁰

This study will look into the extent that the proposition that "any notation" superimposed on a bill of lading renders it "foul" is valid. Neither Williston nor the other authorities, for example, discuss how banks are to treat the disclaimers of liability that carriers frequently stamp on bills. Such disclaimers do not establish that the goods are in bad condition. They only state that the carrier is not responsible for the condition whatever it may be. Williston, moreover, in the quotation already discussed, raises another problem and states, "A question might be raised whether the defect indicated in a foul bill of lading might not be so slight as not to amount to such a breach of the contract as would justify the buyer in refusing the goods." The problem of carrier's disclaimers will be discussed first, then the problem of what notations stamped on a bill are sufficiently substantial to justify rejecting it, and finally certain provisions of the usual letter and application for a letter.

The term "clean bill of lading" was in current commercial usage long

⁸ Perhaps because of the general uncertainty of the law, however, United States exporters apparently chose to proceed against the importer directly upon the underlying contract rather than proceed against the bank issuing the letter of credit and litigate precisely what was a "clean" bill of lading. At least relatively few of the reported cases show litigation on the letter of credit contract. Both the tendency of banks and their customers in normal times to avoid litigation and thus preserve good will, and recently the existence of promulgated *Uniform Customs* (to be discussed *infra* p. 67) have further tended to reduce the volume of litigation. The sketchiness of the text writers thus arises from the lack of case law.

⁹ 292 Fed. 723, 730 (2d Cir. 1923), *aff'd*, 267 U.S. 260 (1925).

¹⁰ 59 F. Supp. 203, 209 (E.D. Pa. 1945).

before its application in the documentary letter of credit situation and earlier cases (which did not arise in this context) throw light on the term's meaning, and particularly the effect of carrier's disclaimer notations. *Restitution Steamship v. Sir John Pirie & Company*¹¹ involved a charterer's agreement to pay advance freight eight days after the signing of a "clean" bill of lading. Because of the failure of the vessel to load on schedule, demurrage accrued, and the question was whether a bill which carried with it such liability was "clean." The court found that it was "clean" and stated:

Now I have had some little difficulty in finding out what is meant by a clean bill of lading. There does not seem to be any case which has ever pressed much on the subject, but there is a very clear statement as to the meaning of the phrase "clean bill of lading" to be found in Pollock and Druce's Law of Merchant Shipping, and there it is said that a clean bill of lading is a bill of lading which contains nothing in the margin qualifying the words in the bill of lading itself, "Shipped in good order and well-conditioned; goods of a certain character, or a certain weight or quality or what not." But where, for instance, you insert in the margin of the bill of lading the weight or quantity or quality unknown, that is not a clean bill of lading, because that contains a qualification. Where, on the other hand, there is no such qualification inserted in the margin, there the bill of lading is a clean one. Looked at according to that definition this bill of lading is a clean one.¹²

This *dictum* thus reiterates the usual formula that a "clean" bill of lading must contain "nothing" qualifying the words "shipped in apparent good order and well-conditioned." In particular, the court emphasizes that a carrier's exemption of liability, "weight, quantity or quality unknown" qualifies the words "shipped in apparent good order and condition."

A Scottish decision also discusses the effect of carriers' disclaimers. *Craig and Rose v. Delargy*¹³ involved a shipment of casks of oil from Bougie, Algeria to Leith, Scotland. All parties admitted the casks on loading were defective and that the original shipper, the assignor of the plaintiff, knew this. The captain of the loading ship also saw that they were defective, but, instead of setting out the defect in detail, merely noted on the bill "not responsible for weight, quality, leakage, or breakage." The holders of the bill sued the shipper and alleged that the shipper in fact knew that the goods did not meet the stipulation in the bill of lading that they were in apparent good order and condition. The Scottish Court of Session held that the disclaimer clause above was

¹¹ 61 L.T.R. 330 (Q.B. 1889).

¹² *Id.* at 333.

¹³ 16 Scot. L.R. 750 (1879).

effective against the original shipper who had notice of the defects, and that, under the Bills of Lading Act,¹⁴ the endorsee had no greater rights than the original shipper. Lord Shand, one of the several justices who rendered opinions *seriatim*, however, stated in passing:

The result therefore is that this bill of lading contained on its face notice to any endorsee taking it sufficient to put him on his guard. It was not a clean bill of lading, if thereby be meant a bill of lading that is free from all exception. . . .¹⁵

He thus seems to suggest as an alternative ground for the decision that, even if the holder of the bill as a *bona fide* purchaser could have greater rights than his transferee, the stamped notation put him on notice. He, however, later seems to indicate that, contrary to his earlier suggestion, a "clean" bill of lading need not be "free from all exception." Thus he states:

Now, I suppose the bills of lading in these two cases [both contained carrier disclaimers] . . . would in loose language have been referred to as clean bills of lading. . . . The onerous endorsee would say—I have got a clean bill of lading, and I may rely on getting my full quantity of manganese, or the silk contained in these bales.¹⁶

Lord Shand never really indicates which of the two views discussed he intends to adopt.

As Lord Shand points out, however, notations exempting carriers from liability were customary long before the decisions in *The Restitution* and *Craig Rose* cases. In *Jessel v. Bath*,¹⁷ for example, the shipmaster receipted for manganese giving the weight in detail, but noted on the bill "weight, contents and value unknown." Baron Bramwell held that the carrier was not liable, and that such disclaimers were not against public policy. In *Lebeau v. General Steam Navigation*,¹⁸ where a parcel of goods was shipped described as linen when in fact it was a type of silk, the court held that the words "weight, value and contents unknown" when stamped on the bill, absolved the carrier from liability.¹⁹ Today, Article 18 of the Uniform Customs Agreement,²⁰ adopted by most United

¹⁴ 18 Vict. c. 3 (1892).

¹⁵ *Craig and Rose v. Delargy*, 16 Scot. L.R. 750, 759 (1879).

¹⁶ *Ibid.* The two cases referred to are *Jessel v. Bath*, [1867] L.R. 2 Ex. 267; and *Lebeau v. General Steam Navigation*, [1872] L.R. 8 C.P. 88, to be discussed *infra*.

¹⁷ [1867] L.R. 2 Ex. 267.

¹⁸ [1872] L.R. 8 C.P. 88.

¹⁹ For an early U.S. decision to the same effect, see *The Delaware*, 81 U.S. 579 (1871) where the particular bill contained in its text "Vessel not accountable for breakage, leakage or rust." The Court seemed to regard this as a valid and effective provision.

²⁰ *Uniform Customs and Practices for Commercial Documentary Credits* fixed by the Seventh Congress of the International Chamber of Commerce (hereinafter called the

States banks in 1938, and incorporated in most letter of credit transactions,²¹ explicitly provides that banks may accept shipping documents bearing "reservations commonly made by carriers affixing stamps mentioning that they decline all responsibility for risks for which the goods are liable by their nature, such as rusting, leakage of oil in barrels, breakage, etc." Section 209 of the New York Personal Property Law²² specifically provides that carriers shall not be liable where they state "contents or conditions of packages unknown" or "shippers weight, load and count."²³ The Federal statute²⁴ dealing with bills of lading issued by carriers engaged in interstate or foreign commerce contains substantially similar provisions.

Although cases and statutes holding exemptions of liability by carriers valid are not necessarily conclusive on the somewhat different question as to whether a bill is "clean" so that a bank can make a payment under a letter of credit, still the authorities evidence a widespread use of such exemptions, and, by the requirement that a bank accept only a "clean" bill, the parties intend primarily to safeguard against unusual provisions which might render bills unmarketable. This is in fact the rational basis for the sharp distinction between matter stamped and matter incorporated in a bill of lading. Whether the defect is noted or disclaimed in the text or stamped on the bill, the buyer who does not receive the goods that he bargained for suffers equally. As a general rule, matter stamped on the bill, however, is unusual and thus renders it unmarketable. If the matter is embodied in the text of the bill, on the other hand, the provision as a part of a form must have some general use and incorporates a risk that, at least a number of buyers apparently have been willing to assume.²⁵

Uniform Customs), set out and discussed in WARD AND HARFIELD, *BANK CREDITS AND ACCEPTANCES* c. 12 (1948).

²¹ The writer has examined the forms of application for a letter of credit (contract of procurement) used by five of the major New York banks; and all the forms either incorporate the provisions of the *Uniform Customs* or contain provisions similar to that quoted above. These forms are not used for applications made by correspondent banks, but the writer understands that New York banks stipulate that the *Uniform Customs* apply to those transactions. See note 40 *infra*.

²² N. Y. PERS. PROP. L. § 209 *et seq.* (1949). These sections correspond to UNIFORM BILLS OF LADING ACT § 23 ff.

²³ N. Y. PERS. PROP. L. § 209 (1949).

²⁴ 39 STAT. 541 (1916), 49 U.S.C.A. § 101 (1951). The Harter Act, 27 STAT. 445 (1893), 46 U.S.C. §§ 190-96 (1946), makes unlawful stipulations relieving carriers from liability for negligence, and from the exercise of due diligence in equipping the vessels. See Note, *Limitations of Carriers' Liability and the Conflict of Laws*, 54 HARV. L. REV. 663 (1941).

²⁵ In most cases statutes control, at least to some extent, the text of bills of lading. Section 4 of the Harter Act, 27 STAT. 445 (1893), 46 U.S.C. § 193 (1946), for example, provides:

It shall be the duty of the owner or owners, masters, or agent of any vessel trans-

Carriers do not embody some customary disclaimers in bills because, though in general use, they apparently are not used sufficiently often to justify a special form. On principle, however, the existence of customary disclaimers, such as "shipper's weight, load and count" or "weight, contents and value unknown," should not affect the bank's accepting the bill.

In *Camp v. Corn Exchange National Bank*,²⁶ in determining whether the bank should have accepted the bill, the Pennsylvania Court looked to see if the matter stamped on the bills was "customary." The opinion first set out the facts about the bill:

The bill of lading, in addition to the printed provisions, had written across its face, in red ink, special notations setting forth that the steamer was not responsible for bursting of bags and loss of contents or for liquifaction of sugar. Other typewritten notices set forth that all expenses incurred at the destination, such as repairing packages, including cost of materials, should be paid by the consignee before delivery, and that the steamer was not responsible for breakage or loss of contents due to frail packages.²⁷

The American purchaser contended that this was not a "clean" bill of lading and instructed the Corn Exchange Bank to make no payments under its letter of credit. The bank, however, paid the draft. The bank sued the purchaser for reimbursement. After holding that the disclaimers by the carrier were not contrary to public policy, the Pennsylvania Court stated: "The letter of credit did not require a 'clean' bill of lading under the strict interpretation that term has sometimes been given."²⁸ Apparently by "strict interpretation" the court referred to the doctrine that any notation on the printed form made a bill foul. As we have already seen, the courts, though repeating the formula as *dicta*, do not apply it in any crucial cases. The court concluded that a purchaser had a right to a bill of lading "conforming to the customary one," and thus did not itself apply the "strict interpretation" test. Any finding that stamped dis-

porting merchandise or property from or between ports of the United States and foreign ports to issue to shippers of any lawful merchandise a bill of lading, or shipping document, stating, among other things, the marks necessary for identification, number of packages, or quantity, stating whether it be carrier's or shipper's weight, and apparent order or condition of such merchandise or property delivered to and received by the owner, master, or agent of the vessel for transportation, and such document shall be prima facie evidence of the receipt of the merchandise therein described.

For an instance where the Act did not apply, however, see *F. A. Straus & Co. v. Canadian Pacific Ry.*, 254 N. Y. 407, 173 N. E. 564 (1930), 79 U. OF PA. L. REV. 635 (1931) (ocean shipment from Shanghai to Vancouver and thence by rail to New York).

²⁶ 285 Pa. 337, 132 Atl. 189 (1926).

²⁷ *Id.* at 341, 132 Atl. at 190.

²⁸ *Id.* at 345, 132 Atl. at 191.

claimers customarily²⁹ used by carriers rendered a bill "foul" would seriously impede the expeditious transaction of commercial business. Where a specific clause of the contract makes the *Uniform Customs* apply, they will usually resolve questions of the validity of a particular disclaimer, and, even where there is no specific clause making the *Uniform Customs* applicable, the general customs that they evidence³⁰ should control the solution of the carrier disclaimer problem.

In the *Camp* case, the court also pointed out that some of the notations did not add materially to the vendee's burden because they were "substantially reiterations of what is contained in the printed part."³¹ Thus whatever some experts may call a "clean" bill of lading, if the notations really add nothing to the conditions in the printed text, then a bank can ignore them and accept the bill.

We now pass to the second problem that Williston raises, the problem of how banks are to treat statements stamped on the bill of lading that are so insubstantial as not to affect the value of the goods shipped. Problems of this kind are particularly difficult because there is virtually no authority to serve as a guide in close cases. A leading but inconclusive English case³² on the subject involved an action in which the National Bank of Egypt sought to recover funds paid out on presentation of a bill of lading which bore the notation "several bags torn and resewn"; the Court of Appeals and the lower court more or less tacitly assumed that a bill bearing such a notation was not a "clean" bill because the notation qualified the phrase in the body of the bill "in apparent good order and condition." The defendants contended that the words "Bills of Lading" as used in the exchange of letters which formed the underlying agreement signified "clean" bills of lading. The Court of Appeals, however, expressly avoided this aspect of the problem and stated that,

²⁹ Some carriers' disclaimers will render a bill foul. In *The Kirkhill*, 99 Fed. 575 (4th Cir. 1900), the Court of Appeals for the Fourth Circuit indicated a statement of cargo "shipped on deck" would render a bill "foul."

³⁰ See *Dixon Irmaos & Cia. v. Chase Nat. Bank*, 144 F.2d 759 (2d Cir. 1944), cert. denied, 324 U.S. 850 (1944); and *Vietor v. Nat. City Bank*, 200 App. Div. 557, 193 N.Y. Supp. 868 (1st Dep't 1922).

³¹ *Camp v. Corn Exchange Nat. Bank*, 285 Pa. 337, 345, 132 Atl. 189, 191 (1926).

³² *National Bank of Egypt v. Hannevig's Bank Ltd.* 1 Ll. List L.R. 69 (Ct. App. 1919). See also *Westminster Bank v. Banca Nazionale di Credito*, 31 Ll. List L.R. 306 (K.B. Div. 1928). The bill of lading bore a stamped notation stating that the frozen meat shipped was "misshapen" and this implied that it had been refrozen, thus affecting the meat's marketability. Although the British court just as in the *Bank of Egypt* case, *supra*, attempted to avoid the problem it in effect held that the notation made the bill "foul." The court, however, did not state that all notations superimposed on the printed form rendered the bill foul.

in view of the war conditions, they entertained some doubt that the buyer intended to demand a "clean" bill. After considerable discussion, both courts ultimately found that the defendants waived the defect in the bags but such a finding would seem to involve the underlying premise that a waiver was required because the bill was not "clean." The decision, however, never explains why the notation "several bags torn and re sewn" should render a bill foul, and thus is of little help in determining precisely what constitutes a "clean" bill of lading. The English court, however, nowhere repeats the formula familiar to the older cases that all notations superimposed on the printed form render a bill "foul."

In a number of cases the problem of precisely what constitutes a "clean" bill is relatively easy. If a bill of lading showing a shipment of scrap iron, for example, bore the stamp "discolored," a bank with the knowledge that the parties could reasonably expect it to have would know that the noted matter would not affect the "apparent good order and condition" of the scrap iron. If, for some unusual reason, a buyer wanted scrap iron that was not "discolored,"³³ he should designate this and any other unusual requirements in his application for the letter of credit. A closer and more difficult case arises where the notation implies rather than states that the goods may arrive in bad condition. Since in order to avoid possible liability, carriers naturally tend to note each and every possible defect, one cannot fairly conclude that, merely by stamping a notation implying a possible defect, the carrier necessarily indicates that the stamped matter is sufficiently serious to affect the market value of the goods. Under the Harter Act, carriers are not required, explicitly at least, to pass on this question, but only to state the shipment's "apparent order and condition."³⁴ Strictly speaking, the fact that containers were of "second-hand" lumber or that scrap iron was "discolored" would be a part of that "apparent order." Under the letter of credit-bill of lading scheme, however, a bank engages with the parties to determine whether a bill is "clean." In requiring a "clean" bill, the parties to a commercial transaction are really interested in the effect on market value of a particular notation rather than the existence of notations in general. If a buyer wants new lumber in the packing, he should specify it in his application letter to the bank.

³³ Another frequently recurring stamp of this type is the statement "container-second hand lumber."

³⁴ 27 STAT. 445 (1893), 46 U.S.C. § 193 (1946). Thus, in *The Caterina Gerolimich*, 43 F.2d 248 (E.D.N.Y. 1930), *aff'd*, 54 F.2d 1080 (2d Cir. 1931), the Court held that admission by carrier in bill of lading reciting onions were received in apparent good order applies only to the visible aspect of the subject matter. The court implied that no other recital was required.

Thus within the limits of the few decisions in the field, the bank exercises the knowledge that it can reasonably be expected to have to determine whether or not the notation is sufficiently serious to affect market value. As a practical matter to affect market value, the implication of bad condition must either be a strong one or must be stated in affirmative terms. Put in this way, the rule is not impossible for the bank to apply. The frequently recurring notation "fragile containers," for example, would not render a bill foul unless the goods were of a type that required strong packing, for instance glass, or unless the notation were put in strong terms, for instance, "containers too fragile for proper shipping."

In these cases, the bank's obligation is a dual one. It engages to the beneficiary that, if the documents tendered conform to the requirements of the letter of credit, it will accept the accompanying draft. Among other things, it also engages to its principal, however, that if the documents do not conform to the contract in the application for a letter of credit,³⁵ it will refuse to accept the accompanying draft. Thus a bank under a letter of credit has a duty to its principal to reject a foul, and a duty to its beneficiary to accept a clean bill. Where the authorities are few and conflicting as in the problem of what is a "clean" bill of lading, this dilemma is especially acute. Sometimes large sums are involved. In the *Corn Exchange* case, for example, because of falling prices of sugar in 1920, the purchaser, if he were successful in contending that the bill was foul, stood to recoup some \$290,000.

In order to make the problem less acute, in their application form for a letter of credit most New York banks have provided certain exculpatory clauses to the effect that the bank is protected if it acts in good faith. A typical clause reads as follows:

. . . we agree that any action, taken by you or by any correspondent of yours under or in connection with the credit or the relative drafts, documents, or property, if taken in good faith, shall be binding on us and shall not put you or your correspondent under any resulting liability to us; and we make like agreement as to any inaction or omission, unless in breach of good faith.³⁶

By virtue of this clause, in a close case, the bank in determining what is a "clean" bill of lading would seem to enjoy an area of discretion.

³⁵ In the normal case, the bank requires in the letter of credit the same documents that are specified in the contract of procurement. FINKELSTEIN, *LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT* 32 (1930), considers the problems arising when there is a variance between the requirements of the letter of credit and the specifications of the contract in the application form.

³⁶ The form currently in use by The Hanover Bank, New York City, contains this clause.

Thus in many cases whether a bill is "clean" or "foul" will depend upon what the bank says it is. One might argue that this seems unfair because banks would usually favor their principal who was the customer that brought them the business. This was not true in the *Corn Exchange* case where the bank rejected its customer's view that the bill was foul and ultimately sued him. Generally the banks engaged in this kind of business, moreover, are so large relative to any one customer that their reputation among principals and beneficiaries generally is more important than their interest in retaining a particular customer.

The *Corn Exchange* opinion contains a number of references that may indicate that in that case the particular contract in the application for a letter of credit contained an exculpatory clause similar to that quoted above. Even if it does not, the opinion at least indicates that, as a matter of law, the court would vest a certain amount of discretion in the issuing bank. Thus the court states:

The integrity of foreign drafts or like bills of exchange, accompanied by commercial bills of lading and other documents drawn against letters of credit, should not be embarrassed or made difficult through technical or inconsequential reasons raised against payment.³⁷

The person who must initially determine whether a reason is "technical or inconsequential" is of course the advising bank. Later in the opinion the court explicitly states that the bank has discretion:

While, in determining strict compliance, they should not be visited with liability for a mistake in the judgment of the officers [of the bank] honestly made, they should not escape responsibility where, from an examination of the papers, it is apparent they do not conform to the letter of credit. The bank has a discretionary power of acceptance. . . .³⁸

The effect of the exculpatory clause quoted above as applied to the "clean" bill of lading is merely to make explicit this "discretionary power," and such a clause would seem almost certainly valid.

The exculpatory clauses in the principal's application for a letter of credit dispose of the problem of a challenge by the principal to the bank's judgment. Although the precise legal position that the beneficiary occupies is not entirely clear, most authorities do not regard him as a third party beneficiary to the contract of application for a letter of credit³⁹ so

³⁷ *Camp v. Corn Exchange Nat. Bank*, 285 Pa. 337, 343, 132 Atl. 189, 191 (1926).

³⁸ *Ibid.*

³⁹ *Bril v. Suomen Pankki Finlands Bank*, 97 N.Y.S.2d 22 (Sup. Ct. Erie County 1950), held that a beneficiary that was not notified of the opening of the credit acquired no rights against a bank that had opened an irrevocable credit in his name. If the court had adopted the third party beneficiary theory, the beneficiary would have acquired rights as soon as the contract of procurement was signed. Authorities have adopted a number of conflicting

that the terms of the principal's contract including the exculpatory clause would not apply to limit the beneficiary's rights. His rights thus arise solely under the letter of credit which is not merely a separate instrument but a separate obligation, and the usual form of letters of credit contains no exculpatory clause. The forms of export letters of credit in use by most New York banks, however, regularly include a provision incorporating the terms of the *Uniform Customs*.⁴⁰ In the usual case where the *Uniform Customs* govern, its terms limit the rights of the beneficiary. Thus Article 18 states:

Shipping documents bearing reservations as to the apparent good order and conditions of the goods may be refused.

Reports of the International Chamber of Commerce have made it clear that the clause was intended to refer to the bank's relations with the beneficiary. One such publication contains the following:

Article 18 of the *Uniform Customs and Practice* lays down that the banks may refuse any shipping documents bearing reservations as to the apparent good order and conditions of the goods. This implies that the transport documents should be free of all reservations in respect of the conditions of the goods, the term "goods" covering both packing and contents.⁴¹

The significant feature about Article 18 is that it looks to the rights of the beneficiary and is phrased in terms that the banks "may" refuse unless the transport documents are "free of all reservations in respect of the conditions of the goods." The Article does not state, however, that the bank owes a duty to its principal to refuse bills bearing any

theories as to the legal category in which a letter of credit fits. Trimble, *The Law Merchant and the Letter of Credit*, 61 HARV. L. REV. 981, 997, 1002 (1948), summarizes the conflicting views and concludes that a letter of credit can best be considered as a "mercantile specialty." See also McCurdy, *Commercial Letters of Credit*, 35 HARV. L. REV. 539 (1922); GUTTERIDGE, *THE LAW OF BANKERS COMMERCIAL CREDITS* 16-19 (1932); Thayer, *Irrevocable Credits in International Commerce*, 36 COL. L. REV. 1031 (1936); and Mead, *Documentary Letters of Credit*, 22 COL. L. REV. 297 (1922).

⁴⁰ On July 7, 1938, the Committee on Foreign Banking of the International Chamber of Commerce recommended to its membership that after October 1, 1938, their export letters of credit should include a provision incorporating the *Uniform Customs* except where otherwise expressly stated. See WARD AND HARFIELD, *BANK CREDITS AND ACCEPTANCES* 196 (1948). Ward and Harfield further point out (at pp. 198-99) that the International Chamber of Commerce made no recommendation "with respect to the incorporation of reference to the *Uniform Customs* in letters of credit issued by our banking institutions." This was because the Committee on Foreign Banking feared that it would impair the negotiability of the instrument until the *Uniform Customs* became better known. Although it was intended that the *Uniform Customs* govern all commercial credits issued by the membership, Great Britain, a large commercial country, has not adhered to the *Uniform Customs*. Most other trading countries have done so.

⁴¹ INTERNATIONAL CHAMBER OF COMMERCE, BROCHURE No. 82, EXPLANATORY NOTE (1933).

reservation regarding the condition of the goods. In effect, this Article therefore, confers upon the bank as against the beneficiary the same type of discretion that the exculpatory clause in the application form confers it *vis a vis* the principal.

In conclusion the prevalent legal saw that "any notation with reference to the condition of the merchandise or its container" renders a bill "foul" enjoys a rather limited application. It is probably not the law and certainly not the practice in regard to certain disclaimers that carriers customarily stamp on bills. On principle, the maxim would not seem to apply where what was stamped on the bill was essentially a repetition of its text. Some notations, such as "discolored" scrap iron, show no damage and thus do not qualify the statement that the goods are in "apparent good order." Other notations, such as "fragile containers," that show a possibility of damage present a more difficult problem. Unless the implication is a strong one, the notation should affirmatively show some damage to the goods or their containers. Otherwise the effect on market value would seem doubtful and the notation fits within Williston's suggested *de minimis* rule.

In the usual application form for a letter of credit, the exculpatory clauses, together with the provisions of the *Uniform Customs* that the letter incorporates, confer upon the issuing bank a limited area of discretion to determine what is a "clean" bill. Since banks in this business generally are large relative to any one customer, they are likely to regard their reputation among principals and beneficiaries generally as more important than their interest in any one transaction. They would thus appear well suited to the role of commercial arbiter within the limited but frequently recurring area where the precise application of the rules governing "clean" bills of lading is doubtful.