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Banks' Security under Letters of Credit on Bills of Lading:

Inherent Risks in Paper and Digital Contexts

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ABSTRACT

A bank under a letter of credit transaction is always expected to become a pledgee on the goods which are the subject of the transaction by holding the related bills of lading. However, the process of creating a pledge in a letter of credit transaction is much more complicated than a mere delivery of a bill of lading, and there are many inherent factors that might impair a bank's ability to become a pledgee on bills of lading. These factors are deeply associated with the mechanism of letters of credit and the characteristics of bills of lading. Some of these factors were identified in the authorities in decades ago; but since then, they have been overlooked by both English courts and academia; meanwhile, some have been being misunderstood for many years. These factors have existed as a risk to a bank's security for a long time and would continue to act as a threat when paper bills of lading are replaced by electronic bills of lading (eB/Ls).

This thesis aims to identify these factors and examine the impacts thereof on bank's position under letter of credit transactions. Also, it evaluates how the usage of eB/Ls to replace paper bills of lading will change the bank's position, especially in the occurrence of the factors mentioned above; last but not least, it proposes suggestions for lawmakers to address the risks brought by these factors, in the context of both the paper world and the digital world.

Through examining each stage of pledging a bill of lading associated with the performance of the parties in a sale of goods transaction, the thesis identifies the following factors that affect (or are assumed to affect) a bank's security under a letter of credit: first, goods have been discharged before a sellers' tender of bills of lading; secondly, the ownership in the goods has passed to buyers before sellers' tender of bills of lading; thirdly, sellers have not intended to transfer constructive possession to banks through their transfer of bills of lading or sellers have not indorsed their bills of lading properly (if necessary) to banks; fourthly, buyers fraudulently dispose of the pledged bills of lading, which are previously redelivered by banks against a trust receipt.

From the detailed discussion on these factors, it concludes that banks' position under letter of credit transactions is less secured than it appears and that the impact of the replacement of paper bills of lading with eB/Ls on banks' position will vary depending on types of electronic-bills-of-lading platforms used. To deal with these factors, the thesis proposes that more certainty and clarity in the law are necessary, especially the law of bills of lading as well as the law of pledge; moreover, more preparation in legal infrastructure is required before entering the digital context.

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DECLARATION OF AUTHORSHIP

I, ZICONG ZENG

declare that this thesis and the work presented in it are my own and has been generated by me as the result of my own original research.

Banks' Security under Letters of Credit on Bills of Lading: Inherent Risks in Paper and Digital Contexts

I confirm that:

1. This work was done wholly or mainly while in candidature for a research degree at this University;
2. Where any part of this thesis has previously been submitted for a degree or any other qualification at this University or any other institution, this has been clearly stated;
3. Where I have consulted the published work of others, this is always clearly attributed;
4. Where I have quoted from the work of others, the source is always given. With the exception of such quotations, this thesis is entirely my own work;
5. I have acknowledged all main sources of help;
6. Where the thesis is based on work done by myself jointly with others, I have made clear exactly what was done by others and what I have contributed myself;
7. None of this work has been published before submission

Signed: .....
Date: .....

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Chapter 1 Introduction

A letter of credit is one of the most common trade finance instruments in international transactions. It has irreplaceable advantages that other instruments do not have. It can well tackle the concerns of parties (of transactions) that are in different countries and not familiar with each other. This is achieved by financing banks absorbing the risks for those parties; in return, financing banks take the goods, which are the subject of the transaction, as collateral. The security interest obtained by financing bank is normally a pledge on the goods, which is created by sellers' transfer of bills of lading to their bank.

Financing banks under letters of credit are always presumed to become pledgees on the goods as long as they are holding bills of lading. However, it is not always the case. The process of pledging bills of lading under a letter of credit transaction is more complicated than our expectation; the usage of trust receipts thereunder could even expose banks to the risk of being deprived of their security interest; as such, the position of financing banks is much less secure than we think. This status lasts for many decades, partly due to the overlook of English courts and academia, and it leads to the uncertainty of banks' security. The issue will become more complicated once the whole process of international transactions is digitalised. The digitalisation of international transactions is deemed as a promising future; by that time, the position of financing banks might become more uncertain and unclear if . Accordingly, it is urgent and necessary to evaluate the position of financing banks under letter of credit transactions, especially to examine prospective pledges held by them; in addition, it is important to discuss what changes the digitalisation will bring to banks' security under letter of credit transactions. Most importantly, a certainty in law must be ready before the digitalisation completes.

1.1 Research Background

A letter of credit used to be and is still a heavily documents-reliant trade financing instrument. One of the reasons is that the documents triggering financing banks' payment obligation are also the ones capable to confer them security interest in the goods. The form of such security interest is normally a pledge, effected by a delivery of transferable bills of lading. This is attributed to the unique legal status of transferable shipped bills of lading under English law, i.e., being the documents of title to the goods.

However, since the containerisation of shipping, the usage of traditional bills of lading has been declined. Goods often arrived before bills of lading, because the examination of and the transmission of paper documentation were highly time-consuming. Thus, the alternatives of bills of lading emerged and were accepted by financing bankers; meanwhile, bankers have to sacrifice their security interest

in the goods; instead, they have to look at other types of security against their customers' default in reimbursement.

Academia has been trying to find a solution for bankers to obtain security interest in goods when no bill of lading is available.[1] However, so far, English law has not yet recognised these proposed solutions; without traditional bills of lading, financing banks continued to lack security interest in the goods under letters of credit, and the risk of nonpayment was exposed. In practice, financing banks might deal with such exposure by increasing the threshold for applying for a letter of credit, such as requiring a deposit of applicants. These extra measures would eventually turn into the increased cost of applying a letter of credit and the harm to the small to medium enterprises that should have benefited most from letters of credit.

In practice, the problems of the traditional trade finance setting have been exposed more because of the pandemic. The pandemic caused a lack of labour, which significantly slowed down the processing of paper documents. And dealing with paper documents was considered unhygienic and had the risk of spreading the virus.

To tackle the problems above, nowadays, in order to facilitate the process of letters of credit and reduce the human contact in consideration of the COVID-19 situation, digitalisation of the whole procedure of letters of credit is growingly needed. Digitalisation, especially with the implementation of blockchain technology, has the benefit of reducing the cost and time in operation and automating the process to avoid manual errors or malicious alteration. So far, all the attempts to digitalise letters of credit were made in a closed system; so were that of bills of lading. The industry is still looking forward to an open-accessed, decentralised system available to everyone around the world, enabling the substitute of paper documents with digital alternatives, such as electronic bills of lading.

This could be a good opportunity to reconsider financing banks' security in goods, and to re-examine the possibility of bankers obtaining a security interest in goods in the upcoming digital era of trade finance.

In a traditional letter of credit, financing banks' collateral security in goods is normally established by a pledge of transferable bills of lading. Under English law, a pledge of transferable bills of lading operates as a pledge of the underlying goods themselves; this is attributed to transferable bills of lading being recognised as documents of title to goods by the relevant custom of merchants. However,

[1] E.g. Swansea University, Bariş Soyer and Andrew Tettenborn (eds), *International Trade and Carriage of Goods* (First edition, Informa Law from Routledge 2017) Chapter 13: 'Lending on Waybills and Other Documents-Banker's Dream or Financer's Nightmare?', at section 13.2.4.

there is no equivalent custom of merchants relating to any electronic alternatives to transferable bills of lading, so a transfer of such electronic alternatives will not create a valid pledge in the goods.

Governed by English law, the current solution for creating pledges through electronic alternatives to transferable bills of lading is based on the contractual web, or contractual nexus, such as Bolero and essDOCS.[2] The system provider acts as the agent of bailees-the carriers-to attorn the goods to any qualified holders of the electronic bills of lading; the carriers thereby become the bailees of any subsequent holders, and those holders thereupon obtain the constructive possession of the goods. If the holder is a financing bank under a letter of credit, it might become a pledgee holder of the electronic bill of lading.[3] Once the applicant fails to reimburse the bank, the latter can realise its collateral security by disposing the electronic bill of lading in its possession. But this solution only applies to the transaction under which every party involved is a member of the same system. Although the system allows switching electronic documents with paper documents so as to enable its member to transact with non-members, such solution would eliminate the benefit of using electronic bills of lading to replace paper bills of lading and make the system less attractive to potential users. Besides, the legal effect of such pledge has not been tested under English law and requires a close examination.

Considering that it is unrealistic to have a closed system having all the parties registered as members, closed systems are not, from the practical perspective, regarded as the ultimate form of electronic bills of lading. Instead, open systems of electronic bills of lading are expected to be the true electronic equivalent to paper bills of lading because participants of international trades do not need to become the members of a system before being enabled to access eB/Ls. The possibility of having an open platform of electronic bills of lading has become real after the distributed leger technology emerged. Nevertheless, an electronic bill of lading under an open platform is still not a document of title like a paper bill of lading, so the financing banks holding it as security will struggle with the same problem. Recently Law Commission, following other international instruments, has proposed a draft Bill, which has been presented to the Parliament, to enable the usage of electronic trade documents to fulfil the possession requirement of documentary intangibles. If it was enacted as expected, electronic bills of lading in an open platform could be used for creating a pledge in an equivalent way as paper bills of lading. However, such proposal does not specifically address the issues which are identified from a pledge with paper bills of lading, so that, presumably, the problems about the paper world found in this thesis are likely to remain existing despite of the enactment of the proposal.[4]

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[2] For Bolero, see http://www.bolero.net; for essDOCS, see http://www.essdocs.com.
[3] E.g., Bolero calls a holder of a Bolero eB/L "Pledgee Holder".
[4] See discussion in Chapter 7.

Financing banks' security is under the risks of exposure in both the current trade finance scheme and the potential digital scheme, and not all those risks have been legally or judicially identified or resolved, some of which though are in practice circumnavigated by extra measures. The cost of placing the extra measures increases the application cost of trade financing instruments and makes the instruments less attractive to small-medium enterprises, which play an important role in economic recovery after the pandemic. Therefore, it is important and necessary to identify and resolve these risks under the paper scheme and the potential digital scheme.

1.2 Research Question

letters of credit are still playing an irreplaceable role in the international sale of goods.[5] And in the process of an international sale under a letter of credit, financing banks are balancing the interests of buyers and sellers; they are, on the one hand, absorbing the risk of buyer's creditworthiness for the seller, and on the other hand, providing advance for the buyer. The most important reason banks play this role in international sales is that they will have sufficient security against buyer's defaults.

Among all the options for a bank's security, having a security interest in goods is the most economical, customer-friendly way. The way for a financing bank to obtain security interest on goods is by seller pledging the related bill of lading; the bank thereby becomes the pledgee of the goods. If the buyer, also the debtor under the letter of credit, failed to repay the bank by due time or went bankrupt before repayment, the bank, as a secured creditor, has a self-help remedy from the pledged goods: it can sell the bill of lading, or take delivery of the goods and sell them to satisfy the debt owed by the buyer, without first applying to courts for permission.

However, the security interest obtained by this way is not as sound as it looks. There are some unsolved issues in the operation of this security mechanism, which could corrode the bank's security under letters of credit and render it an unsecured creditor. These issues affect the bank's security in every stage, from the creation to the enforcement of the security interest. These issues include: 1) the bill of lading become spent before its transfer to the seller's bank; 2) the seller lost its property in the goods before transferring the bill of lading to his bank; 3) the seller might transfer the bill of lading to his bank without the intention to transfer the constructive possession of the goods or properly indorsed to his bank; 4) the buyer improperly disposes of the bill of lading released by his bank against the trust receipt. These issues have been largely overlooked in the existing literature and not sufficiently addressed by common law. Therefore, it is important to ask what these issues are and what solutions are available in law.

[5] See Section 2.1.

Moreover, since the development of digitalisation in international sales, it has been proposed that the digitalisation of documents is a chance for the development of letters of credit. Accordingly, it is worth seeing how digitalisation deals with the bank's security, especially those issues existing in traditional letters of credit.

Therefore, the research question of the thesis is: what are the factors potentially impairing a bank's security as a pledgee under a letter of credit transaction? And how will the digitisation of bills of lading affect these factors? What changes in respect of law shall be made to tackle with these factors so as to reduce the negative impact thereof on bank's security?

Without identifying these factors, the legal validity of the security interest conferred by bills of lading might be uncertain. But, if such factors were identified and solved, no other types of security (e.g., cash deposit) is, theocratically speaking, needed in certain cases; this would in turn reduce the cost and burden for traders to access trade finance, which would be friendly especially for small-medium enterprises. These enterprises are the vast majority in the global business and play an important role in post-COVID economic recovery. However, they are normally unable to provide other types of security, either real estate or moveable property. Due to their informality, it is hard to pass due diligence and to assess risk assess.[6] Therefore, banks are not willing to rely solely on their creditworthiness. Accordingly, having bills of lading as collateral is the most economic and efficient way for financing banks to obtain security interests in letter of credit transactions. Having bills of lading as security gives the banks control over the goods so that banks are easy to enforce their security and do not rely on the creditworthiness of their applicants on which they would otherwise have to reply in the situation where bills of lading are not provided. However, these benefits are only based on the circumstance where the banks have confidence in their security provided by the bills of lading; otherwise, banks will not rely solely on the bills of lading and will ask for extra security from the applicants. The purpose of the current research is to bring more certainty to the bank's security over bills of lading under letters of credit. And it is believed by the author that, through the prism of the findings on paper bills of lading, banks can glimpse their future in the upcoming digital era, namely can predict their legal position of holding different types of electronic bills of lading under different legal environments. By knowing that, banks can make more preparations for their security issue before the digital era comes, and the UK legislators can address these factors before adopting any relevant schemes.

[6] Louise Gullifer and Ignacio Tirado, 'Financing Micro-Businesses and Uncitral's Model Law on Secured Transactions' [2017] SSRN Electronic Journal p650-651 <https://www.ssrn.com/abstract=3033114> accessed 20 December 2021.

Considering the research question and objectives above, the research is confined to a particular scope. First of all, although letters of credit are normally used in cross-jurisdiction transactions, the research focuses only on the relevant legal rules under English law. Secondly, the term "bills of lading" only refers to transferable shipped bills of lading, which are recognised as documents of title to goods under English law; other types of bills of lading, such as straight bills of lading and received bills of lading, are not documents of title to goods under common law and the transfer thereof cannot transfer the constructive possession of the underlying goods;[7] as such, these types of bills of lading cannot be used for creating a pledge of goods without attornment. Thirdly, "bank(s)" or "financing banks" in this thesis refers to confirming/nominated bank(s) or issuing bank(s); various types of banks participate in the workflow of letters of credit, including advising banks, nominated banks, confirming banks, issuing banks, etc; considering the security against the obligations of reimbursement, only confirming/nominated banks or issuing banks could be exposed to the risks of non-reimbursement. Fourthly, considering the research topic is mainly related to the transfer of bills of lading, the discussion on letter-of-credit transaction will use "sellers", "buyers" and "banks" as the representatives of all the parties involved for the purpose of convenience, because they are the main parties transmitting the bills of lading during the whole circle of the transactions; as such, the discussion and finding about these parties could also apply to the "bank-to-bank" circulation of letters of credit. Fifthly, "bank's security" refers only to the bank's right as a pledgee; as such, only proprietary security against insolvency is discussed in the thesis, but not the contractual security, such as the bank's right to sue as a lawful bill of lading holder under the Carriage of Goods by Sea Act 1992.[8]

1.3 Research Contributions

As mentioned above, the aims and objectives of the thesis are to identify the factors affecting bank's pledge under letters of credit, both in the paper context and in the digital context, and to clarify the legal reasoning for how these factors affect bank's security and why they potentially will damage bank's security. Based on these findings, the thesis also attempts to find solutions and suggestions to tackle these factors and risks from the perspective of law.

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[7] Although there is a possibility for a straight bill of lading being recognised as a document of title at common law, the widely accepted view is that it is not a document of title in a sense that a transfer thereof do not pass the constructive possession: see *The Rafaela S* [2005] 2 AC 423 (HL); see Paul Todd, 'Bills of Lading as Documents of Title' [2005] Journal of Business Law 762.

[8] For the detailed comparision of bank's security between COGSA92 and pledge, see Anna-Mari Antoniou, 'Bank Security in Letters of Credit: Mere Pledgee or Something More?' 36 Journal of International Banking Law and Regulation 367.

The thesis further contributes to providing a systematic analysis of the bank's security on bills of lading in letter of credit transactions. Such analysis will include original and novel discussions on various topics related to bank's security. Through the discussions, clarification on relevant legal rules is illustrated. This is achieved by making an innovative contribution to the unsettled debate in a certain area of law, identifying and eliminating the misunderstanding of the law, and expanding the old law into an emerging domain.

A few legal rules of bank's security are vague and unclear; hence, the thesis focuses on these areas and makes a contribution on the certainty and clarity thereof. This thesis will address the unsettled debate on when a bill of lading exhausts as a document of title to goods and what the bank's position is in case of the goods are discharged before it receives the bill of lading. The thesis is also devoted to revealing and clarifying the long controversial issues, such as the indorsement requirement for pledge of bills of lading and its importance thereof on the bank's security; as well as the problems for banks of using trust receipts under letter of credit transactions.

Some legal rules have always been misunderstood for several decades, but their correctness has never been questioned or challenged. The misapplication of the rules would jeopardise bank's interest in certain cases. As such, despite clarification of certain rules, the thesis will critically discuss and argue the possibility that some of the assumptions from the case law are wrong, i.e., whether a seller under a letter of credit transaction needs to reserve his ownership to create a pledge in favour of his bank. Moreover, it will put forward an original proposal in terms of the application of s.24 of the Sale of Goods Act 1979 to the situation where a seller has passed his ownership before pledging the bill of lading to his bank.

Next, the thesis will make a contribution on developing law and practice in digital prospect. It will provide an original and cutting-edge examination in respect of bank's security on electronic bills of lading under letters of credit through analysing the UNCITRAL Model Law on Electronic Transferable Records 2017 together with the latest UK proposal on electronic trade documents in 2022. There have been some influential academic contributions on electronic trade documents and their application in trade finance, but much of which fail to address the factors to be identified by this thesis.[9] The thesis will fill this research gap.

Last but not least, new legal requirement is proposed to be required to respond to the findings above. It is suggested that a registration requirement is needed for the security interest remained in the banks

[9] E.g., Christopher Hare and Dora Neo (eds), *Trade Finance: Technology, Innovation and Documentation* (1st edn, Oxford University Press 2021); Miriam Goldby, *Electronic Documents in Maritime Trade: Law and Practice* (2nd ed, Oxford university press 2019).

after they redeliver the pledged assets to their pledgors. With such requirement, it is believed that it could better balance the interest between banks and other third parties.

1.4 Research Methodology and Structure

The methodology used in this thesis is tailored for the features of this research topic. The objective of the research is to evaluate the current and prospective legal rules regarding bank's security under letters of credit and consequently propose some advice on increasing certainty thereof. Considering such objective, the methodology applied is doctrinal legal research methodology, i.e., "black letter" methodology. The thesis encompasses a discussion on both a traditional area of law and an innovative area that is based on the revolutionary technology and a draft Bill. Both areas embrace numerous legal rules and doctrines. By applying doctrinal methodology, the thesis critically and qualitatively analyses the legal materials, finds the ambiguities and uncertainties in those areas, and provides solutions thereof.

The traditional area is the prolonged law of bills of lading. There have been many defined legal rules as well as uncertainties around this area. These rules are the foundation for financing banks becoming pledgees on the goods in transit under letters of credit. In order to discuss bank's security under letters of credit, it is inevitable to scrutinise those legal rules by examining the relevant cases from which the rules are found. Moreover, most of these rules have been stipulated in the statutes, and their interpretations should be coherent with the related case law.

Regarding the uncertainties in this area, some of them have been discussed by many scholars, and many doctrines have been invented. To make contribution to these issues, a comprehensive literature review and a critical discussion thereupon are needed. Through the discussion and examination of those doctrines and opinions, the thesis will bring out its own contributions to these uncertainties, which aim to make the law in this area more certain.

As to the innovative area, there is no case law or statutes directly related to this area. Although the concept of electronic bills of lading has existed for a while, it has not been widely adopted by the parties taking part in international transactions. There are many reasons for it, legally and practically. To tackle the market's needs, many innovative solutions emerge, including blockchain bills of lading and the legislative proposal on recognising the legal status of these electronic documents. These innovations have not been tested by the market or courts. Also, there are few literatures discussing about the validity of these innovations, especially in the context of bank's security. Therefore, the discussion in this part refers to the legal rules and cases of the closest area; and there are many

hypothetical discussions based on the current practice and law; by analysing those legal materials, the thesis identifies the tenability of the hypothesis.

However, since the research methodology used focuses on the doctrines, few empirical evidence is provided under the thesis to support the arguments or hypothesis thereunder.

The thesis will discuss bank's security in these two areas independently. It will first discuss the bank's security in the context of paper bills of lading because there are more research resources in this context than in the digital era, and the issues here are more closed to the current practice. Moreover, the findings in this part will lay the foundation for the discussion in the other part, since one of the aims of this thesis is to find out whether the same issues identified in the paper world will also occur in the digital world.

Taking all the concerns mentioned above into account, the thesis will be structured as follows:

The first part of the thesis (Chapter 1) will provide a general overview of a letter of credit transaction and the modernisation of international trade and the research background. This part gives an overall picture of the research topic.

The discussion in the main body will start with the paper context for the reasons above. So, the second part of the thesis (Chapter 2) will introduce the commercial and legal foundations for letter of credit transactions in the paper world, especially general legal rules for creating a pledge and the document-of-title function of a transferable bill of lading. It will address the benefit of having bills of lading as a pledge and the importance of bills of lading to banks becoming pledgees under letter of credit transactions. Also, it gives an ideal image of a financing bank's position in a letter of credit transaction. With the understanding of how and why a bank becomes a pledgee on the goods, it would be easier to recognise where a bank's security might go wrong and how a bank will lose its security interest during the letter of credit transaction.

Considering the importance of bills of lading and the characteristic as documents of title to bank's security, banks might become unsecured when something wrong happens around those legal rules and thereby break the ideal image mentioned above. So, the third part of the thesis (Chapters 3, 4, 5 and 6) will identify what factors will cause a bank to lose its security and analyse the reasons for its existence. There will be many factors identified through the discussion in this part, and these factors are located in different stages of a transaction. Since bank's security is working around bills of lading, this part will group these factors by their relationship with bills of lading. As such, this part will divide those factors into three groups: first, factors exist at the stage prior to the seller's transfer of bills of lading to its bank; secondly, at the seller's transfer of bills of lading; and thirdly, after the seller's transfer of bills of lading. By grouping these factors in this way, it will directly show how

fragile and unsecured a financing bank is when it holds a bill of lading as security under a letter of credit, and the bank might lose its security in every stage of the transaction. After identifying these factors, the corresponding proposals are made at the end of each chapter. It is also worth to remind that the findings and discussion are equivalently applicable to the confirming/nominated bank's (if any) transfer to its issuing bank.[10]

Based on the findings in the paper context, part four of the thesis (Chapter 7) will evaluate the bank's security on electronic bills of lading, to discuss whether the factors existing in the paper world still impair bank's security with electronic bills of lading. This part will introduce the types of electronic bills of lading and their legal status under the current legal frameworks and the prospective legal environments. Following that, a detailed discussion and analysis of bank's security with different types of electronic bills of lading under different legal environments. And the discussion in this part will imitate the structure of part three, for the convenience of discussion and comparison.

The fifth part of the thesis (Chapter 8) is the conclusion of the analysis in part three and part four; a proposal for a change of law will be presented in this part as well.

[10] See the section 1.2.

Chapter 2 Commercial Overview and Legal Foundations

This chapter will give an overview picture of letter of credit transactions and the legal foundations thereof. It will address the importance of a letter of credit in international trade as well as its shortcomings. Besides, it will briefly introduce the developing digitisation of letter of credit transactions, especially the electronic bills of lading under closed system and the emerging open-system electronic bills of lading. In terms of the legal foundations, it will analyse the legal rules on security interests; in particular, it will elaborate on the rules of pledge in the context of letter of credit transactions.

It will be difficult to determine the risks for improper operation of the letter of credit mechanism without understanding how it operates properly. Therefore, such commercial overview and legal foundations are necessary for the further examination of bank's security, the inherent risks identified in the following chapters.

2.1 Commercial Overview on Letter of Credit Transactions

A Letter of credit as a trade finance tool is still playing an important role in global transaction. It was estimated in 2014 that the usage of letters of credit supported about one-sixth of total global trade; even though the usage of letters of credit was declining over the last 15 years, there has been an increase in trade finance involving emerging market economies.[11] In 2019, the ICC trade register reported, among 25 financing banks, the estimated usage of letters of credit occupied 28% of global traditional trade finance flows, around USD 0.6 trillion.[12]

A Letter of credit is a payment tool that is designed to reconcile the interests of sellers and buyers under international transactions. In international commerce, counterparty's creditworthiness is more difficult for traders to be investigated than in local commerce. In this scenario, sellers' security against buyers' insolvency relies on their property right in the underlying goods; so, the sellers would be unwilling to part with the property in the goods until they got paid by the buyers. On the other hand, the buyers are unwilling to pay unless they are ensured that the goods will be delivered and the

[11] John James Clark and Bank für Internationalen Zahlungsausgleich (eds), *Trade Finance: Developments and Issues: Report Submitted by a Study Group Established by the Committee on the Global Financial System, the Group Was Chaired by John J Clark, Federal Reserve Bank of New York* (Bank for International Settlements 2014) p1.
[12] ICC Trade Register, '2019 ICC Trade Register Report: Global Risks in Trade Finance', p12.

ownership in the goods passed to them;[13] besides, the buyers might suffer from cash flow problems if they paid the seller before acquiring the property in the goods because they could not re-sell or finance on the same goods. Under a letter of credit, the issuing bank can make advances for the buyers; the dispatch of the goods can be evinced by certain shipping documents (e.g. shipped bills of lading), so that the payment of the banks against the shipping documents can, to some extent, ensure the dispatch of the goods; and the reimbursement of the buyers is only required when the transport documents arrive; therefore, the buyers' concern about delivery could be resolved.

As for the sellers, their risk of nonpayment after parting with their property in the goods could be shifted to the financing banks because, provided they have fulfilled their obligations, they are guaranteed to be paid by the banks under the letter of credit, who normally would be more reliable and creditworthy than their foreign buyers. And this guarantee of payment is dependent on the buyers' obligation to pay under the sale contract.

The banks are willing to absorb the risk of the buyers' insolvency because they have some forms of security against the buyers' default; the security could be the fund deposited by the buyers in the banks or the pledge on the goods to which the letters of credit are related. Moreover, the banks can earn commissions or interests from this process.

Another advantage of using letters of credit is to resolve the cash flow problems of both parties. For buyers, they do not need to hold the cash before receiving the documents, including bills of lading. In some situations, they can even raise funds by disposing of the goods to which these bills of lading are related.[14] As for the seller, they get the credit from the banks, and they can use this credit for further finance.[15]

The basic workflow for an international transaction under letters of credit is that:[16] (1) sellers and buyers agree to use letters of credit as a payment method under their sale agreement; (2) the buyers (applicants) apply to open a letter of credit in favour of the sellers (beneficiaries); (3) the applicant's bank then issues the letter of credit to the sellers as requested, and notify them to prepare the relevant documents for exchange of the payment, including invoices, shipping documents, and insurance policies; (4) the sellers afterwards collect the requested documents and tender to the applicant's bank (or the correspondent bank); (5) after examination of the documents, the applicant's bank (or

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[13] See Ali Malek and others, *Jack: Documentary Credits: The Law and Practice of Documentary Credits Including Standby Credits and Demand Guarantees* (4th ed, Tottel Pub 2009) para 1.2; see Richard King and HC Gutteridge, *Gutteridge & Megrah's Law of Bankers' Commercial Credits* (8th ed, Europa Publications 2001) para 1.03.

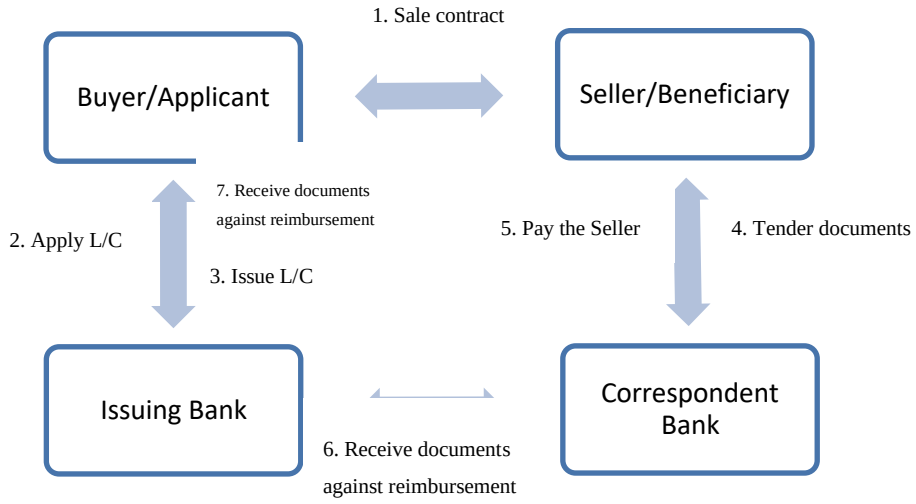
[14] See discussion in Chapter 6.

[15] Paul Todd, *Bills of Lading and Bankers' Documentary Credits* (4th ed, Informa 2007) para 1.44.

[16] For the more detailed workflow, see King and Gutteridge (n 13) para 1.16-1.23.

correspondent bank) is obliged to pay the seller (or accept the drafts) if those documents are strictly compliant; (6) when the banks obtain the documents, they notify the buyer to reimburse in order to collect those documents.

Normally there will be more than one bank in the different countries involved in this process. Both parties of the sale contract prefer the bank in their own country, so a correspondent bank is usually necessary. With the involvement of a correspondent bank, the workflow of a letter of credit transaction is as shown in the following diagram:



Despite these advantages, its disadvantages in practice have been discovered. Most of these disadvantages are related to paperwork. The most obvious is that the whole process is time-consuming. The process of letters of credit is working around paper documents. Therefore, it takes time to post them, to examine them. Even though the importance of fast examination has been noticed, the maximum time for examination by each bank is five working days.[17] This problem becomes more obvious since the speed of shipping transactions has dramatically increased over the years. Also, the heavy paperwork means high demand for human resources and the exposure of risk of human error.

Due to these obvious disadvantages, there has been a suggestion about the digitalisation of the workflow of letter of credit transactions; one of the important parts of digitalisation is replacing

[17] see Uniform Custom and Practice for Documentary Credits No.600 (UCP 600), Art. 14(b);see also Todd (n 15) para 9.20, it was suggested that the test of 'reasonable time' at common law would continue to apply.

documents with electronic documents, including bills of lading. Many attempts to digitise lading bills have occurred, but most were based on contractual frameworks and were not regarded as the true replacement of paper bills of lading.[18] Recently, the advent of blockchain changed this situation. Blockchain was regarded as the most potential technology in the shipping and finance industry because it could create a truly electronic replacement for paper bills of lading.[19] Once the documents were digitalised in either way, the whole process of a letter of credit transaction could be less time-consuming.[20] However, the current law has not catch up the pace of this technological evolution, and the prospective legal initiatives failed to consider the legal uncertainty remaining in the paper world; these concerns could slow down the progress of digitisation, so that it would be necessary to discuss them before fully embracing the upcoming digital era.[21]

2.2 Legal Foundations on Bank's Security under Letters of Credit Transactions

As illustrated by the discussion above, the current mechanism of letters of credit transaction heavily relies on documents. The heavy reliance on documents is not only because paper documents are unique and authenticable but also because of the legal rules behind these paper documents.

As mentioned earlier, the willingness of financing banks to absorb the risk of buyer's default depends on the security that the latter provides to the former. In other words, the banks need some form of security against the buyer's failure in reimbursement; if the buyers failed to fully discharge their obligation under the letters of credit, the banks would be able to recourse to those security given by the buyers. Even though the average default rates across all trade finance products have continued to be low, the default rate for import letters of credit has increased in 2018.[22] This reminds financing banks that taking security under letters of credit is still essential. Besides, taking security on the goods may allow the financing banks to obtain regulatory capital relief.[23]

In terms of security, the most desirable document for the financing bank under a letter of credit is a transferable bill of lading because the possession thereof normally gives the bank control of the

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[18] Law Commission, *Electronic Commerce: Formal Requirements in Commercial Transactions* (19 December 2001) para 4.7.
[19] For the detail discussion about electronic bills of lading, see section 7.1.
[20] See Shuchih Ernest Chang, Hueimin Louis Luo and YiChian Chen, 'Blockchain-Enabled Trade Finance Innovation: A Potential Paradigm Shift on Using Letter of Credit' (2019) 12 Sustainability 188, section 5.
[21] See discussion in Chapter 7.
[22] ICC Trade Register, '2019 ICC Trade Register Report: Global Risks in Trade Finance', p32.
[23] Clyde & Co, 'The Legal Status of Electronic Bills of Lading: A Report for the ICC Banking Commission' (2018), 5 <https://cdn.iccwbo.org/content/uploads/sites/3/2018/10/the-legal-status-of-e-bills-of-lading-oct2018.pdf> accessed 2 July 2020, at p8.

underlying goods.[24] Ideally, such control will take effect as a pledge on the goods, which will enable the bank to have a security interest in the goods not only against the buyer but also against other creditors of the buyer.

Considering the importance of bank acquiring security as a pledgee, this section will mainly discuss the how a bank to acquire security interest via bills of lading (opposed to other types of security interests and the security conferred by the contractual regime). Before detailed examining the legal rationales of pledging with bills of lading, it will generally introduce the ordinary security under a sale contract and how the usage of letters of credit changes the legal positions of each party in terms of security; also, it will compare the pledge of bills of lading with other alternative ways for the bank to acquire security interest.

2.2.1 Security under International Trade Transactions

Generally, security is one of the most important factors concerning every trader. In this sense, having security means that, in the event of a party's default, the other party's interest is protected. In an international sale of goods, the seller needs security mainly against his buyer's default in performing the payment obligation.

The current English law has provided many protections for sellers against nonpayment of their buyers, such as unpaid sellers' right of lien and right of stoppage in transit.[25] These protections are effective even though the ownership of the goods has been transferred to their buyers. Nonetheless, the most powerful security is the retention of property, which could protect an unpaid seller from his buyer's insolvency.[26] The same is true for a buyer who has paid his insolvent seller.[27] Accordingly, sellers invariably desire to retain the ownership of the goods as security against their buyers' default until they receive the payment.

In English law, the exact moment of when the ownership is transferred ultimately depends on the parties' intention.[28] Such intention is "seldom or never capable to proof".[29] Most standard contracts with CIF[30] or FOB[31] terms are silent on the transfer of property. To discern the intention of the parties, the court should consider the terms of the contract, the conduct of the parties and the surrounding

[24] As to other documents possibly used as security for bankers, please see discussion at section 2.2.5.
[25] Sale of Goods Act 1979, s.41-46.
[26] E.g. *Ginzberg* v. *Barrow Haemetite Steel Co.* [1966] 1 Lloyd's Rep. 343.
[27] E.g. *Carlos Federspiel & Co., SA v. Charles Twigg & Co. Ltd.* [1957] 1 Lloyd's Rep. 240.
[28] See Sale of Goods Act 1979, s.17.
[29] *Ross T Smyth & Co Ltd v TD Bailey Son & Co* [1940] 3 All ER 60, at p67.
[30] CIF is short for cost, insurance and freight.
[31] FOB is short for free on board.

circumstances;[32] and it should take into account the legislative presumptions about the timing for transferring the ownership in the goods.[33] If all evidence point to the conclusion that the seller wants to reserve his right of disposal, the court is often able to find an intention to retain his ownership until certain conditions are fulfilled.[34]

Most international sale of goods contracts facilitated by the carriage of goods by sea provides that payment is made against the documents. This is attributed to the finding of bills of lading as capable of transferring ownership of the goods.[35] Under these contracts, the sellers can fulfil the condition of transferring ownership by tendering the proper form bills of lading. But they would not do so until the buyers paid. Therefore, when the sellers retain the bills of lading before getting paid by the buyers, they are normally regarded as intending to reserve their rights of disposal and thereby retain the ownership of the goods.[36]

This is a mere presumption of the seller's intention, which is rebuttable by contrary evidence.[37] Nevertheless, agreeing to use letters of credit for payment is not evidence contrary to this presumption because "even the most copper-bottomed letter of credit sometimes fails to produce the payment."[38] Moreover, even though a letter of credit is issued, the seller desires to retain the ownership to secure his interest in the period between the shipment and the time of obtaining payment from his bank against the bill of lading.

Accordingly, sellers under international transactions are generally keen to retain their ownership of the goods as security against their buyers' non-payment.

2.2.2 Security under Letters of Credit

Normally, the seller will get paid by his bank after submitting the required bill of lading. By paying the seller, the bank has absorbed the risk of the buyer's default. As mentioned earlier, the willingness of issuing banks to absorb the risk of buyers' default depends on the security that the latter provides to the former. In other words, the banks need some form of security against the buyers' failure in

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[32] Sale of Goods Act 1979, s.17(2).
[33] Sale of Goods Act 1979, s.18.
[34] Sale of Goods Act 1979, s.19.
[35] *Lickbarrow v Mason* (1794) 5 Term Rep 683. But it does not mean the ownership will necessarily be transferred along with the bill of lading; see discussion in section 2.2.3.
[36] See *Ross T Smyth & Co Ltd v TD Bailey Son & Co* [1940] 3 All ER 60, at p68; see also Richard Aikens and others, *Bills of Lading* (3rd ed, Routledge 2021) para 6.28.
[37] E.g. *The Parchim* [1918] AC 157; *Albacruz v Albazero (The Albazero)* [1977] AC 774.
[38] *Mitsui And Co Ltd v Flota Mercante Grancolombiana SA (The Ciudad de Pasto and The Ciudad de Neiva)* [1988] 1 WLR 1145, at p1153; see also *Procurator General v MC Spencer (Controller of Mistui & Co Ltd) (The Glenroy)* [1945] AC 124, at p135-136.

reimbursement; if the buyers failed to discharge their obligation under the letters of credit fully, the banks would be able to recourse to those security given by the buyers.

There are plenty of security options for issuing banks: it could be the deposit of the buyers' cash, a debenture on the buyers' assets, a charge over particular properties, or a guarantee from their holding companies.[39] However, one of the advantages of using letters of credit is to resolve the cashflow problem of the buyers, which will be unlikely to be achieved if a cash deposit is required; insisting on a deposit as a precondition of applying a letter of credit will discourage traders from using this trade financing tool, especially for the smaller size companies who are more likely to suffer from the cashflow problems.[40] Therefore, it is more common in letters of credit for the banks to acquire security from the goods themselves.[41]

Under letters of credit, the security interest taken by the banks is normally a pledge on the goods. A pledge is one of the four consensual forms of security in the UK.[42] To understand better why getting a pledge on the goods is important for issuing banks, a general discussion about security interest and its function is necessary.

2.2.2.1 Security Interest

There is no specific concept or definition for a security interest in English law. Briefly speaking, A security interest is a proprietary interest that is granted to the creditor to secure an obligation owed to the creditor.[43]

Unlike mere personal security, a security interest is a proprietary interest in the asset, reflecting the relationship between a security interest holder and the asset.[44] Personal security is a security in the form of a personal undertaking, typically by a third party, to guarantee the debtor's obligation.[45] For example, a standby letter of credit is a type of personal security provided by its guarantor (the issuing

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[39] See Malek and others (n 13) para 11.2; King and Gutteridge (n 13) para 1.17 and fn 38.
[40] Gullifer and Tirado (n 6), it notices the existing financing gap for miro-business.
[41] Cf. King and Gutteridge (n 13) para 8.01, it is suggested that the bank normally relies on the substance and integrity of the customer, and that the security provided by its possession of the documents of title is normally regarded as subsidiary.
[42] They are liens, pledges, mortgages and charges. Meanwhile, some scholars suggested there were only three types of security interest, which are pledges, mortgages and charges: e.g. HG Beale and others, *The Law of Security and Title-Based Financing* (3rd ed, Oxford University Press 2018) para 1.17; MG Bridge and others, *The Law of Personal Property* (2nd ed, Sweet & Maxwell 2018) para 15.004.
[43] See *Bristol Airport v Powdrill* [1990] Ch 744, at p760 (Browne-Wilkinson V-C); *Re Bond Worth Ltd* [1980] Ch 228, at p248 (Slade J).
[44] See Beale and others (n 42) para 4.01 and 4.06, a security interest, like absolute interest, is a right in rem, but limited by being defeasible upon performance of that obligation.
[45] Louise Gullifer, *Goode on Legal Problems of Credit and Security.* (6th ed, Sweet & Maxwell 2018) para 1.06.

bank).[46] Personal security does not provide the creditor with interest in the asset. When the debtor fails to complete his obligation, personal security only avails the creditor to claim the debt from the guarantor. By contrast, a proprietary security interest gives the creditor a recourse to a specific asset when the debtor has failed to perform his obligation. Normally, but not necessarily, a creditor will have a right to sell the secured asset or apply to the court for doing so in the debtor's default.[47] In the insolvency of the debtor, the creditor with a security interest will be separated from unsecured creditors; he does not need to prove his indebtedness to the liquidator or trustee; he can remove the secured asset from the insolvent debtor's assets available to satisfy his unsecured creditors, subject to some limitations.[48]

But overall, a security interest cannot amount to absolute ownership, even though they share many similarities. The extent to which the security interest holder can act as the owner depends on the type of the security interest; for example, a pledgee has a right to retain possession of and a right to sell the pledged asset; by contrast, a lienee only have a right to retain possession. The rest of the rights contained in the full ownership will remain in the debtor.

2.2.2.2 Pledge as Security Interest

Although it is now widely accepted that the financing banks under a letter of credit are holding a pledge on the goods, this is not always out of doubt. In some situations, the banks are not regarded as pledgees. For example, when the shipping documents held by the banks are not documents of title to the goods at common law, the banks only acquire a charge on the goods (without the carrier's attornment).[49] Moreover, even though the banks are holding bills of lading, the legal effect of such holding used to be regarded as a mortgage.[50]

Therefore, a brief introduction to different types of security is necessary for distinguishing different types of security interests.

Generally, a pledge is a delivery of possession of an asset to the creditor by way of security. It is possessory security; therefore, intangible items, except for documentary intangibles, might not be the

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[46] Generally speaking, a standby letter of credit is an instrument providing an undertaking to pay one party of a contract when the other party fails to perform his obligation under the contract, and it is payable on the former's presentation of a written demand.
[47] A lien holder does not have a right to sell the asset at common law, though the agreement normally confers on him with a right to sell.
[48] Gullifer (n 45) para 1.18; as for the limitations, see Royston Miles Goode, *Principles of Corporate Insolvency Law* (4th ed, Sweet & Maxwell 2011) para 11.15 onwards.
[49] E.g. see *Inglis v Robertson* [1898] AC 616 and *Dublin City Distillery v Doherty* [1914] AC 823.
[50] E.g. *Glyn Mills Currie & Co v East and West India Dock Company* (1880) 6 QBD 457 (CA), p480.

subject matter of the pledge.[51] Recently, there have been discussions about the possessibility of digital assets and proposals about the pledgeability of electronic documents;[52] but as far as the current law is concerned, digital content cannot be the subject of possessory security.

Although the term "equitable pledge" has been used by English courts when no possession is delivered by way of security, such security is likely to be characterised as a charge.[53]

In the process of pledging, the special property in the asset is transferred to the pledgee while the general property remains with the pledgor. By obtaining the special property in the asset, the pledgee has rights more than mere custody.[54] And in the event of default in repaying the advance, the pledgee has a right to sell the asset, which is implied by the nature of the pledge and from the authority from his pledgor.[55]

If anyone converted the pledged asset, the pledgee would have a right to sue in conversion because he has a right to immediate possession of the asset. This right of action is important for the banks under letters of credit, especially when the carrier has refused to deliver the goods to it or misdelivered to someone else.[56]

Even though the creditor's possession of the asset is the essence of the pledge, redelivery of the asset to the pledgor does not necessarily render the pledge invalid; releasing the pledged asset to the pledgor for limited purposes, such as for selling the asset on the pledgee's behalf, will not destroy the pledge.[57] Such release is always accompanied by trust receipts, which is very common in letter of credit transactions. In the context of international sale of goods, trust receipts "provide for the release by the bank of the bills of lading to the debtor as trustee for the bank and authorise him to sell the documents or the goods on behalf of the bank".[58]

A contractual lien, like a pledge, is also possessory security; both a pledgee and a lienee have a right of retention; however, unlike a pledge, the possession of asset is not delivered to the creditor for security but for some other purposes, such as repair. And a lienee, without conferring by contracts,

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[51] Some argued that certain intangible assets could be pledged, such as confidential information: see Norman Palmer (ed), *Interests in Goods* (2nd ed, LLP 1998) p635.
[52] Law Commission, *Digital assets: electronic trade documents: a consultation paper* (CP 254, 2021), this UK proposal is now in the policy development status; see discussion in section 7.2.2.
[53] See Beale and others (n 42) para 5.60.
[54] *Donald v Suckling* (1866) LR 1 (QB) 585.
[55] *The Odessa* [1916] 1 AC 145.
[56] See *Sze Hai Tong Bank Ltd. v. Rambler Cycle Co. Ltd.* [1959] AC 576; *Motis Exports Ltd v Dampskibsselskabet AF 1912 Aktieselskab and Aktieselskabet Dampskibsselskabet Svendborg* [2000] CLC 515.
[57] *Re David Allester Ltd* [1922] 2 Ch 211; *Bassano v Toft* [2014] EWHC 377 (QB); [2014] ECC 14.
[58] MG Bridge (ed), *Benjamin's Sale of Goods* (11th ed, Sweet & Maxwell 2021) para 18.504, it was cited by *The Yue You 902* [2019] SGHC 106, [2019] 2 Lloyd's Rep 617, p636.

does not have a right to sell or dispose of the asset, which is inconsistent with the retention of possession.[59]

Neither a mortgage nor a charge is possessory security. Their creation does not require possession of the secured asset.

A mortgage is a transfer of ownership in the asset to the creditor through security; the mortgagee thereby acquires the ownership of the asset, subject to the mortgagor's equitable right of redemption.[60] Theoretically, a legal mortgagee has a right to possession of the mortgaged asset at any time since he is the legal owner of the asset;[61] nevertheless, the contract of mortgage will often modify the mortgagor's right so that he can have right of possession of the asset prior to any default.

A charge in nature is an encumbrance on the property. Though there is no definition of a charge, its distinct features are elaborated by Atkin LJ in *National Provincial and Union Bank of England v Charnley*.[62] The agreement of charge evinces the parties' intention that the chargee will have a present right to make the security available on the asset; and that the chargee will not have any legal property, or any possessory right; and that the chargee is able to enforce his security to discharge the obligation owed to him. Creating a charge is relatively simple, which requires the parties to agree that certain assets are to be appropriated to discharge the obligation. A charge on personal property is equitable, so the chargee has an equitable proprietary interest in the charged asset, enabling him to recourse on the asset and its proceeds to discharge the obligation in priority to unsecured creditors.[63]

Compared with charges, mortgages and liens, pledges are the most suitable type of security interest for letter of credit transactions. Firstly, a lien is not created by delivery only with the purpose of delivery, so a lien is not compatible with the normal operation of letters of credit. Secondly, neither a mortgage nor a charge cannot provide their holder sufficient control over the goods without registration. The loan given under a letter of credit is normally small, and its maturity is short, so it requires the process of letters of credit to be fast. If every letter of credit requires registration, it will cost more than time and money to issue a letter of credit, at least when only paper documents are used.[64] A pledge can provide its holder with a sufficient control on the pledged asset without

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[59] *Donald v Suckling* (1866) LR 1 (QB) 585, at p604 (Mellor J). But normally, there is a contractual right of sale conferred on the lienee.
[60] *Keith v Burrows* (1876) 1 CPD 722, at p731 (Lindley J); The right to redeem can be legal if it is expressed by the contract of mortgage.
[61] *Four-Maids Ltd v Dudley Marshall (Properties) Ltd* [1957] Ch 317, at p320 (Harman J).
[62] [1924] KB 431, at p449.
[63] *In The Matter of Lehman Brothers International (Europe) (In Administration)* [2012] EWHC 2997 (Ch), at [43]; *Re TXU Europe Group Plc* [2003] EWHC 3105 (Ch), at [35].
[64] This comment on registration requirement is not suitable to the digital context, see discussion in section 7.3.3.3.

registration. And its creation only requires a delivery of possession of the pledged asset, which can be completed by transferring a bill of lading. As such, a pledge is a more suitable security interest than other types of security interest.

2.2.2.3 Why a Pledge?

As discussed above, there are four types of security interest in English law. When a seller deposits the bill of lading to his bank on behalf of his buyer, why the legal effect thereof is creating a pledge instead of others?

English law employs freedom of contract in the classification of security agreements as well as other types of contracts; however, the courts are not bound by the label given by the parties.[65] Indeed, English law experienced a long way to finalise the legal effect of deposit of bills of lading as security.

A deposit of a bill of lading used to have the effect of pledging only in the Court of Equity.[66] Later, in the House of Lords of *Meyerstein v Barber*, the majority was in the view that the parting with the bill of lading for the value passed the absolute property/the whole and complete ownership of the goods.[67]

At the same time, some judges contended that it has the effect of pledging the goods.[68] Both Erle CJ and Willes J in the Court of Appeal thought that there was only a pledge of the goods.[69] But they are rejected by the superior court or other authorities.

One of the main reasons for the courts interpreting the deposit of bills of lading as creating a mortgage was the widely accepted custom of merchants found in *Lickbarrow v Mason*, namely, that such delivery of bills of lading passes the legal property.[70] The true effect of the delivery of a bill of lading will be discussed in the following section.

The unsettlement on the legal effect of a pledge with bills of lading was ended in *Sewell Burdick*.[71] In the House of Lords, it was held that the custom of merchants was that the bill of lading was capable

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[65] Bridge and others (n 42) para 16.092.
[66] *Ex parte Westzinthus* (1833) 110 ER 992, p999.
[67] *Meyerstein v Barber* (1870) LR 4 HL 317, both Lord Westbury and Lord Hatherley were in the view that the parting with the bill of lading for value passed the absolute property/the whole and complete ownership of the goods.
[68] E,g. *Harris v Birch* 152 ER 249; *Francis Jenkyns v William Brown, Joseph Shipley, Samuel Nicholso and others* (1849) 14 QB 496, 502;
[69] *Meyerstein v Barber* (1866) LR 2 CP 38.
[70] See *Glyn Mills Currie & Co v East and West India Dock Company* (1880) 6 QBD 457 (CA), p480; cf. *Hibbert v Carter* (1787) 1 Term Rep. 745, it was decided in the same year as *Lickbarrow v Mason* by the same of panel of judges, the court held that, where a bill of lading is taken by a creditor as a security for his debt on his own account, the whole property passes by the delivery; but the parties were always at liberty to vary from the general rule by entering into any particular agreement between themselves, so long as they could show that this was what they intended to do.
[71] *Sewell v Burdick* (1884) 13 QBD 159; (1884) 10 App Cas 74 (HL).

of, not must, transfer property in the goods.[72] Lord Blackburn agreed that neither *Lickbarrow v Mason* nor the custom of merchants justified that the indorsement of a bill of lading for a valuable consideration must pass the entire legal property.[73] The true meaning of the custom of merchants was that the property, which it might be the intent of the transaction to transfer, whether special or general, passed by such an indorsement and delivery.[74] Accordingly, whether the general property or the special one is passed depends on the intention. It was found from the nature of the contract to give security by the delivery of a bill of lading that it only required a pledge accompanied by a power to obtain delivery of the goods and, if necessary, to realise them.[75] Hence, if the parties intended only to pledge the goods with the bill of lading, the general property would remain at the transferor, and only special property would pass to the transferee.

2.2.2.4 Creation of Pledge

The discussion above has demonstrated the differences among four types of consensual security interest; one of the differences is the way of creation. A pledge is unique in the perspective of creation, which requires delivery of possession of the asset. Nevertheless, as a security interest, it is subject to the related general principles about creation. The following paragraphs will introduce how a pledge is created in English law integrated with general principles about the creation of security interests.

In terms of general security interest, its process of creation is often examined from two parts, namely attachment and perfection.[76] The notions of "attachment" and "perfection" have been recognised by English law and are widely used in the US, Canada, Australia, etc.[77] There have been many writers using these notions to explain English law.[78] Using these notions is arguably beneficial to the comparison between English law and other jurisdictions regarding the efficiency and efficacy of their security systems.[79]

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[72] *Sewell v Burdick* (1884) 10 App Cas 74 (HL).
[73] *Sewell v Burdick* (1884) 10 App Cas 74 (HL), p100 (Lord Blackburn).
[74] *Sewell v Burdick* (1884) 10 App Cas 74 (HL), p80.
[75] *Sewell v Burdick* (1884) 10 App Cas 74 (HL), p82 (Earl of Selborne LC).
[76] The term "attachment" is from the Uniform Commercial Code of the US, Art 9, and it is beginning to be used in England, see *Report of the Committee on Consumer Credit* (Cmnd 4596, 1971), para 5.6.4 and Appendix III; see Ewan McKendrick, *Goode and McKendrick on Commercial Law* (Sixth edition, LexisNexis Butterworths 2020) para 22.78.
[77] For example, they are used in the Uniform Commercial Code, Art 9; see also Law Commission, *Consultant Paper on Registration of Security Interests: Company Charges and Property Other Than Land* (Law Com. No. 164, 2002), at para 2.5.
[78] E.g. Gullifer (n 45) at Ch2. See also Law Commission, *Company Security Interest* (Law Com. No. 296, 2005), para 3.6.
[79] ibid at para 2.01 and fn 1.

Attachment is that a security interest has fastened on the asset, and perfection is that such security interest on the asset has been notified to the public so that it is capable of binding third parties. They serve different functions in the process of creating a security interest, but sometimes, they are overlapped with each other. For example, in case of a pledge, a delivery of possession serves both as an attachment and as a perfection.[80]

The effect of attachment is to grant the creditor a security interest in the goods so that he acquires a proprietary interest against the debtor. The debtor is not entitled to deny the creditor's interest in the secured asset.[81] To have a security interest attached to the asset, the asset itself must be identifiable.[82] This might also be a requirement hindering digital assets from being pledgeable.[83] Also, the grantor of the security interest must have sufficient proprietary interest in the asset or have the authority from the owner to grant a security interest to others.[84] This could, to some extent, explain why a security interest cannot be created by retention of title under a sale contract under English law, because the buyer (the debtor) does not acquire the ownership or own the property when he purports to grant a proprietary interest in the underlying asset to the seller (the creditor) as security against the buyer's obligation.[85]

In most cases, the proprietary right created by attachment but without perfection is only able to bind the debtor, not necessarily the whole world.[86] Once the security interest is perfected, it can bind third parties. Another function of perfection is to protect anyone who purports to acquire interests on the same asset by notifying them about the existence of the security interest.

The common method of perfection is by registration. There is no single scheme for registration for every type of security interest. For example, a charge created by a company should be registered in the Company Chargers Register. This is important because sometimes, the security interest held by the financing banks is categorised as a charge rather than a pledge; if so, the financing banks' security interest, without registration, could be defeated by other creditors.

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[80] See Louise Gullifer, *Goode on Legal Problems of Credit and Security*. (6th ed, Sweet & Maxwell 2018) para 2.10 and 2.20; Law Commission, *Company Security Interest* (Law Com. No. 296, 2005), para 3.100.

[81] However, an unregistered security bill of sale is invalid against the debtor under s.8 of the Bills of Sale Act (1878) Amendment Act 1992.

[82] See *Re London Wine Co (Shippers)* [1986] P.C.C. 121; Gullifer (n 45) at para 2.05 and fn 25, the principles of identifying the tangible asset are the same as that of identifying goods under sale contracts.

[83] See Roy Goode, 'Are Intangible Assets Fungible?' [2003] Lloyd's Maritime and Commercial Law Quarterly 379; see Gullifer (n 45) para 2.06.

[84] See *Abbey National Building Society v Cann* [1990] 2 WLR 822, [1991] 1 AC 56, at p92 (Lord Oliver of Aylmerton); see discussion in Chapter 4.

[85] *McEntire v Crossley Brothers Ltd* [1895] AC 457, 462 (Lord Herschell LC).

[86] See Louise Gullifer and Roy Goode, *Good and Gullifer on Legal Problems of Credit and Security* (6th edn Sweet & Maxwell 2017), para 2.02, although it is odd to say that a right in rem available only against the debtor, an unperfected security interest can bind some categories of third party.

Meanwhile, for some types of security interests, they are not required to, or unnecessary to be registered. For instance, a pledge is not subject to the registration requirement because the creditor has possession of the asset, and the existence of his security interest in the asset is evinced by his possession. However, the situation will be more complicated if the creditor's possession is constructive rather than actual. Constructive possession is a right to have actual possession delivered to him immediately when he does not have the actual possession.[87] This is relevant because the financing banks under a letter of credit, which is related to the carriage of goods by sea, is impossible to retain the physical possession or control over the pledged asset, and they have the constructive possession only.[88] Therefore, it is necessary to discuss how constructive possession can perform the same functions as actual possession in the creation of a pledge.

2.2.2.5 Pledge under Letters of Credit

The paragraphs above have addressed how important the possession of the asset is in the creation of pledge. Meanwhile, it is also emphasised that, under a letter of credit transaction involving carriage of goods by sea, the financing banks are impossible to retain the physical possession of the goods. How can the banks become pledgees on the goods under the letter of credit transaction?

As mentioned earlier, this is possible due to the finding that a transferable bill of lading is regarded as a document of title to the goods. Because a bill of lading is regarded as a document of title to the goods, the delivery requirement can be fulfilled by the delivery of the related bill of lading. This will be explained in detail in the next following sections.[89] Before that, it is necessary to clarify the role of each party under a letter of credit transaction in creation of a pledge on the goods.

Under a letter of credit transaction, a pledge is created to protect the banks' interest against the buyer's default. The buyer is obliged to pay his bank (the issuing bank) instead of the seller. Therefore, it is the buyer, as the debtor, who should grant security interest to his bank (the creditor). However, the buyer is normally not the owner of the goods at the time of delivering the bill of lading to the seller's bank, because the seller often retains his ownership until he gets paid by his bank.[90] As such, it seems that the seller is the person creating the pledge to the correspondent bank, on behalf of the buyer.[91] The seller, who has retained the ownership of the goods and the possession of the bill of lading, has the sufficient interest to create a security interest as a pledge.

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[87] E.g. see Duncan Sheehan, *The Principles of Personal Property Law* (2nd edn, Hart Publishing 2017) p11.
[88] See discussion in section 7.2.1.1.1.
[89] See discussion in section 2.2.3.
[90] See section 2.2.1.
[91] Beale and others (n 42) section 9.2.2.; *Ross T Smyth & Co Ltd v TD Bailey Son & Co* [1940] 3 All ER 60; see discussion in section 4.3.1.

When the seller receives the payment from his bank, he delivers the bill of lading to his bank by way of security, and the bank consequently becomes the pledgee on the goods; at the same time, the ownership has transferred to the buyers, subject to the pledge created on the goods. It was suggested that this was normally the intention of the seller, because the seller no longer looks to the documents for his security but looks to the promise of the bank.[92]

After becoming a pledgee, the seller's bank has the security interest against the issuing bank's failure of reimbursement; the seller's bank will assign his pledge to the issuing bank by transferring the bill of lading against the latter's reimbursement.[93]

Based on this flow of proprietary interest, some authorities suggested that, under a documentary credit transaction, the seller must retain the ownership in the goods at the time of transferring the bill of lading to his bank.[94] If this suggestion was reasonable, the financing banks' security is reliant on whether the seller has retained the ownership at the time of transferring the bill of lading.[95]

The description above has shown the overall picture of how security is created under a letter of credit transaction and what role each party is playing in this process. In this process, the most important instrument for such efficient creation of a pledge is a bill of lading, without which the possessory requirement of pledge would not be fulfilled. No discussion about pledge under letter of credit transactions can avoid talking about a bill of lading and its function as a document of title to goods. The following sections, therefore, will discuss how the law of bills of lading works with the law of pledge.

2.2.3 Pledge with Bills of Lading

As mentioned earlier, when the parties intend only to create a pledge by delivery of the bill of lading, only special property but not general property will be passed to the bank. Accordingly, an intention to pledge is important for creation of a pledge through a bill of lading. However, such intention cannot take effect without delivery of possession.[96] Nevertheless, such delivery requirement could be fulfilled by constructive delivery, which can be completed by transfer of bills of lading.[97]

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[92] Malek and others (n 13) para 11.4.; *Sale Continuation Ltd v Austin Taylor & Co Ltd* [1968] 2 QB 849, at p861; *Guaranty Trust Co of New York v Hannay & Co* [1915] 2 KB 536, p659-660; *Guaranty Trust Co of New York v Van den Berghs Ltd* (1925) 2 Ll L Rep 447, p452 col2.
[93] *Bristol and West of England Bank v Midland Railway Company* [1891] 2 QB 653.
[94] See *Ross T Smyth & Co Ltd v TD Bailey Son & Co* [1940] 3 All ER 60; *The Future Express* [1993] 2 Lloyd's Rep 542 (CA).
[95] See discussion in Chapter 4.
[96] *Kum v Wah Tat Bank Ltd* [1971] 1 Lloyd's Rep 439; *The Future Express* [1992] 2 Lloyd's Rep 79 (QB), p90 col2; *Official Assignee of Madras v Mercantile Bank of India Ltd* [1935] AC 53.
[97] *Official Assignee of Madras v Mercantile Bank of India Ltd* [1935] AC 53; *Dublin City Distillery v Doherty* [1914] AC 823.

Generally, to create a pledge on the asset of which the pledgor does not have the actual possession, a transfer of the document issued by the actual possessor cannot fulfil the delivery requirement, without the attornment of the actual possessor.[98] The exception for this attornment requirement is a transfer of documents of title to goods.[99] In *Official Assignee of Madras v Mercantile Bank of India Ltd,* Lord Wright said that:[100]

> …where goods were represented by documents the transfer of the documents did not change the possession of the goods, save for one exception, unless the custodier (carrier, warehouseman or such) was notified of the transfer and agreed to hold in future as bailee for the pledgee. The one exception was the case of bills of lading, the transfer of which by the law merchant operated as a transfer of the possession of, as well as the property in, the goods.

Accordingly, a transferable bill of lading fulfils the delivery requirement of creating a pledge. And the bill of lading cannot be replaced by other shipping documents because those other documents are not recognised as documents of title by common law.[101] It does not mean that a bank cannot acquire a pledge on the goods while holding these non-documents of title; but, without a document of title, a transfer of the document cannot be regarded as a transfer of the goods themselves so that, without other interventions (e.g. a bailee's attornment or operation of exception of *nemo dat* rule), the bank cannot become a pledgee on the goods.[102]

A transferable bill of lading is a shipping document that is issued in respect of a carriage of goods by sea, normally by or on behalf of the shipowner. It normally performs three functions: 1) a receipt for the goods; 2) evidence of the terms of the carriage contract; 3) a document of title to the goods.[103] Among them, it is the third function that enables a bill of lading to be pledgeable under English law. It is well known that a document of title is important and, to some extent, irreplaceable. Then, what is the function of a document of title regarding pledging and what is a document of title at common law?

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[98] *Dublin City Distillery v Doherty* [1914] AC 823; *Official Assignee of Madras v Mercantile Bank of India Ltd* [1935] AC 53.
[99] In sale of goods, see Sale of Goods Act 1979, s29(4).
[100] *Official Assignee of Madras v Mercantile Bank of India Ltd* [1935] AC 53, at p59 (Lord Wright).
[101] Although some shipping documents are regarded as documents of title by statutes, they are not documents of title at common law and not able to be used for pledging save for some exceptions to *nemo dat* rule: see discussion in 4.5.1.
[102] See discussion in section 2.2.5.
[103] See *Homburg Houtimport BV v Agrosin Private Ltd (The Starsin)* [2003] UKHL 12, [2003] 1 Lloyd's Rep 571.

There is no judicial definition of "document of title" at common law. The origin of "document of title" function is the custom of merchants as found in *Lickbarrow v Mason*.[104]

Lickbarrow v Mason itself discusses whether the unpaid vendor's right of stoppage in transit can be exercised after the bill of lading has been transferred to a *bona fide* third party for valuable consideration. To examine whether the property of the goods has passed to the *bona fide* transferee of the bill of lading, the jury found that famous custom of merchants:

> Bills of lading, expressing goods…to have been shipped by any person or persons to be delivered to order or assigns, have been, and are, at any time after such goods have been shipped, and before the voyage performed…negotiable and transferable…by such shipper or shippers indorsing such bills of lading…and delivering or transmitting the same so indorsed, or causing the same to be so delivered or transmitted…and that by such indorsement and delivery, or transmission, the property in such goods [have] been, and is transferred and passed to such other person or persons.

Accordingly, the effect of such custom of merchants is to recognise the capacity of a transferable bill of lading to transfer the property in its underlying goods, if so intended.[105] And this capacity can be performed by delivering and/or indorsing the bill of lading. Although, the custom seemingly indicates that bills of lading are negotiable, bills of lading are later found that they are not "negotiable" as bills of exchange, but only "transferable"; in other words, the effect of a transfer of bill of lading is subject to *nemo dat* rule.[106]

This custom indicated the customary usage of transferable bills of lading in the 18th century, namely that the merchants used bills of lading as instruments for sale of goods while the goods were still in transit. This mechanism is feasible due to the carrier's undertaking to deliver the goods only to the holder of the bill of lading.[107]

Before bills of lading were transferable, they were only working as receipts of goods, because there was no need for selling the goods while they were at sea.[108] At that period, the carriers knew the identity of the consignees. On some occasions, the shippers had not decided to whom the goods were

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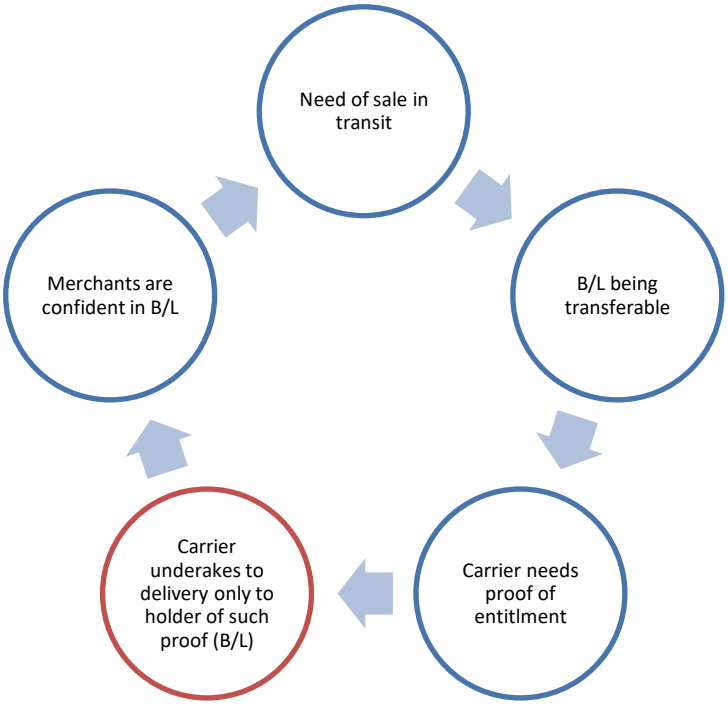
[104] *Lickbarrow v Mason* (1794) 5 Term Rep 683.
[105] *Sewell v Burdick* (1884) 10 App Cas 74 (HL).
[106] *The Future Express* [1993] 2 Lloyds's Rep 542, p547; see Torsten Schmitz, 'The Bill of Lading as a Document of Title' (2011) 10 Journal of International Trade Law and Policy 255, p262-263.
[107] *Glyn Mills Currie & Co v East and West India Dock* (1882) 7 App Cas 591; *The Stettin* (1889) 14 PD 142; *Carlsberg v Wemyss* (1915) SC 616, at p627; *Sze Hia Tong Bank v Rambler Cycle Co Ltd* [1959] AC 576; *Barclays Bank Ltd v Commissioners of Customs and Excise* [1963] 1 Lloyd's Rep 81; *Kuwait Petroleum Corporation v I&D Oil Carriers Ltd (The Houda)* [1994] 2 Lloyd's Rep 541, at p550-556; *Motis Exports Ltd v Dampskibsselskabet AF 1912 Aktieselskab and Aktieselskabet Dampskibsselskabet Svendborg* [2000] CLC 515.
[108] Breif introduction of history of bills of lading, see Aikens and others (n 36) from para 1.7.

consigned when the goods had been dispatched; therefore, transferable evidence of entitlement was needed; at the same time, this practice explored the possibility of selling the goods in transit.[109] When the bill of lading provided that the goods were to deliver to the consignee "to his order or assigns", the identity of the rightful person would be unrecognisable without any proof. Accordingly, bills of lading were used as "evidence of title".[110] This function of bills of lading was beneficial to both the carrier and the merchant. The goods were able to be sold multiple times before arriving at destination ports by merchants; at the same time, carriers can restrict its liability to deliver the goods only to the person who presents the bills of lading at the destination port, without any requirements for investigating the identity of the person claiming delivery from them. Such undertaking of carrier in turn boosted merchants' confidence in transferable bills of lading, which afterwards facilitated the usage of bills of lading in sale of goods.



The development of bills of lading are as shown in the diagram above. It is indicated that the carrier's undertaking plays an important role in this process and ensure that the transferability of bills of lading

[109] ibid para 1.7.
[110] The phrase "evidence of title" was used in *Hatfield v Phillips* (1845) 12 Clark & Finnelly 343, 362.

are functioning.[111] It is regarded as the incidence of the bill of lading contract and the foundation for it being used as a document of title at common law.[112] In addition, this is the incidence enabling bills of lading to be regarded as the "key" of the floating warehouse.[113]

Another description for the "key of floating warehouse" is the "symbol of goods". The word "symbol" was first used by English court to refer to bills of lading in *Maritini v Coles*, where LeBlanc J regarded them as "the apparent symbol of property".[114] Similarly, in the landmark case *Meyerstein v Barber*, Lord Hatherley said that "the parting with the bill of lading is parting with that which is the symbol of property, and which, for the purpose of conveying a right and interest in the property, is the property itself."[115] As such, a bill of lading is a document of title in the sense that the transfer thereof can transfer the constructive possession (or symbolic possession) to the transferee.[116]

In the creation of a pledge, when the debtor transfers the bill of lading to his creditor with the intention to pledge the goods to the latter, such transfer is regarded as a delivery of the goods themselves; and the creditor acquires the constructive possession of, and consequently the special property in, the goods.

2.2.4 Bills of Lading not as Documents of Title

One of the biggest challenges to the financing banks who expect to become pledgees by holding bills of lading is that bills of lading do not always give their holders the right to possession. On some occasions, a transfer of a bill of lading does not transfer the constructive possession of the goods; as such, a bank, who does not receive constructive possession of the goods by receiving the related bill of lading, does not become a pledgee of the goods.[117]

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[111] See *Motis Exports Ltd v Dampskibsselskabet AF 1912 Aktieselskab and Aktieselskabet Dampskibsselskabet Svendborg* [2000] CLC 515, para 19, the undertaking of the carrier to deliver only to the person presenting the bill of lading is fundamentally important to bill of lading contract, and its importance stems from the transferability of a bill of lading; see discussion in Chapter 3.

[112] See *Kuwait Petroleum Corporation v I&D Oil Carriers Ltd (The Houda)* [1994] 2 Lloyd's Rep 541, p550 (Neill LJ).

[113] See *Sanders Brothers v Maclean & Co* (1883) 11 QBD 327, 341 (Bowen LJ); see also *Trafigura Beheer BV & Anor v Mediterranean Shipping Co SA* [2007] EWHC 944 (Comm), [2007] 1 CLC 594, para 66 (Aikens J).

[114] *Maritini v Coles* (1813) 1 M&S 140, p148;see Michael D Bools, *The Bill of Lading: A Document of Title to Goods; an Anglo-American Comparison* (Lloyd's of London Press 1997) p177.

[115] *Meyerstein v Barber* (1870) LR 4 HL 317, p326 (Lord Hatherley); see also *Meyerstein v Barber* (1870) LR 4 HL 317, p337 (Lord Westbury); *Sanders Brothers v Maclean & Co* (1883) 11 QBD 327, 341 (Bowen LJ); *Pease v Gloahec* (1866) LR 1 PC 219, p227-228.

[116] Most scholars consider these terms having the same meaning, while some distinguish them, e.g. Bools (n 114) p173, it was contended that a bill of lading holder had 'symbolic possession' but not 'constructive possession'.

[117] E.g., *The Future Express* [1993] 2 Lloyd's Rep 542 (CA), the bank in this case did not become a pledgee by holding the bills of lading; the detailed discussion about this case, see discussion in Chapter 3.

If, at the time of transfer, the bill of lading has been exhausted as a document of title, there would be no pledge created on the goods. It was held that, to create a valid pledge with a bill of lading, such bills of lading must be valid as documents of title.[118] One of the most common situations where a bill of lading is exhausted as a document of title is that the goods have been delivered by the carrier to the person entitled under such bill of lading.[119] If the goods have been discharged at the time when the seller tenders the bill of lading to his bank under a letter of credit, such bank might not become a pledgee on the goods. This issue is related to the question when a bill of lading become exhausted as a document of title, which is controversial under English law.

Another reason for the bill of lading not performing the document-of-title function is the lack of intention to transfer the right to possession. It was contended that, when the parties did not intend to transfer constructive possession of the goods via the bill of lading, the holder of such bill would not obtain the right to possession of the goods. [120]

Besides, it is still not crystally clear whether a proper indorsement is necessary for a bill of lading to perform the document-of-title function in creation of pledge. In the context of this thesis, the meaning of "proper indorsement" depends on the types of transferable bills of lading. A transferable bill of lading can be a bearer bill of lading, which does not name a consignee, or an order bill of lading, which is made out to a named consignee or to his order, or provides the goods deliverable "to order" without naming a consignee.[121] In case of order bills of lading, the "proper indorsement" simply means the transferor signs the bill and names the party to whom delivery should be made or simply signs its own name; in case of bearer bills of lading, it contains "without indorsement" in addition to the meaning mentioned above. In order to properly perform the document-of-title function in sale transactions, a "proper indorsement" is required. However, it is not sure whether a similar requirement is needed for pledge. If needed, a transfer of the bill of lading without properly indorsement cannot create a pledge of the underlying goods.

These are some of the situations where a transfer of the bill of lading might not operate as a document of title to the goods and thereby would not give the transferee a right to possession of the goods; and it

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[118] *The Future Express* [1992] 2 Lloyd's Rep 79 (QB), p90 col2.
[119] See discussion from Chapter 3 to Chapter 5; as to the definition of "person entitled", see discussion in section 3.3.
[120] See discussion in section 5.1; *The Future Express* [1992] 2 Lloyd's Rep 79 (QB), p90 col2 and p95 col2; *East and West Corporation v DKBS 1912* [2003] EWCA Civ 83; [2003] QB 1509, para 42; Aikens and others (n 36) para 5.13; cf. Bridge and others (n 42) para 12.009 and fn 42, it was submitted that it is wrong to suggest that the transfer of the bill must be accompanied by an intention to pass constructive delivery.
[121] *Union Industrielle et Maritime v. Petrosul International Ltd (The Roseline)* [1987] 1 Lloyd's Rep. 18, p22;see Hardinge Stanley Giffard Halsbury and James Peter Hymers Mackay of Clashfern, *Halsbury's Laws of England [Superseded Volumes]* (5th ed., LexisNexis 2008) p514; Schmitz (n 106) p264.

will consequently affect the validity of the pledge. Therefore, these situations are the factors potentially impair banks' security on bills of lading, which will be identified and discussed below.[122]

2.2.5 Replacing Bills of Lading

According to the previous discussion, the banks' security under a letter of credit transaction is somehow dependent on whether the bill of lading that is transferred by the seller has properly functioned as a document of title to the goods; and there are many inherent and uncertain factors that could hinder a transfer of the bill of lading from working as transferring the constructive possession to its transferee.

Besides, a transferable bill of lading sometimes is not the best option even for the merchants themselves. With development of shipping technology and containerisation, the speed of vessels has become faster and faster. Meanwhile, a paper bill of lading which is circulating in banking chain often arrives at the ultimate buyer's place later than the goods themselves. Since the carrier is bound to deliver the goods to the bill of lading holder, the buyer without the bill of lading cannot take delivery of the goods. This causes troubles for both merchants and carriers.[123] For this reason, in some short-distance voyage, other shipping documents than transferable bills of lading are preferable, such as mate's receipt or sea waybills.

Some of these alternative documents to transferable bills of lading are accepted by bankers of letters of credit.[124] However, without transferable bills of lading, the conventional view is that the banks cannot obtain the security interest as pledge, because other documents are not documents of title to goods.[125] Although there have been exploring the possibility to obtain security when no bill of lading is issued, it is suggested by the author that security on bills of lading is still the best option for bankers in letters of credit.

When no transferable bill of lading is issued, some asserted that a bank would have only a lien on the documents.[126] Some contended that a bank could only have a pledge on the documents.[127] Some even were in the opinion that a bank could still become a pledgee on the goods.[128] The most authority-

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[122] See discussion in Chapter 3
[123] This problem contributes to the usage of letter of indemnity, see section3.2.
[124] See UCP 600, Art 21.
[125] Other transport documents than transferable bills of lading might be recognised as documents of title to goods by custom of merchants, see *Kum v Wah Tat Bank Ltd* [1971] Lloyd's Rep 439; banks might still be able to become pledgee by virtue of exceptions to *nemo dat* rule, see discussion in section 4.5.
[126] See Malek and others (n 13) para 11.9.
[127] *Inglis v Robertson* [1898] AC 616.
[128] *Kum v Wah Tat Bank Ltd* [1971] Lloyd's Rep 439; Swansea University, Soyer and Tettenborn (n 1) Chapter 13: 'Lending on Waybills and Other Documents-Banker's Dream or Financer's Nightmare?', at section 13.2.4;

accepted view, which is also agreed by the author, is that a bank only has an equitable charge on the goods.[129] The following paragraphs will discuss each of these alternative security mentioned above and why these alternatives cannot replace bills of lading in letter of credit transactions.

2.2.5.1 Equitable Charge

When there is an agreement that the bank will have a pledge on the goods, the bank, without transfer of possession, will, most likely, only acquire an equitable charge.[130] The equitable charge enables the bank to restrain the buyer from disposing of the goods in a way that defeats the bank's interest.[131]

However, since it is in nature an equitable interest, it might be defeated when the ownership is transferred for value to a third-party purchaser who does not have any notice about the existence of such interest. In addition, it might be subject to the registration requirement as a charge under S.859A of Companies Act 2006.[132] In other words, if such interest has not been registered, bank's interest on the goods will be prevailed by that of the debtor's liquidators or receivers.

2.2.5.2 Lien or Pledge of Documents

Some might argue that, in the current issue, a bank only has a lien or pledge of the transport document itself, and that whether such interest can be extended to the underlying goods depends on the bailee's attornment.[133]

Without a valid attornment, all the banks can do is retain the transport document. Under the contractual regime, if the bank is named as the consignee under the document, it is able to require the carrier not to deliver the goods because the right of action (and the contractual right of delivery) is vested in the bank.[134]

In addition, as to the proprietary side, it was argued that the bank's retaintion of the bill might establish a lien on the bill, and such lien could safeguard the bank's interest even in the event of the

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see also Patrick Yung, 'Pledge by Constructive Delivery in Hong Kong' (2013) 24 International Company and Commercial Law Review 273.

[129] Sometimes, it is also called equitable pledge: *Kum v Wah Tat Bank Ltd* [1971] Lloyd's Rep 439; *Ishag v Allied Bank International* [1981] 1 Lloyd's Rep 92; but it was argued that "equitable pledge" is not conceptually possible, see Beale and others (n 42) para 5.60.

[130] e.g. *Ishag v Allied Bank International* [1981] 1 Lloyd's Rep 92, p98, col2; *Official Assignee of Madras v Mercantile Bank of India Ltd* [1935] AC 53.

[131] *In re Hamilton Young* [1905] 2 K.B. 772; *Official Assignee of Madras v Mercantile Bank of India Ltd* [1935] AC 53.

[132] *Official Assignee of Madras v Mercantile Bank of India Ltd* [1935] AC 53; *Dublin City Distillery v Doherty* [1914] AC 823.

[133] *Inglis v Robertson* [1898] AC 616; *Official Assignee of Madras v Mercantile Bank of India Ltd* [1935] AC 53.

[134] Carriage of Goods by Sea Act 1992, s.2(1).

buyer's insolvency: such lien would enable the bank to negotiate with the liquidator or receiver that the goods were to be sold on the terms that the proceeds of sale would go in reduction of the bank's claims against the buyer.[135] Obviously, this argument only makes sense when the bank itself is the named consignee, otherwise it is difficult to see what bargaining power the bank has. Moreover, suppose the bank' s interest on the document does not extend to the underlying goods. In that case, such interest cannot stop the liquidator or receiver from asserting their interests in the goods.[136]

If the bank is not the named consignee under the transport document, as mentioned above, it has no legal recourse if the goods have been delivered to the named consignee.

Even though naming itself as the consignee will give the bank some security, it will, at the same time, become a party to the contract of carriage and so liable under it (because of COGSA92). In addition, whether the bank can insist on the request (of naming itself the consignee) will eventually depend on the terms of the contract between the buyer and the seller.[137]

2.2.5.3 Pledge on Goods

For the purpose of current discussion, it was argued that, where no bill of lading is issued, a bank could still have a security interest as a pledgee.[138] However, such argument is very fact-sensitive and cannot be generalised.

In *Kum v Wah Tat Bank Ltd*, the transport document used is a mate's receipt. The court found that the bank became a pledgee on the underlying goods.[139] However, such pledge was not created on transfer of the mate's receipt, but on shipment. In this case, the bank has already made the payment before it received the mate's receipt, which named it as the consignee. Based on this special factor, it was easy for the court to find that the intention of the parties was to consider the delivery to the carrier as the delivery to the bank; if the seller has not been paid, it would likely to reserve the right of disposal so that no irrevocable delivery was made.[140]

In the normal operation of documentary credits, it is unlikely for the banks to pay the seller before receiving any security. The bank in that case must not have become a pledgee on the goods before shipment. Accordingly, the judgment of this case is difficult to be generalised.

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[135] Malek and others (n 13) para 11.9.
[136] E.g. see *Inglis v Robertson* [1898] AC 616.
[137] See Malek and others (n 13) para 8.106.
[138] *Kum v Wah Tat Bank Ltd* [1971] Lloyd's Rep 439; Swansea University, Soyer and Tettenborn (n 1) Chapter 13: 'Lending on Waybills and Other Documents-Banker's Dream or Financer's Nightmare?', at section 13.2.4; see also Yung (n 129).
[139] *Kum v Wah Tat Bank Ltd* [1971] Lloyd's Rep 439.
[140] See comment on *Kum v Wah Tat Bank Ltd* [1971] Lloyd's Rep 439 by Beale and others (n 42) para 5.41.

Nevertheless, it opens the gate to create a pledge on the goods even when only a non-document of title is issued. It was further argued by Andrew Tettenborn that, in a typical operation of documentary credits, a financing bank could be regarded as having the possession in the matter of law, even when only a sea waybill is used.[141] The argument is mainly based on two grounds.[142]

This first ground is about the intention of parties. It was argued that it was the intent of all the parties that the financing bank should have control over the goods, both factual and legal. Such intention can only be implied by courts, because it is rare for parties to stipulate the intention in this regard; and such intention, in my opinion, is difficult to be found in the operation of documentary credits. It is true that, by naming the bank as consignee under the transport document, the bank has all the contractual control on the underlying goods, but not necessarily the factual control. Whether the parties also intend to give the bank the factual control on the underlying goods might ultimately depend on the custom of merchants about the usage of this particular transport document.[143]

Even if this were the intention of the parties, it would not take any effect without attornment. Therefore, it is unsurprised that the second ground for the argument is based on attornment. It was argued that the same result would be achieved based on attornment. This argument is twofold. Firstly, the attornment could be made by the carrier when it receives the goods from the shipper and then issues a transport document under which it agrees to deliver the goods to the bank alone.[144] Secondly, the attornment could be made by the cargo owner instead of the carrier. By depositing the transport document to the bank, an agreement might be implied to the effect that the cargo owner physically holds the goods as the bailee for the bank.[145] Therefore, there is a valid attornment made by the cargo owner. However, the second threshold of this argument is inapplicable to international transactions facilitated by carriage of goods by sea, because the cargo owner does not have the physical possession of the goods.

The arguments based on attornment are quite convincing. If the requirements for attornment are fulfilled in such operation of documentary credits, the bank could have a valid pledge on the goods even though it only holds a non-document of title; however, again, those analyses are all based on

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[141] Swansea University, Soyer and Tettenborn (n 1) Swansea University, Soyer and Tettenborn (n 1) Chapter 13: 'Lending on Waybills and Other Documents-Banker's Dream or Financer's Nightmare?', section 13.2.4.
[142] There are three grounds for this argument, but the third one is considered by the author as negative and only additional, see ibid Swansea University, Soyer and Tettenborn (n 1) Chapter 13: 'Lending on Waybills and Other Documents-Banker's Dream or Financer's Nightmare?', section 13.2.4.
[143] See Paul Todd, 'Bills of Lading as Documents of Title' (n 7) p777..
[144] See *Dublin City Distillery v Doherty* [1914] AC 823, at p852 (Lord Parker); see also *Official Assignee of Madras v Mercantile Bank of India Ltd* [1935] AC 53, at p58-59.
[145] E.g. *Martin v Reid* 142 ER 982; *Dublin City Distillery v Doherty* [1914] AC 823; *Re Hang Fung Jewellery Co Ltd* [2010] 2 HKLRD 1, which is discussed in Yung (n 129)..

particular facts: the bank must be named as the consignee. As mentioned earlier, the bank does not have the ultimate power to insist on this request, and it normally does not want to be a party under the contract of carriage. In conclusion, it is still rare for a bank to become a pledgee on the goods who holds a transport document which is not a document of title to goods.

2.2.5.4 Conclusion

The best often for financing banks under documentary credits is having a transferable bill of lading because they can become pledgees of the underlying goods by holding the document. When no transferable bill of lading is used under the transaction, the bank most likely obtains only an equitable charge on the goods, which is much more vulnerable than a pledge. Both courts and academia are exploring the possibility to have security as pledgee even when no transferable bill of lading is used; however, such possibility is only feasible in some particular situation and thereby cannot be generalised.

2.3 Less Secured than Expected

Although having a transferable bill of lading as security is still the better option for the banks under letters of credit, as suggested from previous discussion, the security on such bills of lading is not as secured as expected; holding a transferable bill of lading does not necessarily give the banks a right to possession of the goods. Besides, there are other inherent factors which could possibly erode bank's security interest. These factors all have strong connection with the bill of lading's document-of-title function and occur at different stage of pledge under a letter of credit transaction; some of them are existing because of either the uncertainty in respect of the law or being overlooked by law or academia. Since the banks' security is working around the bill of lading, the following discussion about these factors will be divided by each stage of a transfer of a bill of lading: 1) before the transfer of a bill of lading to a bank; 2) at the transfer of a bill of lading; 3) after the transfer of a bill of lading.

Chapter 3 Before Transfer: Goods Discharged before Transfer of Bills of Lading

Overall, the purpose of the thesis is to identify the factors potentially impairing bank's interest as a pledgee and to propose solutions thereof. As mentioned earlier, these factors could occur at every stage of a letter of credit transaction. One of them possibly occurring before the seller transferring the bill of lading to his bank is the situation where the goods are discharged by the carrier before the seller transfers the bill of lading to his bank. This situation might render such bill of lading lose its legal effect as a document of title to goods; a transfer of such bill of lading therefore does not transfer the constructive possession to the bank, and consequently, the bank would not become a pledgee on the goods. Taking this into consideration, this Chapter will discuss the particular situation where the goods are discharged before sellers tender the related bills of lading to their banks and the banks' legal position therein.

Why will a bank accept the bill of lading after the goods have already been discharged? Banks under letters of credit only concern relevant documents. They are not concerned about the goods themselves. Also, because of the principle of autonomy, the claims or defences made under the underlying contract cannot affect the banks' duty of payment.[146] The bank is obliged to pay despite that the goods have been discharged when the seller (the beneficiary of the letter of credit) tenders the related bill of lading to the bank. If the bank accepts, it might not obtain a pledge on the goods.

In practice, it is common for goods discharged without presentation of the relevant bills of lading. This is attributed to time-consuming process in banking channel. When bankers are dealing with bills of lading, it is likely that the underlying goods have already been discharged. This situation is not rare and still common in the current practice.[147] Therefore, it is important for the bankers to know whether they can still have the security interest on the goods in this situation. Precisely speaking, the question is whether, in this situation, the transfer of the bill of lading can still transfer the constructive possession to the bank.

When the underlying goods have been discharged by the carrier at the time of transferring the bill of lading, does the constructive possession thereof still pass to the transferee? If not, a financing bank, who obtains a bill of lading from a seller in this situation, would not become a pledgee of the underlying goods.

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[146] See UCP 600, Art 4(a) and Art 5.
[147] Most recent case is *Standard Chartered Bank (Singapore) Ltd v Maersk Tankers Singapore Pte Ltd* [2022] SGHC 242.

The chapter will first explain why a prior-transfer discharge of goods will affect a bank's security on the goods; secondly, it will address the ambiguity of the relevant issue-whether a delivery without presentation of bills of lading will exhaust the bills as documents of title, and it will be concluded by the author's own view on this issue as well as a suggestion for banks under the current law.

Through the discussions below, it is submitted by the author that, when the goods are discharged before the related bills of lading being tendered to the bank, the bank will not become a pledgee of the goods if the goods are delivered to the person entitled to delivery under the bill at the material time, even when the delivery are made without presentation of the bill; if the goods are delivered to the person unentitled, the bank could become a pledgee.

3.1 General Rules

The question of whether a transfer of a bill of lading after the underlying goods have been discharged can still transfer the constructive possession thereunder depends essentially on whether a bill of lading exhausts as a document of title to goods after the goods are discharged. When a bill of lading exhausts as a document of title to goods, its transfer will not transfer the constructive possession of the goods. In this situation, such bill of lading is often called a "spent bill of lading".[148]

It was contended by some scholars that a bill of lading exhausts as a document of title to goods as long as the underlying goods are delivered by the carrier, because a bill of lading cannot give its holder constructive possession of the underlying goods when the carrier no longer possesses the goods. [149] But this contention is incompatible with the general rule of law that a bill of lading exhausts as a document of title only when the goods have been delivered to the person entitled to claim delivery under the bill of lading. [150] Delivery to a person not entitled will not exhaust the document-of-title function of a bill of lading. Moreover, if such broader view were true, the carrier would be able to discharge its liability by its own fault (misdelivery).[151] In cases of misdelivery, the carrier should have been liable to the person truly entitled to delivery; if the bill of lading were "spent" even in this

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[148] Sometimes a "spent" bill of lading is referred to a bill of lading which cannot be used for transferring contractual right of suit. These two senses are said to be distinct but related: *The Ythan* [2006] 1 Lloyd's Rep 457; see also Bridge (n 58) para 18.212.

[149] Aikens and others (n 36) para 2.97; Stephen Girvin, *Carriage of Goods by Sea* (2nd ed, Oxford University Press 2011) para 8.32; Bools (n 114) p193-194; cf. Paul Todd, 'The Bill of Lading and Delivery: The Common Law Actions' [2006] Lloyd's Maritime and Commercial Law Quarterly 539, p559.

[150] *Barber v Meyerstein* (1870) LR 4 HL 317; *The Delfini* [1990] 1 Lloyd's Rep 252, at p269 (Mustill LJ); *East West Corpn v DKBS 1912 AS* [2002] EWHC 82 (Comm); [2002] 2 Lloyd's Rep 182, at [39]-[41]; *The Erin Schulte* [2015] 1 Lloyd's Rep 97, at [53]; see also *BNP Paribas v Bandung Shipping Pte Ltd* [2003] 3 SLR(R) 611, at [30]; *The Pacific Vigorous* [2006] 3 SLR(R) 374, at [5]; *The Yue You 902* [2019] SGHC 106, at [58]-[74].

[151] Todd (n 15) para 7.84.

situation, the carrier would not be liable in tort for the entitled person anymore because of its misdelivery; if so, this would damage the foundation of documents of title.[152]

Following such general rule, if the goods have already been delivered to the rightful person entitled to take delivery of the goods under the bill of lading, the subsequent transfer of the same bill of lading will not operate as a transfer of the goods themselves. In the context of letters of credit, if the seller tenders the bill of lading to his bank after the goods have been delivered to the rightful person entitled to the goods under such bill, the bank will not become a pledgee by receiving this bill of lading. Accordingly, whether the goods have been delivered to the person entitled under the bill of lading has a great influence on bank's security as a pledgee.

Due to its importance, the following will examine this general rule. There are two elements for this general rule. First, the goods must have been delivered; second, the delivery must be made to the person entitled under the bill of lading.

The first element is that the goods must have been delivered in the sense that the shipowner has divested himself of all control on the goods. Merely unloading the goods to the warehouse at the destination port but subject to the order of the carrier does not constitute "delivered".[153] Moreover, the fact that a carrier ceases to be liable under a carriage contract according to a cesser clause does not necessarily means it has also fulfilled the "delivery" in sense of making the bill of lading spent.[154]

The second element, which is less certain, is that the delivery must be made to the person entitled to the possession of the goods under the bill of lading. A fortiori, a delivery to a person not entitled to possession under the bill of lading at the time of delivery does not make the bill of lading stop being a document of title to goods.[155]

The person who is the current bill of lading holder must be within the definition of the person "entitled to possession under the bill of lading" in this sense; therefore, delivering the goods to the person who presented the bill of lading to the carrier would exhaust the bill of lading as a document of title to the goods. The rationale behind it is the same as that of the presentation rule: a carrier is only

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[152] See n 111.
[153] *Barber v Meyerstein* (1870) LR 4 HL 317, at p330-332; *Barclays Bank Ltd v Commissioners of Customs and Excise* [1963] 1 Lloyd's Rep 81; see Nicholas J Gaskell, Regina Asariotis and Yvonne Baatz, *Bills of Lading: Law and Contracts* (LLP Professional Publ 2000) para 14.66.
[154] *Chartered Bank of India, Australia, and China v British India Steam Navigation Co Ltd* [1909] AC 369; see Aikens and others (n 36) para 2.98.
[155] *The Future Express* [1992] 2 Lloyd's Rep 79; *East West Corpn v DKBS 1912 AS* [2002] EWHC 82 (Comm); [2002] 2 Lloyd's Rep 182, at [39]; see also *BNP Paribas v Bandung Shipping Pte Ltd* [2003] 3 SLR(R) 611; *The Yue You 902* [2019] SGHC 106, at [64]-[65].

obliged and entitled to deliver the goods to the person with production of the bill of lading.[156] Both of them are based on carriers' undertaking and obligation to deliver the goods only to the presenter of a bill of lading; following the presentation rule, once the goods are delivered against a bill of lading, the carrier is discharged from its delivery obligation and stop being liable for any subsequent holders; this is so even if the presenter is in fact not the person truly entitled.[157] Accordingly, there is no reason for a bill of lading remaining as a document of title to goods when the underlying goods have in fact been delivered against presentation and when the carrier, who used to be the actual possessor, is not liable for delivery anymore.

3.2 Delivery without Presentation of Bills of Lading

It is the settled law that, when the goods are delivered to the person entitled under the bill of lading, against presentation of the bill of lading, the bill of lading is exhausted as a document of title to the goods. However, it is not sure whether a bill of lading is "spent" as a document of title when the delivery is made to the person entitled against a letter of indemnity but not a bill of lading.

Generally, the reason for using a letter of indemnity is similar to that of using other shipping documents to replace transferable bills of lading, namely, to deal with the situation where the goods have arrived earlier than the bills of lading.[158]

It was held by Channel J in *London Joint Stock Bank v British Amsterdam Maritime Agency* that a bill of lading was exhausted as a document of title when the goods were delivered to the person entitled, even without presentation of the bill.[159] In this case, the delivery was made to the person not entitled so that the bill of lading was held to be not exhausted when it was indorsed to the plaintiff. But if that person were entitled to take delivery, his subsequent indorsement would be ineffective to convey any title to the goods. This case indicates that the person entitled to have the goods delivered to him refers to the person with right to possession, such as the owner of goods or the pledgee of goods; and it thereby excludes the unpaid buyer as consignee under the bill of lading.

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[156] *Motis Exports Ltd v Dampskibsselskabet AF 1912 Aktieselskab and Aktieselskabet Dampskibsselskabet Svendborg* [2000] CLC 515; *Glyn Mills Currie & Co v East and West India Dock* (1882) 7 App Cas 591; *The Stettin* (1889) 14 PD 142; *Carlsberg v Wemyss* (1915) SC 616, at p627; *Sze Hia Tong Bank v Rambler Cycle Co Ltd* [1959] AC 576; *Barclays Bank Ltd v Commissioners of Customs and Excise* [1963] 1 Lloyd's Rep 81; *Kuwait Petroleum Corporation v I&D Oil Carriers Ltd (The Houda)* [1994] 2 Lloyd's Rep 541, at p550-556.
[157] *Glyn Mills Currie & Co v East and West India Dock* (1882) 7 App Cas 591, p610; *Kuwait Petroleum Corporation v I&D Oil Carriers Ltd (The Houda)* [1994] 2 Lloyd's Rep 541, p552.
[158] See n 123.
[159] *London Joint Stock Bank v British Amsterdam Maritime Agency* (1910) 10 Com Cas 102; see also *Seconsar Far East Ltd v Bank Markazi Jomhouri Islami* [1997] 2 Lloyd's Rep 89, 97, in dictum Tuckey J stated that the bills of lading were worthless as security because the delivery has been made without them.

As mentioned earlier, a holder of the bill of lading must be within the definition of the person "entitled under the bill of lading", but it does not necessarily suggest that other person cannot be the person "entitled under the bill of lading" as well. If the person "entitled" could be, for example, the person who was supposed to have the possession of the bill of lading at the time of delivery, but did not have it for some reason, a delivery was made to him without presentation of the bill of lading would also make the bill of lading stop being a document of title to the goods.

It was submitted, as obiter, by Diamond QC in *The Future Express* that the bill of lading should not be exhausted as the document of title when the delivery was made against the letter of indemnity. It was argued that, if the bill of lading stopped being a document of title after delivery to the rightful person without presentation, the values of bills of lading as documents of title would be greatly detracted; and their value to bankers and other party who has to rely on them for security would be diminished; and fraud would be facilitated.[160] One of the values of a bill of lading as a document of title to goods is that it facilitates transactions by removing attornment requirement for transferring constructive possession.[161] The subsequent holder of the bill of lading does not need to acquire the carrier's attornment to perfect his constructive possession. If a bill of lading stopped being a document of title to goods after the goods being delivered to the person entitled without presentation of the bill, the subsequent holder would not benefit from this value of bills of lading and thereby would not acquire the constructive possession of the goods without the carrier's attornment.

Diamond QC, while making the arguments above, addressed the possibility that the bill of lading, which should have been presented, could be passed to a third party for valuable consideration without notice of the discharge of the goods.[162] In fact, this view tightens the test of "spent" under the common law. The effect of this view, if adopted, is that a bill of lading only becomes "spent" when the goods are delivered to the person entitled under the bill of lading, against presentation of such bill of lading.

This view has attracted many criticisms from academia.[163]

It was argued that, if a bill of lading remained as a document of title to the goods after the goods had been delivered to the person entitled without presentation of the bill of lading, a person who afterwards dealt with the actual goods might be correspondingly prejudiced.[164] There is no obvious reason to give priority to the person who dealt with the bill of lading over who dealt with the actual

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[160] *The Future Express* [1992] 2 Lloyd's Rep 79, at p99.
[161] See *Official Assignee of Madras v Mercantile Bank of India Ltd* [1935] AC 53, at p59 (Lord Wright).
[162] *The Future Express* [1992] 2 Lloyd's Rep 79, at p99.
[163] E.g. Girvin (n 149) para 8.3; Aikens and others (n 36) para 2.97; Bridge (n 58) para 18.215.
[164] Bridge (n 58) para 18.215.

goods; moreover, the former person was in a safer position because he has the protection provided by COGSA92, so that he could sue the carrier in contract, who in turn could make a claim under the letter of indemnity.[165]

Although the Diamond QC's view is justified from the holder's view, it could be a nightmare to the carrier, because the carrier is potentially liable to any subsequent holder as long as the bill is in circulation.[166] In addition, it would be uncertain how long after delivery of the goods the bill of lading would remain as a document of title, because the answer of it depends on the facts which are extrinsic to and unlikely to be accessible to the person dealing with the bill of lading.[167]

It was also submitted that Diamond QC's view was contradicted with the Law Commission's reluctance to make rights of action merchandise.[168] If a bill of lading remained as a document of title when the goods were delivered to the person entitled, though without production of the bill of lading, such bill of lading might be circulated only for transferring the right of suit thereunder, but not for the goods (because the goods have been delivered).[169]

3.3 Bills of Lading "Spent" as Documents of Title after Delivery to Person Entitled

The author agrees with the conventional view on the question when a bill of lading becomes "spent", namely that a bill of lading should exhaust as a document of title to goods once the goods has been discharged to the person entitled under the bill of lading, even though such delivery was made without presentation of the bill of lading. Therefore, it is submitted by the author that the Diamond QC's view was not correct.

First of all, the person "entitled to delivery under the bill of lading" does not necessarily the person who currently has the physical possession of the bill of lading. Instead, the person "entitled", in the author's opinion, is the one who can claim delivery if he has surrendered the bill of lading to the carrier or transferred the bill of lading by delivery and/endorsement.

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[165] Ibid.
[166] Paul Todd, 'The Bill of Lading and Delivery: The Common Law Actions' (n 149) p560.
[167] Bridge (n 58) para 18.215; see also Todd (n 15) para 7.85.
[168] Law Commission, *Rights of Suit in Respect of Carriage of Goods by Sea* (Law Com No. 196, 1991) at para 2.43.
[169] See Todd (n 15) para 7.85; Gaskell, Asariotis and Baatz (n 153) para 14.69.

This definition has two indications: firstly, the "person entitled under the bill of lading" is entitled to claim to claim delivery from the face of the bill of lading;[170] secondly, that person can be a person without physical possession of the bill.

In *Yue You 902*, when the Judge considers the problem whether the CFR seller was the person entitled to delivery under the bill of lading at the time of discharge, he said that the seller, after blank endorsing and delivering the bill of lading, had rendered himself incapable of demanding delivery under the bill of lading.[171] The Judge further made a comment that the seller could have his entitlement to delivery back only after the bill of lading was redelivered to him. Finally, the Judge concluded the conditions of "person entitled under the bill of lading": 1) whether the bill was endorsed to him, or was blank endorsed, and 2) whether he had possession of the bill so that he was in the position to present it to the carrier in exchange of delivery of goods.[172]

The same interpretation of "person entitled under the bill of lading" can also be reflected from Diamond QC's statements in *The Future Express*. When he discussed the hypothetical situation, he described the "person entitled under the bill of lading" as the person "who was rightfully entitled them had he surrendered the bill of lading".[173] If the person did not have the bill endorsed to him or blank endorsed, he could not claim delivery from the carrier even with the bill.

Moreover, According to Diamond QC's statements, the fact that the seller neither delete the bank's name as consignee nor divert the goods to the buyer by substituting in the bills the name of the buyer for that of the bank led to the conclusion that neither the seller nor the buyer, under the terms of the bills, any right to demand the goods.[174] And the reason for Tradax, the seller in that case, not doing so was that it would not be able to negotiate the bills of lading and would break the "chain of endorsement".

Accordingly, the "person entitled under the bill of lading" is obviously the person, at least from the face of the bill, entitled to claim delivery with presentation thereof. If a bill of lading is a bearer bill, the physical holder of such bill is the person entitled from the face of the bill; if a person is named as consignee under a bill of lading or if a bill of lading is endorsed to him, that person will be the entitled person from the face of these bills, even though they do not physically possess the bills of lading at the time of discharge.

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[170] The "face" of a bill of lading means the front and the back of the bill.
[171] *The Yue You 902* [2019] 2 Lloyd's Rep 617, at [78].
[172] *The Yue You 902* [2019] 2 Lloyd's Rep 617, at [82].
[173] *The Future Express* [1992] 2 Lloyd's Rep 79, at p99.
[174] *The Future Express* [1992] 2 Lloyd's Rep 79, at p99.

If a holder of a bill of lading that is not a bearer bill and is endorsed to other person, this holder is not a person "entitled under the bill of lading"; but if a person is entitled to delivery from the face of the bill of lading, but without possession of the bill, he still could be a person "entitled". For example, a bill of lading is endorsed to A and on the way of delivering to him (e.g., caused by postage delay); the underlying goods arrive before the bill, so the carrier delivers the goods to A against indemnity. In this situation, A, even though without possession of the bill, is within the meaning of "entitled under the bill of lading".

If A is the consignee of the bill of lading, and if such bill of lading is in physical possession of B at the time of the goods being delivered to A, it is submitted by the author that A is still a person "entitled".

The simple explanation is that B, though possessing the bill, cannot claim delivery from the carrier by presenting this bill; neither can he endorses and passes the bill to a third party. Accordingly, the discharge of the goods to A will make the bill, which is in possession of B, spent. That is a fair result for both carriers and holders of bills of lading: the carriers have discharged their delivery obligations, and the bills of lading cannot be circulated anymore due to the break of endorsement chain. As such, a person "entitled" can be a person without the physical possession of the bill.

Therefore, a delivery made to the person "entitled", even without presenting the bill of lading, will make the bill of lading stop being a document of title to the goods.

There are many arguments against this view, but they are either tenable or inconsistent with basic principles of law.

It has been said that one of the values of a bill of lading as a document of title to goods is that it facilitates transactions by removing attornment requirement for transferring constructive possession.[175] This value is based on the ground that the carrier does not need to know the identity of the person to whom it is entitled to deliver; the carrier is only entitled to deliver the goods to the presenter of the bill of lading. But when the carrier chooses to deliver the goods without presenting the bill of lading, it also chooses not to reply on the bill of lading to identify who is entitled to take delivery of the goods; when the carrier does so, it does it in its own risk.[176] Therefore, what detracts from the value of a bill of lading as a document of title is the carrier's own choice, but not the status of being "spent" as Diamond QC suggested.

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[175] See text in n 161

[176] *Sze Hia Tong Bank v Rambler Cycle Co Ltd* [1959] AC 576, at p586.

This also explains why a carrier will be liable for misdelivery if the person to whom it is delivered without presentation is not entitled under the bill of lading. The carrier's obligation of delivery is not discharged by delivery against a letter of indemnity and is still in existence and enforceable by any subsequent holder of the bill of lading.[177] In this situation, the carrier is the person who should bear the responsibility to subsequent holders of the bill of lading, because their loss, could have been avoided by the proper performance of the carrier, namely to deliver the goods only to the holder. But this obligation does not and should not exist forever. If the goods were delivered to the person entitled under the bill of lading, any subsequent holder claiming delivery of the goods is likely to be a victim of fraud. As mentioned before, Diamond QC, while making his arguments, addressed the possibility that the bill of lading, which should have been presented, could be passed to a third party for valuable consideration without notice of the discharge of the goods.[178] But this possibility is unlikely to happen without fraud.[179] Therefore, the fraud will break the causation between the subsequent holder's loss and the carrier's breach of contract; and, it is unfair to hold the carrier to be liable for any subsequent holder in this situation.

More fundamentally, to hold Diamond QC's view, in the author's opinion, is inconsistent with the background condition of performing document-of-title function. This background condition, as suggested by the author, is that the underlying goods are not physically accessible by the parties.

This background condition is arguably implied by the authorities on bills of lading being a "symbol of goods". Reviewing the landmark case for the bill of lading's document-of-title function, the background for this function is that the goods are not physically accessible by the holder of the bill of lading. Lord Hatherley has mentioned this background, not once but twice. He said "when the goods are at sea the parting with the bill of lading...is parting with the ownership of the goods" and that "when the vessel is at sea and cargo has not yet arrived, the paring with the bill of lading is parting with...the symbol of property, and...the property itself."[180] The similar, but more specific, expression can be found the statement of Bowen LJ in *Sanders Brother v Maclean & Co*, where he said "a cargo at sea while in the hands of the carrier is necessarily incapable of physical delivery. During this period of transit and voyage, the bill of lading...is universally recognised as its symbol."[181] These statements all have mentioned the same background, namely that the goods are in transit at sea.

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[177] *The Erin Schulte* [2015] 1 Lloyd's Rep 97, at [53].
[178] *The Future Express* [1992] 2 Lloyd's Rep 79, at p99.
[179] Paul Todd, 'The Bill of Lading and Delivery: The Common Law Actions' (n 149) p560.
[180] *Barber v Meyerstein* (1869-70) LR 4 HL 317, p326 (Lord Hatherley).
[181] *Sanders Brother v Maclean & Co* (1883) 11 QBD 327, p341 (Bowen LJ).

In addition, this background condition is consistent with the custom of merchants in *Lickbarrow v Mason* that the bill of lading expressing the goods to have been shipped is transferrable, "after such goods have been shipped, and before the voyage performed."[182] This background condition established the basis of the custom of merchants; but for the inaccessibility of merchants to the goods, the custom usage of bills of lading seems unnecessary and redundant. Therefore, when the courts found this custom of merchants, they must have taken this background into consideration.

If the courts had considered the background condition in interpreting the custom of merchants about bills of lading, the same would have been considered in determining the question when the function as a document of title should be exhausted. It was rightly argued that the question whether a bill of lading stops being a document of title at common law was ultimately dependent on the custom of merchants.[183] According to this argument, a bill of lading can perform its document-of-title function because of the rights it gives to its holder and the defences accorded to the carrier; and the substantive rights and defences, in the absence of express intention, depend on the custom of merchants, whether the action be contractual, bailment or conversion; meanwhile, the custom of merchants can also determine when a bill of lading stop performing its document-of-title function.[184] Accordingly, if courts had considered this background condition while interpreting the custom of merchants, they must also have considered it when balancing the interests between each party and interpreting the intentions of the parties, and when the function as a document of title should be exhausted.

This background condition is also consistent with the first element of the general rule of law regarding when a bill of lading exhausts as a document of title.[185] The general rule of law is that a bill of lading exhausts as a document of title when the goods are delivered to the person entitled under the bill of lading; and the first of element of this test is that the goods must be *delivered* to that person; a mere discharge of cargos on the port subject to the carrier's order is not enough, because that person still cannot access to the goods. Once the carrier gives up all its control over the goods to the person entitled, that person can be said to have access to the goods.

As a result, it is submitted by the author that the performance of the document-of-title function by a bill of lading is subject to a background condition, namely that the goods must be inaccessible to the holder of the bill; if this condition is not fulfilled, a bill of lading will exhaust as a document of title to goods. Accordingly, when the goods are delivered to the person entitled under a bill of lading, even without production of the bill, the bill of lading will become "spent" and exhausted as a document of title to goods.

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[182] *Lickbarrow v Mason* 101 ER 380, at p382.
[183] Paul Todd, 'The Bill of Lading and Delivery: The Common Law Actions' (n 149) p560-562.
[184] ibid p560-561.
[185] See text in n153-154.

Combining this finding with the letter of credit scenario, it is not surprising that the bank's security could be invalid when the goods have been discharged without presenting the bill of lading. In a letter of credit transaction, if the goods, which are expected to become the pledged assets, have been discharged prior to the seller's tender of the relevant bill of lading, the validity of the seller's transfer as a pledge of the goods depends on whether the person to whom the goods have been discharged is the person who was entitled to take delivery from the face of the bill of lading at the time of the discharge. If the bill of lading was a "to order" bill of lading or a "to seller's order" bill of lading at the time of discharge, the seller's tender is valid so as to make the bank become a pledgee; if the bill were a "to buyer's order" bill of lading at the time of discharge, such discharge would make the bill become spent, and consequently, the seller's transfer would be invalid to make the bank become a pledgee.

3.4 Conclusion

Through the discussion and analysis above, it is found that the situation where the goods have been discharged prior to the seller's transfer of the bill of lading to his bank could impair the bank's security in some certain circumstances.

When the goods have been discharged at the time of transferring the bill of lading to a financing bank, it is possible that the bank will not become a pledgee of the underlying goods, because the bill of lading might be exhausted as a document of title in this situation. Whether a bill of lading exhausts as a document of title after the goods have been discharged depends on the entitlement of the person to whom the deliver is made. If that person is not entitled to take delivery of the goods under the bill of lading, transfer of the bill of lading can still operate as a transfer of the goods themselves; if that person is entitled, a delivery against presentation of the bill of lading will make the bill become "spent".

However, the position of law is less clear when the delivery is made without production of the bill of lading. The law is ambiguous and unsettled in this regard, which makes banks' security less certain and less secured in this situation. In such case, bankers might seek other types of security from their clients, which in turn increase the cost of application. From the discussions above, a preferable view is drawn: the author agrees with the conventional view that a bill of lading will be exhausted as a document of title when the goods are delivered to the person entitled, even though the delivery is made without presentation of the bill of lading. This view would be more consistent with most authorities and receives many approvals in academia. In the author's opinion, this view could better balance the interests between holders and carrier, and it is compatible with the background condition for a bill of lading being a document of title, namely that the goods must be inaccessible by the

holders. If this contention was correct, a financing bank, which receives a bill of lading as security after the goods have been delivered to a person entitled under the bill even without presentation thereof, could not become a pledgee on the goods.

Concluding all the findings of this factor, it is argued that, if the goods have already been delivered at the time of transferring the bill of lading to the bank, the bank will not become a pledgee unless the goods are delivered to the person not entitled under the bill of lading at the time of delivery, without presentation of the bill. This argument might make banks' position weak in the situation above, because, in such case, the bank will not have title to sue the carrier in conversion either; although it might have a right to sue the carrier in contract under s.2(2)(a) of COGSA92, who is normally protected by a letter of indemnity, the contractual right of action cannot replace the importance of security interests at the event of insolvency[186]; moreover, the requirements of s.2(2)(a) are not always met in this situation.[187] However, the law would become more certain and predictable for banks and other stakeholders; if banks want to avoid being affected by this factor, banks might protect their interest by other practical solutions.

The practical solutions or suggestions for banks to protect their security come from the causes of this factor. To ensure that the presented bill of lading is not spent by the situation that the goods have already been discharged, it is important to eliminate the possibility that the person "entitled under the bill of lading" does not have possession of the bill. If the person "entitled" does not have possession of the bill of lading at the time when the goods are discharged to him, the bill, which is still circulating, will become spent as a document of title.

There are mainly three causes for the person "entitled" not having the physical possession of the bill at the time of discharge: 1) this person deliberately conceals his bill of lading that is in his possession; 2) the bill of lading does not arrive due to postage delay; 3) the bill of lading is still in banking channels.

The first and the second cause are out of the control of banks;[188] but banks can eliminate the third cause; and this could be done by making sure that, whenever the banks in the banking channel are

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[186] For the importance of security interest, see discussion at section 2.2.2.1.

[187] Carriage of Goods by Sea Act 1992, s2(2)(a): Where, when a person becomes the lawful holder of a bill of lading, possession of the bill no longer gives a right (as against the carrier) to possession of the goods to which the bill relates, that person shall not have any rights transferred to him by virtue of subsection (1) above unless he becomes the holder of the bill by virtue of a transaction effected in pursuance of any contractual or other arrangements made before the time when such a right to possession ceased to attach to possession of the bill; the requirements in section have been disputed in different cases, for example *The David Agmashenebeli* [2003] 1 Lloyd's Rep 92, *The Ythan* [2006] 1 Lloyd's Rep 457, *The Pace* [2010] 1 Lloyd's Rep 183 and *The Erin Schulte* [2013] 2 Lloyd's Rep 338; see also Aikens and others (n 36) para 9.88.

[188] The second cause can be eliminated by usage of eB/Ls, see discussion in section 7.3.1.1.2; as far as the fraud is concerned, the frequency of the kind of fraud is extremely low.

holding the bill of lading, they are “the person entitled under the bill of lading”. As submitted above, the person “entitled” is the one who is entitled to take delivery from the face of the bill of lading; therefore, the banks should require a properly indorsed bill of lading under letters of credit; the bill should be either personal indorsed to the banks or blank indorsed. Such requirement can be stipulated under the application form of letters of credit, requiring a tender of bill of lading with “proper indorsement”. If the bill of lading tendered does not meet this requirement, the bank can reject the tender on the ground of incompliance.

The better solution can come from the international community. As an important uniform rules for letters of credit, the UCP 600 can play a role in resolving banks’ position in the context currently discussed. Following that, the same requirement is proposed to be added in the UCP if the UCP is revised in the future. This could be done by specifying the requirements under “Bill of Lading”.[189]

[189] This is currently regulated under Art.20 of UCP600.

Chapter 4 Before Transfer: Ownership Passed before Transfer of Bills of Lading

The previous chapter has illustrated how the situation where the goods under the bill of lading had been delivered before the seller tendered such bill might affect banks' security. Even if the banks had found their ways to prevent this situation from happening, there is another factor occurring before the seller transferred the bill of lading, which were believed to be able to damage the banks' security as pledgees; That is the situation where the ownership in the goods have passed already at the time of tendering the bill of lading.

Ownership in goods is usually retained by sellers until they receive payment or payment is secured.[190] Hence, ownership property is usually located in sellers when they tender bills of lading to financing banks under letters of credit. Meanwhile, it has been seen that, in some cases, ownership has passed to a buyer before a seller tendered the bill of lading to a bank.[191] Under normal operation of letters of credit, it is the seller who is responsible for presenting the required documents to the financing bank. By presenting the bill of lading to the bank, the bank is expecting to obtain security interest in the goods as a pledgee. Normally, the seller retains the ownership of the goods until he has been paid by the bank; in some abnormal situations, a seller might, however, have parted with the ownership to his buyer before presentation of the bill of lading to the bank.

Some authorities seemingly suggest that sellers might need to retain their ownership in the goods at least until they transfer the related bills of lading to their banks, otherwise they could not pledge the bills of lading.[192] If it was agreed and affirmed by authorities, the fact that the ownership has passed to the buyer before presentation would prejudice bank's security interest in the goods. In letters of credit, bankers only deal with documents; they are not dealing with the transactions of goods, so that they cannot reject the tender of compliant bills of lading on the ground that the seller does not have ownership in the goods.[193] Therefore, the bank could not confirm whether it had security interest by way of pledge, which might lead to the uncertainty toward banks' security.

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[190] See discussion in section 2.2.2.5; for the definition of "Ownership", refers to Hodgson Geoggreym, "Editorial Introduction to 'Ownership' by A. M. Honoré (1961)" (2013) 9 Journal of Institutional Economics 223, 108.

[191] e.g. *The Future Express* [1993] 2 Lloyd's Rep 542 (CA); *The Parchim* [1918] AC 157; *Albacruz v Albazero (The Albazero)* [1977] AC 774.

[192] *The Future Express* [1993] 2 Lloyd's Rep 542 (CA); *Ross T Smyth & Co Ltd v TD Bailey Son & Co* [1940] 3 All ER 60; *The Yue You 902* [2019] SGHC 106.

[193] UCP 600, Art 5.

This suggestion has been approved, but without explanation, by most scholars as discussed below and has not been questioned by the English courts for a long time. However, this suggestion might be an assumption of law only, and it could not completely reflect what the law is. This assumption, if correct, could impair bank's security; as a result, a deeper overhaul of this suggestion/assumption is necessary.

This chapter will discuss the question whether a seller under a documentary credit must retain the ownership in goods to make a valid pledge in favour of his bank. It will explain where this assumption comes from; then, it will examine the arguments for and against this assumption and try to challenge the correctness of the assumption; lastly, it will analyse the applicability of s.24 of Sale of Goods Act 1979 and discuss whether a bank under a letter of credit could be protected by this section even if the assumption was correct.

It is submitted by the author that the law does not require the seller to retain his ownership in goods to be able to pledge; moreover, the fact that the ownership in the goods has passed before the seller tendering the bill of lading to his bank is unlikely to affect his bank's security as a pledgee.

4.1 Status Quo of Law

As mentioned above, the authorities are in favour of the view that a seller must retain the ownership so that he is able to pledge documents of title to financing banks. The effectiveness of a pledge depends on seller's ability to pledge. This view is also supported by many scholars.

The most important authority in this regard is *The Future Express*.[194] Most of the fact in *The Future Express* is similar to any situation under a normal CIF contract, except that before the shipment the buyer has agreed with the seller to postpone presentation of the documents under the letter of credit; therefore, by the time of presentation, the goods have been delivered against the indemnity. It was held, both by the Queen's Bench and by the Court of Appeal, that the bank did not become a pledgee.

At the first instance of this case, Diamond QC made this judgment on the ground that, among other reasons, the property in and possession of the goods had passed from the seller to the buyer long before the bank obtained the bills of lading; as such, there was no constructive delivery to the bank by transferring the bills of lading.[195]

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[194] *The Future Express* [1992] 2 Lloyd's Rep 79 (QB), [1993] 2 Lloyd's Rep 542 (CA).
[195] *The Future Express* [1992] 2 Lloyd's Rep 79 (QB).

However, when the case reached the Court of Appeal, the court made the judgment on a different ground. Lloyd LJ contended that a seller must retain the ownership in the goods to pledge the bill of lading. He accepted the carrier's argument that the seller was not capable of transferring the right to possession through the bill of lading, because either the buyer or itself did not have any property in or any right to possession of, the goods at the time of presentation, and a bill of lading is not negotiable as a bill of exchange so that the transferee can only acquire such interest as the transferor is capable of transferring.[196] Further, he added that the bank's security depends not on the contract between the buyer and his bank, but on the ability of the seller to pledge the documents of title on his behalf, or with his consent.[197] This view has received approval from many scholars.[198]

The main authority cited by Lloyd LJ to support his reasoning is Lord Wright's statement in *Ross T Smyth & Co v Bailey Son & Co*:[199]

> The importance of the retention of the property is not only to secure payment from the buyer but for purposes of finance…These credit facilities…would be completely unsettled if the incidence of the property were made a matter of doubt.

In terms of pledge, the importance of retention of general property is to provide the seller with ability to pledge the bills of lading which are symbols of the goods. "The whole system of commercial credits depends on the *seller's ability* to give a charge on the goods and the policies of insurance".[200]

4.2 Seller's Ability: Ownership

By virtue of the strong statements in these authorities, it seems that the current English law requires the seller under a documentary credit to retain the ownership in the goods in order to retain the ability to pledge the goods to the financing bank. However, the statement of Lord Wright which is cited in the Court of Appeal of *The Future Express* does not clarify what the "seller's ability" means: did it refer only to the seller's ownership in the goods? To answer this question, it is necessary to deeper examine the legal reasoning behind these authorities.

The issue in dispute in *Ross T Smyth & Co v Bailey Son & Co* is the timing of transfer of property. In order to interpret the intention of the parties regarding transfer of property, Lord Wright explained that, in an ordinary CIF contract, it was very important for the seller to retain the ownership before

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[196] *The Future Express* [1992] 2 Lloyd's Rep 79 (QB), p547 col1.
[197] *The Future Express* [1992] 2 Lloyd's Rep 79 (QB), p547 col2.
[198] Todd (n 15) from para 6.11; Bridge (n 58) from para 23.309; King and Gutteridge (n 13) para 8.04; cf. Beale and others (n 42) para 5.25.
[199] *Ross T Smyth & Co Ltd v TD Bailey Son & Co* [1940] 3 All ER 60, p156, col2.
[200] *Ross T Smyth & Co Ltd v TD Bailey Son & Co* [1940] 3 All ER 60, p156, col2.

parting with the bill of lading, mainly for two purposes: 1) to secure his buyer's payment; and 2) to raise money on the goods by pledging the bill of lading to the financing bank.[201]

The reason why a transferable bill of lading can be used to create a pledge on the underlying goods is and only is that it is recognised by common law as the symbol of the goods.[202] As the symbol of the goods, the transfer thereof operates as a delivery of the goods themselves. According to *nemo dat* rule, all the interest the seller is required to retain is its right to possession of the goods. It is not necessary for the seller to retain the ownership in order to transfer the constructive possession by transfer of the bill of lading. Therefore, if the law required seller to retain the ownership to be able to pledge the related bill of lading, the law would be that the seller must retain the ownership to give security interest to the bank.

Indeed, this view is consistent with the judgment of Lloyd LJ.[203] Morever, before reaching to the Court of Appeal, Diamond QC in the first instance of *The Future Express* expressed a different view; he said that the seller was lack of not only the general property, but also the right to possession.[204] If all that was required by law to be retained by the seller was mere the right to possession, it would be unnecessary to address the fact that the seller was lack of the general property in the goods. Therefore, the statement of Diamond QC might indicate that merely retaining the right to possession was not enough to pledge.

This judgment of Diamond QC was examined and concluded by Pang Khang Chau JC in *The Yue You 902*; a similar conclusion was drawn. Pang Khang Chau JC said that the bank was not a pledgee, because, inter alia, the seller was incapable of creating a charge over the goods due to the *nemo dat* rule (since general property in the goods had already passed to the buyer before the shipping documents were put in the banking chain).[205] Although there is no similar issue arising in this case, the Judge was in the opinion that the rationale behind Diamond QC's judgments was the *nemo dat* rule; nevertheless, he addressed the general property rather than the right to possession. The Judge seemed to suggest that, because the ownership in the goods had passed to the buyer before presentation, the seller did not have the general property to pass the special property to the bank.

In conclusion, according to the relevant authorities, the reason for the seller required to retain general property seems to be that the seller must retain the ownership to create a pledge on the goods in favour of the bank; as such, the "seller's ability" refers only to the ownership in the goods.

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[201] *Ross T Smyth & Co Ltd v TD Bailey Son & Co* [1940] 3 All ER 60, p156, col2.
[202] See discussion in section 2.2.3.
[203] See text in n 196.
[204] *The Future Express* [1992] 2 Lloyd's Rep 79 (QB), p93, col2.
[205] *The Yue You 902* [2019] SGHC 106, [2019] 2 Lloyd's Rep 617, p628 col2.

There are different attitudes in academia expressed towards this conclusion.

Paul Todd seems to be in favour of this view by saying that a pledge is made by the "legal owner of the goods", and that, if the seller does not retain the ownership in the goods, he can pass "no property to the bank as pledgee".[206]

By contrast, the editors of *Benjamin Sale of Goods* seem to have a different view. It cites *Ross T Symth & Co v Bailey Son & Co* and *The Future Express* to support the view that a pledge, as a possessory security, depends on the seller transferring possession of the goods to the banks with intention to grant security in the form of a pledge.[207] Following this view, it would be sufficient for the seller to merely retain the right to possession to create a valid pledge.

Overall, the authorities suggest that only owners of the goods have the ability to pledge them to the banks through the related bills of lading. Meanwhile, there are different interpretations of these authorities by scholars: some supported this view, but some preferred the view that the retention of the right to possession should suffice. The question of which view is preferable determines the bank's position in the situation where the ownership in the goods has passed before a seller's tender of the bill of lading.

To examine which view is preferable, it is first necessary to ask whether only the owner can create a pledge in general. Pledge is a possessory security interest, and it is subject to the general rule regulating the creation of security interest. Generally, creation of a security interest consists of attachment and perfection.[208] Though the concepts "attachment and perfection" are not used in common law, their underlying rules are similar to English law. Therefore, although the following discussion will use the concept "attachment" to explain, the substantial discussion will be based on the rules under English law. Attachment is said to occur when a security interest fastens on the asset to create a real right against the debtor, but not necessarily against third parties. In order to bind third parties, the security interest must also be perfected. For the purpose of current discussion, only the concept "attachment" is relevant.

It is contended that there are six ingredients of attachment which must co-exist, one of which is that the debtor must have a *present interest* in the asset or a *power* to give it in security.[209] This

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[206] Todd (n 15) para 6.22; see also King and Gutteridge (n 13) para 8.04.
[207] Bridge (n 58) para 23.309.
[208] See discussion in section 2.2.2.4.
[209] Gullifer (n 45) para 2.03, they are: (1) there must be an agreement for security conforming to any statute formalities; (2) the asset must be identifiable; (3) the debtor must have an interest in the asset or a power to give it in security; (4) there must be some current obligation of the debtor to the holder of the security; (5) any contractual conditions for attachment must have been fulfilled; (6) in the case of pledge, actual or constructive possession must be given to the creditor.

requirement can be reflected by granting a security on future property, which cannot be created until the debtor has acquired an interest in the property.

Accordingly, only the person with "present interest" or have the "power" to pledge can create a valid pledge. Here the "power" is used for referring to the exceptions of the *nemo dat* rule, from common law or statutes.[210] As such, the "present interest" must be related to the *nemo dat* rule. The "interest" refers to the interests, the passing of which would enable the bank to have the security interest.[211]

The authoritative statements discussed above is not based on the exceptions of *nemo dat* rule, so they are likely to suggest that the "present interest" can only be the ownership of the goods. But, is the authoritative suggestion that only ownership is the "present interest" for the purpose of creation of security interest consistent with the current English law? It is submitted by the author that it is not; instead, it is argued by the author that a person without ownership but has *other interests* in the goods is also able to create a pledge, even though there is a strong rule of law supporting the ownership requirement of pledgor.

In order to support author's argument, some supporting argument for the authoritative suggestion needs to be qualified, one of which is that only the owner can grant security interest to others: there is an undertaking of pledge implied by law to have the ownership in the asset pledged.[212]The following paragraphs will qualify this supporting legal argument; after that, if ownership is not the only-required interest for pledge, then what are the *other interests* sufficient to pledge?

4.3 Implied Undertaking of Pledgor

As mentioned above, there is an undertaking of pledge implied by law to have the ownership in the asset pledged. If a pledgor broke this implied undertaking, he would be liable for making false representation, upon which the pledgee would be entitled to sue independently.[213] This rule, at first glance, is supporting the view that the "present interest" refers only to the ownership in the goods. However, in the author's opinion, this rule does not support this view and is not suitable to the scenario of pledge under letters of credit.

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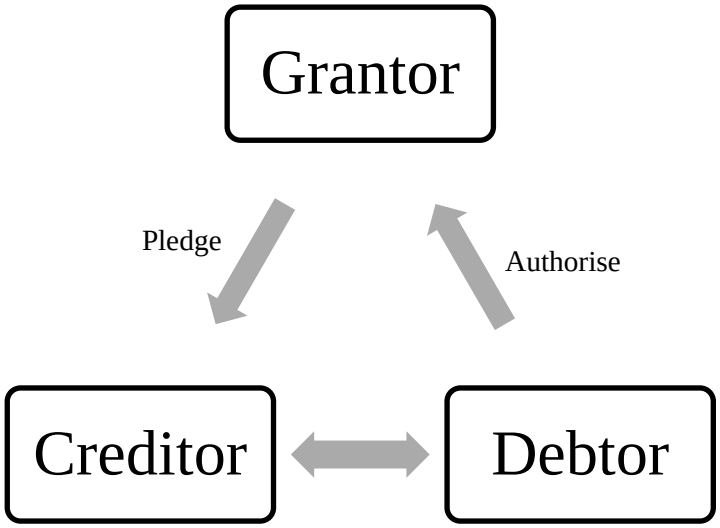
[210] ibid para 2.07.
[211] This interpretation is compatible with the explanation in *The Yue You 902* of Diamond QC's statement: the seller's ability to pledge is related to the *nemo dat* rule: *The Yue You 902* [2019] SGHC 106, [2019] 2 Lloyd's Rep 617, p628 col2.
[212] Cheesman v Exall 155 ER 574.
[213] Advanced Industrial Technology Corp Ltd v Bond Street Jewellers Ltd [2006] EWCA Civ 923, [2006] 7 WLUK 34, at [45].

4.3.1 Special Character of Seller under Letters of Credit

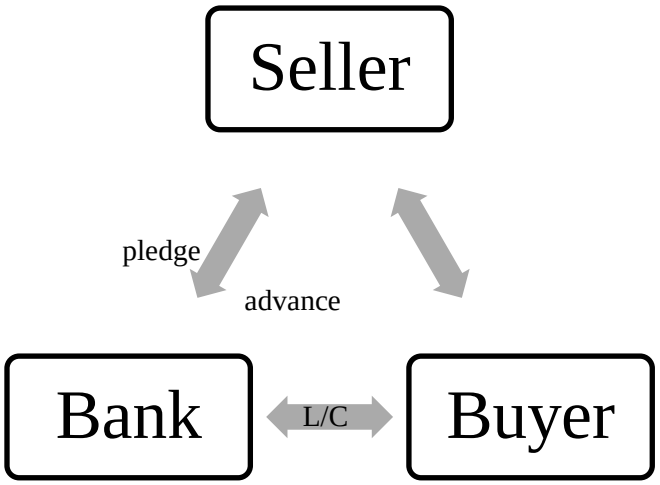
First and foremost, this argument could be qualified by the special character of the seller under a letter of credit transaction. The position of sellers under letters of credit is special in a way that they are neither pledgors nor mere grantors.[214]

In an ordinary case, it is the pledgor who grants the security interest to the pledgee by delivery of the pledged asset. However, that is not always the case. Sometimes, as shown in the diagram below, a grantor is not the pledgor himself. But in this case, the grantor must have the authority from the asset owner to pledge.



The letter of credit relationship is slightly different in both situations. As shown in the diagram below, the seller is not the pledgor under a pledge relationship. But the seller is not a grantor as mentioned above either, because he is normally the owner of the asset that is going to be pledged so that he does not need the authority from the debtor. Moreover, although the seller is normally the owner of the asset at the time of pledge, he is no longer the owner after being paid by the bank.

[214] Generally, see the discussion in section 2.2.2.5.



The most accurate description of the seller's role under letters of credit might be that the seller pledges the goods or the documents of title to the bank on the buyer's behalf or with his consent.[215] Therefore, the general requirements for pledgor or debtor in a pledge do not necessarily apply to a seller under a letter of credit.

4.3.2 Implied Undertaking for Buyers not Sellers

Another qualification for the argument is that, under a letter of credit, it is the buyer not the seller who bears this implied undertaking. When analysing the reasons behind this implied undertaking and taking the special character of a seller under a letter of credit into account, it is found that such implied undertaking is not seller's but buyer's.

It was held that the main rationale for this rule was the pledgor's immediate right to possession after his debt was discharged.[216] After the secured debt is discharged by payment, the pledgee impliedly undertakes to return the pledged asset to the pledgor, otherwise he might be liable for wrongful conversion. However, If the pledgor were not the owner, the pledgee would also be at risk of converting the asset. Therefore, the law implies that a pledgor should have a corresponding undertaking, namely undertakes to have the ownership in the pledged asset.

Normally, a seller will pass his ownership of the goods to the buyer when receiving payment from and pledging a bill of lading to a bank. In such a case, after the buyer's reimbursement, the bank is obliged to redeliver the bill of lading to the buyer, not the seller. If the bank redelivered the bill of lading to the seller, it might be liable to the buyer for conversion since the buyer, after discharging his debt, had the immediate right to possession. As such, it is the buyer who should be subject to the requirement

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[215] *The Future Express* [1993] 2 Lloyd's Rep 542 (CA), p547 col2.
[216] *Singer Manufacturing Co v Clark* (1879) 5 Ex. D. 37.

mentioned above. So, the reasoning of the implied undertaking of ownership does not apply to sellers under letters of credit.

4.3.3 Implied Undertaking to Have Authority to Pledge

The third qualification to the argument is that such implied undertaking does not refer only to ownership but also to an authority from the owner to pledge.

Even If the pledgor is not the owner of the pledged asset, he will not breach the implied undertaking as long as he has the authority from the owner to pledge it.[217] This is the result of the law of agency. It is indicated that not only the ownership, but also the owner's authority to pledge, will give the pledgor sufficient "present interest" to pledge. Under the operation of a letter of credit, it is also indicated that the seller can have sufficient "present interest" to make a valid pledge even when the ownership has passed to the buyer before tendering the bill of lading, as long as he has the authority from the buyer to pledge. This indication is compatible with the accurate description of seller's role under letters of credit, namely that the seller pledges the goods or the documents of title to the bank on the buyer's behalf, or with his consent.[218]

4.3.4 Conclusion on Qualifications

Under the common law, a pledgor is impliedly undertaking that he has the ownership in the pledged asset. At first glance, this implied undertaking rule underpins the view that only owner can create a valid to others (in the case of documentary credits, the financing bank). However, when analysing this rule further, it is found that the rule is not applicable to a seller under a letter of credit transaction. Also, even though the pledgor does not have the ownership in the pledged asset, he will not breach this undertaking if he has the authority from the owner to pledge it.

Accordingly, such implied undertaking rule does not support the view that only owner can create a valid pledge to others; an authority from the owner could suffice. Even if the implied undertaking referred only to ownership, such implied undertaking did not bind sellers under letters of credit.

4.4 Other Possible Present Interests

As analysed in last few paragraphs, the implied undertaking argument could be qualified and does not apply to the seller under an ordinary operation of a letter of credit transaction. This section will

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[217] *Singer Manufacturing Co v Clark* (1879) 5 Ex. D. 37, p42.
[218] see *The Future Express* [1993] 2 Lloyd's Rep 542 (CA), p547 col2.

discuss if there are other interest than the ownership that is enough for creating a security interest, especially a pledge. It is submitted by the author that there are some other interests constituting the "present interest" for creating security interest.

In fact, some authorities of English law have indicated that a person other than the owner is also able to create a security interest to others.[219] If such indication was correct, the view that only owner of the asset was able to create a security interest on that asset was untenable, and the seller was still able to create a valid pledge even though he had passed the property to the buyer before tendering the bill of lading to the bank.

In those authorities, it was established that a special property held by a pledgee was sufficient for him to make a valid pledge;[220] It was also suggested that an interest held by a lessee in possession under an equipment lease was enough.[221] According to these cases, the interest held by a pledgee or a lessee in possession was sufficient for them to create a valid pledge on the assets they possess. Although a seller under a letter of credit is neither a pledgee nor a lessee in possession, it is suggested by the author that he share some similarities with them. Therefore, in the author's opinion, a seller who shares these similarities with pledgee and lessee in possession in terms of a bailee on terms might be capable of granting a security interest to the bank. For this purpose, the following discussion will first deal with what these similarities are and then examine the position of seller's interest with these similarities.

4.4.1 Similarities

The first question is, for the purpose of finding the characteristics making a seller obtain other "present interests", what the similarities between a pledgee and a lessee in possession are.

The most obvious similarity is that they are both the sub-categories of bailee.[222] Consequently, both have, a least, a right of possession. That is because the establishment of bailment is based on possession.[223] A bailment relationship could be a bailment on terms or a bailment at will. There is a substantial difference between these two types of bailments. Some might call them gratuitous

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[219] e.g. *Donald v Suckling* (1866) LR 1 (QB) 585.
[220] *Donald v Suckling* (1866) LR 1 (QB) 585.
[221] See Gullifer (n 45) para 2.07.
[222] see the famous taxonomy of bailment in *Coggs v Bernard* (1992) E.R. 107, they are the third and the fourth categories respectively.
[223] PH Winfield, *The Province of the Law of Tort: (Tagore Law Lectures Delivered in 1930).* (Cambridge University Press 1931) p93; Bridge and others (n 42) para 12.040.; *Volcafe Ltd v Compania Sud Americana de Vapores SA* [2018] UKSC 61, [2019] AC 358 at [8] (Lord Sumption).

bailment and contractual bailment.[224] In a bailment at will, the bailee must return the goods on demand; by contrast, in a bailment on terms, the bailee must return the goods according to the terms of the contract, expressed or implied. Therefore, under a bailment at will, the immediate right to possession is in the bailor; meanwhile, the bailee on terms does not have the immediate right to possession before contract terms being fulfilled.

Both a pledgee and a lessee in possession obtain the possession of the goods for some certain conditions. Before those conditions are fulfilled, their possessory title prevail their corresponding pledgor/leasor, and they thereby have the immediate right to possession. As such, both of them are bailees on terms. There is no general right of any bailees to grant security on the assets bailed to them; normally, a pledge is repugnant to the bailment.[225] But, since they are bailees on terms, whether they can transfer their possessory interests depends mainly on the terms of bailment and the nature of the specific types of bailments. Only certain types of bailees are entitled to grant security on the assets bailed to him. So, the question is whether a seller under a letter of credit can be one of them.

4.4.2 What Is Seller's Position?

Previous section has discussed the similarities between a pledgee and a lessee in possession. In order to find out whether a seller who has parted with his ownership has retained sufficient "present interest" to pledge, this section will examine the seller's position combined with these similarities.

First and foremost, it is necessary to ask whether such a seller can be regarded as a bailee on terms at all. The question is twofold: 1) whether an ordinary seller who has transferred the ownership to his buyer and retained the possession thereof will become a bailee on terms; 2) whether a seller under a letter of credit, who has parted with the ownership but retained the possession of the bill of lading, can be regarded as a bailee on terms.

4.4.2.1 Seller becomes a Bailee on Terms

Seller in some certain situations can also be regarded as a bailee on terms. Under sale of goods, a delivery obligation can be performed by the seller's attornment; in that case, a seller retains the possession of the goods as the bailee on terms for the buyer.[226]

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[224] See Graham S. McBain, 'Modernising and Codifying the Law of Bailment' [2007] Journal of Business Law 1.

[225] *Fenn v Bittleston* 155 E.R. 895, p899 (Parke B); *Mulliner v Florence* (1878) 3 QBD 484.

[226] *Hurry v Mangles* (1808) 1 Camp. 452; *Elmore v Stone* (1809) 1 Taunt. 458; *Marvin v Wallace* (1856) 25 L.J.Q.B. 369; *Castle v Sworder* (1860) 6 H. & N. 828; *Cusack v Robinson* (1861) 30 L.J.Q.B. 264; *Nicholls v White* (1911) 103 L.T. 800; *Dublin City Distillery Ltd v Doherty* [1914] A.C. 823 at 843, p852;*Gamer's Motor Centre (Newcastle) Pty Ltd v Natwest Wholesale Australia Pty Ltd* (1987) 163 C.L.R. 236; *Michael Gerson (Leasing) Ltd v Wilkinson* [2001] QB 514; *Fadallah v Pollak* [2013] EWHC 3159 (QB), at [49]

If a seller has passed the ownership to the buyer while retaining the bill of lading at the time of presenting the bill to the bank, it is likely that a seller, at that time, is a bailee (on terms) for the buyer. In *The Parchim*, although the seller retained the bill of lading (but physically held by a bank on his behalf), the court held that the intention of the parties was to pass the ownership to the buyer on shipment, even though the bill of lading was made to the seller's order.[227] The way in which the seller dealt with the bill of lading only pointed to a desire to support his lien. As such, the seller had retained the right to possession, and the buyer would not acquire it until the payment under the sale contract was made, regardless that the ownership has passed to the buyer. In this case, the seller could be regarded as a bailee on terms.

If a seller, after parting with the ownership but retaining the bill of lading, can be regarded as a bailee on terms, the possibility for such seller to create a valid pledge is open. However, not every seller who has transferred the ownership in the goods but retained the bill of lading will become a bailee on terms. As mentioned earlier, the nature of their bailment relationship is dependent on the capacity of the possessor in dealing with the goods or, in this case, the documents of title to the goods. Only a person with the immediate right to possession can be regarded as a bailee on terms. In some authorities, the holder of a bill of lading did not have the right to sue in conversion; in other words, such holder of a bill of lading did not have the immediate right to possession.[228] Overall, after the ownership has passed to the buyer, whether the seller retains the bill of lading as the bailee on terms for the seller ultimately depends on the intention between the buyer and the seller.[229] However, such intention might be implied from the nature of letter of credit transactions where the seller impliedly has the authority from his buyer to pledge, and this will be discussed in the following paragraphs. If the seller was regarded as having an implied authority to pledge from the buyer, the seller would be implied to have retained the immediate right to possession otherwise the seller would not be able to pledge for the buyer.

4.4.2.2 Seller vs Pledgee

The previous section has discussed about the possibility that a seller after parting with ownership becomes a bailee on terms for his buyer. However, merely becoming a bailee on terms is not enough for the seller to acquire the sufficient "present interest" as, for example, a pledgee, to create a valid

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[227] *The Parchim* [1918] AC 157.

[228] e.g. *The Aliakmon* [1986] AC 785, the holder of bills of lading is regarded as holding them on behalf of the seller, and it was held not to be entitled to sue in conversion; see also *The Future Express* [1992] 2 Lloyd's Rep 79 (QB), the bank with the possession of the bill of lading was not entitled to sue in conversion, because the right to possession was held not to be transferred to it through the bill.

[229] See discussion about intention to transfer right to possession in Chapter 5, the difference between custody and possession is whether the custodier has the intention to possess.

pledge. Assuming that the seller is a bailee (on terms) for the buyer, what else similarities should he share with other bailees on terms, such as a pledgee, so as to have the "present interest" to make a valid pledge?

To better understand the interest held by a pledgee, it should first look at how a pledge makes a valid sub-pledge.

First, there is prerequisite for the validity of such sub-pledge: a sub-pledge by him will not invalidate the original pledge (bailment) relationship.[230]

A mere fact that the pledgee releases his possession of the pledged asset does not necessarily make the pledge invalid.[231] Popplewell J in *Bassano v Toft* reviewed all the key authorities in this regard and summarised that a pledgee will lose his interests by parting with his possession only when "he does so in circumstances which constitute a voluntary surrender of his interest.[232] In the opinion of the Judge, when the circumstances are inconsistent with an intention to preserve the special interest, there will be "a voluntary surrender of his interests".[233] A sub-pledge is not inconsistent with the pledgee's intention to preserve the special interests in the asset, so his special interest is not lost. Also, a sub-pledge is thought not to be so inconsistent with the pledge contract that it will constitute a renunciation; under the pledge contract, the pledgor requires the pledgee to redeliver the pledged assets on repayment and to take care of the asset; the contract can be committed even though the pledgee has sub-pledged the asset.[234] Therefore, a sub-pledge created by the pledgee will not annihilate his security interest.

Then, whether is a pledge made by the seller on the buyer's behalf repugnant to their bailment (on terms) relationship? The terms of their bailment (if any) must be the terms in the sale contract. Among them, the most relevant term is the payment term under which both are agreed to use a letter of credit as the payment tool. The substance of this term might be various, but English courts will find no difficulty to infer from this term that a bank under a letter of credit will have security on the goods by transfer of the bill of lading to it.[235] Accordingly, a pledge made by a seller on his buyer's behalf is unlikely to be repugnant to their bailment.

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[230] *Donald v Suckling* (1866) LR 1 (QB) 585.
[231] *Bassano v Toft* [2014] ECC 14, [50]; *Babcock v Lawson* (1880) 5 QBD 284; *North Western Bank v Poynter* [1895] AC 56; *Reeves v Capper* 132 E.R. 1057; *Donald v Suckling* (1866) LR 1 (QB) 585.
[232] *Bassano v Toft* [2014] ECC 14, [50].
[233] *Bassano v Toft* [2014] ECC 14, [57].
[234] *Donal v Suckling* (1866) LR 1 (QB) 585, p615 (Blackburn J).
[235] See discussion in section 2.2.2.5.

Second, what is the source of the pledgee's ability? A pledgee is not the owner of the pledged asset, neither does he has an express authority to pledge from his pledgor. Where does a pledgee's ability to sub-pledge come from?

It was held in *Donald v Suckling* that this ability was inherent in the special property of pledgee. The interest of pledgee is more than a mere right of detention, and it is "assignable".[236] Therefore, the pledgee's ability to sub-pledge might come from the nature of its special property.

Another explanation, in the author opinion, could be that the pledgor has impliedly authorised the pledgee. Under a certain circumstance, the pledgee might be regarded as being implied authorised by the pledgor, for example when the pledgee realises his security by selling the pledged asset. After the sale, the pledgee must appropriate the proceeds of sale to the debt of the pledgor and account to the pledgor any surplus; therefore Lord Mersey concluded that "these considerations show that the right of sale is exercisable by virtue of an implied authority from the pledgor and for the benefit of both parties."[237] Although the same justification for this implied authority is difficult to apply to sub-pledge, their rationales are similar so as to imply an authority to sub-pledge.

When the original debt becomes due, instead of selling the pledged asset, the pledgee has already "enforced" his security by sub-pledge. The sale of the pledged asset could be later conducted by the sub-pledgee when the pledgee failed to repay his own creditor. At that time, the surplus of the proceeds of sale after paying the debt owed by the pledgee, if any, must be accounted to the pledgee; and the pledgee at the mean time must account any surplus after paying the original debt to the pledgor. Although it is far-fetched to say that the sub-pledge is "for the benefit of both parties", the sub-pledge does benefit both parties in another way. It has been discussed that an ownership is enough to grant a security interest, so is an authority from the owner to pledge.[238] Such authority could be either express or implied. Therefore, the explanation with the respect of implied authority is consistent with implied undertaking requirement.

In the case of seller as bailee, there is no express authority from the buyer to pledge the bill of lading for him (as always the case), but such authority could be implied. Such authority might be implied from the application for the opening of the letter of credit. From the normal terms of an application, there is a manifested intention between an issuing bank and an applicant that the bank is to become a pledgee of the goods upon receipt of the bills of lading.[239] Without any contrary evidence, it is easily

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[236] *Donal v Suckling* (1866) LR 1 (QB) 585, p614 (Blackburn J); *Coggs v Bernard* (1992) E.R. 107, p916 (Holt CJ).
[237] *The Odessa* [1916] 1 AC 145.
[238] See discussion in section 4.3.3.
[239] *The Future Express* [1992] 2 Lloyd's Rep 79 (QB), p89.

implied from the above intention that the buyer, if the ownership has passed to him, will authorise his seller to pledge the goods on his behalf. Since the seller has retained the constructive possession of the goods, he can transfer the constructive possession to the bank on behalf of his buyer so as to perfect the bank's pledge. Therefore, in such case, if an implied authority to pledge was found, the seller was only required to retain the right of possession, which normally can be done by retaining the bill of lading.

Overall, a seller who retains the bill of lading after transferring the ownership might meet the conditions which make a pledgee able to create a valid (sub) pledge.

4.4.3 Conclusion on Other Present Interests

Under a letter of credit, if a seller is regarded as a bailee for his buyer, a pledge made by him arguably will not destroy his bailment with the buyer, and he will have the power to make a pledge from imply authorisation and (symbolic) right of possession. Therefore, without ownership, a seller might still have the "present interest" to pledge the bill of lading to the bank. And, the view suggested by the authorities, namely only the owner is able to pledge the goods to the bank, is incorrect.

4.5 Power to Pledge

As mentioned above, in order to grant a security interest, the seller in the case of letters of credit must have a present interest or a power to do so. We have discussed what amounts to "present interest" in the scenario of letters of credit. If the conclusion above was wrong, namely the seller under this situation did not have the "present interest" to pledge, he might still have the "power" to do so.

The "power" is used for referring to the exceptions of the *nemo dat* rule.[240] There are some common law and statutory exceptions to this general principle.[241] Most of the common law exceptions have been codified by statutes. The relevant provisions are s.24 of Sale of Goods Act 1979 and s.2(1) of FA 1889. If these exceptions were applied to the operation of letters of credit, financing banks would be protected by them and would thereby acquire security on the bills of lading.

4.5.1 Factors Act 1889 section 2(1)

It is stipulated by s.2(1) of the Factors Act 1889 that:

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[240] See text in n 210.
[241] Gullifer (n 45) para 2.07.

> "Where a mercantile agent is, with the consent of the owner, in possession of goods or of the documents of title to goods, any sale, pledge, or other disposition of the goods, made by him when acting in the ordinary course of business of a mercantile agent, shall, subject to the provisions of this Act, be as valid as if he were expressly authorised by the owner of the goods to make the same; provided that the person taking under the disposition acts in good faith, and has not at the time of the disposition notice that the person making the disposition has not authority to make the same."

And s.3 has provided the legal effect of pledge of documents of title:

> "A pledge of the documents of title to goods shall be deemed to be a pledge of the goods."

To better understand the requirements under this section, it is necessary to discuss the background and purpose thereof.

The effect of these sections is to extend the "apparent authority" or "ostensible" of a mercantile agent to pledge the goods or the document of title to the goods. Therefore, a mercantile agent in possession of the goods or the documents of title to the goods by consent of the owner can create a valid pledge on them by delivery, even though he does not have the authority to do so.

Before the enactment of the Factors Acts, there has been a mercantile custom to entrust the goods to an agent for the purpose of sale; such an agent thereby was always deemed to have the authority from the owner to sell the goods. Meanwhile, such agents often pledge the goods in their own name.[242] Nevertheless, such an agent would not always be deemed to have the authority to pledge. In order to protect the bank financing these agents, the Factors Act 1823 was introduced, which made an inroad on the nemo dat rule.[243] However, it was argued by academics that the Act was not an exception of *nemo dat* rule, but merely an extension of the doctrine of "ostensible authority" under the law of agency.[244]

This section only applies to transactions made by a mercantile agent. It is under the group called "Dispositions by Mercantile Agents".[245] The meaning of the "mercantile agent" is defined by s.1(1) of the Act, which provides that a mercantile agent is a person who in the customary course of his

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[242] Andrew P Bell, *Modern Law of Personal Property in England and Ireland* (Butterworths 1989) p496; see Louise Merrett, 'The Importance of Delivery and Possession in the Passing of Title' (2008) 67 The Cambridge Law Journal 376, p379.
[243] *Official Assignee of Madras v Mercantile Bank of India Ltd* [1935] AC 53, p60.
[244] See Merrett (n 244) p379; see Andrew Tettenborn, 'Transfer of Chattels by Non-Owners: Still an Open Problem' (2018) 77 The Cambridge Law Journal 151, p154.
[245] *Inglis v Robertson* [1898] AC 616.

business having authority "either to sell goods, or to consign goods for the purpose of sale, or to buy goods, or to raise money on the security of goods".

If the seller under a letter of credit has parted with his ownership to the buyer before tendering the bill of lading to the bank, is he a "mercantile agent" for the purpose of this Act?

In author's opinion, such seller is not a "mercantile agent" for the purpose of Factors Act. If it was, it would make s.8 of the Act (or s.24 of the Sale of Goods Act 1979)[246] unnecessary. The purpose of this section is to remedy the non-application of Factors Act 1842.[247] This amendment was resulted from the case *Johnson v The Credit Lyonnais Co*. This case is about the effect of a fraudulent pledge made by a seller in possession of the goods which have been sold earlier. The pledgee in this case was held not to be protected by the Factors Act. The Chief Justice of this case has made the distinction between the buyer actively placing the dock warrant in hands of the seller and passively leaving them to the seller.[248] He also explained the doctrine of "apparent authority" or "ostensible authority" that, in order that the owner shall be resisted from denying his assent to an act prejudicial to his right, and which he could have stopped but allowed to be done, it was important that he must have the knowledge of such thing done.[249] Therefore, the doctrine of "ostensible authority" did not apply to this case; a seller who remained in possession of the document of title was not a mercantile agent under the Act and thereby that an innocent purchaser was not protected. In order to protect a *bona fide* third party who deals with the seller in possession of the documents of title, s.3 of Factors Amendment Act 1877 was introduced. Later in 1889, the latest Factors Act has extended the application of this protection to the seller in possession of the goods.[250]

In conclusion, a seller was regarded as a "mercantile agent", those amendments were all unnecessary. So, a seller who retain the bill of lading but without ownership cannot make a valid pledge with the "power" given by s.2(1) of the Factors Act 1889.

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[246] Factors Act 1889, s.8: Disposition by seller remaining in possession: Where a person, having sold goods, continues, or is, in possession of the goods or of the documents of title to the goods, the delivery or transfer by that person, or by a mercantile agent acting for him, of the goods or documents of title under any sale, pledge, or other disposition thereof, or under any agreement for sale, pledge, or other disposition thereof, to any person receiving the same in good faith and without notice of the previous sale, shall have the same effect as if the person making the delivery or transfer were expressly authorised by the owner of the goods to make the same.
[247] *Pacific Motor Auctions Pty Ltd v Motor Credits (Hire Finance) Ltd* [1965] AC 867, at p882-3
[248] *John v Credit Lyonnais* (1877) 3 CPD 32, 37 (Cockburn CJ), this was the reason why *Pickering v Busk* (1812) 15 East 38 was distinguished.
[249] *John v Credit Lyonnais* (1877) 3 CPD 32, p40 (Cockburn CJ).
[250] Factors Act 1889, s.8, this is repeated by the Sale of Goods Act 1979, s24; see Merrett (n 244) p381, it was submitted that the reason for this extension was far from clear.

4.5.2 Seller in Possession

Another exception of *nemo dat* rule which could provide the seller a "power" to pledge is s.24 of the Sale of Goods Act 1979.

It is provided by s.24 of the Sale of Goods Act 1979 that a seller, who "continues or is in possession" of the goods or the documents of title to the goods after sale, can create a valid pledge on the goods by "delivery or transfer" of the goods or the documents of title to a third party "receiving the same in good faith and without notice of the previous sale." S.24 and s.8 of FA are substantially the same.

The section above has explained the purpose and history of s.24 of the Sale of Goods Act 1979. It is known that this section is specifically designed to protect a person who deals with a seller with possession of the goods or the documents of title to goods.

The question is whether this statutory exception is applicable to the situation where the seller under a letter of credit, has transferred the ownership in the goods but retained the bill of lading in his possession. If applicable, the financing bank might be able to become the pledgee of the goods.[251]

There are several requirements in this section. The seller must "continue or is in possession" of the goods or the documents of title to the goods, and there must be a delivery from the seller to the third party; last but not least, the third party who received the goods or the documents of title must be "in good faith" and "without notice".[252] Among them, the most relevant ones are the first and the last. The following parts will examine these two requirements in the context of the current issue. Therefore, the following discussion will focus on these two requirements.

4.5.2.1 Continue or is in Possession

This requirement requires the seller either "continue in possession" or "is in possession" of the goods or documents of title to the goods.

The "in possession" requirement is designed to apply in the situation where the seller has no possession of the goods at the time of sale but gains the possession afterwards.[253] This requirement is not suitable in the cases where the seller pledges the goods or the documents of title to a third party,

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[251] David M Sassoon, *CIF and FOB Contracts* (5th ed, Sweet and Maxwell 2012) p571, it is said that even if the seller merely retains an unpaid seller's lien, property having already passed to the buyer, he can still pass a title to the bank by virtue of s24 of the SGA 1979; cf. Todd (n 15) para 6.22.
[252] Unlike s2 of the Factors Act 1889, the seller is not required to have the goods or documents of title "with the consent" of the buyer: *Worcester Works Finance Ltd v Cooden Engineering Co Ltd* [1971] 3 All ER 708, p217.
[253] *Fadallah v Polla*k [2013] EWHC 3159 (QB), following *Mitchell v Jones* (1905) 24 N.Z.L.R. 932.

because it is impossible for him to pledge without the possession thereof. Therefore, this requirement applies to the situation in discussion.

Then, the crucial question is if such seller in discussion "continue to possession" for the purpose of this section?

"Continue in possession" means that the seller has the possession throughout the whole process. However, there is a divergence in whether a constructive delivery by the seller will break the continuance of his possession.

Under the current discussion, the seller has the possession of the bill of lading at all the material time; however, he has already passed the ownership to the buyer; in most cases, he then become the bailee for the buyer. As such, a constructive delivery (of the bill of lading) was completed. If a constructive delivery could break the continuance of the seller's possession, this statutory exception would not apply.

On the one hand, it was argued that a seller continued in possession of the goods even though he had constructively delivered the goods to the buyer at the time when he delivered the goods to the *bona fide* third party for value.[254] As long as the seller retained the physical possession of the goods, he was regarded as "continue in possession" of the goods regardless of alteration of legal title under which possession was held.[255] It was said that the wording "continue" in s.24 had contemplated the change of legal title. Also, the object of this section is to protect an innocent third party who is deceived by the seller's physical possession and who is unaware of the limitation of the seller's power of disposal.[256] Therefore, accompanied by other reasons, a seller was held to "continue in possession" even though his legal title under which possession was held had changed.[257]

On the other hand, it was held that the seller did not "continue in" possession when he had constructively delivered the goods to the buyer.[258] There is another authority, though less convincing, which could infer the same conclusion. As mentioned above, one of the requirements under this section is "delivery": the goods must be delivered to the *bona fide* third party. In *Michael Gerson (Leasing) Ltd v Wilkinson*, it was held that a constructive delivery by the seller could meet this requirement.[259] In this judgment, a constructive delivery has the same effect physical delivery. It might be indicated that a constructive delivery would break the continuance of the seller's possession

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[254] *Pacific Motor Auctions Pty Ltd v Motor Credits (Hire Finance) Ltd* [1965] AC 867.
[255] *Pacific Motor Auctions Pty Ltd v Motor Credits (Hire Finance) Ltd* [1965] AC 867, p886.
[256] *Pacific Motor Auctions Pty Ltd v Motor Credits (Hire Finance) Ltd* [1965] AC 867, p886.
[257] This is followed by *Worcester Works Finance Ltd v Cooden Engineering Co Ltd* [1971] 3 All ER 708, p217.
[258] *Staffs Motor Guarantee Ltd v British Wagon Co Ltd* [1934] 2 KB 305.
[259] *Michael Gerson (Leasing) Ltd v Wilkinson* [2001] QB 514.

as physical delivery. However, since it was not sure, as Nikki McKay argued, whether the sale and leaseback agreement between the seller and the buyer constituted a constructive delivery, such indication is far from clear.[260]

This view is supported by Louise Merrett, who was in the opinion that a delivery, no matter actual or constructive, would break the continuance of possession.[261] She thought the reasoning under *Pacific Motor Auctions Pty Ltd v Motor Credits (Hire Finance) Ltd* was not wholly convincing. She argued that the legal title under which the possession was held was irrelevant to the "continue in possession" requirement and only relevant to "in possession" requirement. Moreover, it was argued that, although the object of s.24 was to protect the innocent third party who was deceived by the seller's possession, the application of this section did not depend merely on the expectation of that third party; this is only the precondition of any exceptions of *nemo dat* rule; instead, this requirement focus on the conduct of the buyer, namely his failure to take delivery of the goods; therefore, such buyer should be punished by losing his title to the goods. However, in the cases where a seller has constructively delivered the goods to the buyer, the buyer did not fail to take delivery and thereby should not be punished by forfeiting his title;[262] therefore, the third party should be protected by s.24. Following that, a seller who has constructively delivered the goods to the buyer was not a seller "continue in possession" for the purpose of s.24.

The answer to which view is preferable somehow determines whether the seller can be regarded as "continue in possession". If the first view is preferable, the seller might be regarded as "continue in possession" when he becomes a bailee for the buyer and thereby have the "power" to pledge the bill of lading. In author's opinion, the first view is preferable.

Although the seller's retention of the goods or the document of title is not always the consequence of the buyer's failure to take delivery, the buyer, compared to the innocent third party, should take more responsibility for the seller's retention. There is no general obligation for such third party to investigate the legal title of the seller. As long as the seller retained the possession of the goods or the documents of title, the seller has the apparent authority to dispose of them and the ability to deceive others.

Moreover, it is the principle that, where one of two innocent parties must suffer from the fraud of a third party, the loss shall fall on the one who enabled the third party to commit the fraud.[263] If the

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[260] See Nikki McKay, 'Seller in Possession - Constructive Delivery of Goods on Site' [2008] Coventry Law Journal 122.
[261] Merrett (n 244).
[262] ibid p384-389.
[263] *Babcock v Lawson* (1880) 5 QBD 284; *Lickbarrow v Mason* (1787) 2 Term Rep 63 (Ashhurst J).

buyer insisted that the delivery took the form of physical delivery (of the goods or documents of title to the goods), the seller would not be able to commit the fraud. If it was the goods themselves being retained, this argument might not be convincing due to inconvenience; but if it was the document of title to goods, the buyer could have taken the documents.

Accordingly, it is suggested that a seller remained "continue in possession" although the goods have been constructively delivered. As such, in the context of the current discussion, if the seller becomes a bailee on terms, he is still able to have the "power" to pledge the bill of lading to the bank by s.24 of the Sale of Goods Act.

4.5.2.2 Without Notice

Another requirement of s.24 relevant to the current discussion is that the third-party receiver must receive the goods or documents of title to goods "without notice of the previous sale". If the bank did not receive the bill of lading without notice of the previous sale, it could not become a pledgee by applying s.24 even if the seller "continue in possession" of the bill.

It has been argued by Sassoon that even if the seller merely retains an unpaid seller's lien and property has already passed to the buyer, he can still pass a title to the bank by virtue of s.24 of the Sale of Goods Act 1979.[264] As such, he might be in the opinion that the bank could receive the bill of lading without notice of the "previous sale". However, this view was disagreed by Paul Todd, who thought that the bank must be aware of the sale.[265] The divergency on this requirement therefore lays in the meaning of "previous sale". However, there is no authorities saying that, in the operation of letters of credit, the banks could be regarded as "without notice of previous sale".[266]

Paul Todd argued that the fact that the bank was unaware of the transfer of property might not be sufficient to bring them within s.24.[267] What Paul Todd tried to indicate was whether the bank was aware of the transfer of property was irrelevant to the application of s.24. As long as the bank know that there has been a sale regarding the same goods or the documents of title, the bank is regarded as having the notice about "previous sale" and is thereby exempted from the protection of s..24.

In the author's opinion, this argument is not completely right. The purpose of the whole section is to protect the third party who is deceived by the seller's possession of the goods or the document of title to goods and consequently believes that the seller has the ownership in the goods.[268] If the third party

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[264] Sassoon (n 253) p571.
[265] Todd (n 15) para 6.22.
[266] See ibid.
[267] ibid.
[268] Merrett (n 244) p387.; *Pacific Motor Auctions Pty Ltd v Motor Credits (Hire Finance) Ltd* [1965] AC 867, p886.

knows that the seller has sold these goods, the seller will not, or ought not to believe that the seller is still the owner. It is doubtless that a notice about previous sale can make the third party not to believe that the seller is the owner, so that the awareness of the sale is enough to exempt the third party from the s.24 protection; as such, it might be true to argue that whether the third party know the property has passed is irrelevant. However, seller's possession, in some certain situations, might be able to mislead the third party to believe that, although the seller has sold the goods to the buyer, he has the authority from the buyer to dispose of the goods. If so, the notice only on the existence of the "previous sale" might not be able to make him not to believe that the seller does not have the buyer's authority to transfer the goods or the documents of title. Therefore, the substance of notice should be more than the mere existence of that "previous sale".

Before drawing this conclusion, it is important to ask whether the third party is allowed to only show his belief that the seller has the authority from the owner to dispose of the goods so as to bring himself within s.24; or must he show his belief that the seller is the owner of the goods? If the law required that the third party must show his belief that the seller in possession was the owner, it would be irrelevant if the third party believed that the seller had the authority to transfer from the buyer.

Neither English law nor Civil law jurisdictions can reach an agreement on this question.[269] It was argued that restricting the third party's belief only to that the seller has the ownership in the goods would complicate the law.[270] The author agrees with this opinion. Since there is more than one possible way for the seller's possession to mislead others, this restriction will only put the third party in a harder situation where he can be protected from only one possibility. Therefore, a genuine belief that the seller in possession has the owner's authority to make the transfer should be enough to bring the third party within the protection of s.24. In the context of current discussion, such belief should be that the seller who has retained the bill of lading after the sale is holding the bill as an agent for the buyer and has the buyer's authority to pledge.

It might also be argued that the possibility for the third party to genuinely believe that the seller has the buyer's authority to transfer is very small; as such, it is unnecessary to allow a third party with such belief to benefit from s.24. Seller's possession of goods could also be retained for the purpose of security against the buyer's payment. However, in sales under documentary credits, this possibility is much higher than in other ordinary sales. As discussed before, it would be easy for the court to find an implied authority from the buyer if the ownership in the goods has passed to him before the seller tendering the bill of lading to his bank.[271] Therefore, it would also be easy for the bank to believe that

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[269] Tettenborn (n 246) p166.
[270] ibid.
[271] See discussion in section 4.4.2.2.

the seller has the authority from the buyer to pledge the bill of lading. Accordingly, at least in cases under the current discussion, such possibility is not small. For this reason, such permission should not be generalised to other types of transactions, because, in other kinds of transactions, a seller normally does not have the buyer's authority to pledge; also, the seller's possession of other statutory "documents of title" than transferable bills of lading should not have the same effect, because, under a letter of credit transaction, without bills of lading, a mere authority to pledge is not sufficient for the seller to make a valid pledge.

In conclusion, under a letter of credit transaction, although knowing the existence of the sale, the financing bank could be regarded as "without notice of previous sale" and benefit from the s.24 protection (if other requirements were satisfied).

4.6 Conclusion on Ownership Passed Before Bills of Lading

When the bill of lading has retained by the seller, but the ownership has been passed to the buyer, the current law seems to prefer the view that the seller has lost the ability to pledge the bill of lading to the financing bank as security. Since a bill of lading only function as transferring constructive possession in the process of pledge, the seller does not lose his ability to transfer possession of the assets. Then the presumed current law must suggest that the seller's ability to pledge is his ownership in the assets. This suggestion has been approved by many scholars, and its correctness seems to be acquiesced. No comments or discussion has ever been made to challenge its correctness despite of its importance to bank's security. It leaves a research gap about the legal requirements for pledge by bills of lading, which would in turn bring uncertainty to the relevant parties, especially financing banks in practice. Therefore, it is important to clarify the legal position in this regard.

Through the detailed discussion above, it is, however, found that this suggestion is not compatible with the general law regarding the creation of security interest and the rules about pledge. Generally, a person with a "present interest" in the assets or have the "power" to give security has the ability to grant security to others. Although there is a general implied undertaking for the pledgor to have the ownership in the assets pledged, this undertaking does not govern the seller under a letter of credit transaction for various reasons discussed above. In terms of the "present interests", some authorities suggest that certain bailees on terms also obtain the sufficient "present interest" to create security interest, such as a pledgee and a lessee in possession; therefore, it is suggested by the author that, under a letter of credit, if the seller has the same "present interests" as a pledgee or a lessee in possession has, he will retain the ability to pledge even though he has parted with his ownership. As analysed in this Chapter, the seller can obtain the same "present interests" on the condition that he becomes a bailee on terms for his buyer after transferring the ownership in the goods to the buyer.

It is normal to see that a seller who has parted with the ownership but retained the possession of the goods is regarded as a bailee on terms for the buyer. However, as suggested by the authorities, a seller retaining the bill of lading will not become a bailee on terms for the buyer at every event; it depends on the intention between the seller and the buyer regarding the right to possession. In cases of letter of credit transactions, since an implied authority to pledge from the buyer can be easily found, the seller is unlikely to be regarded as a bailee at will; without an immediate right to possession, the seller will not be able to pledge the bill of lading on the buyer's behalf.

Accordingly, if such seller is regarded as a bailee on terms for his buyer, it is submitted that he would still obtain sufficient "present interest" to create valid security to the financing bank, even though he has lost the ownership in the goods. And the suggestion that the seller must retain the ownership to be able to create a pledge is arguably wrong.

Suppose such seller is not a bailee on terms for his buyer, or the contrary evidence proves that he does not have the "present interest" to pledge. In that case, it is submitted by the author that he is still capable of creating a valid pledge with the exception of *nemo dat* rule, namely s.24 of the Sale of Goods Act 1979.

In order to bring such seller within s.24, such seller must, among other requirements, "continue in possession" of the goods or documents of title to the goods, and the potential pledgee must receive them "without notice of previous sale". There are many uncertainties on these two requirements and no discussion about their applicability to banks under letters of credit made by courts or academics. Through the detailed analysis above, it is submitted by the author that a bank under a letter of credit meets these requirements in the case that the ownership of the goods has been passed to the buyer before the seller tenders the bill of lading. Overall, even if the argument that the seller must not retain the ownership in the pledged assets to be able to create a valid pledge would not gain support from the English courts, the bank should be protected by s.24 of the Sale of Goods Act 1979.

To conclude this Chapter, whether the ownership in goods is located at sellers or buyers at the time of transferring the relevant bills of lading is unlikely to affect the validity of pledge created thereupon.

Chapter 5 Transferring Bills of Lading to Banks

The last two chapters have explored the factors occurring before the transfer of the bill of lading by the seller to his bank. They are the situation where the goods have been discharged before the transfer of the bill of lading and where the ownership in the goods has been passed to the buyer before the transfer. It is submitted that the former is likely to put the bank into a very unfavourable position in terms of security, while the latter is less likely to affect the bank's security. Even though the bank can confirm that these situations do not happen when the seller tenders the bill of lading, its security might still be uncertain due to some factors occurring at the time of the transfer of the bill. As such, this chapter will discuss the negative factors which will happen along with the transfer of the bill of lading.

These factors include, first, the intention between the seller and his bank regarding the right to possession under the bill of lading and, second, the indorsement requirement for transferring a bill of lading. Precisely speaking, the first one is the situation where the seller does not intend to transfer the constructive possession of the goods through his transfer of the bill of lading to his bank; the second is the situation where the seller transfers a "to buyer's order" bill of lading without proper indorsement.

The first one is relatively certain as a matter of law; however, it is less certain as a matter of fact because such intention is interpreted from the fact of each case. By contrast, the second factor is not quite clear in law. As such, these uncertainties, either in law or in fact, will potentially affect the validity of delivery of the bill of lading. So, the paragraphs below will discuss these factors respectively.

5.1 Intention on Transferring Possession

It has been seen that the intention of the parties plays a role in a letter of credit transaction. For example, parties' intention determines the legal effect of the deposit of the bill of lading to the bank.[272] And, after parting with the ownership of the goods to the buyer, whether the seller retains the bill of lading as a bailee on terms is also dependent on the parties' intention.[273] The parties' intention is also important to whether the constructive possession is transferred along with the delivery of the bill of lading; in other words, whether a bill of lading performs the document-of-title function depends on the parties' intention in this regard. Accordingly, whether sellers have the intention to transfer the

[272] See discussion in section 2.2.2.3.
[273] See discussion in section 4.4.2.2.

constructive possession to their banks potentially could impact the latter's security interests as pledgees.

It was contended that, when the parties did not intend to transfer constructive possession of the goods via the bill of lading, the holder of such bill would not obtain the right to possession of the goods.[274] As such, there would not be a valid pledge created by a transfer of the bill of lading if there was no intention of the parties to transfer the constructive possession of the goods to the bank.

This contention is arguably tenable because the intention requirement is also applied in determining whether someone has the "possession". The intention to possess is considered by authorities and scholars to be an element of the common law concept of possession.[275] A transfer of possession consists of a giving up of control on the asset and a receiving of the control; receiving of the possession requires the receiver's "intention to possess". Accordingly, though this requirement does not specifically refer to transfer of possession, if having the possession requires the "intention to possess", there should be an intention to transfer the possession for transferring the possessory interest in the goods as well.

However, like property, it is rare for parties to express their intention of transferring the right to possession; it must be implied by the courts. It could arguably be implied according to the factual matrix as a whole.[276] And such factual matrix must include the customary usage of bills of lading. According to the customary usage of bills of lading, a delivery of a bill of lading arguably raises a presumption that the transferor intended to relinquish control of the goods and that the transferee intended to take control of the goods to the exclusion of all others.[277] But these presumptions are only *prima facie* and rebuttable. If there was evidence contrary to these presumptions, a delivery of the bill of lading might not infer an intention to transfer the constructive possession of the goods. It was argued that, If the receiver of the bill of lading receives it only in a "purely ministerial capacity", he

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[274] *The Future Express* [1992] 2 Lloyd's Rep 79 (QB), p90 col2 and p95 col2; *East and West Corporation v DKBS 1912* [2003] EWCA Civ 83; [2003] QB 1509, para 42; Aikens and others (n 36) para 5.13; cf. Bridge and others (n 42) para 12.009 and fn 42, it was submitted that it is wrong to suggest that the transfer of the bill must be accompanied by an intention to pass constructive delivery.
[275] *Powell v McFarlane* [1977] 3 WLUK 188; *Parker v British Airways Board* [1982] QB 1004; *Manchester Ship Canal Company Ltd v Vauxhall Motors Ltd* [2018] EWCA Civ 1100 ; [2019] Ch. 331(CA), para 59, citing *JA Pye (Oxford) Ltd v Graham* [2002] UKHL 30 [2003] 1 AC 419, approved by the Supreme Court at para 42 and 55; *The Tubantia* [1924] P 78, p89, citing Frederick Pollock and Robert S Wright (eds), An Essay on Possession in Common Law (Rothman 1985); see DR Harris, 'The Concept of Possession in English Law' (1961) 69 Oxford Essays in Jurisprudence p75.
[276] Paul Todd, 'The Bill of Lading and Delivery: The Common Law Actions' (n 149) p549.
[277] See Bools (n 114) p173-190.

might not be regarded as having the constructive possession.[278] For example, the receiver is holding the bill of lading as an agent for his transferor. It was contended that: "to create a pledge security, there must be a transfer of possession in fact as well as the right to possession (including immediate possession)".[279] If the seller under a letter of credit transaction transfers the bill of lading to his bank intending to let his bank hold the bill as his agent, such bank will not become a pledgee on the goods; such bank only acquires the custody of the bill of lading, while the seller remains the right to immediate possession.

There are some authorities where the holder of a bill of lading is regarded as holding the bill as agent on behalf of others.

The first example is *The Aliakmon.* In *The Aliakmon*, the House of Lords found that the arrangement between the buyer and the seller was to reserve the property right to the seller and make the buyer the agent of them for taking delivery of the goods with the bill of lading.[280] The buyer was named as the consignee and had the possession of the bill of lading; nevertheless, the Court held that the buyer did not have the title to sue in negligence against the carrier. In the Court of Appeal, agreeing with Staughton J, John Donaldson MR concluded that the parties were not concerned with the passing of property by indorsement and delivery of the bill of lading.[281] He held that the property did not pass to the buyer because the seller had reserved his right of disposal. This was based on s.19(1) of the Sale of Goods Act 1979, providing that the property would not pass if the seller reserved the right of disposal, notwithstanding the delivery of the goods to the buyer.[282] Therefore, the Courts did not address whether the seller also intended to reserve his right to possession. Nevertheless, the Judge, considering the buyer's claim in tort, held that during the period when the goods were in the custody of the carrier the buyer was neither the owner, nor had he any right to possession, other than as persons who held the bill of lading on behalf of the seller.[283] It was thereby indicated that the buyer did not have the immediate right to possession through the possession of the bill.

The second example is that the bank may hold the bill of lading as the seller's agent. In *East and West Corp v DKBS*, Thomas J satisfied that the banks have never had any security or interest in the goods under the bill of lading.[284] In that case, the seller retained full control over the bill of lading, as the

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[278] Thomas Gilbert Carver, Guenter H Treitel and Francis MB Reynolds, *Carver on Bills of Lading* (4th ed, Sweet & Maxwell 2017) para 5.027, it was cited with approval by Mance LJ in *East and West Corporation v DKBS 1912* [2003] EWCA Civ 83; [2003] QB 1509.
[279] Robert Burgess and Robert Burgess, *Law of Loans and Borrowing* (Sweet and Maxwell 1989) para 4.47; William James Gough, *Company Charges* (2nd ed, Butterworths 1996) p21.
[280] See *The Aliakmon* [1986] AC 785.
[281] See *The Aliakmon* [1985] QB 350, p363 (John Donaldson MR).
[282] *The Aliakmon* [1985] QB 350, p363 (John Donaldson MR).
[283] *The Aliakmon* [1985] QB 350, p365 (John Donaldson MR).
[284] *East and West Corporation v DKBS 1912* [2003] EWCA Civ 83.

bank at all times held them to the order and direction of the seller, even though the bank was named as the consignee under the bill of lading. In the first instance, Thomas J held that the bank nevertheless had acquired the contractual title to sue the carrier under the COGSA92, which was later affirmed by the Court of Appeal.[285] Also in the first instance, Thomas J seemed to merge the contractual right to demand delivery with the possessory right, saying that "though the rights under the contract and possessory rights can be separated, they are not separated in these circumstances."[286] According to his judgment, the seller did not have the possessory right on the goods, but the bank might have. But this was rejected by the Court of Appeal on the ground that the seller remained the bailor, despite "whether or not the effect of [the seller's transfer of the bills of lading to the banks] was to confer on the Chilean banks a sufficient possessory interest for them to pursue claims in bailment".[287] Nevertheless, Mance LJ has discussed the question whether the transferee of the bill of lading had acquired a sufficient possessory interest to claim against the carrier.[288] For the question above, the response of the seller was that not only the transfer of property but possessory rights or constructive possession depended on the parties' intention, which was agreed by Mance LJ.[289] Mance LJ analysed *The Aliakmon* and explained that the delivery to the buyer of a bill under which he was named as consignee, with the intention that he should take delivery of the goods under it as the agent of the seller, did not confer on the buyer any possessory title to the goods, because the seller did not intend to transfer any possessory interest to the bank.[290] Mance LJ also referred *The Future Express* as confirming the proposition that "the passing of a possessory interest at common law depends just as much upon the parties' intentions as does the passing of any fuller proprietary interest."[291] Therefore, it was doubted that by physically possessing the bills of lading the bank had acquired at common law a sufficient possessory title on the goods to sue in tort.

The third example is under the operation of letters of credit. While the issuing bank takes the bills of lading presented by its negotiating bank, without accepting them, it only holds the bills for the negotiating bank. In *The Stone Germini*, the carrier argued, inter alia, that at the time of unloading, the negotiating bank had lost any right or interest under bills of lading when forwarded the bills of lading to the issuing bank for acceptance.[292] The provisions of the Uniform Customs and Practice for Documentary Credits (UCP500) recognise that until the documents are accepted and taken up by the

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[285] *East and West Corporation v DKBS 1912* [2002] EWHC 83 (Comm) (QB); [2003] EWCA Civ 83 (CA).
[286] *East and West Corporation v DKBS 1912* [2002] EWHC 83 (Comm); [2002] 2 Lloyd's Rep 182, [52].
[287] *East and West Corporation v DKBS 1912* [2003] EWCA Civ 83; [2003] QB 1509, [39] (Mance LJ).
[288] *East and West Corporation v DKBS 1912* [2003] EWCA Civ 83; [2003] QB 1509, [40] (Mance LJ).
[289] Ibid.
[290] Ibid; see *The Aliakmom* (n 280), at p809.
[291] *East and West Corporation v DKBS 1912* (n 287), at [41] (Mance LJ).
[292] *The Stone Germini* [1999] 2 Lloyd's Rep 255.

issuing bank, the bills of lading are to be held for return to the presenter.[293] The Court found that it accorded with the commercial reality of that case where the bills were to provide security to the negotiating bank until they were accepted by the issuing bank; and the bills were forwarded on the basis that until acceptance they were to retain their character as security; therefore, they did not pass into the "possession" of the issuing bank.[294] The negotiating bank did not lose its right or interest as pledgee by forwarding the bills of lading to the issuing bank for acceptance. Until they were accepted, the issuing bank only held them as the agent of the negotiating bank; and the negotiating bank retained the title to sue the carrier in conversion. Accordingly, it was suggested that the issuing bank, by holding the bill of lading, did not obtain the immediate right to possession of the goods.

There is another example of the bill of lading holder only as the agent for others. In *The Ythan*, the issuing bank was holding the bill of lading when the cargos were destroyed by the explosion of the vessel. [295] The bank did not pay the supplier until the underwriter had agreed to make an ex gratia payment. The bank in turn transferred the bill of lading to the underwriter against the payment made by the latter. When Aikens J considered the application of s.5(2)(b), he stated that the underwriter must be in analogous position to the bank that received the bill of lading for which the payment was to be made; and so long as the payment was not made, the bank would hold the shipping documents to the order of the seller.[296] Similarly, until the underwriter paid the claim, they must hold the bill of lading to the order of the assured. Aikens J therefore held that if only s.5(2)(b) was relevant, the assured rather than the underwriter had become the lawful holder upon the bank passing them to the underwriter. And before the underwriter paid the claim, he would not be subrogated to the rights of the assured. Following the reasoning in *The Stone Germini*, namely that until the bank had accepted and paid against the bills of lading it would not acquire the right to possession, the underwriter in the present case was unlikely to obtain the right to possession from its holding of the bills.

Among the four examples cited above, the holders of bills of lading were all regarded as the agents for other parties; and all of them arguably do not have the constructive possession of the goods. The difference between the first two examples and the other two examples is that, in the former cases, the transferors are actively making the transferees their agents, while in the latter ones, the holders become their agents in a more passive way. It is believed that, in the last two examples, the holders do not intend to become the agents only; however, due to the receivers did not fulfil the condition for transferring the constructive possession, they only became the agents. By contrast, in the first two

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[293] Uniform Customs and Practice for Documentary Credits No.500 (UCP500), Article 14.
[294] *The Stone Germini* [1992] 2 Lloyd's Rep 255, [40], Tamberlin J held that the bills had never left the legal possession of the negotiating bank, notwithstanding that they were physically in the possession of the issuing bank.
[295] *Primetrade AG v Ythan Ltd (The Ythan)* [2005] EWHC 2399 (Comm).
[296] *Primetrade AG v Ythan Ltd (The Ythan)* [2005] EWHC 2399 (Comm); [2006] 1 Lloyd's Rep 457, [88].

examples, it is the intention of the parties to let the holders become the agents of the transferor, so that the holders can take delivery of the goods on behalf of their principals; still the holders do not have any possessory interest in the goods against the carrier. It seems that the bill of lading would transfer no possessory interest in the goods if the intention of the transaction was only to make the holders become agents. In either way by which the holder becomes an agent, the intention is interpreted according to the factual matrix as a whole.[297]

It was contended that the bill of lading did not perform the document-of-title function unless the parties intended to use it to transfer legal property.[298] The dictum of Lord Hatherley says that "the bill of lading is both the symbol of ownership and, for the purposes of transferring that ownership, is the goods."[299] However, if this contention was true, a transfer of a bill of lading, as Paul Todd argued, could not be said to transfer the constructive possession at all.[300] Although this theory could explain the first two examples where the parties actively made the holders become agents, it could not explain the latter two, because there was in fact an intention to transfer the legal property between the parties. Accordingly, this contention is not true.

It was submitted that, when the seller retained the ownership in the goods after delivering the bill of lading, the courts were inclined to regard the seller intentionally letting receiver hold the right to possession as an agent on his behalf.[301] The seller's retention of ownership might have an impact on finding the intention between the seller and the buyer. But this tendency normally does not apply to letter of credit transactions; even though the seller was found to intend to retain his ownership at the time of the transfer of the bill of lading, it would not prevent the court from finding his intention to pass the special property through the bill of lading, which must include an intention to transfer the right to possession because of the delivery requirement for creating a pledge.

Nevertheless, this is only a rebuttable presumption, subject to evidence contrary to this intention.[302] For example, in *The Future Express*, Diamond QC held that a pledge could not be created if the transferor did not intend that the transfer of the bill of lading operate as a transfer of the constructive possession of the goods; and he found that the parties must not intend that a transfer of the bill of lading operate as a transfer of constructive possession of the goods, because, at the time of negotiation of the bill of lading, both the transferor and the transferee knew that the goods had been delivered.[303]

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[297] Paul Todd, 'The Bill of Lading and Delivery: The Common Law Actions' (n 149) p548.
[298] Bools (n 114) p178-179.
[299] *Barber v Meyerstein* (1869-70) LR 4 HL 317.
[300] Paul Todd, 'The Bill of Lading and Delivery: The Common Law Actions' (n 149) p545.
[301] ibid p548. See *The Aliakmon* [1986] AC 785 and *East and West Corporation v DKBS 1912* [2003] EWCA Civ 83.
[302] E.g. *The Future Express* [1992] 2 Lloyd's Rep 79 (QB).
[303] *The Future Express* [1992] 2 Lloyd's Rep 79 (QB), p90 col2 and p93 col2.

Such intention was found in the fact that the goods had been discharged before the transfer of the bill. It might be suggested that the bank is unlikely to acquire a right to possession when it accepts the bill of lading with the knowledge that the underlying goods have been discharged.

The two situations discussed above are the ones which have been discussed in the chapters about the factors occurring before the transfer of the bill of lading, i.e., where the ownership in the goods has passed to the buyer before the transfer of the bill of lading and where the goods have discharged before the transfer. Although these are the situations occurring before the transfer of the bill, they might affect the interpretation of the parties' intention regarding the transfer of the constructive possession. Overall, whether the seller intends only to let the bank hold the bill of lading as his agent only depends on the factual surroundings, which are different from case to case. However, for the purpose of the current discussion, when the goods do not discharge and the ownership is not passed before the transfer of the bill of lading, the courts might still interpret the intention in favour of the bank, namely that the seller does intend to transfer the constructive possession of the goods to his bank under the letter of credit.

5.2 Without Proper Indorsement

As discussed above, the intention about the right to possession is important for a bill of lading acting as a document of title to the goods and thereby for the validity of a pledge. If the court finds that the seller does not intend to transfer the constructive possession to his bank, the bank cannot become a pledgee of the goods. Although the intention is important for judging whether the right to possession has been transferred through the bill of lading, the actual control over the underlying goods must also be taken into account. If the transferor of the bill of lading intends to transfer the right to possession to the transferee, without effective transfer of the actual control over the goods, the transferee cannot be said to acquire the right to possession of the goods.

It is contended by the author that, if a bill of lading is transferred without proper indorsement, the actual control over the underlying goods is not transferred accordingly. In this sense, a seller under a letter of credit transaction cannot pass the constructive possession of the goods to this bank by transferring him the bill of lading but without proper indorsement.

This question whether creating a pledge with bills of lading requires proper indorsement has not been tested by authorities, and the scholars have not reached an agreement.[304]

What does it mean by "actual control" as one of the elements of possession at common law?

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[304] King and Gutteridge (n 13) p212.

Here, the actual control includes the situation where the goods are held by other person on his behalf.[305] However, a carrier cannot be deemed to hold the goods on behalf of every bill of lading holder, because the only bailment relationship exists between (normally) the shipper and the carrier.[306] Nevertheless, the holder of the bill of lading is the one with the greatest control over the goods.

A carrier, who is the actual possessor, undertakes and is bound to deliver the goods only to him.[307] Moreover, the carrier is entitled to deliver the goods only to the holder; in other words, the carrier is entitled to refuse anyone, including the person truly entitled to delivery, claiming delivery except for the bill of lading holder,[308] and it is not liable for misdelivery if the holder is in fact not the person entitled to delivery, as long as the delivery is made against presentation of the original bill of lading.[309] Last but not least, as contended previously, the carrier would not be responsible for any subsequent holder of the bill of lading if it delivered the goods to this person, even though without presentation of the bill.[310]

Accordingly, in the eyes of the actual possessor (the carrier), the bill of lading holder is the only person who is entitled to take delivery of the goods, regardless of the characters in which he is holding the bill of lading. So, the holder essentially has the actual control over the goods shipped by the carrier.

In order to become that "holder" in the eyes of the carrier, a proper indorsement is needed (if necessary). This can be reflected from the statement of Lord Denning about presentation rule in *Sze Hai Tong Bank Ltd.* v *Rambler Cycle Co. Ltd*:[311]

> It is perfectly clear law that a shipowner who delivers without production of the bill of lading does so at his peril. The contract is to deliver, on production of the bill of lading, to the person entitled under the bill of lading. In this case, it was "unto order or his or their assigns," that is to say, to the order of the Rambler Cycle Company, if they had not assigned the bill of lading, or to their assigns, if they had.

The carrier must deliver to the person who is entitled from the face of the bill of lading against the presentation thereof, otherwise it would be liable for misdelivery.

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[305] *The Saetta* [1993] 2 Lloyd's Rep 268, Clarke LJ interpreted the "possession" under the Factors Act; see also Bools (n 114) p173-190.
[306] *The Aliakmon* [1986] AC 785; cf. *Borealis AB v Stargas Ltd (The Berge Sisar)* [2002] 2 AC 205, [18].
[307] See discussion in section 2.2.3; Bools (n 114) p180-190.
[308] *Motis Exports Ltd v Dampskibsselskabet AF 1912 Aktieselskab and Aktieselskabet Dampskibsselskabet Svendborg* [2000] CLC 515.
[309] *Glyn Mills Currie v East and West India Dock Company* (1882) 7 App Cas 591.
[310] See discussion in section 3.3.
[311] *Sze Hia Tong Bank v Rambler Cycle Co Ltd* [1959] AC 576, p586 (Lord Denning).

If the bill of lading transferred is a bearer bill, no requirement of indorsement is needed; if the bill is made out to the transferor's order, the bill must be indorsed to the transferee or blank indorsed.

Also, this contention is consistent with the argument on who is the person "entitled under the bill of lading", delivering to whom will make the bill of lading "spent'; it was submitted by the author that this person must be the one who can claim delivery if he has surrendered the bill of lading to the carrier or transfer the bill of lading by delivery and/endorsement; in other words, he must be entitled to delivery at least from the face of the bill.[312]

This principle should similarly apply to the creation of a pledge with an order bill of lading. If so, a seller gives his bank a bill of lading which is made out to his buyer or the issuing bank, without proper indorsement, his bank cannot become a pledgee on the goods; similarly, if the bill of lading is made out to the order of the buyer, the issuing bank cannot acquire the pledge on the goods without proper indorsement.[313]

However, some scholars have argued that the banks could still become a pledgee on the goods even though the bill of lading has not endorsed to them.[314]

It was argued that the agreement between the buyer and the issuing bank is to create a pledge in favour of the latter, and the buyer had consented to the bank doing so.[315] However, the mere intention to pledge is impossible to create a valid pledge without delivery of possession.[316] Without proper indorsement, the bank does not have the effective control over the bill of lading and the underlying goods; instead, its control is subject to someone else's indorsement.

It was contended that the fact that the bill has not indorsed to the bank would affect the validity of the pledge; instead, it would only affect the pledgee's right of sale. Nevertheless, the bank is entitled to require the buyer to perfect his title by proper indorsement.[317] This contention might be supported by Bowen LJ's statement in *Sewell v Burdick*.[318] In this case, one of the parties argued that no indorsement of bill of lading was needed if it was only intended to pledge.[319] Bowen LJ rejected this contention by saying that "without the indorsement of the bill of lading the common law powers of the pledgee would be incomplete."[320] Although the "powers of the pledgee" here was referred to the

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[312] For the detail discussion on who is the person "entitled", see section 3.3.
[313] See Beale and others (n 42) section 9.2.2 and 9.2.3.
[314] Malek and others (n 13) para 11.4; King and Gutteridge (n 13) para 18.15; Schmitz (n 106) p269.
[315] Malek and others (n 13) para 11.4; King and Gutteridge (n 13) para 18.15.
[316] See n 97.
[317] Malek and others (n 13) para 11.4.; pledge of eB/Ls in Bolero seems to follow this view, see text in fn 489-493.
[318] *Sewell v Burdick* (1884) 13 QBD 159.
[319] *Sewell v Burdick* (1884) 13 QBD 159, p174 (Bowen LJ).
[320] *Sewell v Burdick* (1884) 13 QBD 159, p174 (Bowen LJ).

right of sale, pledgee's right is more than a right of sale, most of which are required the pledgee to be person entitled under the bill of lading; for example, a pledgee is entitled to sub-pledge the same asset to his creditor;[321] if the bill of lading has not properly indorsed to the pledgee, how could he sub-pledge the bill of lading to his creditor, because his creditor would not believe that he, with a bill of lading which was endorsed to someone else, was entitled to make the transfer. Therefore, without proper indorsement, a pledge made by the transfer of the bill of lading is incomplete.

It was also argued that there was no indorsement requirement for transferring right to possession, because it was the bill's character as a freely transferable commercial document.[322] However, this argument is incompatible with the custom of merchants which finds a transferable bill of lading a document of title to the goods. The custom of merchants specifically addressed the requirement of indorsement: bills of lading are "negotiable and transferable…by such shipper indorsing such bills of lading with his name, and delivering the same so indorsed".[323] A blank indorsement was said to have the same effect as a personal indorsement.[324] But the custom does not say that bills of lading are transferable even without any indorsement.[325]

There is another argument, which is less convincing, that: if the law has the indorsement requirement for pledging bills of lading, it was odd that UCP 600 or the application form of opening letters of credit missed the relevant clauses.[326]

The Uniform Customs and Practice for Documentary Credits (UCP) is the rules issued by the International Chamber of Commerce (ICC) aiming to internationally unify the rules and practices on documentary credits. However, itself does not have the force of law.[327] Therefore, its position cannot represent the stance of English law. As for the application form of letters of credit, in author opinion, the lack of the indorsement requirement is the result of commercial convenience. Accepting "to buyer's order" bills of lading might release some of administerial burden of the banks, including the burden of indorsement. Moreover, banks are unwilling to become consignees under the bills of lading, because they would assume liabilities that they would not usually expect to bear.[328] For these reasons, issuing banks do not require a proper indorsement of bills of lading in their application forms.

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[321] *Donald v Suckling* (1866) LR 1 (QB) 585; see discussion in section 4.4.2.2.
[322] Schmitz (n 106) p269.
[323] *Lickbarrow v Mason* (1794) 5 Term Rep 683.
[324] *Lickbarrow v Mason* (1794) 5 Term Rep 683, p686.
[325] See also Michiel Spanjaart, 'The Endorsement of Bills of Lading' [2018] SSRN Electronic Journal <https://www.ssrn.com/abstract=3269133> accessed 24 December 2021.
[326] Charles Debattista, *Sale of Goods Carried by Sea* (2nd edn, Butterworth 1998) p39.
[327] E.g. M. Golodetz & Co Inc v Czarnikow-Rionda Co Inc (The Galatia) [1980] 1 WLR. 495
[328] Schmitz (n 106) p269.

In conclusion, if the banks want to acquire the right to possession of and the special property of the underlying goods from the seller, the bills of lading transferred to them must be properly indorsed; otherwise, by obtaining the bills of lading not properly indorsed, the banks do not thereby obtain the actual control over the goods, regardless of the intention of the seller.

Another reason for taking a properly indorsed bill of lading is that the indorsement might infer a *prima facie* intention to transfer the constructive possession.

The form of the bill of lading has an impact on interpreting parties' intention about transferring ownership; for example, if seller retained a bill of lading which is made out to his order, he is *prima facie* intending to reserve the right of disposal.[329] Such intention can arguably be found in the customary usage of a bill of lading.[330]

The customary usage of a bill of lading is that merchants transfer their right to possession by a transfer of and/or indorse the bill of lading. If such custom can envisage the parties' intention, a transfer of bill of lading accompanying with a proper indorsement can reflect the parties' intention to transfer the right to possession of the underlying goods. Therefore, the form of bills of lading to some extent could assist the courts to find an intention regarding the constructive possession.

Obviously, this is only a presumption, and it could be rebutted by contrary evidence. In some authorities with relatively odd factual factors, a holder does not obtain the constructive possession of the goods even though he has the bill of lading and is named as consignee under such bill.[331] But it still has strong influence on the courts when interpreting the intention, especially when there are not any special factual factors in the case in dispute.

5.3 Conclusion on Factors at the Transfer

From the discussion above, it is found that a bank under a letter of credit might not obtain a security interest on the goods if the factors mentioned in this chapter occurs at the transfer of the bill of lading.

Since the common law concept of possession consists of an intention to possess and an actual control over the asset, a transfer of possession, actual or constructive, is subject to similar conditions, namely that an intention to transfer and a transfer of the actual control; missing either of them will render the transfer of possession ineffective.

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[329] Sale of Goods Act 1979, s.19(2).
[330] See Paul Todd, 'Bills of Lading as Documents of Title' (n 7).
[331] E.g. *The Aliakmon* [1986] AC 785, for the detail discussion about this case, please see the text in n 280-283.

Accordingly, the first factor is the lack of the seller's intention to transfer his right to possession through the transfer of the bill of lading. Although the intention upon possession has been discussed a lot, it has not been discussed in the context of bank's security; in fact, the factor of intention in bank's security is not less important than that in other areas, because the lack of such intention would render the bank unable to obtain the security interest through the seller's transfer of the bill of lading.

In a letter of credit transaction, a seller is obliged to transfer the bill of lading to his bank. In order to effectively transfer the constructive possession of the goods to the bank, there must be an intention of the seller to transfer the constructive possession accompanying with, if necessary, a proper indorsement and delivery of the bill of lading. If the goods were not discharged at the time of the transfer, an intention to transfer constructive possession to the bank would often be found in the letter of credit transactions, because an intention to pledge could be found based on the nature of letter of credit transactions. However, this is just a *prima facie* presumption, which is rebuttable; an intention is a fact-sensitive factor that is hardly possible for banks alone to determine; instead, courts will consider the factual matrix when interpreting it.

It brings out the second factor potentially occurring at the transfer of the bill of lading, i.e., the lack of proper indorsement. The proper indorsement is not required by the common law for transfer of the right to possession, but such requirement can be reflected by the control requirement mentioned above. A transfer of possession requires an intention to transfer it as well as a transfer of the control of the asset. There have not been any materials addressing the linkage between the indorsement requirement and the control requirement under transfer of possession. However, it is submitted by the author that this linkage affects the validity of a transfer of a bill of lading in terms of transferring the constructive possession. Even though an intention to transfer the constructive possession is found, delivery of the bill of lading without proper indorsement cannot transfer the constructive possession as the parties intended, because it is contended there will not be an effective transfer of the actual control over the underlying goods in this situation, regardless of the parties' intention. Besides, a proper indorsement, to some extent, might in turn infer an intention to transfer the constructive possession. So, though not directly confirmed by authorities, the indorsement requirement is consistent with the common law position; as such, it is proposed by the author that the indorsement requirement is necessary for bank's security. Moreover, imposing such requirement at the common law will reconcile the property regime with the contractual regime (i.e., COGSA92) to the extent of transferring right to take delivery of the goods.[332]

[332] For the discussion about the relationship between pledge and COGSA92, see Antoniou (n 8); see also Paul Todd, 'The Bill of Lading and Delivery: The Common Law Actions' (n 149).

Although the requirement of intention brings a lot of uncertainty to bank's security, it is submitted that, without special arrangements, e.g., discharging the goods before tendering of the bill of lading or transferring ownership in advance, the courts rarely find no intention to transfer constructive possession to the bank in a normal letter of credit transaction. As such, the intention issue is unlikely to be a real issue for banks' security, provided that banks require a personal indorsed bill of lading in its favour or, at least, a bearer bill of lading.

Chapter 6 After Transfer of Bills of Lading: Risk of Using Trust Receipts

Assuming all of the factors being discussed do not occur and a valid pledge is created through the transfer of the bill of lading to the financing bank under a letter of credit, is the bank's interest in one hundred per cent secured by the bill of lading?

General speaking, under a letter of credit transaction, a financing bank's security interest as pledgee is possible to be prevailed by a third party's pledge when the former releases the pledged document of title to its customer against a trust receipt. This risk does not occur in the normal operation of a letter of credit; instead, it occurs in a certain situation when a financing bank as the pledgee, before reimbursement, has redelivered the document of title to goods, which was previously delivered as security by its customer, in exchange for a trust receipt.

In a normal operation of a letter of credit as explained before, the financing bank obtains the document of title to the goods as security for its customer's obligation of reimbursement.[333] As such, the document of title will remain in the possession of the bank until it gets paid fully by its customer. By contrast, when a trust receipt is used in the operation of the letter of credit, the bank's customer can acquire back the document of title before he fully fulfils the obligation of reimbursement. The purpose of a trust receipt is to permit the purchaser to sell the goods or the relevant document of title on behalf of the bank so that the former can reimburse the latter with the proceeds of sale.

Ideally, the usage of a trust receipt is not a problem; instead, it allows the purchaser to use the pledged asset to generate income so as to relieve his cashflow. For this sense, the usage of a trust receipt overcomes the significant disadvantage of pledge itself, namely the pledgor loses the control over his pledged asset. Meanwhile, it opens the gate to the purchaser disposing of the document of title or the underlying goods as he wishes, even though his wish is inconsistent with the bank's. For example, the purchaser can pledge the same document of title to another bank in order to receive advances from it.[334] Or, the purchaser can retain or dissipate the proceeds for his own interest after selling the document without accounting to the pledgee.

This could be a serious problem for the financing bank because, in the situation where the customer re-pledges the document of title to a third-party bank, this third-party bank's pledge is likely to be

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[333] See discussion in Chapter 2.
[334] E.g. see *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1937] 2 KB 631 (QB); [1938] 2 KB 147 (CA).

regarded by law as valid, even against the first bank; therefore, the financing bank will lose its security interest in the documents of title; [335] as a result, it could not have the priority in the related goods of its customer anymore if the latter went insolvent.[336]

Theoretically, this risk could be generalized to any improper disposition by the pledgor. The bank's security interest could be prejudiced not only by a re-pledge, but also by any pledgor's improper disposition if such disposition is made beyond the authority given by the bank. It includes the improper appropriation of the proceeds of sale or the goods themselves. Therefore, the bank's security becomes very fragile when the bank releases the bill of lading to the pledgor against a trust receipt.

Although those risks take different forms, overall, the substance and the reasons behind them are similar to each other. Hence, the following discussion will focus on the most common form of the risk occurring in the usage of trust receipt, namely re-pledge by pledgors. The examination of this particular form of risk would provide the whole picture about the risk of using trust receipts in letters of credit. For this reason and for the convenience of discussion, this risk will be called the "double pledge" problem in the following discussion.

6.1 Causes of the "Double Pledge" Problem

The crux of the "double pledge" problem is the misbehaviour of the pledgor who obtained the possession of the bill of lading against the trust receipt. The trust receipt itself is not the problem. It is not uncommon to use trust receipts in letter of credit transactions. As mentioned earlier, the usage of a trust receipt allows the buyer to use the pledged asset to generate income to relief his cash flow and consequently overcomes the significant disadvantage of pledge itself, namely the pledgor gains the control over his pledged asset. This is attributed to its capacity to protect the bank (the pledgee) from the insolvency of the buyer (the pledgor). A bank, which releases bills of lading under a trust receipt, retains its interest as pledgee in the goods and their proceeds and is thereby entitled to proceeds of sale (which had not been paid over to the pledgor) in preference to the pledgor's general creditors at the event of the pledgor's insolvency.[337] Nevertheless, it might not be able to protect the bank from the fraud of the buyer.

The "double pledge" problem can be simplified as that: in cases of the pledgor's fraud, the title of the third party who made a deal with the pledgor is protected by law if some criteria are satisfied; as such, his interest prevails the pledgee. At the first glance, the problem looks like a typical situation where a *bona fide* third party made a deal with a fraudster whose title in the goods is defective. In fact, this is

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[335] See *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147.
[336] The financing bank still have a contractual claim against its customer for breach of the trust receipt.
[337] *North Western Bank Ltd v John Poynter, Son & Macdonalds* [1895] AC 56.

how the English law characterised the "double pledge" problem. Therefore, to find out the causes behind this problem, it is necessary to first figure out why the English law so characterised.

As will be concluded from the following discussion, there are mainly two kinds of reasons attributed to the prevalence of "double pledge" problem: first, the strict legal requirements for exclusion of s.2 of the Factors Act 1889 in the trust receipt situation; second, strong policy reasons supporting the protections for third parties in this situation.

6.2 Legal Requirements for Excluding Section 2 of the Factors Act 1889

There are certain requirements for applying s.2 of the Factors Act 1889. In order to protect the bank's security from the third party who received the bill of lading from the pledgor, such third party must be excluded from the protection provided by s.2. However, through the following discussion, the author thinks that the threshold for excluding the third party from such protection is very high in the trust receipt situation.

Before looking at how to exclude such third party from the protection of s.2, it would be better to discuss why s.2 is applicable.

The "double pledge" problem is originated from *Lloyds Bank Ltd v Bank of America National Trust and Savings Association*.[338] And it is the most renowned case illustrating this problem; therefore, its judgments are also the significant legal reasoning for this problem.

The fact of this case is similar to the description in the previous section. In this case, Lloyds Bank agreed to advance money to its customer, Strauss & Co, and to receive the related bills of lading as security; as a result, Lloyds Bank became the pledgee of the underlying goods. Before fulling the obligation of repayment, Strauss & Co issued a trust receipt to Lloyds Bank, which was to enable the former to have the bills of lading back so that it could sell the goods as trustee for the latter; hence, Lloyds Bank surrendered the bills of lading to Strauss & Co against this trust receipt. However, instead of selling the goods according to the trust receipt, Strauss & Co fraudulently re-pledged the bills of lading to the Bank of America National Trust and Savings Association (hereafter referred as "Bank of America"), who acted in good faith and without knowing the interest of Lloyds Bank. Eventually, Strauss & Co went insolvent before fully repaying Lloyds Bank, so it claimed against Bank of American for the return of the bills of lading or their value, or damages for conversion.

[338] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147.

It was held by the High Court and affirmed by the Court of Appeal that the pledge Bank of America had was valid because s.2(1) of the Factors Act 1889 was applied;[339] therefore Lloyd's Bank was not entitled to claim back the bills of lading from Bank of America.

One of the reasons why this case is the origin of the "double pledge" problem is that the fact of this case is common, even in the current operation of letters of credit. In the current operation of a letter of credit, an issuing bank under a letter of credit holds bills of lading as security, just like Lloyds Bank; moreover, the usage of trust receipts is still welcomed by traders of international sale, so the issuing bank will probably release the bills of lading to its customer against a trust receipt, who, in the same position as Strauss & Co, undertakes to sell the goods as trustee of the issuing bank by virtue of this trust receipt. In addition, although the terms of each trust receipt are different, their essence is the same.[340] Therefore, its judgment is likely to be generalized when a trust receipt is used under a letter of credit. Although the applicability of this judgment ultimately depends on the particular fact of each case, this judgment and its legal reasoning should have raised an alarm of financing banks under letters of credit.

From the discussion above, it is clear that the bank's security might be prejudiced by the application of s.2, which is one of the statutory exceptions of *nemo dat* rule under English law. The following question is why the law need such exceptions? This should be answered by examining the limitation of the general law of agency in the commercial world.

6.2.1 General Law of Agency

Generally speaking, the fact of *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* can be categorized as an agency situation that an agent improperly disposed of the asset to a third party. Strauss & Co can be regarded as an agent because, without the authority given by Lloyds Bank, it could have not been entitled to dispose of the asset.[341]

It is the common law principle that a person cannot pass a better title to another person than he has, which is also known as *nemo dat quod non habet* (hereafter referred as "*nemo dat* rule").[342] This rule is subject to several exceptions. These exceptions are: if this person has the authority to dispose of the

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[339] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1937] 2 KB 631 (QB); [1938] 2 KB 147 (CA).
[340] Bridge (n 58) para 18.286.
[341] See *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p164-165.
[342] See *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1937] 2 KB 631, at p637; *Whistler v Forster* (1863) 14 CBNS 248; *Cundy v Lindsay* (1878) 3 App Cas 459; *Colonial Bank v Whinney* (1886) 11 LR App Cas 426; *Cole v North Western Bank* (1874-75) LR 10 CP 354; *Farquharson Bros & Co v King & Co* [1902] AC 325; see also Sale of Goods Act 1979, s21.

asset, he can pass a good title to another person; if not, he is still able to pass a good title under certain circumstances: first, when this person has the apparent or ostensible authority to dispose of the asset;[343] secondly, where other statutory exceptions are applicable.[344]

The commercial reasons for why these exceptions exist are that 1) the goods may be perishable and need to be dealt with quickly, and 2) the buyer is difficult to investigate the title of the goods.[345] More generally, the interest of a *bona fide* third party involved in an agency situation can be protected. It is, however, worth noticing that the protection of a *bona fide* third party is not always needed and justifiable, which later will be discussed in detail. For now, it is fair to say that a *bona fide* third party who receive the goods or the documents of title to the goods for value and without notice of default in his transferor's title generally deserves the protection in law.

It is worth noticing that, if the goods are sold under the authority given by the owner, but the seller misappropriates the proceeds of sale, the title of the goods will be passed to the *bona fide* buyer; in such situation, the original owner does not have any claim to the goods. Hence, in the trust receipt situation, if the pledgor sells the bill of lading within the authority under the trust receipt and then misappropriates the proceeds, the pledgee will not have any claim on the bill of lading and the underlying goods. If the proceeds are traceable, the pledgee might have proprietary claim to the proceeds against the pledgor.

6.2.2 Section 2 of the Factors Act 1889

In *Lloyds Bank Ltd v Bank of America National Trust and Savings Association*, Strauss & Co has the authority from Lloyds Bank; But it only has the authority to sell but not to pledge. Porter J has rightly stated that the authority to sell did not give Strauss & Co an authority to pledge, even impliedly, because, at the time of this case, "no such authority can be implied from the mere possession of the goods".[346] For this reason, Bank of America must establish that one of the exceptions stated above is applicable so as to have priority over the Lloyds Bank's in the disputed goods.

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[343] See *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1937] 2 KB 631, at p637; *Pickering v Busk* (1837) 6 Ad & El 469; as for sales of goods, this exception is also recognized by statute, see Sale of Goods Act 1979, s21.
[344] E.g. Factors Act 1889, s 2(1) and Sale of Goods Act 1979, s 25.
[345] Merrett (n 244) p378.
[346] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1937] 2 KB 631, at p638; *Pickering v Busk* (1837) 6 Ad & El 469; *Cole v North Western Bank* (1874-75) LR 10 CP 354; see ibid p379; Sean Thomas, 'The Origins of the Factors Acts 1823 and 1825' (2011) 32 The Journal of Legal History 151, p172.

In most cases of the agency situation, a third-party receiver for value and without notice of the lack of authority can acquire a good title relying on s.2 of the Factors Act 1889 or s.25 of the Sale of Goods Act 1979. Particularly, if the third party acquired the goods by purchase, he could also rely on an estoppel which is recognized by s.21 of the Sale of Goods Act 1979.[347] Since the bill of lading in *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* is disposed of by way of pledge, s.21 of the Sale of Goods Act 1979 will not be discussed. Also, s.25 of the Sale of Goods Act 1979 will not be discussed in this Chapter because the relationship between Lloyds Bank and Strauss & Co is not that of buyer and seller. Accordingly, s.2 of the Factors Act 1889 is the best starting point to explore the exceptions of *nemo dat* rule.

S.2 is one of the statutory exceptions to the *nemo dat* rule; and as explained in the last paragraph, in cases where the goods or the documents of title to the goods are inappropriately pledged by an agent, s.2 is a strong weapon for a *bona fide* third-party pledgee to protect its interest against the principal. This has been proved to be true even though the pledgor is not a proper, traditional "agent" and, instead, is the owner. In *Lloyds Bank Ltd v Bank of America National Trust and Savings Association*, Strauss & Co was the buyer of the goods and obtained the ownership thereof. For this reason, Lloyds Bank tried to argue that s.2 did not apply because Strauss & Co was not a "mercantile agent" but an owner of the goods to which the bill of lading was related.[348] Therefore, s.2 is a strong protection for the third-party pledgee, but also a potential nightmare for the original pledgee and assumably for financing banks under letters of credit.

S.2(1) of the Factors Act 1889 provides that:

> Where a mercantile agent is, with the consent of the owner, in possession of goods or of the documents of title to goods, any sale, pledge, or other disposition of the goods, made by him when acting in the ordinary course of business of a mercantile agent, shall, subject to the provisions of this Act, be as valid as if he were expressly authorised by the owner of the goods to make the same; provided that the person taking under the disposition acts in good faith, and has not at the time of the disposition notice that the person making the disposition has not authority to make the same.

To examine whether s.2(1) is applicable or not, there are five questions to be answered:[349] 1) whether the agent is a "mercantile agent" within the meaning of this Act; 2) whether the agent is in possession

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[347] *Fairfax Gerrard Holdings v Capital Bank* [2007] EWCA Civ 1226, [2008] 1 Lloyd's Rep 297, at [16] (Waller LJ).
[348] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1937] 2 KB 631, at p634.
[349] Four of them (except for "by consent of owner") were examined by HHJ Mackie QC in *Fairfax Gerrard Holdings v Capital Bank* [2006] EWHC 3439, [2007] 1 Lloyd's Rep 171, at [31]; the other one was examined in

of the goods or of the documents of title to the goods; 3) whether the agent is in possession of them with the consent of the owner; 4) whether the agent disposes of them in the ordinary course of business of a mercantile agent, and; 5) whether the third-party receiver enters into the transaction in good faith and without notice of the agent's lack of authority.

Not all of these questions should be examined for the purpose of the current discussion, because the answers for some of them are quite obvious compared to others. In the situation where a trust receipt is used under a letter of credit, the agent must have been in possession of the documents of title to the goods, because otherwise the agent is unable to sell the goods as trustee of the financing bank. Therefore, the second question will not be discussed in this Chapter.

6.2.2.1 "Mercantile Agent"

The first requirement of s.2(1) is that the person disposing of goods or documents of title to goods must be a mercantile agent. This requirement can be reflected not only in the provision itself but also in the title of the group to which the provision belongs.[350] S.2 is one of a group of provisions that are collected under the statutory heading "Dispositions by Mercantile Agents", and it must be read as only applicable to cases of persons indicated by that separate part of the statute.[351]

A "mercantile agent" is defined by the Act in s.1(1), which provides that:

> The expression "mercantile agent" shall mean a mercantile agent having in the customary course of his business as such agent authority either to sell goods, or to consign goods for the purpose of sale, or to buy goods, or to raise money on the security of goods

The question whether Strauss & Co is a "mercantile agent" was examined in the first instance and was little challenged in the Court of Appeal. It was held by Porter J that Strauss & Co was a mercantile agent within the meaning of s.2(1).[352]

Lloyds Bank Ltd v Bank of America National Trust and Savings Association [1937] 2 KB 631 (QB), affirmed by [1938] 2 KB 147 (CA); see also Bridge (n 58) para 7.034-7.046.

[350] See *Inglis v Robertson* [1898] AC 616, it was held that whether s.3 of the Factors Act 1889 was applicable depends on whether the person pledging came within the part of the statute as applicable to "Disposition by Mercantile Agents", and s2 is under the same part of the statute as s.3.

[351] *Inglis v Robertson* [1898] AC 616, at p624 (Earl of Halsbury LC).

[352] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1937] 2 KB 631, at p639-640.

Porter J's argument is that, if Strauss & Co is an agent, it is a mercantile agent, because it is employed by Lloyds Bank to sell the goods.[353] Therefore, the real question should be whether Strauss & Co is an agent at all.[354] There are two major factors considered by Porter J about this question.

The first one is the trust receipt itself. According to his judgment, Strauss & Co was by virtue of the trust receipt employed as an agent, and its duty was to sell on behalf of Lloyds Bank.[355] However, there is no further explanation for this factor. Meanwhile, Lloyds Bank tries to argue in the Court of Appeal that the trust receipt did not constitute Strauss & Co as a mercantile agent, because it was only a pledgee's permission to the pledgor to exercise its own power of disposition, namely the ownership.[356] But this argument was rejected by Sir Wilfrid Greene MR on the ground that it misconceived the relationship between Strauss & Co and the bill of lading which it received.[357] According to his judgment, the relationship is that, before repayment is made, Strauss & Co will never have obtained the bill of lading without the trust receipt, and that it will have never been entitled to sell without the trust receipt; the trust receipt itself enabled Strauss & Co to sell the goods under the bill of lading as "trust agent" for Lloyds Bank; so the authority given under the trust receipt was one of that given to a mercantile agent.[358] Accordingly, Strauss & Co was an "mercantile agent" within the meaning of s.2(1).

The second factor is that this practice has been in fact existence between Lloyds Bank and Strauss & Co.[359] English law seems to constitute a party as a mercantile agent according to what it is doing rather than its occupation. The question whether it is a mercantile agent is regarded as a matter of substance.[360] In *Lowther v Harris*, it was held that a mercantile agency under the Act may exist even though the agent was acting for one principal only and had no general occupation as agent.[361] Therefore, it does not matter that it was only an agent in this particular matter but not an agent for sale generally, either of grain or any other commodity.[362]

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[353] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1937] 2 KB 631, at p639.
[354] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1937] 2 KB 631, at p639; but the mere fact that he is an agent is not enough to enable him to pass a good title by disposition of the goods, see *Kendrick v Sotheby & Co* [1967] 1 WLUK 261.
[355] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1937] 2 KB 631, at p639.
[356] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p164.
[357] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p164 (Sir Wilfrid Greene MR).
[358] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p165 (Sir Wilfrid Greene MR).
[359] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1937] 2 KB 631, at p640.
[360] *Fairfax Gerrard Holdings v Capital Bank* [2006] EWHC 3439, [2007] 1 Lloyd's Rep 171, at [31](a), it follows *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147;see also Bridge (n 58) para 7.032..
[361] *Lowther v Harris* [1927] 1 KB 383; see also *Weiner v Harris* [1910] 1 KB 285; see also *Oppenheimer v Attenborough & Son* [1908] 1 KB 221; see also *Beverley Acceptances Ltd v Oakley* [1982] RTR 417.
[362] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1937] 2 KB 631, at p640.

These two factors can easily apply to the general operation of a trust receipt under a letter of credit. The essence of different trust receipts is similar, so that a buyer who obtains a bill of lading against a trust receipt can be considered as being employed as an agent for his issuing bank to sell. Additionally, a buyer can be regarded as a mercantile agent even though he is acting for his issuing bank only or only for a single occasion. The substance of this practice determines the character of a buyer under a trust receipt.

Overall, when a financing bank releases the bill of lading pledged to its customer by virtue of a trust receipt, it is likely for its customer to be regarded as a "mercantile agent" for the purpose of s.2(1) of the Factors Act 1889; the reasoning of Porter J seems to be difficult to be rebutted. Perhaps the solution for the "double pledge" problem needs to be explored from the other elements of s.2 of the Act.

6.2.2.2 Consent of the "Owner"

The second element of s.2(1) relevant to the trust receipt situation is that the mercantile agent must have the possession of the documents of title with the consent of the "owner". Taking the literal meaning of the word "owner", it is unlikely to call Lloyds Bank, who is only a pledgee, the owner of the goods, because it only obtains a special property in the goods while the general property remains in Strauss & Co. In fact, this is what Lloyds Bank argues in the Court of Appeal.[363] But Sir Wilfrid Greene MR rightly reframed the question as to whether Strauss & Co is the "owner" in s.2(1).[364] If Lloyds Bank was considered as the "owner" under this section, Strauss & Co's possession of the bill of lading must be acquired with the consent of Lloyds Bank, the "owner", because the latter signed the trust receipt and voluntarily released the document of title to the former.

It was held in the Court of Appeal that Lloyds Bank was the "owner" under s.2(1).[365] It was suggested from the judgment that the position of Lloyds Bank, who handed over the bill of lading to Strauss & Co for the purpose of sale, was consistent with the history and object of the Factors Act.[366]

From the provisions of the Factors Act 1889 and its predecessors, the object of the Acts are to protect the person who deals with an agent entrusted with goods or documents of title to goods, as long as that person is in good faith and without notice of the agent's lack of authority; the person adversely affected by this protection is the person who has entrusted the goods or documents of title to goods to

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[363] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p150-151.
[364] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p161 (Sir Wilfrid Greene MR).
[365] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147.
[366] See *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p161.

the agent.[367] The first Factors Act was the Factors Act 1823, which was entitled "an Act for the better protection of the property of merchants and others, who may hereafter enter into contracts or agreements in relation to goods….intrusted to factors or agents." The Factors Act 1825 did not make much amendment except for extending the protection to the cases where the bills of lading or other documents of title were used; moreover, it added the requirement that the person who dealt with an agent or factor must not have noticed that the agent was not authorised to sell the goods. This new requirement indicated that "the owner" referred only to the owner who had entrusted the goods to the agent.[368] The other Factors Acts, including the 1889 Act, did not make any change on this indication, so the effect of the Factors Act 1889 is still to adversely affect the title of the person who entrusted the goods or documents of title to the mercantile agent. The entrustment is the foundation of this protection; therefore, it is also the fundament of the identity of "the owner".[369] Although it is not explicitly explained by Sir Wilfrid Greene MR in *Lloyds Bank Ltd v Bank of America National Trust and Savings Association*, the author is in the opinion that the Judge interpreted "the owner" partially according to this object of the Act.[370] The Judge interpreted "the owner" as the "the person who would be in a position to give express authority with regard to the dealing in question".[371] Another reason for this interpretation is the language of this section itself.[372]

Accordingly, it is relatively clear that who cannot be "owner"; it is clear from the judgments that "the owner" cannot be a person who is not entitled to entrust a mercantile agent with the possession of the goods or the documents of title to the goods for disposition of them. This is why a person who deals with a mercantile agent entrusted with the possession of goods or documents of title to goods by a thief cannot be benefited from the protection under s.2(1).[373]

However, it is relatively unclear who can be "the owner". According to the judgment of Sir Wilfrid Greene MR, "the owner" can be more than one person, when the ownership of goods is divided into different parts which are located in different persons; but only when these different persons with different parts of the ownership together confer on a third party a title to their goods can such third party get a good title against all of these persons. In the case *Lloyds Bank Ltd v Bank of America*

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[367] *National Employers' Mutual General Insurance Association Ltd v Jones* [1990] 1 AC 24, at p58 (Lord Goff of Chueveley).
[368] *National Employers' Mutual General Insurance Association Ltd v Jones* [1990] 1 AC 24, at p58 (Lord Goff of Chueveley).
[369] See *National Employers' Mutual General Insurance Association Ltd v Jones* [1990] 1 AC 24, at p58 (Lord Goff of Chueveley).
[370] See *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p161, the Judge thought the object of s2(1) was too familiar to require statement.
[371] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p161.
[372] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p161.

[373] *National Employers' Mutual General Insurance Association Ltd v Jones* [1990] 1 AC 24.

National Trust and Savings Association or situation where a trust receipt is used under a letter of credit, the financing bank has acquired a special property in the goods to which the bill of lading is related, while the buyer has the general property thereof; therefore, both of them together can be regarded as "the owner" under s.2(1), when they agreed to hire a broker for sale.[374]

But this is not how it normally operates. Normally, the financing bank only entrusts the buyer himself with the bill of lading for the purpose of sale, rather than employs another person as agent to sell the goods. The question is if the agent employed by "the owner" (if there are more than one person together considered as "the owner") can be one of "the owner". The Court of Appeal held that it did not matter if the agent employed was the buyer himself.[375] It might be a common case where a mercantile agent has some interest in the goods while somebody else retains the remaining interest. When this mercantile agent is entitled to the possession of the goods for the purpose of sale, by the person who keeps the remaining interests, there is no reason why the person who deals with this mercantile agent is not deserved the protection provided by s.2(1).[376] As far as the author's concerned, in the eyes of this person, there is no difference whether the mercantile agent he deals with has initially some interest in the goods or not. Therefore, it is agreed that it does not matter whether the agent itself was a holder of the partial interest in the goods.

In the author's opinion, it seems that the Court of Appeal in *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* has given a wide interpretation to the meaning of "the owner" under s.2(1) so that it can cover almost all the cases where a trust receipt is used under a letter of credit. The Court specifically addressed only the negative factors on the meaning of "the owner", namely who cannot be "the owner" under this section; however, it is less clear on its positive factors, namely who can be "the owner". The implication of this is the possibility that s.2(1) tends to embrace as many cases as possible. Therefore, it is highly possible for a case where a trust receipt is used under a letter of credit to be governed by this section, which also means it is highly unlikely for the financing bank to find a solution to the "double pledge" problem through arguing it is not "the owner".

6.2.2.3 Ordinary Course of Business

The third element for applying s.2(1) is that the mercantile agent must dispose of the goods or the documents of title to the goods "when acting in the ordinary course of business of a mercantile agent". This element is seldomly disputed under English courts, compared with the other elements discussed

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[374] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p161.
[375] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p163.
[376] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p163.

above. Moreover, this issue has been argued neither in the first instance nor in the Court of Appeal under *Lloyds Bank Ltd v Bank of America National Trust and Savings Association*. Nevertheless, it is worth discussing because it is to some extent related to the next element "good faith and notice".

In the author's opinion, this element is more relevant to the cases where the "mercantile agent" is a traditional agent, such as dealer or factor, than the cases where the "mercantile agent" itself is a merchant. This is reflected in the definition of "ordinary course of business" given by *Oppenheimer v Attenborough & Son*.[377] In that case, all of the Judges in the Court of Appeal, Lord Alverstone CJ, Buckley LJ and Kennedy LJ, agreed that the terms "when acting in the ordinary course of business of a mercantile agent" under s.2(1) meant the mercantile agent must act in such a way as a mercantile agent would act in his ordinary course of business.[378] That is to say, the agent must deal with the goods or the documents of title in his possession, at the proper time, at the proper place, by the proper manner and in other respects in the ordinary way in which a mercantile agent would act.[379] A traditional agent, like a diamond broker in *Oppenheimer v Attenborough & Son*, is normally deemed to be restricted from disposing of the goods of its principal in a way inconsistent with its authority; by contrast, a merchant with the possession of the goods or the documents of title is normally deemed to have the full ownership thereof. It is unlikely for a third party to consider an agent as having unrestricted title to the goods, but it is relatively normal for the third party to assume that a merchant is fully entitled to dispose of the goods. Therefore, it would be easier for a third party to find out an agent dealing with the goods beyond its authority than to find out a merchant who in fact is lack of authority to dispose of the goods. For this reason, the law should set up a higher standard for the third party who deals with a traditional agent than who deals with a merchant; and this higher standard is provided in s.2(1), namely the agent with whom the third party make transaction must act "in the ordinary course of business as the mercantile agent". As a result, when a third party deals with a traditional agent, he should be cautious whether such agent disposes of the goods in a way that an agent would ordinarily do. But when he is dealing with a merchant, such caution is unnecessary, because a merchant ordinarily must have the authority to sell or pledge the goods.

In the case where a trust receipt is issued under a letter of credit enabling the buyer to sell the goods on the bank's behalf, the buyer receives the bill of lading as "the mercantile agent" from the financing bank, for the reasons discussed in the previous section. Because the buyer himself is normally a merchant, whose ordinary business is dealing with the goods, he must be disposing of the bill of lading in "the ordinary course of business as the mercantile agent" when he is pledging the bill of

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[377] *Oppenheimer v Attenborough & Son* [1908] 1 KB 221.
[378] *Oppenheimer v Attenborough & Son* [1908] 1 KB 221, at p226 (Lord Alverstone CJ), at p230 (Buckley LJ) and at p231-232 (Kennedy LJ).
[379] *Oppenheimer v Attenborough & Son* [1908] 1 KB 221, at p226 (Lord Alverstone CJ), at p230 (Buckley LJ) and at p231-232 (Kennedy LJ).

lading to a third party; here "the ordinary course of business as the mercantile agent" includes both to sell the goods or the documents of title and to pledge them. Therefore, the element "acting in the ordinary course of business as the mercantile agent" is difficult to be contested in this situation.

In fact, this element is difficult to be contested even in the cases where a traditional agent is involved.[380] There were two arguments raised in *Oppenheimer v Attenborough & Son* regarding this element: 1) there was an express prohibition of pledge in the contract between the true owner and the diamond broker, so that pledge is beyond the ordinary course of the business as the broker; 2) there is a custom of this particular trade that an agent employed to sell goods has no authority to pledge them, so that pledge is not within the ordinary course of his business. Both of them have been rejected by the Court of Appeal. The first one was rejected for the reason that, one of the purposes of the Act was to protect the interest of the third party who dealt with the agent in good faith, by taking effect on this transaction of the goods. The second one was rejected because the essence of this element is whether the agent has done anything leading the third party to suppose that the agent has done anything wrong or bring him the notice that the disposition is one which the agent had no authority to make.[381] This essence is related to the element "good faith and notice". It was admitted by Buckley LJ and Kennedy LJ that, if the said custom was so notorious that everybody must be taken to know it, s.2(1) would not protect the third-party pledgee in that case.[382] In other words, if a custom of this particular trade was proved to be so notorious that everybody should be taken to know, the third-party pledgee should be taken to have the notice that the agent has no authority to pledge the goods.

Accordingly, this element has a deep relation with that of "good faith and notice". Although s.2(1) is in fact difficult to be contested by arguing that the mercantile agent does not dispose of the goods in "the ordinary course of business as the mercantile agent", the same argument might succeed in contesting the element of "good faith and notice." Therefore, the element of "good faith and notice" could be a door opened for the financing bank to challenge the application of s.2(1), and thereby to find the solution for the "double-pledge" problem.

6.2.2.4 Good Faith and without Notice

The last element of s.2(1) is that the person who takes the goods or the documents of title shall act "in good faith, and at the time of the disposition has not noticed that the person making the disposition has not authority to make the same." Under the operation of a trust receipt, the element requires the

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[380] Cf. this element is contested successfully in cases of sale of second-hand cars, see *Pearson v Rose and Young Ltd* [1951] 1 KB 275.
[381] *Oppenheimer v Attenborough & Son* [1908] 1 KB 221, at p231 (Buckley LJ).
[382] *Oppenheimer v Attenborough & Son* [1908] 1 KB 221, at p230 (Buckley LJ) and at p231 (Kennedy LJ).

third party who deals with the buyer to act in good faith without notice that the buyer does not have the authority to pledge from the financing bank. The element of "good faith and notice" was not disputed in the Courts of *Lloyds Bank Ltd v Bank of America National Trust and Savings Association*, because both parties have admitted that the pledge by Strauss & Co to Bank of America was completed in good faith.[383] There could be a deeper reason why Lloyds Bank did not dispute this issue, namely that it is normally difficult for the "owner" to establish the opposite.

At first glance, this element might be the simplest way for the financing bank to exclude the operation of s.2(1) so as to recover its interest from the third party.

First, the element of "good faith and notice" is, unlike the others, the only element restricting the third party. The other elements discussed above are the conditions for the disponer and the person entrusting the disponer with possession of goods or documents of title.

Second, in order to establish this element is fulfilled, the burden of proof is on the third party.[384] Generally, the third party needs to prove himself that he has in fact fulfilled the requirement of "good faith and without notice". That is to say, he has to prove 1) that he was in good faith when receiving the goods or the documents of title, and 2) that he did not have any notice of the lack of authority at that time.

It appears to be big trouble for the third party when he wants to be protected by s.2(1). However, it is not as friendly to the "owner" as it appears. From the relevant authorities and scholars' discussion, it is found that the standard for proving the opposite is much higher than proving the "good faith and without notice." Therefore, the author believes that this element is difficult for the "owner"-the financing bank-to challenge, under the traditional operation of a letter of credit.

The element of "good faith and notice" is composed of two components: 1) the third party must receive the goods or documents of title in good faith at the time of disposition (good faith); 2) the third party must also not have the notice that the "mercantile agent" in fact is lack of authority to dispose of them at the time of disposition (notice).

In order to discuss this high standard, the following paragraphs will discuss the components respectively, even though it is sometimes not easy to completely separate them.[385]

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[383] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1937] 2 KB 631, at p638.
[384] *Heap v Motorist's Advisory Agency Ltd* [1923] 1 KB 577, at p590.
[385] See *Barclays Bank Plc v TOSG Trust Fund* [1983] BCLC 1, at p18.

6.2.2.4.1 Good Faith

Good faith is a subjective component. There is no definition of "good faith" under the Factors Act 1889, but it is commonly accepted that it means "genuinely and honestly".[386] It is not very clear of the boundary of "good faith", but it is sure that a party who acts in bad faith must not satisfy the standard of "good faith".[387]

Although the burden of proof regarding "good faith" is on the third party himself, this itself will not make this component friendly to the "owner" under the Act, because it is normally much easier for the third party to prove his good faith than for the "owner" to prove his bad faith.[388]

In fact, the standard of bad faith is high under English law. It is not easy for English courts to be satisfied that there is a bad faith. This can be reflected by the following examples.

A carelessness of the third party in respect of the agent's want of authority might be evidence of bad faith, but only an honest carelessness is certainly not. It was held by Blackburn LJ in *Jones v Gordon* that an honest carelessness was not a dishonesty; in order to establish dishonesty, the court has to find that the third party must have had a suspicion that there was something wrong with the agent's disposition, and he refrained himself from asking questions, not because he was honestly careless, but because he fears to have the answer which might show that something was wrong.[389]

The agent's acting out of the ordinary course of business might be evidence of bad faith. In *Summers v Havard*, the first instance Court found that Halfway, who agreed to resell the cars of both the appellant and the defendant, sold the cars in question (which were the appellant's) to the defendant at lower prices than would have been achieved in ordinary retail sales and in so doing that Halfway had exceeded its authority as the agent of the appellant; and the Court thereby found that the defendant must have had the notice that the sales were not made in the ordinary course of Halfway's business.[390] When the case reached the Court of Appeal, the Judge was considering the ground that the cars were not sold in the ordinary course of Halfway's business so that the defendant was not entitled to the protection under s.2(1) of the Factors Act 1889; and she said that the judge in the first instance relied

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[386] *Barclays Bank Plc v TOSG Trust Fund* [1983] BCLC 1, at p18; see also Sale of Goods Act 1979, s.61(3) and Bills of Exchange Act 1882, s.90.
[387] *Mogridge v Clapp* [1892] 3 Ch 382, at p391.
[388] *Mercantile Bank of India Ltd v Central Bank of India Ltd* [1938] AC 287; Oliver Riley, 'Sale of Goods by a Non-Owner: The Competing Property Rights of a True Owner and a Good Faith Purchaser' (2017) 8 QMLJ 99, p104; Angela Foster, 'Sale by a Non-Owner: Striking a Fair Balance between the Rights of the True Owner and a Buyer in Good Faith' [2008] Coventry Law Journal 1.
[389] *Jones v Gordon* (1877) 2 App Cas 616, at p629 (Blackburn LJ); Approved by *Whitehorn Bros v Davision* [1911] 1 KB 463, at p478 (Vaughan Williams LJ).
[390] *Summers v Havard* [2011] EWCA Civ 327.

on the element of "ordinary course of business" as part of his finding of another element, namely a lack of good faith.[391]

Nevertheless, a mere purchase at a much lower than ordinary price is not enough to constitute a bad faith. A purchase with lower price can be made in good faith if the price only reflects a reasonable bargain.[392]

When the third party has the knowledge that the agent is lack of authority to dispose of the goods and he nevertheless takes up the goods from the agent, he must be acting in bad faith.[393] But when the third party ought to know but did not know the agent's want of authority, is he necessarily acting in bad faith? It was said that a third party who deals with a mercantile agent under the circumstances where he ought to know that the agent has no power to dispose of the goods would not necessarily act in good faith.[394] It seems that there is no necessary causation between good faith and whether the third party ought to know the fact.

If a third party should have known this fact but did not know, and still received the goods from the agent, he would be regarded as acting unreasonable.[395] This argument was raised in *Barclays Bank Plc v TOSG Trust Fund*; it was argued that "reasonableness" should be one of the ingredients of good faith.[396] But it was rejected by the Court, because "reasonableness", which was an objective test, was not applicable to a subjective element.[397] Therefore, there is no direct connection between good faith and whether a third party ought to know the fact. The "owner" is not allowed to say that the third party is acting in bad faith because he ought to know the agent's want of authority.

As illustrated by these examples, the standard for the establishment of bad faith is high under English law. Perhaps the high standard could be relieved in the other component, namely "without notice", because at least the ingredient of "reasonableness" is applicable to this component.

6.2.2.4.2 Without Notice

Unlike "good faith", the component "without notice" is objective. Hence it can be inferred from the surrounding circumstances of the disposition made by the "mercantile agent" to the third party. Whether the third party has the actual knowledge is not the only standard of "notice".

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[391] *Summers v Havard* [2011] EWCA Civ 764, [2011] 2 Lloyd's Rep 283, at [16] (Arden LJ).
[392] See *GE Capital Bank Ltd v Rushton* [2005] EWCA Civ 1556, [2006] 1 WLR 899, at p913.
[393] *Midland Bank Trust Co Ltd v Green (No.1)* [1981] AC 513, at p529, it is cited by *Barclays Bank Plc v TOSG Trust Fund* [1984] BCLC 1, at p18.
[394] *Midland Bank Trust Co Ltd v Green (No.1)* [1981] AC 513, at p529, it is cited by *Barclays Bank Plc v TOSG Trust Fund* [1984] BCLC 1, at p18.
[395] *Barclays Bank Plc v TOSG Trust Fund* [1984] BCLC 1, at p17.
[396] *Barclays Bank Plc v TOSG Trust Fund* [1984] BCLC 1, at p17.
[397] *Barclays Bank Plc v TOSG Trust Fund* [1984] BCLC 1, at p18.

Lord Tenterden has confirmed in *Evans v Trueman* that an approach similar to constructive notice was applicable to the component "notice" in the Factors Act. It was said that a person might have knowledge of a fact by being aware of the circumstances which must lead a reasonable man to the conclusion that the agent is short of authority when he applied and judged from these circumstances.[398]

As mentioned above, the reasonable test shares many similarities with the doctrine of constructive notice. The doctrine of constructive notice applies where a person who has discovered the fact if he had taken proper steps. Both the reasonable test and the doctrine of constructive notice focus on whether the person ought to know the fact. Moreover, it was held that, when the surrounding circumstances have raised a suspicion of the person that there was something wrong with the transaction, but he deliberately turned a blind eye to them, this would amount to notice of the fact.[399] Similar expression was made regarding the doctrine of constructive notice:

> if the party asserting that he takes free of the earlier rights of another knows of certain facts which put him on inquiry as to the possible existence of the rights of that other and he fails to make such inquiry or take such other steps as are reasonable to verify whether such earlier right does or does not exist, he will have constructive notice of the earlier right…

However, it is well-established that the doctrine of constructive notice, which lies at the heart of equity, does not apply to commercial transactions.[400] The similarities and the conflict between reasonable test and doctrine of constructive notice are considered as the tension between notice as understood by commercial lawyers and equity lawyers.[401]

Regarding this tension, it is submitted that although the doctrine of constructive notice does not normally apply to commercial transactions, the English courts in most cases were unable to decide whether the person has had the notice without referring from the surrounding circumstances of the commercial transactions; therefore, it was certainly appropriate to apply the reasonable test to those

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[398] *Evans v Trueman* (1830) 1 Moody & R 10, at p12, the statute in dispute was the Factors Act 1825.
[399] *May v Chapman* (1847) 16 M&W 355 at p361, it is approved by *Raphael v Bank of England* (1855) 17 CB 161, at p174; *Heap v Motorist's Advisory Agency Ltd* [1923] 1 KB 577, at p591; *Worcester Works Finance Ltd v Cooden Engineering Co Ltd* [1927] 1 QB 210, at p218; *Feuer Leather Corp v Frank Johnstone & Sons Ltd* [1981] Com LR 251, at p253. But a mere suspicion is not enough: *Evans v Trueman* (1830) 1 Moody & R 10, at p12; *Navulshaw v Brownrigg* (1852) 2 De GM & G 441, at p451.
[400] *Barclays Bank Plc v O'Brien* [1994] 1 AC 180, at p195; *Manchester Trust v Furness* [1895] 2 QB 539; *Greer v Downs Supply Co* [1927] 2 KB 28; *Worcester Works Finance Ltd v Cooden Engineering Co Ltd* [1927] 1 QB 210, at p218; *Feuer Leather Corp v Frank Johnstone & Sons Ltd* [1981] Com LR 251, at p253; *Neste Oy v Lloyds Bank Plc* [1983] 2 Lloyd's Rep 658, at p665; *Westdeutsche Landsbank Girozentrale v Islington LBC* [1996] AC 669, at p704.
[401] *Gray v Smith* [2013] EWHC 4136 (Comm), at [132].

transactions.[402] By applying this test, whether the person can be taken as having the notice is only a question of degree.[403] The standard is whether a reasonable person in the same circumstances must have known of the fact or must have had suspicion and wilfully shut his eyes to the means of knowledge available to him.[404] This standard is not easy to reach.

This tension is also addressed in Snell's Equity, where the author submits that such a tension did not necessarily exist.[405] Its author suggests that the question of whether a person was fixed with constructive notice should not depend simply on the characterization of the transaction, instead it should depend on whether there was a recognized practice of making inquiry of the agent's title in certain type of transaction.[406] There is no such practice in commercial transaction.[407] That is because it will otherwise be inconsistent with need of commercial transaction, namely fast and finality.[408] Therefore, the only evidence of the agent's title is its possession of goods or documents of title.[409]

This is consistent with the statement in *Oppenheimer v Attenborough & Son*, where it is said that whether the Factors Act applies is not relevant to whether the third party believes that the person dealing with him has the character of a mercantile agent; the third party chooses to deal with this person because he has the possession of the goods.[410] The third party can only rely on that person's possession of goods to judge whether he has the right to dispose of the goods or not. He does not have time to investigate. That is one of the reasons why the Factors Act was introduced.

Accordingly, when there is no practice of inquiring the title of the transferor in commercial transactions, the threshold for a person to be fixed with constructive notice will be very high. It was submitted that the person might not be put on enquiry unless he knew facts which so clearly to the want of authority that he would have actual notice of it at any rate.[411] Otherwise, it would be inconsistent with the purpose of the Factors Acts.

From the analysis of the views in respect of the tension, both of them agree that the reasonable test is possible to apply to commercial cases, but subject to a very high standard of application. This

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[402] Bridge (n 58) para 7.047.
[403] ibid, it is approved by *Gray v Smith* [2013] EWHC 4136 (Comm), at [132].; see also *Feuer Leather Corp v Frank Johnstone & Sons Ltd* [1981] Com LR 251, at p253.
[404] *Ceres Orchard Partnership v Fiatagari Australia Pty Ltd* [1995] 1 NZLR 112, at p117; ibid.
[405] John McGhee and Edmund Henry Turner Snell (eds), *Snell's Equity* (32nd ed, Sweet & Maxwell 2010) para 4.035.
[406] ibid.
[407] *Hambro v Burnand* [1904] 2 KB 10, at p20; *Dobell, Beckett & Co v Neilson* (1904) 7 F 281, at p288; *Curtice v London City and Midland Bank* [1908] 1 KB 293, at p298; *Reckett v Barnett and Slater Ltd* [1928] 2 KB 244, at p258 and p266; *Feuer Leather Corp v Frank Johnstone & Sons Ltd* [1981] Com LR 251, at p253.
[408] McGhee and Snell (n 407) para 4.035; see Merrett (n 244) p378.
[409] *Manchester Trust v Furness* [1895] 2 QB 539, at p545.
[410] *Oppenheimer v Attenborough & Son* [1908] 1 KB 221, at p229.
[411] McGhee and Snell (n 407) para 4.035.

standard is very difficult to reach. Therefore, the "owner" is difficult to let the court be satisfied that the third party in fact has had the notice.

6.2.2.5 "Good Faith and without Notice" in "Double Pledge" Problem

After the detailed examination of the element of "good faith and without notice", it is time to discuss how this element applies to the "double pledge" problem.

In cases where a trust receipt is issued under a letter of credit in order for the buyer to obtain the bill of lading from the financing bank, the protection of s.2(1) does not apply if the third-party pledgee does not receive the bill of lading in good faith and without the notice that the buyer does not have the authority to pledge it. For this purpose, the courts have to look at this subjective component and the objective component.

It is hardly seen that a third-party pledgee was taking up the bill of lading dishonestly; he was only dealing with a merchant (the buyer) with the possession of the bill of lading, and the merchant was acting within his ordinary course of business; he thought this merchant was the owner of the goods. He might be put in suspicion that there might be something wrong with the pledge if the interest rate of pledge was substantially lower, and he would be regarded as dishonesty if he deliberately refrained himself from inquiring in fear of that the answer would make him known the defeat of the merchant's title. It has been seen that "good faith" and "notice" were often mixed and could not be completely separated. Therefore, this situation might also make him be considered as having the "notice". However, this situation is very rare and unlikely to happen.

In addition, there is no general requirement for a buyer to investigate the title of a seller with whom he is making transactions. In the "double pledge" situation, even though the third-party bank tries to investigate the title of the pledgor, it cannot find out there has been a pledge created on the same bill of lading because a pledge is not registerable.

Moreover, the third-party pledgee is unlikely to have the actual notice of the buyer's want of authority to pledge. Only the financing bank is interested in the goods except for the buyer and the third-party pledgee; so, only the financing bank wants to send a notice to the third-party pledgee about the defect of the buyer's title. But the financing bank cannot know to whom the buyer would re-pledge the bill of lading. Accordingly, the third party is not likely to have the actual notice, unless there is something on the bill of lading indicating the defect in the buyer's title.

For now, it is hardly possible for the "owner" to challenge the third-party pledgee's interest by arguing that he has not acted in good faith and that he has the notice of the buyer's want of authority

to pledge. That is probably the reason why this element is not disputed in *Lloyds Bank Ltd v Bank of America National Trust and Savings Association*.

6.3 Policy Reasons Supporting Protection

It has been discussed that it is extremely difficult for the "owner" to exclude a third party from the protection of s.2 in the "double pledge" situation. Moreover, there are strong policy reasons supporting that the protection should be available to the third party in the trust receipt situation.

The s.2 protection is available to a third-party pledgee for reasons. There has been a dramatic discussion about the rationality of this protection before and after its introduction. But it is questionable whether such reasons can be extended to the current generation, where globalization and technology has been significantly progressing since the first introduction of the Factors Acts.

If those reasons or justifications for the protection are no longer suitable for the current practice, even for the future where digitization becomes the most important feature of international transactions of goods, preserving this protection may damage commerce. Accordingly, it is important to review the reasons and justifications behind the protection of s.2.

6.3.1 Commercial Background of the Protection

It has been mentioned that the common law normally does not recognize a mercantile agent as having the authority to pledge the goods.; and in order to remedy this situation, the Factors Acts were introduced to extend the common-law doctrine of ostensible authority to agents who pledge or disposed of the goods in other manners to a third party. As agents became more and more common and independent, the law had started to be unsuitable to the commerce.

From the 18th century, it was very common for merchants to entrust agents with their goods in order to let the agents sell the goods on their behalf. Besides, it had also been common for such agents to pledge the goods in their own name.[412] Pledging by agents was also an important practice at that time, especially for corn trade with America, which was regarded as impossible without pledging.[413]

The popularity of agents was partly due to the progression of transportation technology, which largely expanded the geographical extent of the market; meanwhile, the poor communication technology has

[412] Merrett (n 244) p379; Bell (n 244) p496.
[413] See Thomas (n 348) p172, citing House of Commons Parliamentary Papers, 1823 (452) IV 265, at p319.

inevitably made agents become independent.[414] This to some extent increased the risk of agents' fraud. Some agents fraudulently pledged the goods for their own account.[415]

However, as mentioned earlier, the common-law doctrine of ostensible authority was not able to protect a third-party pledgee who dealt with agents, even though such agents had the possession of goods or documents of title. The protection available for third-party buyers was not consistent with that for third-party pledgee.[416] Accordingly, a reform was proposed in order to deal with this inconsistency.

Since the reform was proposed, a great volume of evidence and arguments have been presented regarding the necessity of the reform.[417] For the supporters of the reform, they mainly argued that the law had become a hindrance of commerce and "prevented circulation of goods".[418] Finance has always been the blood of commerce. However, with the knowledge that the agents did not own the goods, the financer had to be extremely cautious to make advances on those goods; and it would seriously "cramp the trade" by doing so.[419] That was because the law did not protect the pledgee who made advances to agents.

6.3.2 Theoretical Justification of the Reform

The inconsistency of legal protection provided for pledgees and buyers, accompanied by the significance of finance on goods, had already hit the confidence of merchants. The reform of law seemed to be inevitable. However, it was still questionable whether the change of law would certainly benefit commerce rather than damage it in other ways.

The essence of the reform is to provide a third-party pledgee with similar protection as a third-party buyer who buys the goods from an agent. If such protection was provided, the true owner of the goods would be bound by the pledge made by his agent; if not, the pledgee would lose the security on the goods. Therefore, it is about the distribution of loss arising from the fraud of an agent.

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[414] Grant Gilmore, 'The Good Faith Purchase Idea and the Uniform Commercial Code: Confessions of a Repentant Draftsman' (1980) 15 Ga. L. Rev. 605, p609, it is suggested that the independence of factors is due to the mismatch between the technology of long-distance communications and the technology of long-distance transportation.
[415] See ibid; see Grant Gilmore, 'The Commercial Doctrine of Good Faith Purchase' (1953) 63 Yale LJ 1057, p1057-1058.
[416] Thomas (n 348) p172.
[417] For the general debate about the Factors Act, see *House of Commons Parliamentary Papers*, 1823 (452) IV 265; see also Thomas (n 348).
[418] *Parliamentary Debates*, new series, vol.9, col. 211, 12 May 1823 (House of Commons); ibid p160.
[419] ibid p171, citing *House of Commons Parliamentary Papers*, 1823 (452) IV 265, at p303.

6.3.2.1 Owner's Entrustment

Within the debates on the reform, one of the justifications was that it was the owner himself who entrusted the agent with the goods or the documents of title; therefore, the true owner should bear the loss arising from the fraud of his agent.[420]

This reasoning originates from the general principle laid down by Ashhurst J in *Lickbarrow v Mason*, which states that "wherever one of two innocent persons must suffer by the acts of a third, he who has enabled such third person to occasion the loss must sustain it".[421] Ashhurst J applied this principle to explain the "negotiability" of bills of lading: it was the seller himself made the bill of lading transferable, so he could not claim the goods if his buyer transferred the same bill of lading to others without making the payment; the assignee of the bill of lading is entitled to rely on the indorsement and delivery.[422]

In the situation where an agent fraudulently pledges the goods or documents of title to a third party, the same principle is also applicable. In this situation, it is the owner himself that entrusts the goods or documents of title to the agent, enabling the latter to commit the fraud. And it could have been prevented by the owner's caution in selecting his agent.[423] The third parties can rely on the agent's possession of either goods or documents of title.[424]

This reasoning, in my opinion, can be considered from two aspects: 1) true owner's aspect and 2) possession's aspect.

First, this reasoning emphasizes the entrustment of the true owner. In this situation, only the true owner can entrust the agent with the possession of goods or documents of title. If the agent did not have the possession of either goods or documents of title, he could have not been able to commit the fraud. This analysis is based on the second aspect, namely possession's aspect.

Before discussing the second aspect (possession), it is worth looking at another analysis from the owner's aspect.

It is submitted by Professor Andrew Tettenborn that, when balancing the interest of true owner with that of a good-faith acquirer, sufficient emphasis should be given to the essential nature of ownership

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[420] See *Parliamentary Debates*, new series, vol.9, col. 212, 12 May 1823 (House of Commons); ibid p161.
[421] *Lickbarrow v Mason* 100 ER 35, 39 (Ashhurst J).
[422] "Negotiability" does not mean the negotiability as bills of exchange have, but only means "negotiability against right of stoppage in transit: see *Lickbarrow v Mason* 100 ER 35, 39 (Ashhurst J).
[423] Thomas (n 348) p161, citing Parliamentary Debates, new series, vol.9, col. 212, 12 May 1823 (House of Commons), where David Ricardo argued that if one must suffer, the sufferer ought to be the one who did not use proper caution.
[424] See Gilmore (n 416) p609; see Gilmore (n 417) p1058-1059.

itself.[425] Therefore, according to his words, it is necessary to make ownership rights "presumptively indefeasible, unless and until the owner chooses to do something consistent with consent to being divested."[426] Based on it, he proposes that there should be a general background rule when dealing with *nemo dat* questions, which is "entrusting rule".[427]

I agree with the idea that the ownership should not be easily divested unless the owner chooses to do so. When the owner passes the possession of the goods or documents of title to his agent for the purpose of sale, the former has expressed his intention to alienate his ownership. Therefore, in this situation, the good-faith acquirer should be protected against the claim of the owner.

Looking at the second aspect, the agent's possession is one thing on which a third party is entitled to rely when judging the title of the agent. Having the possession of the goods or the documents of title to the goods, the agent is deemed by a good-faith third party to have the ability to dispose of the goods. As mentioned earlier, the third party chooses to deal with the agent not because of his characters, but his possession.[428]

In fact, it was proposed in the debate on the reform that the rule "possession constitutes ownership" might be adopted in the legislation.[429] But the select committee refused to make a radical change and thought that, in the eyes of a third party, any symbols of property would be enough to evidence the title of agent.[430] Therefore, by allowing an agent to obtain such "evidence of title", the owner should be responsible for any misdealing of the agent.

The US law has adopted the similar reasoning in the situation where a debtor being entrusted with the possession of goods by his secured creditor has improperly disposed of the goods to a good-faith purchaser. According to Article 9 of the Uniform Commercial Code (UCC), a good-faith purchaser generally does not take the goods without subject to the security interest, unless the secured party authorised the disposition free of the security interest.[431] The authorization rule behind the Article is similar to the "entrustment rule" mentioned above.[432] The policy behind it is that by authorizing the debtor to sell the goods, the secured creditor has essentially abandoned any claim to the goods and has

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[425] Tettenborn (n 246) p159, there are two distinguishing characteristics of ownership: 1) it exists as the irremovable residual or background right to dictate how a thing is to be used or exploited; 2) it is a degree of performance.
[426] ibid.
[427] ibid p158-178, it is said that a proprietor putting or leaving another in possession of goods *prima facie* takes the risk of subsequent misdealing.
[428] *Oppenheimer v Attenborough & Son* [1908] 1 KB 221, at p229.
[429] See Thomas (n 348) p173, citing House of Commons Parliamentary Papers, 1823 (452) IV 265, at p285.
[430] See ibid, citing *House of Commons Parliamentary Papers*, 1823 (452) IV 265, at p285.
[431] Uniform Commercial Code, § 9-315.
[432] See Tettenborn (n 246) p162-163.

chosen to retain only an interest in the proceeds of sale.[433] Moreover, it was also suggested that, if the third-party purchaser should be subject to the previous security interest, it would make the purchaser "an insurer of events beyond his knowledge and/or control (i.e. the remittance of the proceeds of the seller)."[434]

The voluntary authorization of the secured creditor means, under the UCC, he has divested his security interest in goods. This is different from English law, where the security interest is reserved even though the creditor entrusts the debtor to realize the security on his behalf. Nevertheless, the result is the same: the good-faith third party can acquire the interest in the goods free of the previous security interest, even though the debtor improperly disposed of them; the creditor loses his claim on the goods, and he can only make a claim on the proceeds. If the creditor still had the right to claim on the goods in this situation, it is agreed that the third party would become an insurer of the debtor's default, which is completely beyond his control. Therefore, it will be unfair to let the third party bear the loss arising from the unauthorized dealing of the debtor. The same reasoning can also apply to the situation where the agent is misdealing the owner's goods.

6.3.2.2 Owner is more Suitable to Bear the Loss

Another reasoning for supporting the reform is that, compared with the third party, the owner is more suitable to bear the loss in the situation where his agent improperly disposed of his goods to this third party.

It would be difficult for a third party to fully ascertain the title of the agent; by contrast, it would relatively be easier for the true owner to take extra measures to prevent the loss arising from the improper disposition by the agent; the true owner could have been more cautious in selecting his agent, and he could have prevented the loss by, for example, insurance.[435] Therefore, by evaluating the likelihood of the efficiency in loss-bearing, the owner is regarded as "the most efficient loss bearer".[436]

Moreover, after assuming the loss by the owner, he could recover the purchase price from the third party, if the agent fraudulently sold the goods to the third party but has not been paid.[437] If the agent

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[433] *Bitzer-Croft Motors v Pioneer Bank & Trust Co* (1980) 82 IllApp3d 1, 401 NE2d 1340, at p1348; Sean Thomas, 'The Role of Authorization in Title Conflicts Involving Retention of Title Clauses: Some American Lessons' (2014) 43 Common Law World Review 29, p45.
[434] *First National Bank & Trust Co of Oklahoma City v Lowa Beef Processors* (1980 USCA10 Okla) 626 f2D 764, at p769; ibid.
[435] See Katherine Fekula Jillson, 'UCC Section 2-403: A Reform in Need of Reform' (1978) 20 Wm. & Mary L. Rev. 513, p553-554; Thomas (n 435) p40.
[436] See David Morris Phillips, 'The Commercial Culpability Scale' (1982) 92 The Yale Law Journal 228, p232, this is the approach taken under the UCC Article 9.
[437] See Angela Foster (n 390) p11.

fraudulently pledged the goods to the third party, the owner could recover the possession of the goods by paying the third-party pledgee. Therefore, it is suggested that the owner might has not suffered any real loss, and that such loss could have been avoided by a cautious selection of agents.[438]

The owner himself authorizes his agent to sell the goods on his behalf and entrusts the agent with the possession of goods or documents of title. By doing so, the owner allows a risk of fraud by the agent to exist. But the risk can be controlled by the owner, either by cautions in selecting the agent or by insurance; conversely, this risk is out of the control of any third party who is dealing with this agent, because it is much more difficult for him to fully investigate the agent's title in the goods. Therefore, it is more appropriate for the owner to bear the loss arising from the fraud of his agent, rather than, as mentioned earlier, letting the third party be an "insurer" of the owner. Plus, it is still questionable whether the owner has suffered any real loss in this situation.

6.3.2.3 Greater Benefit than Loss

The last reasoning for supporting the reform, though less convincing, was that the benefit arising from the reform would be much greater than any loss from the reform.[439] It was widely accepted that a factor could not pledge his owner's goods without authority, so it was argued that the potential reform would cause great commercial inconvenience; moreover, it would facilitate the frauds of agents.[440]

However, to reply to this argument, it was submitted that, although the reform might cause some inconvenience, a greater benefit would arise from it. Even though it would to some extent facilitate the frauds, the cost arising from such frauds would be much less than the benefit to be derived from the reform.[441]

The possible commercial inconvenience might be that the protection available under English law for pledgees who made advances to agents would be different from that in other jurisdictions; therefore, it would cause uncertainty for the financers, especially for those who were involved in international transactions of goods. As for the argument that the reform would facilitate the frauds, a discussion in this regard will be in the next section.

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[438] ibid.
[439] See Thomas (n 348) p160 and 173.
[440] See *Parliamentary Debates*, new series, vol.9, col. 212, 12 May 1823 (House of Commons).
[441] *House of Commons Parliamentary Papers*, 1823 (452) IV 265, at p285; Thomas (n 348) p173.

6.3.2.4 Counterargument: Fraud

As mentioned above, it was counterargued that the proposed reform would facilitate frauds of agents. Providing the protection for a third-party pledgee would enable agents to unauthorizedly dispose of their principals' goods; therefore, it would open the door for agents to commit frauds.

This counterargument is related to the "double pledge" problem, because the similar argument has been made in *Lloyds Bank Ltd v Bank of America National Trust and Savings Association*.[442] It was argued that to apply s.2 of the Factors Act 1889 to the "double pledge" situation would allow the debtor to fraudulently dispose of the goods or document of title to the goods, and that it would have "a serious effect upon the continued use of the practice [of using trust receipts] in the future."[443]

There are mainly three reasons why this counterargument is untenable.

First of all, it was submitted by MacKinnon LJ that the frauds might not be as easy as a lawyer thought and that they in fact occurred rarely in business.[444] This can be to some extent proved by the fact that similar kind of disputes become less and less in English courts. Perhaps it is because the commercial community has found a way in practice to reduce the influence of frauds.

Secondly, fraud in business cannot be completely eradicated. The risk of fraud is always here as long as the business is ongoing.[445] It was argued by Professor Roy Goode that the risk in business could be categorized into two types, namely the inherent risk and the systemic risk; the latter should be dealt with by regulators, while the former, including fraud, is regarded as a necessary consequence of a market-orientated society.[446] The risk of fraud cannot be eradicated unless by non-participation.[447]

Last but not least, almost none of the commercial dealing is fraud-proof, because the basis of business is honesty and good faith.[448] Either the practice of pledging goods by agents or that of using trust receipt in a letter of credit, is not established for preventing fraud of agents or buyers. For example, it was submitted that the trust receipt was not meant to constitute good security against the buyer's fraud.[449]

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[442] See *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p166 (MacKinnon LJ).
[443] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p166 (MacKinnon LJ).
[444] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p166 (MacKinnon LJ).
[445] Thomas (n 435) p61.
[446] Royston Miles Goode, *Commercial Law in the next Millennium* (Sweet & Maxwell 1998) p46.
[447]ibid..
[448] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p166 (MacKinnon LJ).
[449] E.P. Ellinger, 'Trust Receipt Financing' [2003] Journal of International Banking Law and Regulation 305, p310.

Overall, the occurrence of fraud should not be the reason for opposing the reform. For the reasons above, the author agrees with the statement of MacKinnon LJ that dishonesty or bad faith is rarely able to undermine business practice.[450]

6.3.3 Valuation of the Justifications for Section 2

The paragraphs above have discussed the background of the introduction of the Factors Acts and the essential arguments towards it. The introduction of the Acts has a particular linkage with the commercial practice at that time. It was the outcome of the progression of the commercial practice: agents had become common and independent from their principals; and they started to pledge their principal's goods on their own name. It pushed the regulators to extend the protection to the financers who had made advances to such agents.

However, the possibility of frauds, as discussed earlier, was partly due to the fact that the development of long-distance communication technology could follow that of long-distance transportation. Nowadays, the communication technology is much more advanced. The simultaneous communication technology has made the agents less independent.

Nevertheless, it is still difficult to distinguish a merchant acting on his own from that acting as an agent for another merchant. In fact, the law has inclined to protect the good-faith acquirer in the cases where an agent improperly disposes of its principal's goods, based on the agent's possession of either the goods or the documents of title to the goods.[451] Whether the merchant has the character of an agent is not important. The possession of an agent is sufficient to let a good-faith acquirer believe that he owns the property. Moreover, such possession is impossible without the owner's entrustment or authorization; therefore, it is fair to have the party who enables the possibility of fraud bear the loss of fraud. Those reasons are the ones irrelevant to the commercial practice of that time and are not becoming less persuasive through the development of communication technology. Also, these reasons are applicable to the "double pledge" situation where the "owner" is the secured creditor and where the "agent" is the debtor.

Overall, it is contended by the author that most of the justifications for s.2 are still applicable to the current conflict of *nemo dat* problem and applicable to the current "double pledge" problem.

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[450] *Lloyds Bank Ltd v Bank of America National Trust and Savings Association* [1938] 2 KB 147, at p166 (MacKinnon LJ).

[451] See the discussion in section 6.2.2.1. To decide whether the merchant is a "mercantile agent" or not, it is not relevant that the merchant works as an agent only for one time.

Therefore, the third-party pledgee should be provided with the protection of s.2 of the Factors Act 1889.

6.4 Conclusion on Risk of Using Trust Receipt

Even though the bank somehow ensures that the negative factors occurring before or at the transfer of the bill of lading do not occur and obtain a valid pledge on the goods, using a trust receipt will place the bank in a risky situation where its security interest would be damaged by the fraud of the buyer.

The sections above have analysed the legal reasons and the policy reasons for the occurrence of the "double pledge" problem. The essential reason is the appliance of s.2 of the Factors Act 1889. From the examination of each element behind s.2, it is found that, in the ordinary "double pledge" situation, the "owner" (the original pledgee) is difficult to exclude the third party (the third-party pledgee) from the protection of s.2. As for the policy reasons behind s.2, even though some of them has already outdated and not suitable for the current international transactions of goods, most of them are currently as convincing and persuasive as the first time when the Factors Act was introduced; as such, it would be unlikely and unfair to replace banks with the third party to bear the fraud of the buyer under "double pledge" situation.

Therefore, due to the high standards of exclusion of s.2 and the strong policy reasons, it is submitted by the author that, when accepting a trust receipt, the bank under a letter of credit will put itself into an unfavourable position where it might lose the security interest. For the best interest of both the bank and the third party, one of the measures to solve the issue is to make the bank's interest more visible or noticeable to other parties, including the third party; if so, the third party would have not accepted the bill of lading provided by the buyer. To achieve that, registration requirement might be needed. Specifically speaking, if a pledgee redelivers the pledged asset to his pledgor, a pledgee's security interest would be recategorized as a charged, which then is subject to registration requirement. Such proposal has been raised in the Law Commission reform on companies' security interests, but not adopted eventually without explanation.[452] In order to make such proposal feasible, other policy infrastructure should also be established. For example, an easy and fast registration procedure is necessary, otherwise it would make the transmission of bills of lading much slower and more costly. Before these legal and policy infrastructures are established, perhaps the advice for the banks is to avoid using trust receipts, but it definitely would cramp the transaction; then the better advice would be that the banks should be more cautious about the creditworthiness of their customers.

[452] See discussion in section 7.3.3.3.

Chapter 7 Bank's Security in Digital Context

It has been argued in previous chapters that bank's security gained through paper bills of lading is not capable of protecting bank's interest under a letter of credit as it first appears. The security is under different challenges at different stages of transferring bills of lading. It is concluded by the author that before the seller transfers the bill of lading to his bank, there are two situations that might affect the bank's security as pledgee: the first is the fact that the goods have been discharged, the second is that the ownership in the goods has passed. At the transfer of the bill, there are two factors that need to be addressed: first, whether the seller intends to transfer the constructive possession to the bank; second, whether the seller has, if necessary, indorsed the bill of lading in favour of the bank. After the transfer of the bill and the subsequent creation of pledge, the bank needs to be careful if a trust receipt is used for releasing the bill of lading to the buyer.

The central question in this chapter now turns to if the paper bill of lading was replaced by an electronic bill of lading, would these factors still be relevant to bank's security?

In the last few decades, digitization of transactions has been a fast-developing topic. That is because the industry has suffered from problems arising from paper documents for a long time. Using paper documents means that it needs people and time to examine them and is thereby exposed to the risk of malicious activities and delay.[453] In addition, personal contact with paper documents is considered as not hygienic in the COVID-19 period, and digitization of documents thereby is called for acceleration to adapt the "new normal".[454]

Under the current operation of letters of credit, the manual examination process is time-consuming, so it often causes the delay in transmission of the required documents. Such delay will in turn bring trouble to the buyers who want to surrender them to take delivery of the goods, because the carrier is entitled and obliged to deliver the goods only to the person with presentation of bills of lading.[455] The digitization of documents used under letters of credit is believed to be able to tackle these drawbacks of using paper documents.

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[453] See Sukand Ramachandran, Jarryd Porter, Rony Kort, Ravi Hanspal and Hunny Garg, *SIBOS 2017: Digital Innovation in Trade Finance: Have We Reached a Tipping point?*, The Boston Consulting Group, Octber 2017, available online at <https://www.swift.com/sites/default/files/documents/swift_bcg_swiftfocus_white_paper.pdf> [accessed 14 September 2020], 2; see Chang, Luo and Chen (n 20) table 1; Paul Todd, 'Electronic Bills of Lading, Blockchains and Smart Contracts' (2019) 27 International Journal of Law and Information Technology 339, p355 and fn 115.; Clyde & Co, 'The Legal Status of Electronic Bills of Lading: A Report for the ICC Banking Commission' (2018), 5 <https://cdn.iccwbo.org/content/uploads/sites/3/2018/10/the-legal-status-of-e-bills-of-lading-oct2018.pdf> accessed 2 July 2020, at p5.

[454] https://www.bimco.org/news/priority-news/20200602-maritime-digitalisation.

[455] See discussion in section 5.2.

However, financing banks, as an important sector in the industry, are hesitating to quickly adopt this new trend, because of the uncertainty of law regarding their security. The law in this regard has not been well examined.

Such uncertainty attributes mostly to the status of electronic alternatives to the paper documents from which bankers used to acquire the security. A lot of efforts have been made on both the international stage and domestic level; at the same time, many private companies have tried to bypass the unc with contractual frameworks. No matter which measure will be adopted in the UK, there are still many unclarities and ambiguities about bank's security on electronic documents. Among those ambiguities, my focus will be on the factors which are likely to affect bank's security in paper bills of lading as well as whether these factors will still be a problem in the digital context.

Hence, the following parts will discuss what electronic bills of lading are, how a financing bank under a letter of credit acquires security through electronic bills of lading and how those factors identified in the paper world affect bank's security in the digital context.

7.1 Electronic Bills of Lading

From the previous discussion, paper bills of lading play an important role in the process of letters of credit. In the same vein, one of the most important tasks in the digitization of letter of credit transactions is to digitize bills of lading.

The trade industry has been trying to fit in the era of digitization by replacing traditional paper documents with electronic data for decades. The invention of Electronic Database Interchange (EDI) has allowed traders to communicate business documents electronically, including bills of lading. The term "electronic bills of lading" or "eB/L" is not unfamiliar to the world. The concept of electronic bill of lading has already existed for more than 30 years. There already are many platforms that are invented to replace traditional paper bills of lading with electronic bills of lading; and the first system using electronic bills of lading-SeaDocs-was established in 1983.[456]

There are many different platforms of eB/L, and there are many ways of categorisation for these platforms. This phenomenon might contribute to the lack of a uniform definition for eB/L, even though the concept of "eB/L" has existed for such a long time.

Generally speaking, an electronic bill of lading, like other digitized commercial documents, is only a kind of data transferred from a computer to another computer. But how the data is presented varies

[456] See Todd (n 455) p340; see also Marek Dubovec, 'The Problems and Possibilities for Using Electronic Bills of Lading as Collateral' (2005) 23 Ariz. J. Int'l & Comp. L. 437, p449.

from platform to platform. The aim of these platforms is to replicate the functions of a traditional bill of lading into its electronic alternative; and how the functional equivalence is achieved in different platforms is not the same. Therefore, it is difficult to have a specific and uniform definition for all the eB/Ls in different platforms.

For the convenience of current discussion, an electronic bill of lading can be defined as an electronic record which aims to achieve the functional equivalence of a traditional paper bill of lading.[457]

7.1.1 Categorization of eB/Ls

There are different ways to categorise eB/Ls: they can be categorised by the platform operators[458], by the technology applied to digitize documents[459], or by the openness of the platform.

For current purpose of discussion, the last way of categorization is preferred since this categorization is more legal-orientated. Their openness somehow determines how a platform achieves functional equivalence to documents of title. Generally, closed platforms, which are currently the most popular for the industry, are inclined to use attornment to transfer constructive possession; meanwhile, open platforms, which are deemed to be the future of eB/Ls, are less likely to be adapted without legislative intervention.

Based on the openness of eB/L platforms, there are two types of eB/Ls as mentioned earlier: the eB/L under an open platform and that under a closed platform. The difference between these two platforms is that the former does not rely on multipartite agreements, but the latter does. That is why the former is sometimes called member-only, permissioned or club platform, while the latter is called non-member or permissionless platform.

7.1.2 EB/Ls under Closed Platforms

Nearly all the current operating platforms of eB/L are closed platforms. Among them, the most well-known ones are Bolero and essDOCS.

These platforms invariably require all their members to sign up to a multipartite contract, so that all members are contractually connected with each other and with the platform operators. For examples, in Bolero, all the members are governed by Bolero Rulebook; in essDOCS, the platform connects all

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[457] This is also definition used under Clyde & Co, 'The Legal Status of Electronic Bills of Lading: A Report for the ICC Banking Commission' (2018), at p5.
[458] For example, the eB/L under Bolero is called "Bolero Bills of Lading".
[459] For example, blockchain bills of lading are referred to the eB/Ls under blockchain-based platforms.

the members with the Databridge Services & Users Agreement (DUSA).[460] With the contractual framework, the rights and interests under the eB/L can be transferred among the members, and this ascribes to novation and attornment, which will be explained later in detail.[461]

Because of the member-only feature, a non-membership party cannot receive or transfer the eB/L from any members in a closed platform. Closed platforms address this issue by allowing members to switch the eB/L to a paper B/L at any point in the transaction.

Despite the popularity of using closed system, it is regarded as one of the practical barriers of adoption of eB/Ls.[462] Since a closed platform is essentially a centralized data platform, its operation cannot be maintained without the involvement of a third party, namely the platform operator. The members' information is stored in the server of the operator. For example, both Bolero and essDOCS use central registries for storing the holdership of the eB/Ls.[463] Plus, the member might not be in the same jurisdiction as the operator. Therefore, it is normal for the members to concern about the confidentiality and security of their information.[464] Last but not least, the rights arising from possession of the eB/Ls of closed platforms can only bind those who have signed up to the contractual framework of the platforms; conversely, the rights arising from possession of a paper B/L can be enforceable against the world.[465]

7.1.3 EB/Ls under Open Platforms

The closed platforms for eB/L are using contractual framework to bond each of their users and to achieve functionally replication of paper bills of lading. Therefore, each transfer of such an eB/L requires the participation of the carrier or the platform operators. It is said that a true B/L replacement would not require such involvement and that such eB/L is essentially an electronic contract for carriage.[466]

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[460] For Bolero's Rulebook generally, see https://www.bolero.net/rulebook-and-title-registry; for essDOCS's DUSA generally, see https://www.essdocs.com/capabilities/users-agreement-dsua.
[461] See discussion in section 7.2.1.1.
[462] Goldby (n 9) para 11.6; Koji Takahashi, 'Blockchain Technology and Electronic Bills of Lading' (2016) 22 The Journal of International Maritime Law Published by Lawtext Publishing Limited 202, p205.
[463] See UK P&I Club, 'Legal Briefing: Electronic Bills of Lading' (2017) p4, Bolero uses its Title Registry which is a shared service for holder details and essDOCS uses its centralised database; see also UK P&I Club, 'Electronic Bills of Lading-An Update: Part II' (2020), both Bolero and essDOCS are now intergraded with blockchain-based platforms.
[464] United Nations Conference on Trade and Development (UNCTAD), *The Use of Transport Documents in International Trade* (2003), para 75.
[465] See Law Commission, *Digital Assets: Electronic Trade Documents: A Consultation Paper* (CP No. 254, 2021) para 2.37 and 2.40.
[466] Law Commission, *Electronic Commerce: Formal Requirements in Commercial Transactions* (19 December 2001) para 4.7.

In addition, since the eB/L under a closed platform can only be accessed and transferred by its member, it cannot be used by anyone and thereby is not regarded as a true replacement of paper B/Ls.[467] Instead, an eB/L under an open platform can be said to be a true replacement of paper bills of lading.[468]

An open platform of eB/Ls is unattainable without the advent of blockchain technology.[469] Blockchain technology is used in Bitcoin, which is a type of cryptocurrency. It is based on the notion of synchronised distributed-ledgers, which can effectively avoid double-spending on same Bitcoin.[470] It is this feature that blockchain technology is regarded as the most potential technology in shipping and finance industry.[471] It enables electronic transferable data to be tamper-proof and immutable, which ensures the security of data transaction.[472] Accordingly, it tackles the trader's concerns arising from using a centralised database to store all their information.[473]

Without requirement of sign-up as membership, an open platform does not connect every user with a contractual framework like what a closed platform does; therefore, it is impossible to use the same ways of novation and attornment as closed platforms to transfer the rights and interests under eB/Ls in an open platform. Accordingly, the possible solutions in this are being explored among academics and policymakers, nationally and internationally.[474]

The following discussion regarding open platforms of eB/Ls is based on the potential solutions from both the national stage and the international stage. As for the national stage, Law Commission recently has presented the Parliament with a proposal to allow for legal recognition of trade documents such as bills of lading.[475] This is the first time for Law Commission to address the

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[467] Todd (n 455) p341.
[468] ibid..
[469] But blockchain technology is not unique to open platforms, closed platforms can use permissioned, private and consortium blockchains.
[470] See Takahashi (n 464) p203; for Blockchain general, see Satoshi Nakamoto, 'Bitcoin: A Peer-to-Peer Electronic Cash System' [2008] Decentralized Business Review 21260.
[471] See Takahashi (n 464) p204; Elson Ong, 'Blockchain Bills of Lading' [2018] SSRN Electronic Journal p10-11 <https://www.ssrn.com/abstract=3225520> accessed 30 December 2021.; Clyde & Co, 'The Legal Status of Electronic Bills of Lading: A Report for the ICC Banking Commission' (2018), at p10.
[472] See Jean Bacon, 'Blockchain Demystified: A Technical and Legal Introduction to Distributed and Centralized Ledgers' (2018) 25 Rich. JL & Tech. 1, p9.
[473] However, it is also argued that blockchain technology is not the optimal solution for eB/Ls: see Feng Wang, 'Blockchain Bills of Lading and Their Future Regulation' [2021] SSRN Electronic Journal <https://www.ssrn.com/abstract=3817112> accessed 30 December 2021; Karl Marxen, 'Electronic Bills of Lading in International Trade Transactions - Critical Remarks on Digitalisation and the Blockchain Technology' [2020] Coventry Law Journal 31.
[474] International efforts: such the Rotterdam Rules, UNCITRAL Modal Law on Electronic Transferable Records; National efforts: Law Commission is currently presenting the Pariliement with the proposals to allow for legal recognition of trade documents such as bills of lading, https://www.lawcom.gov.uk/project/electronic-trade-documents.
[475] Ibid.

possessory feature of eB/Ls, and it is likely to be enacted in 2023. As for the international stage, UNCITRAL Model Law on Electronic Transferable Records ("MLETR") is arguably compatible with eB/Ls in open platforms. The common feature of these models is that they all consider the notion of "exclusive control" as functional equivalent to "possession". The detailed comparison of this notion under two models will be provided in the following sections of this thesis.

As discussed in the previous chapters, the concept of "possession" is fundamentally important to bills of lading having the conveyance function and to creation of pledge. Hence, whether the "exclusive control" notion is workable and how this notion works have great influence on bank's security on eB/Ls under open platforms.

7.2 Bank's security on eB/Ls

When traditional paper bills of lading are digitized to eB/Ls and used in letters of credit, the way of creation of bank's security is totally different.[476] The most fundamental reason is that an eB/L, whether in a closed platform or in an open platform, is not recognized as a document of title under English law.[477] As a result, a transfer of an eB/L cannot validate a pledge on the underlying goods without the carrier's attornment; without the legislative intervention, the platform itself has to find their own way to create security interests under its eB/Ls.

7.2.1 Closed Platform: Attornment

Closed platforms of eB/Ls try to overcome the problems of bank's security by using attornment.[478] That is to say, the platform operator acts as the carrier's agent and attorns to each successive holder of the eB/L on its behalf so that the carrier will hold the goods to the order of that holder of the eB/L. The platform operator acts as the media among the transferor, the transferee, and the carrier. By such attornment, that holder thereupon has the constructive possession of the goods.[479]

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[476] In this case, the letter of credit will be issued incorporating eUCP, which is the supplement to UCP600 and allows for presentation of electronic records.
[477] In other jurisdictions, such as the US, Australia, Germany and South Korea, eB/Ls are recognized as documents of title by their respective legislations: Goldby (n 9) para 6.33.
[478] Not all the closed platforms of eB/Ls are using the principle of attornment. For example, Wave BL and e-title do not use attornment and novation, instead intergrading COGSA92 into their user agreements: see UK P&I Club, 'Legal Briefing: Electronic Bills of Lading' (2017) p4; UK P&I Club, 'Electronic Bills of Lading-An Update: Part I' (2020).
[479] Clyde & Co, 'The Legal Status of Electronic Bills of Lading: A Report for the ICC Banking Commission' (2018), at p9.

7.2.1.1 How Closed Platforms Achieve Attornment

Such attornment is impossible under the current English law without the contractual framework. As mentioned earlier, both Bolero and essDOCS connect their users by their contractual nexus.

In Bolero, each user must sign up for the Bolero Rulebook. The Rulebook links every user to every other user and Bolero itself. As a result, upon a transfer of a Bolero B/L, Bolero will give the new holder an undertaking that the carrier will hold the goods to its order, so as to validate the attornment on behalf of the carrier.[480]

Bolero is essentially a centralized registry system, and it uses its Title Registry to store and authenticate the information about each Bolero B/L, such as its holdership and status.[481] All the transfer of a Bolero B/L is recorded under the Title Registry, which also ensures the singularity of each Bolero B/L. Therefore, it ensures each holder's exclusive control of the Bolero B/L.

A Bolero B/L contains the acknowledgment that the goods have been receipt by the carrier.[482] And when the carrier creates a Bolero B/L, it must designate the Holder of the Bolero B/L.[483] This has the effect that the carrier is holding the goods to the order of the Holder and that the Holder can designate a new holder.[484] The goods under such Bolero B/L thereby can be said to be under the Holder's constructive possession.

The transfer of constructive possession of the goods is effected by the process of "designation"; the current Holder of the Bolero B/L is entitled to designate a new Holder, and the effect of such "designation" is that the carrier acknowledges that from the time of designation it holds the underlying goods to the order of the new Holder.[485] It means that, upon the "designation", the carrier attorns to the new Holder and that the constructive possession of the goods is thereby transferred to the new Holder.

When a user wants to pledge its Bolero B/L to another user (such as an issuing bank of a letter of credit), it can designate the latter as a new "Pledgee Holder".[486] A "Pledgee Holder" is defined as "a User who is or becomes Designated as both Pledgee and Holder simultaneously".[487] In other words, the constructive possession is transferred to the "Pledgee Holder" by the carrier's attornment. The

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[480] Bolero Rulebook, Rule 3.4.2; see Goldby (n 9) para 6.35.
[481] Bolero Rulebook Rule 1.1 (53).
[482] Bolero Rulebook Rule 1.1 (53).
[483] Bolero Rulebook Rule 3.1 (4).
[484] Bolero Rulebook Rule 3.3 (3) and 3.4.1 (2).
[485] Bolero Rulebook Rule 3.4.1 (1) and (2).
[486] Bolero Rulebook Rule 3.4.1 (1).
[487] Bolero Rulebook Rule 1.1 (42).

legal effect of the designating banks under letter of credit transactions as "Pledgee Holder" shall be accordance with the parties' intention: if the parties only intend to transfer the special property in the goods to the "Pledgee Holder", only special property will be transferred, nothing more.[488]

It is worth noticing that a "Pledgee Holder" under Bolero is not necessarily the To Order party.[489] When the current Holder, which could be a Bearer Holder, Holder-to-Order, or a Pledgee Holder, designate a Pledgee, such Pledgee will automatically become a Pledgee Holder. If the transferor blank endorsed the eB/L to the Pledgee, the Pledgee Holder is in a similar position of a Bear Holder.[490] If the transferor personal endorsed to the Pledgee, the Pledgee Holder would automatically become a Holder-to-Order only when he enforced his pledgee.[491] If the transferor designates a Pledgee Holder without endorsement, the Pledgee Holder will not become a Holder-to-order but will become a Bearer Holder once he enforces his pledge.[492] In the last situation, even though the Pledgee Holder is not the current To Order party, the constructive possession of the goods can be delivered to him, because the effect of designation of a Pledgee Holder is that: the carrier acknowledges from the time of designation it holds the underlying goods to the order of the Pledgee Holder.[493]

The "Pledgee Holder", just as a normal Holder of a Bolero B/L, is entitled to transfer the Bolero B/L, reject the transfer, and ask for switching to a paper bill of lading.[494] However, a "Pledgee Holder" is not allowed to blank endorse or surrender the Bolero B/L.[495]

The essDOCS uses different practical ways from Bolero to achieve the functional equivalence to paper bills of lading, but they are legally the same: both achieve the functional equivalence about conveyance function by using attornment. Therefore, it is not necessary to elaborate the workflow of the essDOCS for the purpose of current discussion.

As explained earlier, the constructive possession of goods stated under a closed-platform eB/L is transferred through the carrier's attornment; and such attornment is made by the platform operator on the carrier's behalf. However, the legal validity of this method under closed platforms has never been

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[488] Bolero Rulebook Rule 3.11(4) and 3.10(1).
[489] See Bolero Rulebook Rule 3.5.3 (3)
[490] See Bolero Rulebook Rule 3.8 (7): "Where a Bolero Bill of Lading is Blank Endorsed, the Designation of a Pledgee shall make the User so Designated a Pledgee Holder, not a Bearer Holder."
[491] See Bolero Rulebook Rule 3.5.3 (2): "A Pledgee Holder that is also the current To Order Party enforcing its pledge over a Bolero Bill of Lading shall automatically become the Holder-to- order."
[492] See Bolero Rulebook Rule 3.5.3(3): "When a Pledgee Holder, who is not the current To Order Party, enforces its pledge over a Bolero Bill of Lading, the current To Order Party, if any, shall be automatically deleted from the Title Registry Record, and the Pledgee Holder shall automatically become the Bearer Holder."
[493] Bolero Rulebook Rule 3.4.1 (2).
[494] Bolero Rulebook Rule 3.4.1 (1) and (6), 3.7 (1).
[495] Bolero Rulebook Rule 3.8 (1).

tested in courts, so it is relatively uncertain.[496] Such uncertainty lies in its difference from the conventional attornment, especially in the form of attornment. Therefore, the following paragraphs will discuss the legal rationale behind the conventional attornment and compare it with the attornment in closed platforms.

7.2.1.1.1 Conventional Attornment

English law has recognized this method of delivery for a long time. It has its basis in medieval land law.[497]

Delivery by attornment is a kind of constructive delivery. At common law, delivery could be completed either actually or constructively; constructive delivery means the delivery is completed while the actual possession of the chattel need not be changed; and this could be done by symbolic delivery or by the attornment of the actual possessor.[498] The requirement of attornment for constructive delivery is now codified in s.29(4) of the Sale of Goods Act 1979.[499] Once the actual possessor attorns the chattel to other people, the former agrees that he shall hold the chattel in the name or on account of that person; the actual possessor thereby becomes the bailee of that person.[500]

The conventional attornment can be used for fulfilling the delivery requirement in the creation of pledge. In Scotland, a similar principle is called "intimation", which means the deliveree must give notice of his title to the goods to the warehouseman. In *Inglis v Robertson*[501], the House of Lords found that, in order to make the pledge effective by constructive delivery, the pledgee must intimate to, or give notice to the warehouseman about his pledge. The same principle also applies in Ireland. In *Dublin City Distillery v Doherty*[502], the liquidator of the whisky company claimed its right over the whiskies which were alleged by its lender to be subject to a pledge. The lender contended that the pledge on the whiskies was created by its debtor's delivery of the related delivery warrants to it by way of security against an advance. In the House of Lords, Lord Atkinson has reviewed in detail the authorities about constructive delivery and held that the lender did not acquire a pledge on the

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[496] Law Commission, Digital Assets: Electronic Trade Documents: A Consultation Paper (CP No. 254, 2021) para 2.40.
[497] See William Searle Holdsworth, *An Historical Introduction to the Land Law* (Lawbook Exchange 2002) p129-130.
[498] *Dublin City Distillery v Doherty* [1914] AC 823, at p843.
[499] Sale of Goods Act 1979, s29(4), this section uses the word "acknowledgment" instead of "attornment" due to the consideration of its application in Scotland: see Bridge and others (n 42) para 12.004.
[500] *Farina v Home* 153 ER 1124; *Castle v Sworder* (1861) 6 H & N 828; *Dublin City Distillery v Doherty* [1914] AC 823; *Mercuria Energy Trading Pte Ltd v Citibank NA* [2015] 1 CLC 999, at [55]-[60]; such an attornment might give rise to other effects, such as on estoppal or on contract, at this regard, see generally Bridge (n 58) para 18.403 et seq.
[501] *Inglis v Robertson* [1898] AC 616.
[502] *Dublin City Distillery v Doherty* [1914] AC 823.

whiskies, because the warehouseman had not attorned to him. The Judge's reasoning is based on the doctrine that the warehouseman holds the goods as the agent of the owner until he has attorned in some way to the transferee of a delivery warrant; and then, and not until then the warehouseman become a bailee for that person; and then, and not until then, there is constructive delivery of the goods.[503]

The rationale behind this method of delivery was allegedly based on estoppel and promise. In *Inglis v Robertson*, Lord Kincairney said that the reason for why the intimation is important to constructive delivery is said to be that, without such intimation or notice to the warehouseman, the warehouseman cannot know to whom he is bound to deliver the goods.[504] Similarly, Lord Summer in In *Dublin City Distillery v Doherty* expressed that the warehouseman, as the bailee of the goods, promises to the party to which its delivery warrant was issued that the goods would be delivered to him; if that party transfers and indorses the delivery warrant to another person, after the attornment of the warehouseman to the latter, a like promise will arise in him favour.[505] By contrast, Donaldson J in *Alicia Hosiery Ltd v Brown Shipley Co Ltd*[506] explained the attornment in the contractual basis; he described an attornment as a contractual key which gives the constructive possessor control over the goods held on his behalf in the possession of another; by attornment, the actual custodian agrees to enter a similar contractual relationship with the transferee.[507]

As illustrated by the authorities above, attornment is necessary to constitute a delivery. Regardless of its importance, there is no uniform for how attornment is made. In this regard, there is a judicial divergence found in *Dublin City Distillery v Doherty*.

In the House of Lords of *Dublin City Distillery v Doherty*, Lord Atkinson emphasised the importance of attornment in constructive delivery and held that a mere transfer of a delivery warrant was not enough to constitute an attornment.[508] By contrast, Lord Parker contended that a constructive delivery not only requires a direction from the transferor to the custodian, but also the latter's acknowledgement. Following that, he continued to say that the form of such acknowledgement is immaterial, so that even an entry in the warehouse book of the name of the transferee would be enough.[509]

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[503] Ibid, at p847-848 (Lord Atkinson), the other Judges of this case have the same view at this regard.
[504] *Inglis v Robertson* (1897) 24 R 758, p784 (Lord Kincairney) (QB).
[505] *Dublin City Distillery v Doherty* [1914] AC 823, p862-863 (Lord Summer).
[506] *Alicia Hosiery Ltd v Brown Shipley Co Ltd* [1970] 1 QB 195.
[507] *Alicia Hosiery Ltd v Brown Shipley Co Ltd* [1970] 1 QB 195, p207.
[508] *Dublin City Distillery v Doherty* [1914] AC 823, at p847-848 (Lord Atkinson).
[509] *Dublin City Distillery v Doherty* [1914] AC 823, at p852 (Lord Parker of Waddington).

Lord Parker's view might have impact on Scrutton LJ in *Laurie and Morewood v Dudin & Sons*, who was in the opinion that a very little would suffice to create an attornment.[510] When the delivery warrant is transferred to and then presented by the transferee to the warehouseman, the form of the attornment could be: that the warehouseman writes on the warrant in the presence of the transferee the word "accepted", so that he sees it; that the warehouseman delivers part of the goods to the transferee; that the warehouseman makes a claim for charges on the transferee; that the warehouseman tells the transferee that he has entered his right to the goods in his books; or that the warehouseman issues a release confirmation or a new warehouse receipt.[511]

Regardless of how minimal the requirement for attornment is, it is suggested by the relevant authorities that an attornment must fulfil some conditions for establishment.

Firstly, there must be assent from the actual custodian. To transfer a bailment relationship, it was contended that there must be a complete assent of all three parties.[512] The assent of the person actually holding the goods is thereby important to establishing an attornment. This condition is well accepted and reflected by authorities.

Secondly, the custodian's attornment requires communication to the transferee. The existence of this condition could possibly resolve the judicial divergence in *Dublin City Distillery v Doherty*. Although Scrutton LJ regarded the requirement for attornment as minimum, he stated that an attornment is impossible without communication to the transferee.[513] Moreover, when Pollock and Wright described the importance of custodian's consent, they referred to the cases of stoppage in transit; it was concluded that the right of stoppage in transit would end when the carrier attorned to the buyer and held no longer as carrier but as his agent, and quoted that "it is not at an end until the carrier, by agreement between himself and the consignee, undertakes to hold the goods for the consignee not as carrier but as his agent."[514] The word "agreement" might suggest that the consent must be communicated, otherwise "agreement" sounds improper.

The second condition of attornment is also agreed by the editors of *The Law of Personal Property*, where they thought that a mere entry in the books of the bailee without effective communication to the transferee that the bailees agree to hold goods to his order is insufficient.[515] Accordingly, the main reason for their argument is the lack of effective communication to the transferee about the baileee's

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[510] *Laurie and Morewood v Dudin and Sons* (1925) 23 Lloyd's Law Rep 177, p180 (Scrutton LJ).
[511] *Laurie and Morewood v Dudin and Sons* (1925) 23 Lloyd's Law Rep 177, p180 (Scrutton LJ); see also *Mercuria Energy Trading Pte Ltd v Citibank NA* [2015] EWHC 1481 (Comm); [2015] 1 CLC 999 [78].
[512] Pollock and Wright (n 277) p73.
[513] *Laurie and Morewood v Dudin and Sons* (1925) 23 Lloyd's Law Rep 177, p180 (Scrutton LJ).
[514] Pollock and Wright (n 277) p74, quoting Ex parte Cooper (1879) 2 Ch Div 68, at p78 (James LJ).
[515] Bridge and others (n 42) para 12.008.

consent. They further explained that the requirement of communication is said to be reflected from the wordings of s.29(4) of the Sale of Goods Act 1979, requiring that the bailee "acknowledges to the buyer".[516]

Overall, it is submitted that Lord Atkinson's view is favourable. The form of an attornment can be various, but effective communication with the transferee is indispensable.

7.2.1.1.2 Comparison with Closed-Platform Attornment

Closed platforms of eB/L allege to achieve the functional equivalence of a document of title to goods by using the attornment mechanism. However, as explained earlier, the attornment used in a closed platform is slightly different from the conventional attornment. Then, will the closed-platform attornment achieve the same legal effect as the conventional one, regardless of the difference between them?

Under a closed platform of eB/L, all its members are connected by and communicate through the platform. When a direction of transferring an eB/L is made in the platform, the platform operator, acting as the agent of the carrier, verifies and then accepts this direction on behalf of the carrier; at the same time, according to the request of the transferor, the operator will change the record of the holdership regarding this eB/L in the central title registry. As such, the transferee will become a new holder of the eB/L, unless he rejects it.

In the process above, the direction to transfer the eB/L is sent to the closed platform; once the operator of the platform verifies and changes the name of the holder from the transferor to the transferee, it is taken to have accepted the direction about this transfer. After the name of the holder is changed into the transferee, it is more than a change of the name in the warehouse book because the transferee of the eB/L will be notified instantaneously about the transfer, which constitutes a communication to the transferee. After being notified, the transferee has the option to reject it as he wishes.

Therefore, the attornment used in closed platforms arguably satisfies the minimum conditions of attornment suggested above; as a result, the operator's transferring the eB/L as an agent of the carrier is sufficient to constitute an attornment under English law.

7.2.1.2 Concerns about Pledge in Closed Platforms

As discussed above, although the attornment used in closed platforms is slightly different from the conventional attornment, it is arguably effective as the conventional one and able to be used for pledging the goods under eB/Ls. However, there is one concern about the effect of a pledge created by

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[516] ibid.

the conventional attornment, which could similarly affect a pledge created by closed-platform attornment; this concern is its effect against third parties. Such effect can be easily justified for the conventional attornment, but it is relatively difficult in the closed-platform attornment. If the same justification could not apply to the closed platform attornment but the law still insisted to recognise its legal validity without careful consideration, it might prejudice third parties' interest in some situations. Besides, there has not been many discussions from this perspective of the closed-platform attornment. For the reasons above, the following paragraphs will fill this gap by addressing this issue and examining its effect against third parties.

As in the previous discussion, a creation of security interest includes attachment and perfection; the effect of perfection is to protect and bind any third parties who want to acquire interests on the same secured assets, by notifying them about the existence of the security interest.[517]

For a pledgee, his possession of the debtor's asset enables him to secure his interest by control of such asset; more importantly, his possession has perfected his security interest as a pledge on the asset, so that it can be against third parties. Especially in the insolvency of his debtor, his interest as a pledgee enjoys priority over the insolvent's liquidator or other creditors. This is true even though the possession is only a constructive possession.

Dublin City Distillery v Doherty is an example where the creditor of the insolvent sought to claim its security interest of pledge, which was allegedly created by receipt of a delivery warrant from the insolvent, against the liquidator of the insolvent; but for the want of attornment from the custodian, the creditor's claim on the goods should have not defeated the liquidator's.[518] Likewise, in *Inglis v Robertson*,[519] the creditor who alleged to have become a pledgee by acquiring the delivery order from its debtor has failed to defeat the claim of another creditor; if there was an attornment for the favour the creditor, it would have been no need to refer to s3 of the Factors Act 1889, and the creditor's right as pledgee could have prevailed the other creditor's.[520]

Normally, perfection is fulfilled by registration of the security interest; pledge and other possessory security are the exceptions to the registration requirement because possession is a sufficient public notice of a security interest.[521] So, it is easy to justify this exception when the pledgee has the actual possession, but not easy in cases where the pledgee's possession is only constructive.

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[517] See discussion in section 2.2.2.4.
[518] *Dublin City Distillery v Doherty* [1914] AC 823.
[519] *Inglis v Robertson* [1898] AC 616.
[520] Factors Act 1889, s.3: "A pledge of the documents of title to goods shall be deemed to be a pledge of the goods."
[521] Gullifer (n 45) para 2.20 and 18.010, even the UCC Art 9 and PPSAs do not require a pledge to be registered.

The justification for it could be that, when the actual possession of the pledged asset is in a third party's hands, the risk of false wealth is relatively lower because few people will regard an asset stored in, e.g., a third-party warehouse or a carrier as the asset of the debtor without enquiry.

As discussed before, where the good are in transit on a vessel, a transferable bill of lading, if any, which being a document of title at common law is the best evidence on the title to such goods.[522] Though such evidence is not conclusive, its evidentiary effect is very strong to the parties other than the original parties of the carriage contract. Hence, when there is a bill of lading issued, other evidence about the title to goods is less convincing. Therefore, if a bill of lading has been issued and the debtor does not possess it, no one will think that the goods is the debtor's.

However, when there is no bill of lading issued for the goods, there is no evidence of title. In this situation, if someone holds a document under which he is named as consignee, such as a delivery warrant or a mate's receipt, a third party of the carriage contract might think that the underlying goods are this person's. That is because, where there is no strong evidence of title as a bill of lading, a third party has to look at other evidence if he wants to know whether the person with whom he deals owns the goods or not.

Therefore, it is contended by the author that, when the goods are stored in the carrier's place and there is no bill of lading issued, the risk of false wealth exists, even though the risk is relatively small. If the risk existed, a pledge created by a third party's attornment should be subject to the registration requirement, otherwise it could not bind other creditors in the event of insolvency. Nevertheless, the English law so far seems to recognize its effect against other creditors without requiring it to be registered.

The only explanation for this exemption of registration in pledge created by carrier's attornment might be that, even a pledge created by pledgor's attornment, which potentially has higher risk of false wealth, is not subject to registration requirement, why should a pledge with lower risk be? The risk of false wealth is much higher when a pledgor had the actual possession of the pledged asset. This situation is similar to the situation where the pledgee redelivers the pledged asset to the pledgor against a trust receipt.[523] In such cases, the pledgor's possession may mislead others. Accordingly, some scholars advise a pledge created by the pledgor's attornment should be registrable like a company charge.[524] Such advise has also been recommended in the Law Commission proposal regarding company security interests, but eventually it was not adopted.[525] It is not sure why this

[522] See discussion in section 2.2.3.
[523] See discussion in Chapter 6.
[524] e.g. Gullifer (n 45) para 18.010.
[525] Law Commission, *Company Security Interests* (Law Com No 296, 2005), at para 3.20-3.21.

proposal eventually is not adopted, but this proposal indicates the existence of the risk of a pledge created by the pledgor's attornment and its need for registration requirement. Their difference in the risk level is not big enough to justify their different treatments in terms of the registration requirement. Therefore, considering the reasons above, both types of pledge might necessitate the registration requirement so as to protect innocent parties from false wealth. Although the registration requirement is arguably necessary for the perfection of a pledge created by attornment, either that is made by a pledgor or by a third-party custodians, no such requirement has been placed in this area; perhaps it is because the difficulty for its achievement in practice is relative high, considering that it will need a registry to record these interests and that traders might be sensitive to let their information being stored in other's hands, such as governments.

Although a pledge created by carrier's attornment could be accompanied by a risk of false wealth, the same risk is much less likely to occur in the digital context. In a closed platform of eB/Ls, the evidential function of an eB/L is much convincing than a paper mate's receipt or a delivery order. Even though they are both using attornment mechanism to transfer constructive possession of the goods, anyone in the closed platform could not hold the eB/L without the carrier's attornment; by contrast, the holdership of a paper mate's receipt or a delivery order is possible without carrier's attornment. In addition, integrating with advanced technology for authentication and verification can make the control of an eB/L more reliable and trustworthy. Accordingly, in a closed platform, if a person cannot prove his holdership of the eB/L, no one will assume that he has the title to the goods, and therefore, risk of false wealth in the digital context is much less than that in the paper world.

Through the careful examination and analysis above, it is found that a pledge that is created by a closed-platform attornment is less likely to raise a risk of false wealth than a pledge created by the conventional one, it has the effect against third parties who intend to acquire interests on the same goods under the eB/Ls.

7.2.2 Open Platform: Exclusive Control

Closed platforms can use attornment mechanism and contractual nexus to achieve functional equivalent to paper bills of lading. However, open platforms for eB/Ls cannot rely on them to achieve functional equivalent to paper bills of lading as closed platforms do, because open platforms do not require their users to sign in or become membership in advance.

Same as closed-platform eB/Ls, the common law has not recognised eB/Ls as a transferable document of title. Therefore, it is unlikely for eB/Ls under an open platform to perform the conveyance function of paper bills of lading without legislative intervention.

There are different attitudes towards the need for this legislative intervention.

Some suggested that the functional equivalence could be achieved without legislative intervention. As for transfer of contractual rights under eB/Ls, it was argued that, in an open platform, it could be achieved by a chain of assignments and indemnities, or by novation.[526] The assignment mechanism was inferred from the statement of Lord Brandon in *The Aliakmon*.[527] It was suggested that, when COGSA92 did not apply, the buyer could have had title to sue by taking of an assignment.[528] In author's view, although this method can be used for transferring contractual right under bill of lading contracts, a proprietary right of possession cannot be transferred, at least merely by assignments and indemnities. As for novation scheme, it was argued that an open system could use "smart contracts" to set up novation and attornment.[529] But there is no explanation of how attornment could be set up without contractual nexus. It is doubtful by the author whether the novation alone could have the impact on the proprietary interest of the goods.

Some also suggested that, due to the conservation of the maritime industry and the limitations of positive law instruments as sole source of regulations, self-regulation instruments should provide a basis for filling the regulatory gap.[530] Nevertheless, it is undeniable that the positive law instruments are necessary for eB/L to become a document of title.[531]

Therefore, it is assumed that the conveyance function of paper bills of lading cannot be replicated to eB/L under an open platform without the intervention of legislations.

For this purpose, there are several models available for recognizing the legal effect of eB/Ls. In the UK, the Law Commission recently has published the consultation paper in respect of legal recognition of electronic trade documents (hereafter referred as "UK proposal") and proposed a draft bill in this regard (hereafter referred as "draft Bill").[532] In the international stage, the latest development is the UNICTRAL Model Law on Electronic Transferable Records (MLETR), which was adopted by the United Nations Commission on International Trade Law (UNICTRAL) in 2017.[533] Besides, there are other models existing both on domestic and on international stage, such as the US UCC Art 9 and the Rotterdam Rules. Considering the purpose of current discussion and the similarity among different models, only the UK proposal and MLETR will be discussed below.

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[526] Todd (n 455) p365-368.
[527] *The Aliakmon* [1986] AC 785, p818 (Lord Brandon).
[528] Todd (n 455) p365.
[529] ibid p368.
[530] Wang (n 475).
[531] ibid p25.
[532] Law Commission, *Digital assets: electronic trade documents: Report and Bill* (Law Comm 405, 2022),
[533] For the background information, see https://uncitral.un.org/en/texts/ecommerce/modellaw/electronic_transferable_records.

7.2.2.1 UK Proposal

The UK proposal was brought out for the similar purposes as other initiatives, namely, to recognize the legal effect of using electronic documents in international trade. The Law Commission of the UK has identified the conflict between the heavy burden of using paper documents and the lack of legal certainty on using their electronic counterparts.[534]

The legal uncertainty comes from inpossessibility of electronic documents.[535] In the UK, the House of Lords in *OBG v Allen* held that an intangible asset could not be possessed.[536] Following this decision, Moore-Bick LJ in the Court of Appeal of *Your Response Ltd v Datateam Businsness Media Ltd* made the judgment that the intangible electronic database could not be possessed and thereby could not be the subject of lien.[537] However, the current law governing documentary intangibles, especially bills of lading, are based on their legal possessibility and transferability.[538] As a result, the transfer of the electronic equivalents to documentary intangibles does not have the same effect as the transfer of the paper documents.

Although there have been some contractual-based workarounds, which are used in closed platforms, the rights under their eB/Ls can only be enforceable against the parties who also signed up to the contracts of the same platform; these rights allegedly cannot be enforced against the whole world like the rights from the possession of paper bills of lading.[539]

In addition, the advent of blockchain and distributed ledgers technology makes things possible which were impossible in the past, including making electronic records possessable.[540] For example, DLT can ensure the integrity of electronic documents and the authenticity of holders' identities, with which the electronic documents can be designed to be exclusively controllable.[541] Part of the reasons for this

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[534] Law Commission, *Digital assets: electronic trade documents: Report and Bill* (Law Comm 405, 2022), para 2.7.
[535] Law Commission, *Digital assets: electronic trade documents: Report and Bill* (Law Comm 405, 2022), Ch.2 and Ch.5.
[536] *OBG Ltd v Allen* [2007] UKHL 21, [2008] 1 AC 1, at [321].
[537] *Your Response Ltd v Datateam Businsness Media Ltd* [2014] EWCA Civ 281, [2015] QB 41, from [23]-[27].
[538] Law Commission, *Digital assets: electronic trade documents: Report and Bill* (Law Comm 405, 2022), para 2.7.
[539] Law Commission, *Digital assets: electronic trade documents: Report and Bill* (Law Comm 405, 2022), para 2.12; Law Commission, *Digital assets: electronic trade documents: a consultation paper* (CP 254, 2021), para 2.37.
[540] Law Commission, *Digital assets: electronic trade documents: Report and Bill* (Law Comm 405, 2022), para 2.21; Law Commission, *Digital assets: electronic trade documents: a consultation paper* (CP 254, 2021), Ch5 (Possessing electronic trade documents), it is submitted that certain electronic trade documents which meet certain criteria of possession can be factual and legally possessable.
[541] Law Commission, *Digital assets: electronic trade documents: Report and Bill* (Law Comm 405, 2022), Appendix 3; See Takahashi (n 464) p203.

proposal is the potential of DLT being used for replicating the functions of documentary intangibles, such as transferable bills of lading.[542]

The UK proposal shares the similar object as MLETR; it is aimed to make the electronic trade documents to have the same effect as trade documents in paper form. To achieve this purpose, the Proposal tries to extend the coverage of possessibility under English law to the electronic transferable documents that meet the criteria suggested in the draft Bill.[543]

An electronic trade document is, as the Law Commission proposed, amendable to possession if some criteria are met: if a reliable system is used to 1) identity the document so that it can be distinguished from any copies; 2) protect the document against unauthorised alteration; 3) secure that it is not possible for more than one person to exercise control of the document at any one time; 4) allow any person who is able to exercise control of the document to demonstrate that the person is able to do so, and; 5) secure that a transfer of the document has effect to deprive any person who was able to exercise control of the document immediately before the transfer of the ability to do so (except to the extent that the person is able to exercise control by virtue of being a transferee).[544] For these purposes, exercising "control of a document" equates using, transferring or otherwise disposing of the document.[545] The eB/L platforms based on DLT can satisfy these requirements and thereby be amendable to possession according to the draft Bill.[546]

Under the draft Bill, a person can "possess, indorse and part with possession of" or do "anything done in relation to an electronic trade document that corresponds to anything that could be done in relation to the equivalent paper trade document", with the same effect as the equivalent paper trade document.[547]

Regarding using the electronic trade documents as pledged asset, the Law Commission proposed that, after the electronic trade documents being possessable, it should be able to be the subject of pledge.[548] Since one of the reform principles is to adopt the least interventionist approach, it is the Law Commission's intention that electronic trade documents should be capable of being the subject matter

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[542] Law Commission, Digital assets: *electronic trade documents: a consultation paper* (CP 254, 2021), para 2.48.
[543] Law Commission, Digital assets: electronic trade documents: Report and Bill (Law Comm 405, 2022), Ch.7.
[544] Electronic Trade Documents Bill, s.2(1).
[545] Electronic Trade Documents Bill, s.2(2)(a).
[546] See Law Commission, Digital assets: electronic trade documents: a consultation paper (CP 254, 2021), para 6.166-6.172.
[547] Electronic Trade Documents Bill, s.3.
[548] Law Commission, Digital assets: electronic trade documents: Report and Bill (Law Comm 405, 2022), para 8.24-8.37.

of pledge in the same ways and for the same purposes as paper trade documents.[549] Therefore, when the prospective pledgee takes possession of the electronic trade documents, its pledge become perfected.[550]

The Law Commission addressed the distinction between the pledge of a private key itself and the pledge of the eB/Ls under open platforms, which was that the former might not be sufficient to establish a transfer of possession, subject to court's findings in each case.[551]

7.2.2.2 MLETR

The purpose of MLETR is to enable the legal use of electronic transferable records both domestically and across borders.

Until it has been transposed into binding domestic legislation, it does not have the effect of law. At the time of writing, there are only three jurisdictions has adopted MLETR as domestic legislations: Bahrain, Singapore, and Abu Dhabi Global Market.[552]

One of the principles to achieve its aim is functional equivalence. This is reflected by Art 11, which provided that the legal requirement of possession or transfer of possession of transferable documents or instruments is met by the exclusive control or the transfer thereof in respect of their electronic counterparts.

MLETR regards control of electronic transferable records as functional equivalent to physical possession of their paper counterparts, provided that a reliable method is used to establish the exclusive control of that electronic transferable records by a person and to identify that person as the person in control.[553]

According to the definition of "transferable documents or instruments" under Art 2, MLETR covers order bills of lading which are recognized as documents of title at common law. Hence, when it is required by law for delivery of an order bill of lading, such requirement would be fulfilled by transfer of the exclusive control of the electronic transferable records which is designed to be an eB/L. Such "electronic transferable records" designed to replace paper bills of lading must meet the conditions

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[549] Law Commission, Digital assets: electronic trade documents: Report and Bill (Law Comm 405, 2022), para 8.23.
[550] Law Commission, *Digital assets: electronic trade documents: Report and Bill* (Law Comm 405, 2022), para 8.26.
[551] Law Commission, *Digital assets: electronic trade documents: Report and Bill* (Law Comm 405, 2022), para 8.28.
[552] See https://uncitral.un.org/en/texts/ecommerce/modellaw/electronic_transferable_records/status.
[553] UNCITRAL Model Law on Electronic Transferable Records, Art 11.

under Art 10. Art 10 requires the electronic transferable record to contain "the information that would be required to be contained in a transferable document or instrument" and to use a reliable method to "identify that electronic record as the electronic transferable record" and "render that electronic record capable of being subject to control from its creation until it ceases to have any effect or validity" and "retain the integrity of that electronic record".[554]

Both Art 10 and 11 have referred to a "reliable method"; and the requirements of reliability are stipulated in Art 12.[555] It has been submitted that both registry model and token model meet these requirements.[556] This reflects its another principle, namely technology neutrality. Therefore, the eB/Ls under open platforms, which use DLT/token model, must fall within the definition of "electronic transferable records" and compatible to MLETR.

Art 1(2) expresses that MLETR is not designed to affect the substantive law in respect of transferable documents or instruments.[557] For example, using electronic transferable records as collateral for security purposes is the issue which is the matter of substantive law.[558] The provision specifically related to using electronic transferable records as security in secured transactions was initially included in the Model Law; but, eventually, it has been taken out because the drafters of the Model Law thought the ability to use electronic transferable records as collateral would be the obvious result of Art 1(2).[559] Therefore, the validity of pledge is still governed by the substantive law. Even though the law governing the validity of pledge created through paper bills of lading does not refer to their electronic equivalents, it would affect the validity of pledge created through eB/Ls if MLERT was ratified. For creating a pledge on the goods, the common law requires a transfer of the transferable bill of lading representing the goods. Under MLETR, this requirement can be (not necessarily) met by a transfer of the exclusive control on the relevant electronic transferable records.

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[554] UNCITRAL Model Law on Electronic Transferable Records, Art 10; see also Elson Ong, "Blockchain Bills of Lading and the UNICITRAL Model Law on Electronic Transferable Records"(2020) 3 Journal of Business Law 202, at p210, it is submitted that the wording of Art 10 is ambiguous, so it should be changed into "where the law recognises a transferable document or instrument, that recognition and enforceability is given to an electronic record."

[555] This is different from the Rotterdam Rules which have left the requirements of reliability to be determined by the parties themselves, see the Rotterdam Rules, Art 9.

[556] See https://uncitral.un.org/en/texts/ecommerce/modellaw/electronic_transferable_records; Goldby (n 9) para 6.128; Jung-Ho Yang, 'Applicability of Blockchain Based Bill of Lading under the Rotterdam Rules and UNCITRAL Model Law on Electronic Transferable Records' (2019) 23 Journal of Korea Trade 113; see also Elson Ong, 'Blockchain Bills of Lading and the UNCITRAL Model Law on Electronic Transferable Records' Journal of business law, it is submitted that, although MLETR can apply to both models, the registry model is generally not compatible with the transferability of bills of lading.

[557] UNCITRAL Model Law on Electronic Transferable Records, Art 1(2): "Other than as provided for in this Law, nothing in this Law affects the application to an electronic transferable record of any rule of law governing a transferable document or instrument including any rule of law applicable to consumer protection."

[558] UNCITRAL Model Law on Electronic Transferable Records, Explanatory Note to MLETR, at [24].

[559] United Nations Document A/CN.9/834 (2015), para73; Henry D Gabriel, 'THE UNCITRAL Model Law on Electronic Transferable Records' (2019) 24 Uniform Law Review 261.

7.2.2.3 Comparison between MLETR and UK Proposal

To recognize the legal effect of using electronic documents in international trade, MLETR and UK proposal use slightly different approaches.

As mentioned earlier, MLETR uses functional equivalent approach. An electronic record is regarded as the functional equivalent to a transferable paper document or instrument if several requirements listed in Art 10 are met. Where the law requires the possession of a transferable paper document or instrument, that requirement is met by the exclusive control of an electronic record. As such, MLETR considers exclusive control as the functional equivalent of possession. It develops a concept distinct from possess in the digital context.[560]

By contrast, UK proposal does not rely on the concept of control. It simply expands the concept of possession in the paper context to cover possession of the electronic trade documents. But only the electronic trade documents which fulfil the requirement under s.2(1) is amendable to possession.

Despite of the subtle difference between these two regimes, they share the common approach in nature. Both approaches try to equate the legal effect around possession of electronic trade documents to that of their paper counterparts. Such difference between them can be justified by the UK Proposal's need to cater for the UK law and to benefit from the existing law on possession.[561]

Therefore, the following discussion related to open-platform eB/Ls will use the phrase "functional equivalence approach" to refer both MLETR and UK proposal.

Since an open platform is permissionless, every party in a letter of credit transaction (as long as it has the basic infrastructure, such as access to internet) can join the platform without signing up an agreement in advance. And those "functional equivalence" initiatives do not deal with the substantive law, including the law of secured transactions. So, the basic workflow of a letter of credit transaction presumably would not change a lot, except that the paper bill of lading will be replaced by an eB/L transferring within the platform.

7.3 Same Factors, Different Context

Two main categories of eB/Ls and their measures to digitally replicate functions of paper bills of lading, especially document-of-title function, have been elaborated and compared in the paragraphs

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[560] Law Commission, *Digital assets: electronic trade documents: a consultation paper* (CP 254, 2021), para 5.135.
[561] Law Commission, *Digital assets: electronic trade documents: Report and Bill* (Law Comm 405, 2022), para 2.74.

above. The closed platforms are using attornment approach to achieve the replication; meanwhile, the open platforms are currently impossible to replicate this function without legislative interventions. There have been several initiatives trying to copy this function on eB/Ls, domestically and internationally; among them, MLETR and the UK proposal are the ones using the "functional equivalence" approach to achieve it. Assuming these initiatives are adopted under English law, it is suggested that the requirement of transfer of a paper bill of lading can be fulfilled by the transfer of the control of an eB/Ls under an open platform.

Therefore, the following discussions will be based on these two approaches trying to replicate the document-of-title function of paper bills of lading into eB/Ls: 1) Attornment approach in closed platforms; 2) Exclusive control approach in open platforms.

It is worth noticing that this categorisation does not suggest that "exclusive control" approach is only applied in open platforms. Since all the users can be linked contractually in closed platforms, there is assumably less need for legislative intervention than in open platforms.

From the previous chapters, it has been argued that the bank's security under a letter of credit transaction could be negatively affected by several factors that might occur at the different stages. The discussion has been divided into three parts: 1) before transferring of bills of lading; 2) at the transfer of bills of lading, and 3) after the transfer of bills of lading. The same factors might still exist after paper bills of lading are replaced by eB/Ls, either in closed or in open platforms. There have not been any literature discussing these factors in the digital context, let alone the authorities. Therefore, it is important to test the legal certainty of eB/L under letter of credit transactions before eB/Ls are widely used or before the adoption of the "functional equivalence" approach.

Since the previous discussions related to paper bills of lading are divided into three parts, the following discussion will also be ongoing with the same sequence.

7.3.1 Before Transfer of eB/L

In the previous discussions, there are two situations which might happen before transfer of paper bills of lading to financing banks: 1) where the underlying goods have been delivered without presentation of the bill of lading; 2) where the ownership in the underlying goods has been transferred to the buyer.

Will these situations affect the bank's security interest in the digital context as they do in the paper world?

7.3.1.1 Goods Discharged before Transfer of eB/Ls

In the paper world, when the goods have already been discharged at the time of transferring the paper bill of lading, it is submitted that the bank is unlikely to become a pledgee on the goods unless the delivery was made to the person not entitled under the bills of lading without presentation of the bill.[562]

Replacing paper bills of lading with eB/Ls will dramatically decrease the time cost on documentation transmission. It is natural to think that the goods will not arrive earlier than eB/Ls. However, this is not true. A similar concern might still arise in the digital world. One of the fundamental reasons for this situation happening is that the goods arrive before the documents; as a result, the consignee does not have the bill of lading to claim delivery from the carrier. The reason for the late arrival of the document can be varied. As for paper documents, the main reasons are time-consuming postage and examination through banking channel. Although digitizing documents can fix the postage problem, it cannot fix the latter.[563] Documentation examination still requires manual checking and examining. This process cannot be automated yet. The eUCP does not alter the provision that the banks have a maximum of five working days to determine whether the documents are compliant or not.[564] It is not uncommon to have several banks involved in one transaction; when the examination time of each bank accumulates, it is not surprising (though not common) for the electronic documents to arrive later than the goods themselves.

Although it is much easier to access the information about the goods, including whether they have been discharged, banks are not allowed to reject documents on the ground that the underlying goods have been delivered. Presumably, using eB/Ls to replace paper bills of lading will still face the similar problems.

7.3.1.1.1 Closed Platforms

In the paper world, when the goods have been discharged before the seller transfers the bill of lading to his bank, the bank's security to some extent depends on whether the bill has become exhausted at the material time.

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[562] See discussion in Chapter 3.
[563] See Bolero, 'Electronic Bills of Lading for Carriers Frequently Asked Questions' https://www.nepia.com/media/66269/eBL-FAQs-BOLERO-Oct-2013.PDF , at p1, Bolero claims that they can significantly reduce the likelihood of goods arriving before the eB/Ls and therefore reduce the requirement for letter of indemnity, but it does not address the time for document examination under letters of credit.
[564] See UCP 600, Art 14(b).

The biggest difference between pledge of paper bills of lading and that of closed-platform eB/Ls is that: the former relies on the document-of-title character of bills of lading, but the latter does not; instead, the latter relies on the attornment mechanism. Therefore, the problem is not whether the eB/L has exhausted as a document of title. Instead, the question should be whether a carrier can make an attornment when it does not actually possess the goods. It is submitted by the author that a carrier is unable to do so.

Attornment is an acknowledgement of the actual holder that he is holding the goods as a bailee of the attornee. When a carrier has delivered the goods, its subsequent acknowledgment that he will hold the goods for someone else is meaningless, because a carrier cannot "acknowledge" to hold something for somebody while it in fact does not hold the thing. Therefore, it is suggested that any subsequent "acknowledgement" after the goods is discharged will not give the attornee constructive possession of the goods.[565]

Accordingly, when the carrier discharged the goods without presentation of the related eB/L, any subsequent acknowledgement made by him will not have any legal effect on transferring the constructive possession. As such, if the seller transferred the control of the eB/L to his bank after the goods have been discharged, the bank, though would be recorded as a Holder of the eB/L, would not become a pledgee on the goods.

In this situation, the bank could have a right to sue the carrier in contract. Under the contractual nexus of closed platforms, carriers are only allowed to deliver the goods to the Holder, or to its order, against the surrender of the eB/Ls.[566] A carrier who delivers the goods without the surrender of the eB/L is liable for misdelivery under the contract of carriage; and, since the contractual rights and liabilities are transferred through novations within the platform, the current Holder of the eB/L has a right to sue the carrier in contract.[567] If the ownership of the goods is transferred to the next Holder, it might have a right to sue in tort as well, because the owner has the right to immediate possession of the goods after the goods are misdelivered; but if the transfer of the eB/L is only for a pledge, the Holder will not have a title to sue in tort, because the constructive possession has not transferred to him; neither can the Holder of the eB/L sue the carrier in bailment, because the attornment made to him is ineffective.

Accordingly, the subsequent Holder of an eB/L, especially the purported Pledgee Holder, will be in a difficult situation if he receives the eB/L after the goods are discharged. No constructive possession would arise from the carrier's attornment. Therefore, the advanced discharge of the goods will

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[565] See e.g. Colin & Shields v W Weddel & Co Ltd [1952] 2 Lloyd's Rep 9.
[566] See Bolero Rulebook, Rule 3.6(1).
[567] See Bolero Rulebook, Rule 3.5.

significantly affect the bank's security in closed platforms. From this sense, it seems that replacing paper bills of lading with closed-platform eB/Ls would magnify this factor rather than revolve it.

7.3.1.1.2 Open Platforms

As shown in the previous discussion, the digitization of paper bills of lading will not eliminate the possibility that the goods arrive earlier than eB/Ls, so that similar concerns to the closed platforms might also bother the open platforms eB/Ls users after the enactment of the draft Bill.

The purpose of the UK proposal is to address the so-called "possessibility problem" of digital documents. Specifically, the problem of current English law in this regard is that the electronic alternatives to trade documents, whose legal effect are reliance on their possessibility, cannot be "possessed" in the eyes of law. To remedy this problem, the draft Bill was introduced to give the usage of eB/Ls the same legal treatment as that of their paper equivalent.

However, the proposal will not change the substantive law. As mentioned earlier, a pledge on eB/L in an open platform will still be governed by the common law which requires a delivery of possession of the goods. If the law sees a delivery of a bill of lading as a delivery of the goods themselves, the delivery requirement will be fulfilled by a transfer of the control of the eB/L.

But, in some certain situation, if the common law renders the transfer of the bill of lading having no such effect, neither have the transfer of eB/Ls. It was argued in the previous chapter that a paper bill of lading will be exhausted as a document of title once the carrier delivers the goods to the person entitled under the bill of lading, and this is true even though the delivery is made without presentation of the bill of lading.[568] Therefore, any subsequent transfer of the bill of lading will not have the effect of transferring the constructive possession of the goods. The question is who the person "entitled under the bill of lading" is in the digital context.

In the paper world, the person entitled is the one who is entitled to claim delivery if he has surrendered the bill of lading to the carrier or to transfer the bill of lading by delivery and/indorsement. The "surrender", "transfer" or "indorsement" of an eB/L is considered by "functional equivalence" approach as having the same effect as their paper counterparts.[569] Accordingly, the answer to the question who the person "entitled under the bill of lading" should be the same in the digital context; this person should be one who is entitled to claim delivery from the carrier with the surrender of the eB/L or to transfer the control of the eB/L with proper indorsement, if necessary.

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[568] See discussion in 3.3.
[569] E.g. Electronic Trade Documents Bill, s3(3).

The threat to bank's security in this situation is the possibility that, before the seller transfers the bill of lading to his bank, the goods have been discharged to the person who was the person entitled to delivery under the bill at that time. The reasons for the person "entitled under the bill of lading" not surrendering his bill of lading to the carrier (except that he intentionally conceals the bill) in the paper world are: 1) the bill of lading is still on the way to the person "entitled" due to postage delay; 2) the bill of lading is still in the possession of other financing banks who are not the persons "entitled" on the face of the bill.

After application of eB/L, the possibility of postage delay will be eliminated. When a person, who would be entitled to claim delivery had he surrendered the bill of lading, does not possess the bill, the absence of the bill cannot attribute to the postage delay; instead, the delay of the bill's arrival is most likely to be caused by the delay in the banking channels. As such, when the advanced discharge happened, the eB/L was most likely to be in the control of other banks. If, at the time of discharge, the holder bank in the last bank channel is the person entitled on the face of the eB/L (either the consignee in a to order eB/L or the holder of a bearer eB/L), the discharge of the goods without presentation of the eB/L would not exhaust the eB/L; if the holder bank was not the person entitled, an advanced discharged would render the eB/L spent, and the subsequent transfer of the eB/L by the seller, who received the eB/L from such holder bank, to the seller's bank in the current bank channel would not operate as transfer of the constructive possession of the goods.

One of the methods to restrict this risk is to prevent other parties than the holder from becoming the persons "entitled" under the eB/Ls. For example, if the eB/L is circulating in the banking channels, the bankers in these channels should make sure they are the person "entitled" until they get paid; and this can be done by requiring the eB/L to be indorsed to them or blank indorsed. This is achievable either by law or by design of the open platforms. If the law requires the creation of a pledge by bills of lading to be subject to the indorsement requirement, banks under letters of credit will require the bills of lading which are indorsed to them or blank indorsed. The same effect will be seen in the digital context as well. Therefore, the author's proposal would be the same as that in Chapter 5: the indorsement requirement need to be judicially or legislatively confirmed, to eliminate the risk of uncertainty.[570]

7.3.1.2 Before Transfer: Ownership Passes before Tender of eB/Ls

Regarding paper bills of lading, although some authorities suggested that a seller had to retain the ownership of goods at the time of pledge and was otherwise unable to pledge the goods to the financing bank, it is submitted that there is no such general ownership requirement for sellers to create

[570] See discussion in section 5.3.

a valid pledge for their buyers.[571] Moreover, when sellers retain the right to possession and become the bailees on terms for their buyers, they can still make a valid pledge in favour of the banks, even though the ownership of the underlying goods has been parted with. Besides, sellers can make a valid pledge even when they have not retained the right to possession, by applying s.24 of the Sale of Goods Act 1979 (seller in possession). If the contention of the author was correct, the fact that the ownership has passed before the seller tendering the bill of lading to the bank might not affect the bank's security very much.

The possibility for ownership in the goods passed before seller's tender of eB/L to their banks remains after paper bills of lading are replaced by eB/Ls. Neither closed platform nor open platform deals with transfer of ownership in underlying goods[572]; therefore, the related law is presumably the same as the paper world. The concern in this regard is whether the arguments applied in the discussion around paper bills of lading will become ineffective or less convincing in the digital context. If so, the fact that the ownership passed before the tender of eB/L might affect bank's security as pledgee.

7.3.1.2.1 Closed Platforms

Similar to the discussion about the advanced discharge in closed platforms, the legal risk to bank's security in the paper world is different from that in the digital world, because the whole mechanism for transferring constructive possession of the goods is changed. Unlike the paper world where it relies on the document of title character of the bill of lading, closed platforms rely on contractual nexus and platform operators' attornment. Therefore, the question in this section is whether the seller's lack of ownership will affect the validity of the attornment and thereby affect the bank's security as a pledgee on the underlying goods.

As suggested in the discussion in paper bills of lading context, there is no general requirement for the seller under a letter of credit transaction that he must have ownership in the goods otherwise he is not able to pledge the goods to the bank; other "present interests" than ownership might be enough for the seller to make a valid pledge. In the context of paper bills of lading, the "present interest" could be the interest held by a bailee on terms who has the implied authority to pledge. However, whether the seller has retained the right to possession ultimately depends on the intention of the parties, so it is uncertain that whether the seller has retained the right to possession so as to retain the ability to pass it to his bank through the bill of lading.

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[571] See discussion in Chapter 4.
[572] For closed platforms, see Bolero Rulebook, Rule 3.10 (1); cf. Law Commission, *Electronic Commerce: Formal Requirements in Commercial Transactions* (2001), para 5.10, it was said that, though Bolero did not deal with the title to goods, a buyer would become designated holder after the goods had been sold him.

In the case of eB/Ls in closed platforms, however, such intention is less important. In cases of transferring constructive possession by attornment, the transferor's intention might not be as important as that in case of bills of lading. When the constructive possession is transferred by the delivery of bills of lading, the intention of the parties is important. If the transferor does not intent to transfer the right to possession to the transferee via the bill of lading, the transferee will not have the immediate right to possession in the underlying goods, though he has a valid bill of lading. However, in cases of transferring constructive possession by attornment, the transferor's intention might not be as important as that in case of bills of lading. The carrier who has the actual possession of the goods is holding them as the shipper until he or his agent acknowledges that he will hold them as the bailee for another party. Though the carrier makes such acknowledgement based on the shipper's direction, this direction is impossible to take effect without the cooperation of the carrier.[573] Upon the acknowledgement of the custodier, he is estopped from denying the possessory title of the transferee, let alone the transferor. Once the transferor made an order to transfer the bailment to the transferee, he has consented to relinquish his possessory title; then, when the carrier accepts and acknowledges the order, the transferor is no longer the bailor, the transferee is.[574] By contrast, in the transfer of possession by the transmission of bills of lading, the carrier does not involve in the whole process until the discharge of the goods. Therefore, the intention of the parties in transferring the right to possession is less important than that in cases of bills of lading. Following that, until the carrier has attorned to others, the seller always remains the right to possession, regardless of the location of ownership in the goods; and until then, he always remains the ability to transfer the constructive possession to the bank.

In Bolero, its Rulebook is essentially a contract binding all the members and the operator. Although it is stipulated by the Rule 3.4.1(1) of Bolero Rulebook that the "constructive possession" is transferred by "designation", this is only a contractual term, by which alone a right to possession-a proprietary right-cannot be created. Nevertheless, such provision at least has the evidential effect of the party's intention to transfer the constructive possession by the action of "designation". Such intention will not take effect without the carrier's attornment. In Bolero, attornment is automatically made by the platform operator as the agent of the carriers once the current Holder has made an order of "designation". Once such attornment is made, both the transferor and the carrier cannot deny the transferee's possessory title to the underlying goods, unless the transferee himself rejects the transfer.[575]

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[573] See *Mercuria Energy Trading Pte Ltd v Citibank NA* [2015] EWHC 1481 (Comm); [2015] 1 CLC 999, at para 61; *Natixis SA v Marex Financial* [2019] 2 Lloyd's Rep 431, from para 240

[574] See *Dublin City Distillery v Doherty* [1914] AC 823, p864 (Lord Sumner).

[575] Bolero Rulebook, Rule 3.4.1(5) and (6); see *Godts v Rose* (1855) 139 ER 1059.

Since only the Holder of the transferable eB/L can make an order of "designation" to transfer the eB/L to another member, only the current Holder can pass the constructive possession of the goods to other members. The holder cannot retain the eB/L while transferring the right to possession to the buyer. If the transferor wants to retain his right to possession, he should not transfer the eB/L at all.

In conclusion, the fact that the ownership has passed before the eB/L will not affect the validity of attornment and consequently will not affect the bank's security as a pledgee on the goods; in other words, using closed-platform eB/Ls do solve this issue.

7.3.1.2.2 Open Platforms

Both MLETR and UK Proposal are using the "functional equivalence" approach to give legal effect to control of electronic trade documents. Also, they both leave the issue about the validity of pledge created by these electronic documents to the current law.[576]

As suggested above, in the context of paper bills of lading, whether a seller remains his ability to pledge ultimately depends on the parties' intention regarding transferring the right to possession of the goods. Since the "functional equivalence" initiatives will not change the substantive law, the suggestion above might be the same after the initiatives are adopted. After transferring the ownership of the goods to the buyer but retaining the eB/L, the seller under a letter of credit transaction could become a bailee for his buyer. For example, the UK proposal expressly suggests that the electronic trade documents meeting their criteria should be able to the subject of bailment;[577] hence, the eB/L can be the subject of the bailment. However, whether the seller in this situation is a bailment at will or a bailment on terms depends on the parties' intention; although an authority to pledge could be implied from the nature of letter of credit transactions, only a bailee on terms has the right to possession. Therefore, to retain his ability to pledge, the seller should intend to retain his right to possession of the underlying goods after passing the ownership to his buyer, by retaining the control of the eB/L. As such, the position of the bank in the context of open platforms is similar to that in paper world.

If the seller does not retain the right to possession by retaining the eB/L, can he acquire the power to pledge by the operation of s.24 of the Sale of Goods Act 1979?

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[576] UNCITRAL Model Law on Electronic Transferable Records, Art 1(2); for the UK Proposal, Miriam Goldby, 'The Proposal of the Law Commission of England and Wales for Reform in the Area of Electronic Documents' [2021] Journal of International Maritime Law 87, p88.

[577] Law Commission, Digital Assets: electronic trade documents: Report and Bill (Law Comm 405, 2022), para 2.70 and 3.71-3.72.

In the paper world, it is argued by the author that this section is applicable to the situation in discussion, so the bank could benefit from the protection against a seller in possession of a paper bill of lading after sale.[578] But it is not sure whether this section can still apply when the paper bills of lading are replaced by the eB/Ls after implement of "functional equivalence" approach.

The Sale of Goods Act 1979 does not expressly apply to electronic trade documents. It is unclear whether a seller with the "possession" of an eB/L could be regarded as a seller in possession for the purpose of s.24. This relies on the coverage of the term "document of title to goods" under this section. The definition of "document of title" under Sale of Goods Act 1979 refers to that under the Factors Act 1889, which provides that:[579]

> The expression "document of title" shall include any bill of lading, dock warrant, warehouse-keeper's certificate, and warrant or order for the delivery of goods, and any other document used in the ordinary course of business as proof of the possession or control of goods, or authorising or purporting to authorise, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented.

It has been argued that eB/Ls meet the requirements under this definition, because eB/Ls, like other paper documents of title to goods, are used as "proof of possession or control of goods, or authorising or purporting to authorise, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented" and used in the "ordinary course of business" in the digital context.[580] A paper bill of lading is within this definition, because it contains all the characteristics under this definition. This is the result of the current English law: the law gives its possessor the legal control over the underlying goods. If the "functional equivalent" approach was adopted, the law would see the controller of an eB/L as having the legal control over the goods as well. As such, there would be no difficulty to fit an eB/L which satisfies the requirements of these initiatives into the definition of "document of title" under the Factors Act 1889. Therefore, it is submitted that s.24 of the Sale of Goods Act 1979 applies to such eB/L.

If s.24 of the Sale of Goods Act 1979 applies to open platforms, can a seller with the control of the eB/L be regarded as the seller "continue in possession" "without notice of previous sale"?

As previous discussion, the main problem for a seller in possession of a paper bill of lading is whether a constructive delivery by him would break the continuance of possession for the purpose of s.24, and

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[578] See discussion in section 4.5.2.
[579] Factors Act 1889, s.1(4).
[580] Hugh Beale and Lowri Griffiths, 'Electronic Commerce: Formal Requirements in Commercial Transactions' [2002] Lloyd's Maritime and Commercial Law Quarterly 467, p468-469; cf. Todd (n 455) p356, it is assumed that eB/Ls do not meet the requirements of the definition of "document of title".

it was submitted that it would not. In author's opinion, this contention would remain the same after replacing paper bills of lading with open-platform eB/Ls.

The usage of eB/Ls does not affect the main arguments supporting this contention. In paper world, it is argued that a constructive delivery by the seller will not break the continuance of his possession; otherwise, the bank would bear an extra burden of investigation on the character under which the seller is holding the bill of lading; and it was the buyer rather than the bank should bear the risk of the seller's fraud, because it is the buyer enables the seller to commit the fraud, unless the bank has the notice about the fraud.[581] After using eB/Ls, these arguments remain effective. The fact that paper bills of lading are replaced by open platform eB/L does not change the position of those three parties and the balance among them. Therefore, it is submitted that a seller, who becomes a bailee on terms for his buyer after constructively delivering the eB/L to the buyer, is still regarded as a seller "continue in possession".

The next question is whether the bank receives the eB/L from the seller "without notice of previous sale". In the paper world, it is argued that a bank under a letter of credit should not be deemed as having the notice of previous sale even though it must be aware of the existence of the sale: the seller's possession of the bill of lading could mislead the bank to believe that the seller has the ownership in the underlying goods, or that, though the seller might not have the ownership, he must have the authority from the owner to pledge the bill of lading.[582]

The justification for the bank's belief lays in the nature of letter of credit transactions and is not relevant to media of trade documents. After adoption of the "functional equivalence" approach, the control of the eB/L should have the same legal effect as the possession of the paper bill of lading; therefore, having an eB/L in one's control should have the same indication about the holder's title to the underlying goods as possessing a paper bill of lading. Moreover, if a pledge of eB/L is regarded as having the same effect as a pledge of a paper bill of lading, the same inference from the letter of credit transactions could be drawn, namely that the seller would have the permission to pledge from the buyer on his behalf; as such, implied authority from the buyer to pledge could be found by courts.

Moreover, the usage of DLT in verification of each transfer of eB/Ls makes the control of an eB/L more reliable and convincing in terms of the misleading effect on the seller's title, which makes the bank more deserved to be protected by the law.

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[581] See discussion in section 4.5.2.1.
[582] See discussion in section 4.5.2.2.

Therefore, it is assumed that these justifications are still applicable in the digital context. As such, a bank should be regarded as having no notice of previous sale under s.24 of the Sale of Goods Act 1979.

In conclusion, the fact that replacing paper bills of lading with open platform eB/Ls and that the "functional equivalent" approach is adopted will not change the suggestion relating to paper worlds about bank's position in the situation when the ownership has passed to the buyer before tendering the bills of lading. Therefore, even though the ownership has passed to the buyer before pledging the eB/L to the bank, the seller might retain the ability to pledge, either by his interest as a bailee on terms with implied authority from the buyer or by the operation of the exception of *nemo dat* rule.

7.3.2 At the Transfer of eB/Ls

In the previous discussion, it has been addressed that there are two elements relevant to the validity of the transfer of a paper bill of lading: an intention to transfer constructive possession of the underlying goods and a proper indorsement, if necessary; and it is contended that the lack of either of them will render the transfer of the bill of lading ineffective regarding transferring the constructive possession.[583]

When paper bills of lading are replaced by eB/Ls, it is unclear how these elements affect the validity of transfer of eB/Ls. Therefore, the following paragraphs will discuss these two elements in the context of both closed platforms and open platforms.

7.3.2.1 Intention to Transfer Constructive Possession

In the context of paper bills of lading, it is submitted that, in order to transfer the constructive possession of the underlying goods, the transfer of the paper bill must be accompanied by an intention to transfer the constructive possession. In a letter of credit transaction, if a seller did not intend to transfer the constructive possession to his bank by the transfer of the bill of lading, his transfer of the bill did not thereby transfer the constructive possession to his bank, and consequently, no pledge would be created in the bank's favour.

However, the element of intention is less important in the context of closed platforms. Unlike the paper world where a transfer of constructive possession relies on the document of title character of the bill of lading, a transfer of constructive possession in closed platforms relies on the attornment mechanism. As previously discussed, the transferor's intention is not as important as the carrier's.[584]

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[583] See discussion in Chapter 5.
[584] See discussion in section 7.3.1.2.1.

Moreover, in Bolero, an intention to transfer constructive possession of the good can be found in the action of "designation".[585] When a holder of an eB/L makes a direction of designation to the platform operator, the latter will verify the direction and attorn to the transferee on behalf of the carrier who issues the eB/L accordingly; once the attornment is made, both the transferor and the carrier cannot deny the transferee's title to the goods. As such, the constructive possession is transferred to the transferee of the eB/L.

Accordingly, the requirement of intention will be automatically fulfilled every time when an eB/L in closed platform is transferred; hence, replacing paper bills of lading with closed-platform eB/Ls might bypass the requirement of intention for transferring constructive possession, so that the intention risk might be eliminated.

In the context of open platforms, the intention issue has been addressed by the UK proposal. In UK proposal, it expressly clarifies that the draft Bill should not be read as implying that the intention to possess is not required in the context of electronic trade documents.[586] The same clarification should also apply in the transfer of possession of the electronic trade documents; therefore, a transfer of eB/L should require an intention to transfer the constructive possession. The banks' position seemingly does not become better when using open-platform eB/Ls.

7.3.2.2 Proper Indorsement of eB/Ls

It has been argued in the past chapter that the proper indorsement is an essential requirement for transferring the constructive possession by transferring the paper bills of lading; this requirement is reflected by the relevant authorities and the customary usage of the bills of lading; moreover, the indorsement on the bill of lading could evidence the parties' intention to transfer the constructive possession, when there is no other special situation proving the contrary.[587]

Although there are still some debates in academia about the necessity of the indorsement requirement, both closed platforms and open platforms for eB/Ls consider it as an important requirement that must be fulfilled for transferring the constructive possession of the underlying goods.

In a closed platform, e.g., Bolero, although its mechanism for transferring constructive possession is attornment, where an indorsement is not needed, its process for transferring an eB/L process is copying the indorsement process of paper bills of lading.

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[585] Ibid; Bolero Rulebook, Rule 3.4.1.
[586] Law Commission, *Digital assets: electronic trade documents: Report and Bill* (Law Comm 405, 2022), para 7.21-7.25.
[587] See discussion in section 5.2.

The process for transferring constructive possession in Bolero is called "Designation".[588] The process of "designation" is that the current Holder of the eB/L designates a new Holder-to-order, a new Pledgee Holder, a new Bearer Holder, or; a Consignee Holder.[589] If he designates a Holder-to-order, the eB/L will become an electronic "to order" bill of lading.[590] If he designates a Bearer Holder, the eB/L will become an electronic bearer bill.[591] If the eB/L is designated to a Consignee Holder, it will become a non-transferable eB/L.[592] The first situation is similar to personal indorsement, and the second one similar to blank indorsement.

However, pledging an eB/L in Bolero has its own special process; pledging an eB/L could be completed by personal indorsement in favour of the pledgee or blank indorsement; besides, Bolero allows pledging an eB/L by transferring the holdership of eB/L without indorsement.[593] Nevertheless, if such Pledgee Holder wants to enforce his pledge, he has to become a Bearer Holder first, otherwise he cannot enforce his security.[594]

The purpose for such design might be to reduce the threshold for pledging an eB/L, by shifting the burden of indorsement from the creation of pledge to the enforcement of pledge. But this is achievable because of the design of the platform which allows the indorsement to happen automatically. Without such technology and design, the pledgee needs to bear the extra burden of indorsement to enforce his security interest.

Another purpose might be to give an option for the pledgee not to become a party of the carriage contract. Except that the designated pledgee is also the to order party of the eB/L, being a Pledgee Holder will not automatically become a party of contract of carriage, until he enforces his pledge over the eB/L.[595]

By comparison, a similar relief for banks becoming pledgees is unlikely to be given in open platforms.

Both the UK proposal and MLETR has expressly addressed the legal effect of indorsement of eB/Ls. In the s.3(3) of the draft Bill, it provides that:

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[588] Bolero Rulebook, Rule 3.4.1(1).
[589] Ibid.
[590] For definition of "Holder-to-order", see Bolero Rulebook, Rule 1(31).
[591] For definition of "Bearer Holder", see Bolero Rulebook, Rule 1(7).
[592] For definition of "Consignee Holder", see Bolero Rulebook, Rule 1(22).
[593] See discussion in section 7.2.1.1.
[594] See Bolero Rulebook, Rule 3.8 (1), a Pledgee Holder in Bolero is not allowed to surrender the eB/L to the carrier.
[595] See Bolero Rulebook, Rule 3.5.3 and 3.5.4.

> Anything done in relation to an electronic trade document that corresponds to anything that could be done in relation to the equivalent paper trade document has the same effect in relation to the electronic trade document as it would have in relation to the paper trade document.

Similarly, Art. 15 of the MLETR provides that:

> Where the law requires or permits the endorsement in any form of a transferable document or instrument, that requirement is met with respect to an electronic transferable record if the information required for the endorsement is included in the electronic transferable record…

Both initiatives try to recognize the legal effect of indorsement of eB/Ls. The driving factor for them making stipulations specifically for indorsement requirement is that the indorsement requirement is necessary for transferring constructive possession of the underlying goods. In the consultation paper of the UK proposal, it explained the importance of indorsement requirement in documentary trade as "part of the process of transferring transferable documents, a process which must be followed if the transfer is to be recognised as legally valid."[596] As such, the draft Bill expressly provided that an electronic trade document can be indorsed.[597]

In the discussion of paper bills of lading, it is submitted that the English law shall requires indorsement of bills of lading, both in sale and in pledge; if so, the same requirement would be fulfilled by indorsement of eB/Ls after the "functional equivalence" initiatives were adopted; and, a transfer of eB/L without indorsement, if needed, would not give the transferee the constructive possession of the underlying goods; therefore, a pledge of an eB/Ls without proper indorsement will not take effect as pledging the goods.

If open platforms try to achieve the same relief or to provide the same option to the person who wants to acquire special property over eB/L as Bolero, they must design the platforms specifically to tailor these needs. However, there is no motivation from the legal requirement to urge the platform designers to do so, unless this requirement becomes a widely accepted legal rule for transferring constructive possession; therefore, the author's proposal is, again, that English law shall find a way to legally confirm the indorsement requirement.

As far as the open platform is concerned, it is technically much easier and needed for it to follow the indorsement requirement if there is one, because the chain of indorsement can be verified through the audit trail by hashing technology;[598] as such, a transfer of an eB/L without proper indorsement in an

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[596] Law Commission, Digital assets: electronic trade documents: a consultation paper (CP 254, 2021), para 6.55.
[597] Electronic Trade Documents Bill, s.3(1).
[598] Law Commission, Digital assets: electronic trade documents: a consultation paper (CP 254, 2021), para 6.57.

open platform will not take effect after verifying by hash technology, because otherwise such transfer will break the chain of indorsement. This trait of open platforms make the indorsement requirement more feasible than any other contexts. As such, it is believed by the author that there is no reason not to embrace this requirement in the context of open platforms.

7.3.3 After Transferring eB/Ls

In paper world, there is a risk that the bank under a letter of credit will lose its security interest as a pledgee due to its acceptance of a trust receipt. When the pledged bill of lading was released by the issuing bank to his buyer against a trust receipt, the buyer will become a trustee for the issuing bank and obtain an authority to dispose of the bill of lading on its behalf. This practice enables the buyer to use the proceeds of sale to reimburse his bank so as to deal with the cashflow stress. However, by enabling the buyer to obtain the pledged bill of lading, the issuing bank places itself in a very unfavourable position that its security as pledgee would lose if the buyer fraudulently disposed the bill; for example, if the buyer pledged the bill of lading to another bank for his own interest, the security interest held by such bank might prevail over that of the issuing bank; that is because such bank could benefit from the protection provided by s.2 of the Factors Act 1889. From the previous discussion, it is found that, in case of a letter of credit transaction where a trust receipt is used, the thresholds for excluding such third-party bank from the protection of s.2 of the Factors Act 1889 are very high; therefore, if the buyer commits a fraud by repledging the pledged bill of lading to a *bona fide* third-party bank which receives it for value, the original issuing bank is likely to lose his security interest as pledgee.[599]

If the paper bill of lading were replaced by eB/Ls, would the usage of trust receipts still affect the bank's security?

First and foremost, it is necessary to examine whether a trust receipt will still be used in the letter of credit transaction after replacing paper bill with eB/Ls. The reason for using trust receipts under letter of credit transactions is to enable the pledgors/the debtors to relieve their cashflow burden, and a mere decrease in transmission time of documents will not have the same effect. Therefore, it is submitted that the usage of eB/L to replace paper bills of lading would not affect the need of trust receipts in letter of credit transactions.

Since the similar situation is possible to occur in digital context, the following parts will discuss whether the bank who has eB/Ls as pledged assets will still be under the risk of losing security interest by usage of trust receipts.

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[599] See discussion in section 6.2.

7.3.3.1 Closed Platforms

If, under the trust receipt situation, paper bills of lading were replaced by closed platform eB/Ls, such eB/Ls would only be transferred within their closed platforms. As mentioned above, it would be still possible for the parties under a letter of credit transaction to use a trust receipt to tackle with the cashflow tension. The buyer might issue a trust receipt to the bank, who has become pledgee by attornment, and ask it to transfer the eB/L to him (under Bolero, to designate him as the eB/L Holder);[600] after signing the trust receipt and transferring the eB/L by the bank, the buyer thereby becomes the trustee for the bank to sell the underlying goods on its behalf. Instead of selling the goods as trustee for the bank, the buyer fraudulently pledged the same eB/L to a third-party bank for his own interest. Will the security interest of the third-party prevail that of the original pledgee?

First and foremost, is the Factors Act 1889 applicable in cases of closed platforms at all?

Like the discussion about the applicability of s.24 of the Sale of Goods Act 1979 in the context of open platforms, the applicability of the Factors Act 1889 also relies on the definition of "document of title".[601] Within this definition, there are mainly three requirements to be met by the eB/L under closed platform: 1) it should be a "document"; 2) it must be used as the proof of possession or control of the underlying goods and authorising or purporting to authorise the "possessor" to transfer or receive the underlying goods; 3) it must be used in "ordinary course of business".

As for the "document" requirement, it has been argued by Law Commission that an eB/L under Bolero was essentially not an electronic equivalent of a paper bill of lading, but an "electronic contract for carriage".[602] Nevertheless, it might arguably satisfy the "document" requirement, because there was a consensus that information stored in an electronic form was a "document"[603] The author agrees with the view that the data stored in an electronic media should not be an barrier for applying the s.2 of the Factors Act 1889, especially when other requirements have been met.[604]

If a closed platform eB/L could be regarded as a "document" for the purpose of this section, the controller of such eB/L should be considered as the "possessor" within the definition of "document of title".

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[600] In Bolero, Pledgee Holder is allowed to make a designation, see Bolero Rulebook Rule 3.4.1 (1).
[601] See discussion in fn 579-580.
[602] Law Commission, *Electronic Commerce: Formal Requirements in Commercial Transactions* (19 December 2001) para 4.7.
[603] Law Commission, *Electronic Commerce: Formal Requirements in Commercial Transactions* (19 December 2001) para 4.7; see Victor Chandler International v Customs and Excise Commissioners [2000] 1 WLR 1296.
[604] See Law Commission, *Electronic Commerce: Formal Requirements in Commercial Transactions* (19 December 2001) para 5.8.

As to the "ordinary course of business", it should be read together with the second requirement.

Is a closed platform eB/L used as a proof of "the possession or control of goods, or authorising or purporting to authorise, either by endorsement or by delivery, the possessor of the document to transfer or receive goods thereby represented"? Although such eB/L cannot be a proof of the "possession" of goods, it could be that of "control" of the goods. "Control" here refers to the possessory right of the goods of which another has the actual possession.[605] That could explain why dock warrants and warehouse-keeper's certificate are regarded as "document of title" by the Factors Act 1889.[606] The transfer of the "control" of goods under these documents relies on the actual possessor's attornment. In closed platform, transfer of constructive possession of the underlying goods also relies on attornment. Therefore, such eB/Ls satisfy the second requirement.

When the members of a closed platform agree to use the eB/Ls to replace paper bills of lading, they also agree to adapt their business into the new mode of transaction, namely using eB/Ls to fulfil their delivery obligations. As such, it will make no sense to interpret the "ordinary course of business" with the same meaning as that in paper worlds; so, its interpretation should be adapted to the context of closed platforms.[607]

In conclusion, the Factors Act 1889 is applicable to closed platform eB/Ls.

The following question is whether the third party, who received the eB/L within the closed platform, has the notice that "the person making the disposition has not authority to make the [pledge]."[608]

It is clear that, if the third-party bank is not the member of the closed platform, it would be regarded as without notice of the original pledge. That is because the title registry in the closed platform is not open to public and is not aligned with the existing public registry; the information within this registry cannot bind anyone who is not the member of the platform.[609] However, it is less clear when the third party is also the member of the closed platform.

Under Bolero, it uses Title Registry to record the holdership and status of each eB/L;[610] however, it only records the current holdership and status of each eB/L (at least for normal members). A Holder of an eB/L could be regarded as "Pledgee Holder" by the Title Registry, and such "Pledgee Holder" is

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[605] *The Saetta* [1993] 2 Lloyd's Rep 268.
[606] Factors Act 1889, s.1(4).
[607] See Law Commission, *Electronic Commerce: Formal Requirements in Commercial Transactions* (19 December 2001) para 5.8.
[608] Factors Act 1889, s2(1).
[609] See Dubovec (n 458) p453.
[610] Bolero Rulebook, Rule 1.1(53): Title Registry is an application operated by Bolero International and providing: (a) the means to execute the functions relating to Holdership and transfer of Bolero Bill of Lading; (b) a record of the status of current Bolero Bills of Lading; and (c) an audit trail of dealings with such Bolero Bills of Lading.

entitled to transfer the eB/L by designation. However, once the "Pledgee Holder" transfer the eB/L to another member, including the pledgor, the latter would become the Holder and is thereby entitled to all rights under eB/L. At the same time, the Title Registry would record the new Holder as the current Holder of the eB/L. As such, any other member who subsequently deals with this Holder cannot be aware of the existence of the original pledge and is therefore consider as "without notice" for the purpose of s.2 of the Factors Act 1889.

In conclusion, even though paper bills of lading are replaced by the closed platform eB/Ls, the third-party bank under trust receipt situation is likely to be entitled to the s.2 protection.

From the discussion above, the question of whether such third party who is one of the members in the same platform can be regarded as "without notice" depends on the design of the Title Registry. He is not regarded as "without notice" because the current Registry does not show the previous pledge of the same eB/L. The crux for the risk of bank's security in this situation is the invisibility of its security interest as pledgee. This can be achievable by the design of platforms that enables their members to access the records of each transfer of eB/Ls; if so, the third party, in the author's opinion, could not be regarded as "without notice" anymore;[611] however, in practice, it is unlikely for a closed platform so designed, because the history of holdership can be sensitive to its users. This can be reflected from the fact that the carrier is blocked from accessing the transfer record of the eB/L it issued.[612] Therefore, no pressure, either from stakeholders or from law, is borne by platform designers to make such interest visible. In order to urge them to redesign the platforms accordingly, the relevant law shall be proposed. For this purpose, a legal requirement for registering this piacular type of security interests might be a solution, subject to the same preconditions discussed in the context of paper bills of lading.[613] And the detailed analysis and examination of this proposal will be at the Section 7.3.3.3 of this thesis.

7.3.3.2 Open Platforms

In the context of open platforms, the first question is still whether the Factors Act 1889 applies at all. This question has been discussed in the previous sections, and it was suggested that the Act was applicable in the context of open platforms.[614]

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[611] He could be regarded as having the "constructive notice", see discussion in section 6.2.2.4.2.
[612] See Bolero, 'Electronic Bills of Lading for Carriers Frequently Asked Questions' https://www.nepia.com/media/66269/eBL-FAQs-BOLERO-Oct-2013.PDF , at p5, the carrier users in Bolero will not be automatically shown the history of movement of the eB/L they issued.
[613] See discussion in section 6.4.
[614] See discussion in section 7.3.1.2.2.

As to the applicability of s.2 of the Factors Act 1889, the conclusion would be the same as that in the context of closed platforms. The only uncertainty is on the "without notice" requirement: is a third party who receives an eB/L via DLT from the pledgor allowed to argue that he has no notice about the defect of the pledgor's authority?

It is suggested by the author that such a third party would still not be regarded as having notice about the existence of the previous pledge. The mere fact that open platforms are integrating DLT into their performance does not place a third party of the trust receipt into a better position to investigate the buyer's title. Although all the history of transfer of eB/Ls will be recorded in the Distributed Ledgers, these records are mainly used for authenticating the validity of each transfer of an eB/L, so that it can avoid "double spending" of the same eB/L.[615] As to the title and interests behind the holdership of each eB/L, this is the matter of substantive law. Moreover, with implement of DLT in open platforms, the third party will have more confidence in the buyer's control of the eB/L, because the eB/L controlled by the buyer must be authentic.

Since the question whether the buyer's title is defective or not is the matter of substantive law, the adoption of the "functional equivalence" initiatives would not change the third party's position. The benefit of adopting the "functional equivalent" approach is give legal effect to the control of eB/Ls as the possession of their paper counterparts; it tackles the possessibility of eB/Ls in the eyes of law. It does not, and does not intend to, change the legal position of holders of eB/Ls. Therefore, if such third party could be regarded as "without notice" in the paper worlds, he should be so regarded in the context of open platforms as well.

In conclusion, the third party in the trust receipt situation is likely to be protected by s.2 of the Factors Act 1889 even when paper bills of lading are replaced by open-platform eB/Ls.

7.3.3.3 Need of Registration Requirement

As discussed above, replacing paper bills of lading with eB/Ls, either in closed platforms or in open platforms, is unlikely to reverse the issuing bank's position in the "double pledge" dilemma; the bank's security will still be at risk if a trust receipt is used in the letter of credit transaction.

Using eB/Ls will not increase the chance for a third party to be aware of the previous pledge, unless the platforms themselves design a method to notify the pledgee's interest. However, there is lack of motivation for these platforms to be so designed; as such, there should be a legal requirement which will match the need for notifying the security interest.

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[615] See discussion in section 7.1.3.

When the "double pledge" problem first occurred, there was a discussion on whether a pledgee's interest should be registrable as a charge after the pledged bill of lading was released to his pledgor against a trust receipt. But the suggestion on registration was not accepted. After replacing paper bills of lading with eB/Ls, many arguments against registration requirement become less effective and less convincing. When eB/L platform integrates with DLT, it makes what is impossible becomes possible. As such, it is good timing to reconsider the registration requirement of pledges in the trust receipt situation.

It is worth noticing that registration is normally not required in the case of pledge, because possession of the creditor has already been a strong notice about the existence of the security interest; therefore, a pledgee with the possession of the pledged asset has the priority over other creditors of his pledgor. But once the pledged asset is redelivered to the pledgor, the notice function of possession is lost. Any third-party creditor can rely on the debtor's possession of the asset to assume he has the title thereof. Therefore, it was suggested that a registration requirement was necessary for this scenario.

This suggestion was once proposed by Law Commission when discussing the reform on company security interests.[616] At the time of discussion, the security interest that was held by a pledgee after he has redelivered the pledged asset to his pledgor against a trust receipt was regarded as not registrable under the Companies Act by case law.[617] It was argued that the trust receipt did not create a charge but simply enabled the pledgee to realize a pledge which existed before.[618] And it was argued that it was not registrable as a bill of sale either, because, apart from the reason that a trust receipt did not create a charge, it was likely to fall into the exception in s4 of the Bills of Sale Act 1878, which was "documents used in the ordinary course of business as proof of the possession or control of goods, or authorising or purporting to authorise, either by indorsement or by delivery, the possessor of such document to transfer or receive goods thereby represented".[619]

Once the pledged asset is redelivered to the pledgor, the possession of the pledgor would constitute a false wealth of the pledgor. But since such an arrangement will normally be of short duration, it does not seem to pose a great threat to third parties. It is unlikely to mislead other creditors thinking the debtor owns the assets.[620]

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[616] For the general discussion, see Law Commission, *Company Security Interests* (Law Com No. 296, 2005) 3.22-3.25; see also Beale and others (n 42) para 11.25.
[617] *Re David Allester* [1922] 2 Ch 211.
[618] *Re David Allester* [1922] 2 Ch 211.
[619] *In Re Hamilton Young*, a trust receipt was held to be a document "used in the ordinary course of business as proof of the possession and control of goods" under s.4 of the Bills of Sale Act 1878; cf. it was argued that these reasoning relied on the specific wording of the trust receipts: E.P. Ellinger (n 451).
[620] Law Commission, *Company Security Interests* (Law Com No. 296, 2005), para 3.22.

But if such arrangement lasts for longer time, it might still mislead other creditors, as it constitutes a form of non-possessory security. Therefore, it was proposed that such security interest should be registered within 15 days unless the collateral is returned to the creditor before that time.[621] Unfortunately, this proposal has not been adopted in the new Companies Act. It is doubtful whether the benefit from registration is real.

Moreover, imposing a registration requirement will increase the cost of business. It is expensive for compliance. Also, the goods in transit may be located in different jurisdictions, unless there is a universal registry, the goods might be subject to overlapping register requirements, which potentially will decrease the speed and convenience of the B/L's transfer and increase the burden of the traders.

There are some scholars suggesting that a pledgee interest under a trust receipt should be recharacterized as a charge and therefore should be registered. The main argument was that there was only little distinction between a trust receipt issued following a pledge, and one issued where there is no pre-existing pledge.[622] In the latter scenario, the reasoning of *Re David Allester* (a trust receipt did not create a charge but only enabled the pledgee to realize a pledge which existed before) is arguably not applicable.[623] Moreover, it was submitted that the trust receipt has created an interest in the proceeds of sale in favour of the pledgee, and such interest is categorized as a charge over book debts.[624] This type of charge was registrable under what was s.860(7)(f) of Companies Act 2006.[625] However, this suggestion has not been tested by English law.

In conclusion, the registration requirement is not preferrable in the paper world. But such conclusion might not be effective in digital context. When replacing paper bills of lading with eB/Ls, the speed of transactions has been dramatically increased, so has the frequency of transactions. Meanwhile, the amount of fraud cases has also increased in the area of letters of credit. The problem of fraud is necessary to be addressed, especially when it is justified to do so.

About the high cost of registration, this is a practical problem, so it should leave it to the community to deal with. Once all transactions can be completed digitally, the cost of compliance and filling registration would be very low. Especially when integrating with smart contracts, the process of registration could be automated. And there could be no extra burden for other third parties, who want to acquire property interest in the same underlying asset, to check the registry, since the registry, if

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[621] Law Commission, *Company Security Interests* (Law Com No. 296, 2005), para 3.25.
[622] See Beale and others (n 42) para 11.25. See Hugh Beale, Michael Bridge, Louise Gullifer, and Eva Lomnicka, *The Law of Security and Titled-based Financing* (3rd edn, OUP 2018), from para 11.25.
[623] See text in fn 618.
[624] See also E.P. Ellinger (n 451).
[625] The current law registration requirement does not differentiate between charges over book debts and over other types of assets.

any, could be interconnected with the location of eB/Ls, and they would need to check the location of eB/Ls whenever they want to make a deal with other traders who claim to have the eB/Ls.

As to the other argument that the duration of false wealth is status too short to mislead the other creditors, it is submitted that this is not tenable in the digital environment. When all process is completed digitally, the speed of each transaction is dramatically faster than in the paper world.

In the paper world, bills of lading might only be delivered few times before the goods arrive at the destination port. Imagine when the speed of transferring the bills is 10 times faster, how many transactions would have been done within one voyage of goods. The time for the eB/L staying in the control of each holder would generally be much shorter. At that time, there might be no difference between a normal business holding an eB/L and a debtor holding an eB/L as the trustee of his creditor. As such, the misleading argument is not working.

In conclusion, it is proposed by the author that a registration requirement is needed when a pledgee of an eB/L releases the eB/L to the pledgor against a trust receipt.

7.4 Conclusion on Bank's Security in Digital Context

The discussion about digitisation of bills of lading is still developing. Though the legal status of electronic bills of lading have not been recognised by English law, the efforts for the recognition have never stopped. Along with the invention of DLT, eB/Ls seem to be widely accepted as the promising future for the international transactions facilitated by carriage of goods by sea. The same hype is also developing in the trade finance. However, there have not been much discussion on banks' security under this era, despite the fact that banks' security is fundamental to the health of a trade finance system.

This chapter has examined the bank's security on eB/Ls, particularly by analysing the factors identified in the previous chapters which potentially will affect the bank's security in the paper worlds; it aimed to find out whether and how these factors affect the bank's security in the digital context.

Through the detailed discussion and analysis in this chapter, it is found that the bank's position in terms of security will be changed by the fact that the paper bill of lading is replaced by the eB/L and that the eB/L is issued under a closed platform or an open platform (under their respective legal models governing their legal effects).

As to the factor that the goods have been discharged in advance, holding a closed-platform eB/L will arguably make the bank's position even worse than that in the paper world, while its position with an

open-platform eB/L is more secured, provided that bankers stick to the indorsement requirement for transferring eB/Ls.

As to the factor that the ownership in the goods passes before the transfer of the eB/L, it is found that the position of the bank will not change significantly by the fact that the paper bill is replaced by an eB/L, either under a closed platform or under an open platform. Similar to its position in the paper world, the bank's security is unlikely to be affected by this factor. It is still worth noticing that banks will be more deserved to be protected if it holds an open-platform eB/L as its intended security under the situation where the ownership in the underlying goods has passed before the bank receives such eB/L; as such, it is recommended that an amendment is needed to adapt the UK proposal so that a bank under this situation is expressly protected by s.24 of Sale of Goods Act 1979.

The factor of the intention of the transferor is less influential in closed platforms than in the paper world; however, it might play the same role in open platforms. Such difference is due to their different mechanism for transferring constructive possession. Regarding the indorsement factor, it is found that the indorsement requirement will become more practically feasible in digital world, so it will arguably play a more important role in the transfer of constructive possession than in paper world.

For the factor of "double pledge" problem, it is submitted that, under either closed platforms or open platforms, bankers will be stuck in the same dilemma as they are in the paper world. That is because the usage of eB/Ls will not make the pledgee's interest more visible so that any third party will be informed about its existence. For this reason, it is argued by the author that registration is required for a pledge under which the pledged asset has been redelivered to the pledgor.

The legal status of eB/Ls, either of closed platforms or open platforms, has not been tested by English courts, neither has that of the bank's security on eB/Ls; so the analysis in this chapter requires a combination of the law in the paper world with the hypothesis that the respective governing legal initiative is adopted; nonetheless, the findings in these chapters can provide a perspective on the potential influence of digitalisation of bills of lading towards bank's security and constructive advice to policymaker about the measures that could enhance bank's position in the new era. Moreover, before such legal initiatives are adopted by the UK, this chapter can alert banks, who accept the currently available eB/Ls in closed platforms as security, to the potential risks that they might encounter.

Overall, the discussion in this chapter has filled the gap in the effect of bank's security on eB/Ls, under attornment models and functional equivalence models. It also has made its own contribution on how the UK proposal and MLETR will work and their drawbacks from the perspective of bank's security.

Chapter 8 Conclusions

Banks are the vast majority of the financers who provide “blood” to global commercial transactions, and their role is of vital importance to the operation of international trade. By financing international transactions of goods, bankers provide traders with a constant money stream to develop their business. Among many types of finance instruments, the letter of credit instrument is popular in international transactions, especially the transactions which are facilitated by carriage of goods by sea. It is supposed to be a MSME (micro, small, medium enterprises)-friendly trade finance instrument because the rate is relatively low. One of the reasons for banks willing to finance, either by letters of credit or by other financing instruments, is that they have security against the risk of their clients’ default of repayment. In this sense, to protect bank’s security is to protect the healthiness of the letter of credit system and consequently to the normal operation of the global trade system.

Despite the importance of bank’s security to letter of credit system, it is found by the thesis that banker’s position is not as secured as it appears. Instead, there are many inhere factors identified in this thesis, which might affect bank’s security as pledges under letter of credit transactions. Mostly, banks acquire their security from the bills of lading tendered by the sellers. At common law, the seller’s transfer of the bill of lading to the financing bank will ideally create a pledge of the underlying goods in the bank’s favour. However, the bank will not become a valid pledgee at every event after receiving the bill of lading from the seller because of these factors identified by the thesis.

Before, these factors had not been identified or discussed systematically by English courts or academics. Although some of the issues related to these factors have been discussed, they have not been analysed in the context of bank’s security under letters of credit. Together, all these factors contribute to the uncertainty of bank’s position in letters of credit transaction. If banks have little confidence in their security on bills of lading, they have to look for alternative security, which will increase the thresholds for opening a letter of credit; then, it will end up losing its advantage compared with other trade finance instruments and increasing the financial gap of MSMEs.

Moreover, the UK has taken its next step towards the digitisation of goods transactions, by proposing a draft Bill aiming to recognise the legal effect of eB/Ls. However, it is considered by the author that this is a risky step for bank’s security under letter of credit transactions. Except for the above-mentioned insufficiency of discussion on bank’s security on paper bills of lading, there are far fewer discussions on the validity of bank’s security on eB/Ls; let alone the thorough debate on the new draft Bill. Before fully knowing the inherent risks faced by the banks, rashly replacing paper bills with

eB/Ls might dramatically make bank's security more uncertain, because the same factors identified by the author might continue to affect bank's position in the digital world.

Considering the significance of the certainty of bank's security and the inadequacy of relevant discussions thereof, it is important and necessary to scrutinize these factors and explore the corresponding strategy under the paper world and the digital world.

Through the discussion on bank's security on paper bills of lading, there are five factors identified by the author:

1) The goods have been discharged before the seller's tender of the bill of lading. (addressed in Chapter 3)
2) The ownership in the goods has passed to the buyer before the seller's tender of the bill of lading. (addressed in Chapter 4)
3) The seller does not intend to transfer constructive possession to the bank through the transfer of the bill of lading. (addressed in Chapter 5)
4) The seller does not indorse the bill of lading properly (if necessary) to the bank when tendering the bill to the latter. (addressed in Chapter 5)
5) The buyer fraudulently disposes of the pledged bill of lading, which is redelivered by the bank against a trust receipt. (addressed in Chapter 6)

The first factor is essentially related to the question of when a bill of lading becomes spent so that the transfer thereof will not transfer the constructive possession of the goods. There is still divergence towards this question, which results in the uncertainty of bank's position when this factor occurs. As such, vagueness of law in this area should be swept away. It is submitted by the author that a delivery of the goods to the person "entitled" will exhaust the bill of lading as a document of title, even though the delivery is made without presentation of the bill, and that the person "entitled" must be the one who was entitled to claim delivery from the carrier on the face of the bill. This finding requires the person "entitled" must be the person to whom the bill of lading is delivered and/or properly indorsed, because other people, without proper indorsement, is not entitled to claim delivery or indorse the bill of lading even if he holds the bill of lading. Any discharge to this person, even without presentation of the bill, will render the bill become spent. This rule might render banks in an unfavourable position, but it could be tackled by the banks' practice and, which is more effective, the revise of the UCP.

The second factor comes from the strong indication in the authorities that the seller under a letter of credit transaction must retain his ownership in order to retain the ability to pledge the bill of lading to his bank. If the indication were correct, the passage of ownership, which depends entirely on the intention of the parties under the sale contract, would affect the validity of the creation of pledge, making bank's security on bills of lading significantly fragile. Such indication has been referred to

with approval by English courts and academics without further analysis of its correctness or its limitations. This leaves banks' position under the risk of being unsecured, because the location of the ownership seemingly would affect the validity of their pledges. In order to bring certainty to the law and banks' legal position in this regard, the correctness of such indication need to be examined. After detailed analysis on the authorities from which the indication is drawn and the principles of creation of security interests, it is doubted by the author that such indication might not be completely correct; instead, not only the owner has the ability to pledge under English law; it is submitted by the author that a seller, even though without ownership, might have the ability to pledge as a bailee on terms for the buyer. Moreover, even if such finding was not correct, a pledge made by the seller when the ownership has passed could still be valid by virtue of s.24 of the Sale of Goods Act 1979. The existent literature and authorities only drew a conclusion on its application in letter of credit transactions, but they did not examine the requirements of s.24 in the relevant context. The finding of this thesis, therefore, fills this gap in the area. Overall, it is found that bank's position is relatively secured even though the second factor occurs.

In terms of the third and the fourth factors, they occur at the transfer of the bill of lading. Though discussed separately under this thesis, these factors are connected with and mutually affect each other. Much literature has discussed their respective impacts on transfer of possession, but none has discussed their combined impact in the context of bank's security under letter of credit transactions. Under English law, intention to transfer constructive possession is necessary for a bill of lading to perform the document-of-title function. Such intention can be expressed or implied. It is submitted that the custom of merchants regarding the transfer of a bill of lading is one of the elements that the court will consider when interpreting the parties' intention to transfer the constructive possession of the underlying goods; the customary usage of bills of lading for transferring constructive possession includes a delivery of the bill as well as the proper indorsement of the bill. However, such intention cannot take effect without the transfer of the actual control over the underlying goods. The author submitted that a delivery of the bill of lading without properly indorsement could not transfer the actual control over the goods to the transferee. This submission is compatible with the previous submission about the first factor that the person "entitled" is the one who is entitled on the face of the bill of lading. Following that, a transfer of the bill of lading which is not indorsed to the bank or blank indorsed, shall not transfer the constructive possession to the bank. The requirement of proper indorsement, though is not judicially confirmed by the common law, is consistent with the legal rules around transferring constructive possession by bills of lading. Hence, it is proposed by the author that such requirement shall be officially confirmed.

The last factor is the most outstanding among all the factors identified by the thesis, because its impact on bank's security has not been challenged. Through the scrutiny on its reasoning, especially

the requirements under s.2 of Factors Act 1889, it is found by the author that, once the buyer fraudulently disposes the pledged bill of lading to a *bona fide* third party, the bank's interest as a pledgee is under the high risk of being overridden, because of the invisibility of a pledge after the secured asset being redelivered to the pledgor. In order to make such interest more visible to public, it is proposed by the author a registration requirement shall be imposed. However, the registration requirement has previously been proposed to fix this problem and was not adopted eventually. This requirement is difficult to fulfil and make positive impact to banks' security without the cooperation of suitable policy. Before then, bankers hardly can do anything to avoid the fraud except by being more cautious about the creditworthiness of their buyers.

Before the proposals provided above are taking effect, some practical suggestions for banks are proposed by the author, which might help them mitigate the risk of losing security in the paper world.

Before accepting the bill of lading tendered by the seller, banks should provide an indorsement requirement in their application form of letters of credit, to make sure the tendered bill of lading is either a "to order" bill or a "to bank's order" bill; by doing so, it can limit the possibility that, at the time of discharge, the person entitled under the bill does not have the bill of lading to surrender[626]; besides, since the indorsement requirement existed in the custom of merchants, and the customary usage of bills of lading can imply the parties' intention about the transfer of constructive possession, an indorsement of the bill can imply a *prima facie* intention in this regard; such *prima facie* intention is less likely to be rebutted provided that the goods have not been discharged at the time when the seller tenders the bill to the bank. More importantly, a proper indorsement can arguably indicate a transfer of the actual control over the underlying goods.[627]

Also, banks should make sure that a pledge provision is provided in their application form of letters of credit. Normally, most application forms provide a pledge provision, but some do not.[628] Such an agreement can imply a buyer's authority given to his seller to pledge the goods or the bill of lading to him, in case the ownership in the goods has passed to the buyer before the tender of the bill and that s.24 of Sale of Goods Act 1979 does not apply. [629]

Even if some of the banks adopted the suggestions above, these banks could not ensure other banks would adopt them as well. If other banks did not stick to the indorsement requirement, the risk under

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[626] See discussion in section 3.4.
[627] See discussion in Chapter 5
[628] E.g., a detailed pledge agreement is provided under HSBC's Standard Trade Terms, which is expressly incorporated in its application form of documentary credit, available at <https://www.gbm.hsbc.com/gtrfstt>; AIB's application form does not include a lien agreement instead of a pledge agreement, available at < https://aibni.co.uk/fxcentre/fxcentre-docs/forms/irrevocable-letter-of-credit-application-form.pdf>.
[629] See discussion in Chapter 4.

the first factor is still high; besides, the legal validity of the suggestion above is based on the assumption that the UK law implements the indorsement requirement. Therefore, the effect of the practical mitigation listed above is quite limited, and a change from the perspective of law is still inevitable. Hence, the English courts should step in and provide incentives for banks to follow the indorsement requirement. English law is vague in terms of the indorsement requirement.[630] If English law strictly implemented such requirement, banks would spontaneously require a proper indorsed bill of lading in their favour.

When the paper bill of lading is replaced by an eB/L under a letter of credit transaction, the legal rules governing paper bills of lading do not automatically apply to eB/Ls. For this reason, communities and legislators have tried to replicate the functions of documents of title to eB/Ls; in closed platforms, this function is alleged achieved by platforms' attornment; by contrast, the similar cannot be replicated without legislative interventions (such as MLETR, UK Proposal). The legal validity of pledge created by closed-platform attornment has not been tested in English courts and has rarely been discussed; as for the mechanism of pledge of eB/Ls in open platforms, no discussion has been ever made. The thesis has filled this gap by detailed analysis of pledges under these types of platforms, and it is found that a pledge created by closed-platform attornment is valid and justifiable under English law, and that the "functional equivalence" model can apply to a pledge of open-platform eB/Ls.[631]

Based on the findings summarised at the previous paragraph, the fact that the paper bill of lading is replaced by an eB/L under a letter of credit transaction arguably changes the impact of certain factors on bank's position.[632]

For practical reasons, the application of eB/Ls in letter of credit transactions will eliminate the possibility of postage delay[633]; also, it will make the indorsement requirement more achievable.[634] By using hashing technology to verify the validity of each indorsement, it will make sure the continuance of the chain of indorsement; if so, the transfer of holdership of eB/Ls can be bound by the indorsement requirement. Such binding, on the one hand, will make the holders' control on the underlying goods more reliable; on the other hands it will make a third party much easier to be misled by the holder's control (e.g., when the holder is a pledgor of the eB/L as the trustee of its bank).[635]

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[630] See discussion in section 5.2.
[631] See discussion in section 7.2.1 and section 7.2.2.
[632] See discussion in section 7.3.
[633] See discussion in section 7.3.1.1.2.
[634] See discussion in section 7.3.2.2.
[635] See discussion in section 7.3.3.3.

Also, under closed platforms, the transfer of constructive possession of the goods is achieved by the closed-platform attornment. It is found by the author that, the usage of such attornment will make the bank's security more vulnerable in front of the first factor (i.e., the goods have been discharged before the eB/L is transferred)[636]; meanwhile, it will make it more secured under the second factor (i.e., ownership in the goods passed before the transfer of the eB/L).[637]

For legal reason, the statutory protection for banks against the second factor under the paper world does not necessarily apply to the digital world. There is no specific provision to recognise the application of s.24 within Sale of Goods Act 1979; and the draft Bill of the UK only regulates this situation by a miscellaneous provision, whose effect is uncertain. However, through the discussion in the thesis, it is argued by the author that this section can still apply to letter of credit transactions in the digital context.[638] Nevertheless, it is suggested by the author that a specific provision on the application of s.24 to eB/Ls is required, either in the draft Bill or the Sale of Goods Act 1979 itself.

What is consistent between the paper world and the digital world is the urge for the English law to formally accept the indorsement requirement for transferring constructive possession by bills of lading, either in paper form or in digital form. The affirmation of this requirement would benefit banks' security in both contexts.

What arguably remains the same is that bank's position is still vulnerable under the last factor. Either in the paper world or the digital world, there is a huge risk for banks using trust receipts arising from their buyers' fraud. The public attitude towards fraud in commerce has dramatically changed since the concept of "blockchain" (specifically, DLT) was invented, because some believed that a trade system based on "blockchain" was "trustless", and that every transaction thereon was authentic; however, it is found by the author that this is not the case. The most significant reason for its vulnerability is the invisibility of pledgees' interest on the pledged goods. As such, in the paper context, there has been a proposal to place a registration requirement on pledgee's interest after they redeliver the pledged assets to their pledgors against trust receipts; but this proposal was rejected by Law Commission. There are many justifications for such rejection in the paper context,[639] but, considering the practical changes brought by the usage of eB/Ls, it is found by the author that these justifications become less convincing in the digital context.[640] Therefore, it is proposed by the author that the registration requirement should be placed on the security interest held by the bank after releasing its control over the eB/L to the buyer against a trust receipt.

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[636] See discussion in section 7.3.1.1.1.
[637] See discussion in section 7.3.1.2.1.
[638] See discussion in section 7.3.1.2.2.
[639] Such as, compared to the third party, the owner is more condemnable and suitable to bear the loss caused by fraud of the agent, which is discussed in section 6.3.2.
[640] See discussion in section 7.3.3.3.

Registration might still not be accepted under closed platforms, because traders are concerned about the confidentiality of their information, especially when the registry of the closed platform is not in their jurisdictions.[641] Besides, due to the limited access of closed platforms, the registry is difficult to be accessed by non-member parties, so they will not be informed about the existence of the member pledgees' interest. By contrast, in open platforms, the information in the registry is tamper-proof, because the registry is controlled by a private entity; such registry can be a governmental registry or an open registry integrating with the existent governmental registry, either of each is more acceptable than a central registry in a closed platform. Moreover, the implementation of registration requirement is more feasible in the digital world than in the paper world; the process of registration can be simple and automated by applying smart contracts technology.

Overall, under the current letter of credit mechanism which relies on paper documents, bank's security on bills of lading is under deterrence of different factors potentially occurring at every stage of transactions. Its position is far less secured than it appears to be. Those factors shall be addressed by the community and the English courts, otherwise the interests of both the bankers and the traders might be impaired to some extent. The English courts shall be more certain and consistent towards some legal rules in this area, and the community shall stick to the rules correspondingly. Although the digitalisation of trade documents could mitigate some of the risks, bank's position in terms of its legal status as a pledgee would be uncertain in the innovative environment. Without addressing the risks identified in the thesis, a step forward into the digitalisation era might cause a backfire on letter of credit industry. Different types of eB/L platforms are exposed to different risks regarding bank's security. As such, bankers need to be cautious on the difference between these platforms and enhance their security on the basis of such difference, especially the difference in openness. For lawmakers, it is suggested that more emphasis on the visibility of pledgee's interest on eB/Ls is required to meet the "perfection" function of "possession" in the context of digital world.

[641] Miriam Goldby, 'Electronic Bills of Lading and Central Registries: What Is Holding Back Progress?' [2008] Information & Communications Technology Law 125, p130.

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