PITFALLS IN RELYING ON BILLS OF LADING

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Reliance on bills of lading in trade finance is often pivotal, but just how good security are bills of lading and in what circumstances will a bank's ability to exercise its security rights be compromised or even lost?

A bank will most commonly find its security rights tested when a customer fails to pay or otherwise defaults and the bank demands delivery of cargo. It may find that the cargo has already been discharged without production of the bills and therefore seek to exercise its remedies against the carrier.

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However, even where the bank holds the original set of bills, its claim for misdelivery may not necessarily succeed. Furthermore, as the holder of the bill, a bank may owe certain liabilities to the carrier for unpaid freight, demurrage, storage costs and undeclared dangerous goods.

We examine below how robust bills of lading are as security in the hands of a bank. We also discuss the circumstances in which a bank may not be able recover its losses from the carrier under the bills, as well as the when the carrier may make a counterclaim. In addition, we consider the extent to which the same position would apply where electronic rather than paper bills are issued.

BILLS OF LADING

Banks may come into possession of bills of lading in a number of circumstances. In connection with a letter of credit, a bank will check that the documents are compliant. A bank financing the purchase of goods may wish to hold the bills to give it possessory security over the goods pending payment by the customer. The bank may agree to release the bill under a trust receipt to its customer to enable the latter to obtain delivery of the goods but hold those goods to its order pending payment of the advance to the bank.

Banks may be content simply to have possession of the bills of lading without obtaining title to the goods, in which case the bank may not be named as either the consignee or order party in the bills or simply hold the bills endorsed in blank. However, for the bill to be validly transferred to the bank, it must not only be in possession of the bill but have also unconditionally accepted it (see section 5(2) UK Carriage of Goods by Sea Act 1992 "COGSA").

RIGHTS UNDER BILLS OF LADING

There have been a number of recent decisions which cast doubt on the ability of banks to make claims under the bills which they had accepted as security for the financing of the purchase of cargo (such as **STI Orchard (2022) SGHCR 6**, ***Standard Chartered Bank (Singapore) Ltd v Maersk Tankers Singapore Pte Ltd*** **(2022) SGHC 242** and ***UniCredit Bank AG v Euronav NV*** **[2023] EWCA Civ 47**). A bank is rarely named as a shipper in the bill, but in any event, this may not strengthen the bank's position. A shipper will lose its right of suit in contract against the carrier when the bill has been endorsed and transferred such that the transferee becomes the lawful holder of the bill of lading (although it may still have a claim in bailment; *East West Corporation v DKBS 1912* (2003) 1 LLR 239).

A transferee is a person to whom the bill of lading has been physically transferred or delivered and endorsed (either the bill may be endorsed in blank or the consignee made out 'to order').

S.5(2) of COGSA (or Singapore Bills of Lading Act ("BLA")) provides that a person shall be regarded for the purposes of that act as having become the lawful holder of a bill '…*wherever he has become the holder of the bill in good faith…*'. The concept of good faith is not stipulated in the COGSA or the BLA, but it is understood and equated with honest conduct (*Aegean Sea* (1998) 2 LLR 39). Rights of suit can be obtained if:

(a) it is the consignee of a bill without the need for a shipper to endorse the bill to the consignee (and this would include a consignee whose interest was that of a pledgee; see ***The Berge Sisar*** **(2002) 2 AC 205**);
(b) in the case of an endorsee, when the bill is delivered to it and the endorsee accepts the bill; and
(c) a person possesses a bill where it would have become a holder under either (1) or (2) above but for the fact that it became so after delivery provided that the transfer took place in reliance upon a prior existing contractual arrangement.

This latter category of holder is especially important for a bank which only comes into possession of bills of lading after the goods have been delivered and wants to assert its rights at that point.

A case in point is the ***Erin Schulte*** **(2016) QB 1**) where the bank received the documents, did not accept them, did not pay the seller to whom the letter of credit had been transferred but retained the documents on behalf of the original shipper. After the cargo had been delivered, the seller sued the carrier for misdelivery of the cargo without production of the bills.

At first instance, the court held that the bank as endorsee of the bill of lading had title to sue under s.5(2)(b) alternatively under s.5(2)(c).

The Court of Appeal held that the bank as endorsee did not become holder because endorsement by delivery required not only voluntary and unconditional transfer of possession but also unconditional acceptance by the bank. Given the bank only retained the documents including the bill on behalf of the shipper, there was no unconditional acceptance by the bank and so the bank could not rely on s.5(2)(b).

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However, the bank could rely upon s.5(2)(c) because the bank's agreement to pay under the letter of credit related to a transaction which predated delivery of the cargo, namely the transfer of the letter of credit. It did not matter that the letter of credit had expired shortly before discharge began because it was open to the bank to waive the expiry date (as it did) and subsequently accept the documents in return for paying the full value of the letter of credit.

MISDELIVERY CASES

Three recent cases illustrate the difficulties in which banks can find themselves if the court takes the view in determining claims for misdelivery that the bank has not relied on the bills of lading as security.

These are the ***STI Orchard***, ***Standard Chartered Bank (Singapore) Ltd v Maersk Tankers Singapore Pte Ltd*** and ***UniCredit Bank AG v Euronav NV***. Rather than go through the specific facts of those cases, we will consider the principles in the context of common forms of security taken by banks when providing trade finance and the potential pitfalls which may arise depending on which form of security is taken and the circumstances.

(a) Bills of lading

Banks commonly require that they become the holders of the bills as part of the financing arrangement. Often the bills will be presented to them under a documentary credit but if the bills are not available for presentation within the validity of the credit, the bank may therefore be asked to accept a letter of indemnity ("LOI") from the beneficiary in place of the bills.

By the time the original bills come into the hands of the bank, the cargo will likely already have been delivered against a LOI given by the receiver to the carrier. In which case, if its customer defaults, the bank will wish to make a claim for damages for misdelivery on the basis that the carrier has delivered the cargo without production of the original bills (as in ***Sze Hai Tong Bank Ltd v Rambler Cycle Co Ltd*** **(1959) AC 576**).

In pursuing a misdelivery claim, there are multiple circumstances which may apply and impact on a bank successfully bringing its claim.

Discharge and delivery into a warehouse: if a bank and its customer arrange for the goods to be discharged to the customer or its agent and then warehouse the goods without presentation of the bills, arguably the carrier has either delivered to the party entitled to possession of the goods or delivery to the customer or its agent is treated as delivery to the holder of the bills. In consequence, the bank will not be able to show that delivery of the cargo caused any loss to the bank (as occurred in ***The Nika* (2020) EWHC 254** where the cargo was removed from the warehouse with the aid of forged bills of lading). A solution would be for the warehouse receipts to be issued to the order of the bank with the storage costs for the account of the customer.

Acquisition of rights after discharge: commonly the bank may not become holder of the bill until after discharge of the cargo against a LOI. The carrier will argue that discharge without production of the bill did not cause the bank any loss if its customer has defaulted or become insolvent. The bank may be required to show that it would have enforced its security against the cargo in the event of default.

That may involve the bank demonstrating that if the carrier had approached the bank for consent to discharge, the bank would have refused and ordered the carrier to keep the cargo on board alternatively discharged the cargo into a warehouse or storage tanks for the account of the bank (in ***UniCredit***, the bank was unable to show that it would have refused such a request from the carrier).

Alternatively, the financing arrangements may be such that the bank did not regard bills as security because of the way that the trade was structured. In ***Maersk Tankers*,** the bank issued its documentary credit after the anticipated date of delivery of the cargo and without requiring presentation of the bills.

Another danger is that the bills are spent by the time the bank comes into possession of them. It is trite law that a bill does not become spent until it is presented to the carrier by the lawful holder. Therefore, delivery to a person not entitled to delivery or delivery of goods against a LOI without production of the original bill (arguably even to a person rightfully entitled to delivery under the bill, **as in *Future Express* (1992) 2 LLR 79**) will not cause the bills to be spent. In order to qualify as a holder and acquire rights of suit against the owner, the bank will have to rely upon a contractual arrangement entered into before the bills became spent such as a facility agreement or trust receipt loan.

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Further, in order to satisfy the good faith requirement, the bank will need to demonstrate that as a matter of causation it was relying upon the bills as security rather than, as was found to be a triable issue in ***STI Orchard***, looking to the sale proceeds of the cargo. The lesson is that banks must ensure that they are demonstrably and genuinely relying upon the bills as security or they will not be able to qualify as the holder of the bill and maintain rights of suit for misdelivery against the shipowner.

Finally, a misdelivery claim is subject to the 12-month time limit in the Hague-Visby Rules even if the misdelivery occurred after discharge of the cargo (***FIMBank plc v KCH Shipping Co Ltd* (2023) EWCA Civ 569**).

(b) Trust receipts and pledge

The bank may release the bills to its customer to enable the latter to take delivery of the cargo whilst preserving the security by a pledge of the bills. To perfect its pledge, the bank must be either named as the consignee or the bills issued to its order or all the bills must be endorsed in blank and delivered to the bank. If the bank is not so named then it runs the risk on making a misdelivery claim that the carrier will assert that the bank did not intend to take security through the pledge of the bills. Rather, that the bank is relying on the trust receipt to look to the proceeds of sale instead (which is the argument that owners advanced in the *STI Orchard* to defeat a summary judgment application).

(c) Assignment of sale proceeds and trade credit insurance

In its trust receipt loan documentation, a bank may require the customer to agree to hold the bills, goods and proceeds of sale on trust for the bank. That will usually be in conjunction with requiring that the sale proceeds be paid into a blocked account with the bank itself or require the customer to hold the proceeds on trust for the bank in a separate account.

In ***Credit Agricole Bank v PPT Energy Trading Co Ltd*** **(2023) SGCA (I) 7**, the applicant for a letter of credit had assigned the receivables from a sale contract twice. Though the bank could not rely upon the fraud to avoid liability to pay the beneficiary under the letter of credit, it was able to rely upon the LOI which the beneficiary presented to obtain payment in the absence of the bills. The LOI had a standard provision that the beneficiary had marketable title to the cargo free and clear of any lien or encumbrance. It was held that there was a breach by the beneficiary of the warranty of marketable title due to the fraud and the cargo was not clear of encumbrances because the double financing and assignment of the sale proceeds had crystallised floating charges created in the security documentation.

As to trade credit insurance, this became relevant in ***Euronav*** since on the facts the bank was unable to show that it would have enforced its security against the cargo. Instead it appeared to have relied on taking an assignment of the trade credit insurance held by the buyer insuring 90% of each of the sub-buyers' receivables.

OBLIGATIONS AND LIABILITIES UNDER BILLS OF LADING

In addition to rights of suit that are transferred to the bank upon consignment or endorsement of the bill of lading, there are obligations and liabilities owed to the carrier.

S.2(1) COGSA vests rights of suit in various categories of holder but s.3 does not automatically transfer liabilities to the holder. Instead, it lays down the circumstances when liabilities under a bill are transferred to a party who is not an original party (i.e., shipper or consignee) but an endorsee or transferee.

Thus, where the lawful holder of a bill of lading takes or demands delivery of goods, makes a claim against the carrier in respect of those goods or at any time before those rights were vested in it demanded delivery from the carrier then that holder becomes subject to the same liabilities under the bill as if it had been an original party to it.

If a bank therefore takes or demands delivery from the carrier of any of the goods under the bills, s.3 will be satisfied and the bank may find itself liable to pay storage charges and container demurrage after physical discharge from the vessel, but pending delivery, even if the costs of doing so exceed the value of the cargo. This situation occurred in ***Bao Yue*** (**[2015] EWHC 944**), but a similar claim failed on the facts in ***Stemcor v IOB*** (**[2011] EWHC 538**).

A bank making a misdelivery claim as a holder of a bill of lading will still be bound by an arbitration clause in the bill notwithstanding it has not made a demand in respect of the cargo and therefore any liabilities have not vested in it under section 3 COGSA (***Sea Master Shipping Inc v Arab Bank (Shipping) Limited* [2018] EWHC 1902)**.

EBILLS OF LADING

A number of countries have adopted the UNCITRAL Model Law on Electronic Transferable Records, including UK and Singapore, whilst others such as South Korea have provided in national legislation that ebills have the same effect as paper bills.

Before the adoption of this legislation, there were differences in treatment of a bill in electronic form. These included that an ebill was not regarded as a document of title and that neither the Hague nor Hague-Visby Rules applied to ebills. The UK Electronic Trade Documents Act 2023 gives electronic trade documents the same status as their paper equivalents.

There are situations where ebills will greatly assist in combating fraud or eliminate delays in receiving paper documents:

1. *Bills are not available at discharge*: commonly, this was dealt with by offering a LOI to the carrier but (a) this was only as good security as the credit of the person who issued it; (b) claims which arise as a result of a LOI being issued are not covered by P&I insurers; and (c) this does not prevent a mis-delivery claim against a carrier if the lawful holder is different from the entity who obtained delivery by presenting the LOI. The ability to transfer ebills digitally and to trace transfers to the person whose key matches that of the last recipient of the key to the ebill on the system, together with an identity check on the presenter, will give confidence to the carrier that delivery is being made to the lawful holder.
2. *Multiple persons demand delivery*: this is a clear indication that there is more than one set of bills circulating. This may be a set of photocopies being passed off as originals or switch bills that have been issued without collecting and cancelling the original set. It may also mean that the original set of three originals has been broken up and passed into different hands. With ebills, only the final holder of an ebill will be able to demand delivery and may lead to the scrapping of the practice of issuing bills in triplicate.
3. *Change of delivery port or consignee after bills issued*: Switching of bills requires the surrender of the first set of bills and replacement by a second set reflecting the changes. Ebills will enable changes to be made more quickly without the need to track down and arrange the return of the paper bills.

CONCLUSION

There have been a number of false dawns for ebills since the concept was first mooted in the 1990s. However, the game changer is the recognition in law of ebills on a par with their paper equivalents. The familiarity of trade users with paper documents needs to be overcome as the speed with which ebills are accepted will be dictated by how quickly the use of ebills and other electronic trade documents overtakes their paper counterparts.

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