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Bill of Lading as Collateral Security

The recent article from Bob Ronai regarding the consignee respectively order party in a bill of lading raises a couple of interesting points. The desire to simplify the issuance of documents for presentation under L/Cs is perfectly understandable and one that I can fully endorse.

As to why certain banks require bills of lading to be issued to their order, rather than to order and blank endorsed, or indeed to order of the buyer or a 3rd party, may I suggest the following rationale;

One function of a bill of lading¹ is that it incorporates title to the underlying goods. It can also govern the means of transferring title to said goods. If it is a Bearer² document then mere possession of same empowers the holder to claim delivery of the goods. If a bank is looking to the bill of lading to secure its rights over the goods, this will not be an ideal form as the unforeseen loss (or theft) of the title document impinges upon the bank's ability to maintain control the underlying goods, at least until the point of endorsement.

A bill of lading issued to order of a named consignee (e.g. the issuing bank of L/C) on its face empowers that consignee only to determine to whom the goods should be delivered. A bill of lading issued "to order and blank endorsed" on its face grants no such rights of determining delivery of the goods hence this right is held to vest in the shipper.³ There is a precedent for a shipper redirecting delivery of goods under a bill of lading consigned to his buyer, this was done by endorsing the bill by way of pledge to a bank.⁴ This right to redirect the goods is held to expire once the goods and/or the bill of lading have been delivered to the consignee, the latter having presumably acquired constructive possession of the goods. Why is any of this relevant to the article mentioned above? It is suggested that a bank acquires greater security because it makes express the transferor's (seller's) intent to grant the bank "special property" or security interest in the goods⁵ albeit general property remains unaffected by the transfer of the bill of lading.

¹ "straight" i.e. non-negotiable BLs, sea waybills et al are excluded from this genus

² BL does not name the person to whom or to whose order the goods are to be delivered, the possessor of the BL can claim delivery as per the Carriage of Goods by Sea Act 1924, ss. 1(2)(a), 5(2)(b) e.g. an Order BL that is blank endorsed

³ *Laemthong International Lines Co Ltd v Artis (The Laemthong Glory) (No.2)* [2005] EWCA Civ 519; Lloyds Rep. 688 at [6]

⁴ Carver on Bills of Lading, 2nd ed. (Sweet & Maxwell) 2005, Ch. 1 para. 1-012 ff refers

⁵ *Hibbert v Carter (1787)* 1 T.R. 745, *Brandt v Liverpool, etc. Steam Navigation Co* [1924] 1 K.B. 575

Having said that, it is however ordinarily the case that property in specific or ascertained goods passes when the contracting parties intend it to pass.⁶ Why does this matter? Because the seller has to be legal owner of the goods at the time of tendering documents in order to make his financing bank pledgee. According to Todd⁷ “*Where a bill of lading names a buyer as consignee, retention of that document by the seller can lead to an inference of retention of property by him,*⁸ *because the bill of lading is needed for the buyer to obtain delivery of the goods after discharge. On the same reasoning, substituting the bank for the buyer named as named consignee, a pledge would not be created on shipment. This will be true for any document of title, possession of which is required to obtain delivery of the goods.*”

Thus, by tendering the title document to his financing bank, having issued same to order of said bank, there is a reasonable assumption that it is the seller’s express intention to make the bank pledgee of the goods. Hence, to paraphrase Todd⁹, if it is the seller’s intention to create a pledge, the bank does not obtain the general property in the goods, but only a special legal title, which gives the holder of the bill of lading¹⁰

“A pledge accompanied by a power to obtain delivery of the goods when they arrive, and (if necessary) to realize them for the purpose of the security.”

To reinforce the concept of this special legal title obtained by the bank as pledgee, it has been stated by Lord Devlin in *Kum v Wah Tat Bank Ltd.* that “*this is not property in the ordinary sense; the pledgee has not even temporarily the use and enjoyment of the goods but simply the right to retain them until the pledge is honoured and, if it is not, to sell them and reimburse himself out of the proceeds.*” This right is of particular value should the buyer, or indeed the issuing bank of the LC, become insolvent before putting the (confirming) bank in funds for the financing of the goods.

There is however an important caveat to the above. The seller must have legal title to the goods or the title documents¹¹ symbolising same at the time of tendering such documents to the bank. To quote Todd again: ‘*If the property in the goods has already passed from seller to buyer before the documents are pledged by the seller to the bank, then the seller can pass no property to the bank as pledgee. Only if property passes on tender of documents is the bank likely to be adequately protected against the bankruptcy of the buyer (or in the case of a confirming bank, the bankruptcy of the issuing bank).*’

It is perhaps for this reason that many banks demand a Trust Receipt that makes the client their trustee and agent for sale of the goods, obliging them to remit the sales proceeds to the bank alone. It gives the bank equitable title to the goods¹² and can perhaps aid in withholding goods from a liquidator in the event of the end- buyer’s bankruptcy.

⁶ Sale of Goods Act 1979, s. 17(1)

⁷ Paul Todd, *Bills of Lading and Bankers’ Documentary Credits*, 4th ed. (Informa, London, 2007) at pp 153, 6.14 ff

⁸ *The Kronprinsessan Margareta* in para. 6.35 ff.; *The Rafaela S* in para. 7.123 ff, also (1884) 10 App. Cas. 74

⁹ Paul Todd, *Bills of Lading and Bankers’ Documentary Credits*, 4th ed. (Informa, London, 2007) at pp 154, 6.19 (1884) 10 App. Cas. 74, at 82

¹⁰ *The Future Express* (1993) 2 Lloyd’s Rep. 542 i.e. the title documents must be valid as such when delivery is made, once goods have been discharged this function is lost

¹² *Sale Continuation Ltd. V. Austin Taylor & Co. Ltd.* (1968) 2 Q.B. 849

I have found no authority asserting that a bill of lading issued or endorsed to the order of a financing bank is *prima facie* better able to furnish such bank with greater rights and/or protection than a bill of lading issued or endorsed “to order” but the former would appear to make express the seller’s intention to render the bank pledgee of the goods until same have been paid for.