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Documentary Letter of Credit: A Pivotal Case for the Inefficiency of the Law of Contract

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Article abstract

This study compares the methods used both in common law and civil law jurisdictions to deal with the basic problems relating to the documentary letter of credit. A unique commercial device was thus developed in international trade as a means of ensuring safe and swift payment for goods. Even though this distinct mechanism works efficiently in practice, the numerous attempts made to classify it legally have been unsuccessful.

A comparative analysis of the legal conceptualizations traditionally used to explain the nature of credit reveals apparent shortcomings in contractual theories. Because the basis of the documentary credit appears to be an abstract promise to pay, this phenomenon seems to break through the conceptual framework of traditional contract law theory. This is due to the fact that the process of forming the credit does not fit into the ordinary offer-acceptance formula. Yet, the easiest solution—the credit as a "mercantile specialty" or a "*sui generis* contract"—avoids facing the true challenge of our era, which is re-thinking the concept of "contracts" under modern laws. Legal debates should be directed in a more functional direction in order to provide satisfactory theoretical grounds for providing solutions to obvious, but still unanswered questions such as why people ought to keep their promises and why only some of those promises are likely to be legally enforced. It seems that, in this regard, documentary credit would be a convenient "guinea pig" for most contemporary concepts relating to the law of contracts.

DOCTRINE

Documentary Letter of Credit: A Pivotal Case for the Inefficiency of the Law of Contract

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ABSTRACT

This study compares the methods used both in common law and civil law jurisdictions to deal with the basic problems relating to the documentary letter of credit. A unique commercial device was thus developed in international trade as a means of ensuring safe and swift payment for goods. Even though this distinct mechanism works efficiently in practice, the numerous attempts made to classify it legally have been unsuccessful.
A comparative analysis of the legal conceptualizations traditionally used to explain the nature of credit reveals apparent shortcomings in contractual theories. Because the basis of the documentary credit appears to be an

RÉSUMÉ

Cette étude compare les méthodes que la common law et le droit civil ont mis au point pour résoudre les problèmes fondamentaux du crédit documentaire. Il s'agit d'un mécanisme unique que la pratique du commerce international a inventé afin d'assurer la sécurité et la rapidité du paiement des marchandises. Même si le crédit fonctionne efficacement dans le domaine du commerce, sa qualification juridique demeure toujours problématique.
L'analyse comparative des conceptualisations juridiques utilisées comme explication de la nature juridique du crédit démontre l'insuffisance apparente des théories dites « contractuelles ». Comme on le constate, l'essence même

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*abstract promise to pay, this phenomenon seems to break through the conceptual framework of traditional contract law theory. This is due to the fact that the process of forming the credit does not fit into the ordinary offer-acceptance formula. Yet, the easiest solution — the credit as a "mercantile specialty" or a "*sui generis *contract" — avoids facing the true challenge of our era, which is re-thinking the concept of "contracts" under modern laws. Legal debates should be directed in a more functional direction in order to provide satisfactory theoretical grounds for providing solutions to obvious, but still unanswered questions such as why people ought to keep their promises and why only some of those promises are likely to be legally enforced. It seems that, in this regard, documentary credit would be a convenient "guinea pig" for most contemporary concepts relating to the law of contracts.*

du crédit est la promesse abstraite du paiement; or, ce phénomène semble aller au-delà du cadre fondamental traditionnel du droit des contrats. C'est précisément en raison de ce fait que le processus de formation du crédit n'entre pas facilement dans la catégorisation d'offre-acceptation. La solution la plus simple — le crédit vu comme « contrat sui generis *» — esquive la véritable question, soit celle de la remise en question du « contrat » en droit contemporain. Le débat juridique doit dès lors se concentrer sur les fonctions et les principes du droit des contrats pour énoncer une base théorique qui permettrait de répondre aux questions fondamentales — mais néanmoins rhétoriques — telles : pourquoi l'homme doit-il tenir ses promesses? Pourquoi seules certaines de ces promesses peuvent-elles faire l'objet d'exécution forcée? À cet égard, le crédit documentaire peut certainement servir de point de convergence pour la plupart des problèmes auxquels se heurte la théorie contemporaine du droit des contrats.*

SUMMARY

Chaque élément de fait porte virtuellement en lui la qualification qui doit un jour le traduire plus ou moins fidèlement dans le domaine du droit.[1]

[legal reasoning] is an exercise in constructive interpretation; the best justification of our legal practices as a whole, ... the narrative story that makes of these practices the best they can be.[2]

1. F. TERRÉ, *Volonté et qualification*, in Arch. Philo. Dr. Paris, Sirey, 1957, p. 114; cited in L.M. COSTA, Tome 308, *Le crédit documentaire : Étude comparative*, Paris, L.G.D.J., 1998, para. 426.
2. R. DWORKIN, *Law's Empire*, Cambridge, Mass. Belknap Press, 1986, p. VII.

INTRODUCTION

This study compares the methods that the legal systems belonging to different traditions employ to deal with the basic problems with the documentary letter of credit; this unique commercial device developed in international trade as a means of ensuring safe and swift payment for goods. Even though this distinct mechanism works efficiently in practice, it still escapes numerous legal classifications. In particular, its very legal nature is surrounded in utmost confusion.

One reason for this may be that the credit, this practical, viable instrument of international origin, must eventually be "translated" into the various "legal languages" of particular jurisdictions. Credits are always enforced before the national courts that apply domestic law and basic domestic legal concepts. On the other hand, however, this practical inconvenience is in fact a great challenge for any comparative analysis; and here, the documentary letter of credit serves rather as a *pretext* for a discussion on the legal doctrines employed by the traditions of common law[3] and of civil law (both, the French[4] and German tradition[5]),[6] and as the "doctrinal responses" to this "social phenomenon" that the credit is, are strikingly divergent, a really fascinating exercise would be to understand the reasons for such theoretical

3. The discussion on the common law will focus on the doctrines of England, the United States and the common law provinces of Canada; the rest of the common law jurisdictions were deliberately omitted.

4. For the purposes of this paper, the "French tradition" will mean mostly the doctrines of France, and also of Québec, notwithstanding the extraordinary influence of the Napoleonic Code in Continental Europe, Central and South America, Louisiana, the Near East, the Maghreb and francophone Africa — they are together sometimes called "the Romanistic legal family" : K. ZWEIGERT, H. KÖTZ, *Introduction to Comparative Law*, trans. by Tony Weir, 2nd rev. ed., Oxford, Clarendon Press, 1987, Volume I : The Framework, p. 103ff.

5. This will denote the legal doctrines of Germany, Austria and Switzerland. The other jurisdictions belonging to the "Germanic legal family" will not be considered here. They would include : Greece, Turkey, Hungary and other countries from Southern and Eastern Europe, which have been greatly influenced by the concepts of the *Bürgerliches Gesetzbuch* (German Civil Code) (BGB) and *Zivilgesetzbuch* (Suisse Civil Code) (ZGB) in particular; K. ZWEIGERT, H. KÖTZ, *op. cit.*, note 4, p. 159ff.

6. Consequently, as this study focuses on the *doctrinal concepts* only, even though the laws of the particular legal families are eventually compared, they are not, however, the main subject of this analysis and are only used for reference purposes for the theories invented thereupon.

disagreement, in order to ascertain whether the desired compatibility of the legal rules on the credit is at all possible.[7]

I. EXISTING FRAMEWORK: A NOVEL DEVICE

International commercial practice has developed the letter of credit regardless of, and outside of, traditional laws on obligations. The only internationally used regulation of the rules on letters of credit, is the ICC *Uniform Customs and Practice for Documentary Credits* (UCP), a product of independent merchant practice.[8] One might probably say that as long as the letter of credit works, there is no reason for the law to intervene. For what would be the purpose of all its attempts to squeeze the allegedly self-sufficient commercial practice into a rigid legal framework?

In fact, "if a legal institution performs in accordance with its purpose it is truthful both to the socioeconomic forces that prompted its use and to the legal conceptualization that made it operative".[9] Any adequate legal examination should, however, emphasize the objectives that merchants wish to achieve by employing the credit, i.e., the need to secure the

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7. For these reasons, this paper does not aim either at explaining all the diverse types of credit that might be: revocable or irrevocable, documentary or clean, confirmed or not, with green or red clauses, revolving or not, transferable or not, back-to-back, or stand-by credits etc. Its subject is the "simple" irrevocable documentary letter of credit only, not accompanied by any of those characteristic stipulations.

8. This codification of the international trade usages, specifically crafted by the International Chamber of Commerce, Paris, is the most respected regulation of the rules relating to letters of credit. First adopted in 1933, it has been continuously revised since then in order to embrace contemporary tendencies and the development of the specific techniques used in credit transactions. The version currently in force is dated 1993. Although the authority of the UCP is unanimously revered, its legal character is also subject to countless debates. See for instance, L. SARNA, *Letters of Credit: The Law and Current Practice*, 3rd ed., Toronto, Carswell, 2002, p. 2-24ff; or, E.A. FARNSWORTH, "Unification and Harmonization of Private Law", (1996) 27 *Can. Bus. L. J.*, p. 48, who describes UCP as "transactional interfaces."

9. B. KOZOLCHYK, "Letters of Credit", in P. SIEBECK (ed.), *International Encyclopedia of Comparative Law, Commercial Transactions and Institutions*, vol. 9, ch. 5, Tübingen, J. C. B. Mohr, 1979, para. 245. And "the nature of legal science is such, however, that empirical observation alone is insufficient when attempting to grasp the being of an emerging legal institution; one must not only appreciate its socio-economic role, but also acquire an awareness of its relationship to other legal institutions." B. KOZOLCHYK, "The Legal Nature of the Irrevocable Commercial Letter of Credit", (1965) 14 *Am. J. Comp. L.*, p. 395.

efficiency of international transactions; this economic purpose that has given birth to letters of credit is also reflected in the mechanisms of the credit operation. For this reason the identification of the credit's functions (I A) will be followed by an analytical review of the legal doctrines that purport to embrace this phenomenon and reinterpret it in legal terms, by finding the relevant and appropriate legal form for the given "economic substance." (I B)

A. THE SUBSTANCE : ORIGINAL ECONOMIC FUNCTIONS

1. Specific Needs

The credit's historical development reveals the basic economic functions this particular device is ready to serve.

Having evolved from the 12th and 13th centuries letter of payment,[10] some four hundreds years later, when the rules on bills of exchange became more standardized and formalized, the letter of credit began to obtain its distinct characteristic. A promise to reimburse the payor under the letter began to be expressly, or at least impliedly, inserted in the letter of credit.[11] In the 19th century, this new instrument was already clearly separate from bills, but still gave no strong rights to the creditor (the beneficiary) under such document.[12] As neither party could rely on this so-called "buyer's credit," it was confined only to "constant dealing between two or more mercantile houses that normally traded

10. It was an early Mediterranean form of the bill of exchange that did not contain an express promise to pay, but only an order to pay by another person. B. KOZOLCHYK, "The Legal Nature...", *loc. cit.*, note 9, p. 395.

11. *Id.*, p. 397.

12. Such a feature was then conceptualized as the *revocable* character of the credit. Contrary to bills of exchange, the 19th century credit could not be protested, "could be issued only in favor of a designated person [...] and never, as with bills of exchange, to the "order of" a given payee, and the instrument had to contain specification of a specific sum or of a maximum amount." *Id.*, p. 398, citing the relevant provisions of the Spanish and Latin America commercial codes. J. F. Dolan claims that the modern commercial credit differs from the early one in three ways : the seller (the beneficiary) is usually specified in the letter of credit, secondly, he is frequently a broker or a manufacturer, and he usually enters into the sales contract before the credit issues; J.F. DOLAN, *The Law of Letters of Credit : Commercial and Standby Credits*, Boston, Warren, Gorham & Lamont, 1984, para. 5.01[1] and 3.05.

on an open account or credit basis [...] mainly in domestic transactions and within a circumscribed area."[13]

During the second half of the 19th century, a new type of letter of credit emerged, i.e., the *commercial* letter of credit.[14] The novelty was that the exporter now drew his drafts, not on the importer, but directly on a bank (or a factoring house). The latter used to promise the exporter that he would duly honor a draft (or a simple demand for payment) presented to him, if it were accompanied by the documents specified in the promise. The banks' function was to carefully verify whether the documents submitted by the beneficiary (the payee) strictly comply with their description in the notification of the issuance of the credit. Without question, they were not interested, or unable to, or sometimes not allowed to, look beyond the documents in order to "judge the seller's performance under the underlying agreement."[15] The justification was indeed simple : "otherwise, the reliability of the bank's promise and the frequency of letter of credit transactions would suffer from the uncertainties in the buyer-seller relationship."[16] As a result, the letter of credit has obtained its modern form.

2. Distinctive Structure

The credit's unique characteristic is the specific role of the bank that issues the letter of credit (the issuing bank), and its two-fold responsibility towards two other participants in this structure : the applicant for the credit and the credit's beneficiary. The two relationships prepare the grounds for the bank's intervention. The first is "the underlying contract"[17] between the seller (the beneficiary of the documentary letter

13. B. KOZOLCHYK, "The Legal Nature...", *loc. cit.*, note 9, p. 398.

14. According to the findings of Professor Llewellyn, the reasons would be : the competition of factorage houses for business, the specialization of banking activities, the growth of manufacturers, and the use of telegraph as a means of communicating; *id.*, fn15.

15. *Ibid.*

16. *Id.*, p. 399.

17. The underlying contracts may be of different character, depending on the parties' needs. As the most common one is the sales contract, this paper will use it as an example of the underlying agreement. This relationship is also called *the value relationship (relation de valeur)*.

of credit) and the buyer (the applicant for the credit),[18] where the parties agree that the credit will be the means of payment. By operation of the documentary transaction at the later stage, the bank will undertake to pay the seller a specific amount of money (usually by accepting the beneficiary's drafts), corresponding to the price of the goods. The actual payment under the letter of credit by the obligated bank is, therefore, functionally equivalent to payment by a buyer under a sales contract.

The second relationship arises from the agreement to issue a credit, concluded between the buyer and his bank.[19] In this agreement, the bank undertakes to the applicant that it will pay the beneficiary upon the presentation of specific documents that represent both the title to the goods and the right to dispose of them.[20] The applicant assures the bank that the necessary funds will be transferred (or that they have already been transferred) to the bank as reimbursement for payment of the credit.

The third commitment, completing this outline, is "a definite undertaking of the bank to [...] make payment to, or to the order of, the beneficiary [...], provided that the terms and conditions of the credit are complied with."[21] This last undertaking is *autonomous* — it is a "separate transaction from the sales or other contract(s) on which it may be based, and banks are in no way concerned with or bound by such contract(s) even if any reference whatsoever to such contract(s) is included in the credit."[22]

Typically, a fourth participant enters this scheme, namely the second bank, which is usually the issuing bank's correspondent bank in the seller's country. The role of this

18. The terms "account party" or "customer" are also routinely used to denote the purchaser; the UCP uses "applicant".

19. It is sometimes called *the cover relationship* (*relation de couverture*).

20. The documents are: commercial invoice, bill of lading and the insurance policy covering goods in transit. Additional documents may be required by the credit, usually referring to the quality of goods (such as inspection certificates, certificates of origin, and certificates of quality etc.).

21. Article 9a and article 2 of the UCP. This relationship, which might be called a letter of credit *sensu stricto*, is also labeled *the performance relationship* or *the payment relationship (relation de paiement)*.

22. Article 3 of the UCP.

second bank is to either advise the seller that the credit has been issued for his benefit, or to negotiate the drafts presented by the seller, or finally, to confirm the credit issued by the issuing bank. In this last case, the confirming bank becomes directly liable to the beneficiary — in the same way as the issuing bank is — to pay or accept and pay the drafts presented by the beneficiary.[23]

This structure has been developed in order to eliminate the risks inherent in the international character of the underlying transaction and to grant substantial assurance to its participants : the beneficiary, the applicant and also the bank.

3. Unique Functions

Consequently, the more precise identification of the specific aspects of such assurance seems to be a prerequisite for any legal analysis of the documentary letter of credit — an adequate legal conceptualization must ensure a proper and smooth operation of all the credit's advantageous features. These most characteristic qualities will be presented from the point of view : (i) the beneficiary, (ii) the applicant and (iii) the bank, respectively.

(i) security for the beneficiary

Under the irrevocable credit[24] the obligated bank cannot cancel or withdraw its promise to pay. An enforceable legal obligation is created thereby and unjustified refusal to pay constitutes the basis for a claim by an unsatisfied beneficiary.

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23. The confirmation constitutes a "definite undertaking of the confirming bank, in addition to that of the issuing bank, provided that the stipulated documents are presented [...] and that the terms and conditions of the credit are complied with" (Article 9b of the UCP).

24. According to article 6(c) of the UCP, in the absence of any indication as to whether the credit is revocable or irrevocable, it shall be deemed to be irrevocable. This is a significant change from the previous UCP (1983), where the presumption was to the contrary. Similarly, § 5-102(a)10 of the *1995 American Uniform Commercial Code* (UCC), the other comprehensive codification of the law concerning letters of credit, describes the letter of credit as "a definite undertaking" by an issuer to a beneficiary "to honour a documentary presentation, by payment or delivery of an item of value."

The seller is paid under the tendering of documents that confirm he has performed his part of the contractual obligations and, in particular, that he has transferred the title to goods of a given quantity and quality. What is more, all these "documentary conditions" are specified clearly and well in advance in the letter of credit itself. The beneficiary is paid once the set of documents representing the goods is accepted, thereby saving time, avoiding transit risks and any disputes as to the goods, which may occur while the buyer takes over possession. It also means that the seller is then provided with an additional debtor; a bank, whose credibility can be verified much more easily, who is in principle trustworthy, and who neither replaces, nor discharges the original debtor.[25]

Another significant advantage for the beneficiary is the independence of the obligation of the issuing bank from the underlying contract (the *autonomy* rule). The bank cannot refuse to honor documents presented by the seller (together with the demand for payment) on the grounds of alleged non-performance of the sales contract. It is allowed to look at "the face" of the documents only, and unless they comply strictly with the terms and conditions of the credit (hence the doctrine of *strict* compliance, article 13a of the UCP), they will not be accepted and the seller paid. The other consequence is that in the ordinary course of dealing, the applicant cannot prevent the bank from accepting the documents.[26]

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25. For the buyer will be deemed to have fulfilled his part of the obligations no sooner than upon the actual payment to the seller. In particular, when the issuing bank gets insolvent prior to the presentation of the documents, the buyer is still primarily liable for payment, on the basis of the sales contract; J.-G. CASTEL *et al.*, *The Canadian Law and Practice of International Trade with Particular Emphasis on Export and Import of Goods and Services*, 2nd ed., Toronto, Edmont Montgomery, 1997, fn 148, p. 403.

26. The only exception that limits the scope of the autonomy rule is the case of fraud. This stimulating issue, however, is indeed so complex that it requires separate and thorough treatment; as it is clearly beyond the scope of the present paper, it will not be dealt with here. It is argued, however, that although the independence may occasionally favor sellers, they "more often lose when conforming shipments are not corroborated by a set of documents that strictly conform to the credit's requirements"; M.S. BLODGETT, D.O. MAYER, "International Letters of Credit: Arbitral Alternatives to Litigating Fraud", (1998) 46 *Am. Bus. L. J.*, p. 450. What is more important is that the number of cases where banks were sued for not honoring documents with minor nonconformities to the credit's conditions is indeed significant.

(ii) security for the applicant

Firstly, the issuing bank may be seen as an intermediary expert who — solely upon examination of the documents — ascertains whether the seller has duly performed his contractual obligations.[27] Secondly, the applicant's interests are protected under the agreement for the issuance of the letter of credit (the cover relationship), where the responsibility and liability of the bank towards him are agreed. From the applicant's point of view, a crucial issue therein is the commitment of the bank to accept only the documents that conform strictly to the credit's conditions. Unjustified acceptance may constitute (and usually does) the basis for claims raised by the applicant against the bank, for the alleged breach of the bank's obligations arising from the application agreement.

Such assurance to the applicant arises via the issuing bank's inevitable dilemma, i.e. a conflict between its role as an independent intermediary and as a debtor of both the seller (the beneficiary) and the buyer (being the bank's customer). Any disputes between the parties, relating to the performance of the sales contract and the operation of credit, usually place the bank in a difficult position.[28]

(iii) security for the bank

First of all, the *autonomy* rule provides that either relationship, other than that between the issuer and beneficiary, may not impact (amend or restraint) the operation of the letter of credit; as a result, the bank is relieved from the examination of any factual circumstances (articles 3 and 4 of

27. Usually, the more specific the conditions; the better the applicant is protected. On the other hand, an excessive number of these conditions may cause undesirable formality and may also render the demand for payment totally inoperative.

28. In particular, this is the case where the applicant attempts to stop a payment under the credit, alleging the beneficiary's wrongful conduct and claiming that the operation of the credit should be "frozen." In practice, however, "banks will not refuse to honor a credit unless the applicant's allegations are confirmed by a court order and the court prohibits the bank from honoring the credit." Prof. Dr. R.A. SCHÜTZE, Dr. G. FONTANE, *Documentary Credit Law Throughout the World*, 1998, ICC Publ., N° 633, p. 34. Indeed, if banks involved themselves in a dangerous play outside their role of intermediary stranger to a commercial contract, it would threaten the very basis of this operation. L.M. Costa, *op. cit.*, note 1, p. 251.

UCP). Secondly, as under the doctrine of strict compliance, banks examine only "the face" of the document (without any inquiry as to the issues beyond it), this contributes to reducing costs and speeding up the documentary transaction.[29] Last but not least, the bank's right to be reimbursed by the applicant (of the sums transferred upon the payment of the letter of credit) is protected by the fact that it legitimately possesses the documents that the applicant has an interest in. Besides this security in the documents representing goods, banks are usually entitled to reimburse themselves out of the assets of the applicant (his account at the issuing bank) immediately after the payment is effected.

This brief description demonstrates that any legal conceptualization of the documentary credit should preserve a sensitive balance between securing the interests of all participants; otherwise, the credit would not operate efficiently.

B. THE FORM : DISTORTING LEGAL FRAMEWORKS

The response of jurisprudence to the expanding commercial practice has, however, been very disappointing — in fact, the clear "practical" language of the UCP cannot be simply adapted to the more specific and precise language of law. Neither the systematic and abstract civil law tradition, nor the practical, problem-solving common law, can answer sufficiently the following basic questions : *why* is the bank's promise legally binding, *when* does it become binding and what is the *characteristic* of the bank's undertaking?[30]

29. Besides, this simplicity that makes the checking of documents almost an "administrative task" enables the employment of bank clerks with lower qualifications (saving the costs of experts' services).

30. The other inevitable dilemma still exists; namely, what kind of approach should we take in order to explain letters of credit in legal terms? Should we understand the entire multilateral picture at once, as it elucidates better the nature of this unique transaction, or to the contrary, has one to focus only on the relationship between the bank and the beneficiary (with no reference whatsoever to the other interdependent relationships)? As we shall see, either way appears misleading.

1. Credit Intertwined with Other Relationships

A brief comparative overview of the credit's "legal theories" (i.e. its legal conceptualizations) illustrates the problem perfectly. None of them can ensure the efficient operation of all the credit's functions mentioned above; no contractual theory in either legal tradition embraces the originality of the credit as it is : its functions, its structure and its participants with their specific needs.

Firstly, we cannot treat the bank as an agent of the account party, who enters into the relationship with the beneficiary on behalf of the bank's principal — as civil law ***mandate* theory** and common law **agency theory** would do.[31] Contrary to the case with credits, the *mandate* not only may be revoked at any time by either party[32] but also, as a rule, vests the agent with the power of representation — the agent acts *in the name of the principal*, and the latter remains directly bound by the contractual relationships the agent enters on his behalf.[33] The same concept exists under common law, but what is more, no "agency without representation" is recognized there; even the "undisclosed agency" binds the principal.[34] This is certainly not the case with the credit, the essence of which is a direct action by the beneficiary against the bank, and not the account party (the "principal"). Indeed, if a "theory" focuses only on the acts and the role of the buyer, and disregards the separate and distinct

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31. *Le mandat* is regulated by articles 1984ff of *The French Civil Code* (C.C.) and articles 2130ff of the *Civil code of Québec* (C.c.Q.). The term "agency" is used here in its generic meaning, with no claim to equate it with *common law* agency. Similarly, *agent* certainly replaces the more appropriate *mandataire* for purely linguistic reasons.

32. This is due to the fact that it is a relationship of confident reliance. Some, but not all, of the legal systems allow the waiving of this power to revoke; nevertheless, in order to preserve the *irrevocable* character of the letter of credit, one has to specifically tailor the mandate and employ this rather exceptional form. See L.M. COSTA, *op. cit.*, note 1, para. 280. In Québec, either party to the mandate may terminate it unilaterally, but according to article 2179 C.c.Q., this power may be waived in the circumstances prescribed therein; article 2175ff C.c.Q.

33. Articles 2157 and 2160 C.c.Q. The parties may, however, employ the exceptional, so-called *imperfect mandate*, i.e. without representation.

34. K. ZWEIGERT, H. KÖTZ, *Introduction to Comparative Law*, trans. by Tony Weir, 2nd rev. ed., Oxford, Clarendon Press, 1987, Volume II : The Institutions of Private Law, p. 119.

obligation of the bank — an obligation that does not derive from another relationship — no adequate explanation for the *autonomous* character of the bank's undertaking can be provided.[35]

The *cautionnement*[36] (the surety or guaranty) theory would emphasize that the bank does not actually pay the price; it only *assures* payment of the buyer's debt. Despite this perfunctory resemblance, the liability of the civil law surety (guarantor, i.e. the bank) is of a subsidiary and incidental nature.[37] Under common law, the creditor may demand that the guarantor (the bank) pay only when the primary debtor (the buyer) defaults, and what is more, he also must exhaust his remedies against the buyer prior to such a claim. Similarly, the common law surety may be discharged when the parties to the basic contract amend it, or it turns out to be invalid.[38] Secondly, the civil law surety (the bank)

35. The same arguments may be raised against the **payment of the buyer's debt theory**, according to which the bank simply pays the debt of the buyer, i.e. the price for the merchandise shipped by the seller; see F.P. DE ROOY, *Documentary Credits*, Antwerp, Kluwer Law and Taxation, 1984, p. 90. De Rooy rejects this theory for an other reason : "the buyer does not make a payment, but offers a means of obtaining payment; he presents the seller with a key to a full safe, which is still not the same as presenting him with the money contained in that safe. The seller is then at liberty to use or not to use that key." *Id.*, p. 91. Another setup is also referred to, namely the one that would treat **the *buyer*** (and not the bank) acting **as the seller's implied or special agent**, who arranges with third parties for the payment to the beneficiary (this concept is defended by Professors Gutteridge and Megrah, see B. KOZOLCHYK, "The Legal Nature...", *loc. cit.*, note 9, p. 409). Even though, however, this agency contract instead of being autonomous would be ancillary to the contract of sale and there is no explanation for *direct action* by the beneficiary against the bank.

36. Articles 2011ff C.C., articles 2333ff C.c.Q.

37. Under the C.C., the *cautionnement* is an *obligation abstraite* in the meaning that the surety (this would be the bank) cannot utilize against the creditor (the beneficiary) the exceptions from the relationship between the surety and the original debtor (i.e. between the bank and the account party); L.M. COSTA, *op. cit.*, note 1, para. 299. However, "the claim against the surety cannot be greater than that against the principal debtor and can only be made if the principal debtor has first defaulted," F.P. DE ROOY, *op. cit.*, note 35, p. 88. See also article 2341 C.c.Q. and article 2342 C.c.Q. Moreover, upon the surety so-called *bénéfice de discussion* is granted : he may demand that the creditor sue the original debtor first; L.M. COSTA, *op. cit.*, note 1, para. 308. The benefit of discussion is also provided for in articles 2347ff C.c.Q.

38. *Shutee* v. *Coalgate Grain Co.*, [1918] 172 P. 780; *Wynne, Love & Co.* v. *Bunch*, [1923] 157 Ark. 395, 248 S.W. 286. See also L.M. COSTA, *op. cit.*, note 1, para. 375.

may utilize, against the creditor (the beneficiary), all the defenses available for the original debtor (the buyer).[39] Thirdly, in both traditions, in order to detect default on the part of the applicant (which makes the bank's promise to pay due), the bank would have to inquire not only about the original terms of the sales contract, but also whether the underlying contract was valid and enforceable.[40] The incidental character of the *cautionnement* (the surety or guaranty) would consequently deprive the credit of any effectiveness that is ensured by its *autonomous* character.[41] Indeed, the parties to the credit wish to rely on the direct, primary and independent engagement of the bank, whose liability "arises upon the presentation of documents, not on the non performance of a principal obligor."[42]

It must be mentioned, however, that continental European banking practice has created another type of *guarantee*, the nature of which differs from the surety and from the guaranty. This **"unconditional" or "at first demand" bank guarantee** creates a primary and abstract liability on the part of the bank-guarantor,[43] which is entirely independent of the relationship between the bank and the customer. Although its abstract nature may indeed resemble credits

39. This would include, in particular, the *exceptio non adimpleti contractus*. See also L.M. COSTA, *op. cit.*, note 1, para. 300.

40. *Wichita Eagle & Beacon Publishing Co.* v. *Pacific National Bank*, [1974] 493 F. 2d 1285 (9th Cir.).

41. According to established jurisprudence even the invalidity, termination or non-existence of the underlying contract does not affect the bank's obligation to pay. See F.P. DE ROOY, *op. cit.*, note 35, p. 89. For the authorities see in particular L.M. COSTA, *op. cit.*, note 1, para. 305, at fn 71.

42. J.F. DOLAN, *op. cit.*, note 12, para. 2.10 [1]. For these reasons, the American courts "recognize that surety rules regarding consideration, damages, construction, security, release, and subrogation do not apply to letters of credit, which have developed their own special rules in these areas;" *Ibid.* As regards the United States, another formal argument may also be put forward : private institutions are not permitted to issue guarantees, which is reserved only for governmental bodies; L.M. COSTA, *op. cit.*, note 1, para. 378; a significant number of bibliographical references on the topic are given at n° 207. The author points out that another complication would appear, that is the problem of the applicability of the formal requirements of the Statute of Frauds, *Id.* para. 376. J.F. Dolan also deals with the American Statute of Frauds; J.F. DOLAN, *op. cit.*, note 12, para. 3.03 [3]. All the above would be the reason the American banking practice has developed the functional equivalent for the guaranty, which is the stand-by letter of credit. See note 44 below.

43. B. KOZOLCHYK, "The Legal Nature...", *loc. cit.*, note 9, p. 239.

(and in particular, its relationship to the stand-by letters of credit might be confusing), bank guarantees and credits may, nevertheless, be distinguished by their *functions*. Firstly, the guaranty is employed to ensure that *another* debt will be paid, while in the credit operation the only "guaranty" is the financial standing and the reputation of the particular bank who promises that *this bank's obligation* (and not someone else's) will be duly performed. Secondly, under this guaranty, proof of default (which could be a beneficiary's mere statement of the buyer's default) is nonetheless required. For these reasons, it resembles more the *stand-by letter of credit* rather than the *commercial* one.[44]

The credit does not arise from **a contract for the benefit of a third party (*la stipulation pour autrui*[45])** either, even though both the credit and the third party stipulation confer a right upon a third party beneficiary. The stipulation, however, constitutes part of the contract between the promisor and the stipulator (the bank and the account party), and, therefore, it is entirely subordinated to this contract, and subject to any claims relating to the relationship of cover. If this were applied to the credit, the *autonomy* rule would have been patently contravened. For the same reasons, this theory

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44. According to Folsom, Gordon and Spanogle, stand-bys are "almost a mirror image of the letter of credit in the documentary sale. In the stand-by credit, the account party is the contractor [...] the beneficiary is the purchaser [...] and the documents do not control goods and have no independent value of their own. Often the documentation is mere certification," R.H. FOLSOM, M.W. GORDON, J.A. SPANOGLE, *International Business Transactions : A Problem-Oriented Coursebook*, St. Paul, Minn., West Pub., 1991, p. 156. As regards stand-by letters of credit, I am of the opinion the stand-by credit and the bank guarantee perform basically the same functions and, therefore, their nature is at least very similar (especially when juxtaposed with the documentary letter of credit). This is the reason a specific body of rules applies only to the former, such as the *United Nations Convention on Independent Guarantees and Stand-by Letters of Credit* (January 26, 1996), A/RES/50/48, or the *International Standby Practices ISP '98* (ICC Publ. N° 590) and *Uniform Rules for Demand Guarantees* (1992) (demand guarantees are deemed to be the functional equivalent of the stand-by letter of credit) by the International Chamber of Commerce, accompanied by some other publications that compare the rules on documentary letters of credits and stand-by letters of credit : *UCP 500 and ISP '98 Compared* (ICC Publ. N° 950) or *The Official Commentary on the International Standby Practices* (ICC Publ. N° 947). An examination of their subtle differences, however, requires a more thorough analysis, certainly beyond the scope and the objectives of the present study.

45. Articles 1119ff C.C., articles 1444ff C.c.Q.

is rejected in those common law jurisdictions that do recognize the *ius quæsitum tertio*.[46] The benefit arising out of the contract would be greatly affected by the contract between the applicant and the bank and would be subject to underlying equities.[47]

On similar grounds, the **assignment** or a ***novation* theory** fails. The assignment, whether conceptualized as the assignment to the beneficiary of the applicant's right to demand payment from the bank, or whether interpreted as the assignment of the profits resulting from the contract between the applicant and the bank, would make the bank's obligation towards the beneficiary even more bound to, or dependent on, the cover relationship.[48] The *novation* would also assume that the buyer's basic obligation under the sales contract is discharged at the moment the credit is issued. This means that the seller would lose all the rights he has against the buyer and would be denied the right to demand the price. Both concepts are obviously not suitable in any case.

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46. Under common law, the primary obstacle is the traditional hostility to recognizing third party beneficiary's rights. This is the natural result of the strict interpretation of the principle that contract requires consideration. See *inter alia*, M.M. MACINTYRE, "Third Party Rights in Canadian and English Law", (1965) 2 *UBCL Rev.*, p. 103. Since the beneficiary is not a party to the contract, he has not provided consideration and is deprived of the right to sue upon the contract (on this issue, see also Part II A below). Although English law, as well as the other common law jurisdictions, has been significantly changed since the adoption of this rule, the legislative reform of the common law in this regard is fairly recent: Western Australia (1969), Queensland (1974), New Zealand (1982), England (1999). In the United States, the rule was overridden a long time ago in the landmark case *Lawrence* v. *Fox*, [1859] 20 NY 268, subsequently adopted in the Restatements on Contracts. Notwithstanding the critics, the laws of Canada (except Prince Edward Island and Québec) tend to preserve the traditional strict approach to the principle of "privity of contract."

47. For instance, the bank's supervening insolvency, fraud, "as well as the lack, insufficiency, or inadequacy of considerations affecting the underlying agreement may be raised as defenses" against the beneficiary; B. KOZOLCHYK, "The Legal Nature...", *loc. cit.*, note 9, p. 406. The possibility of the bank's defense that the irrevocable letter of credit is not binding because the bank has not received consideration, is dealt with in Part II A below.

48. See B. KOZOLCHYK, "El credito documentario en el derecho americano — Un estudio comparativo". Madrid, Ediciones Cultura Híspánica, 1973, in L.M. COSTA, *op. cit.*, note 1, para. 398.

2. Unclear Establishment of the Performance Relationship

While the first group of legal theories failed to explain the independence of the credit from either the relationship of cover, or the relationship of value, the following theory obfuscates the moment at which the bank's obligation arises.

This is also another argument against the **contract for the benefit of a third party** theory. The right to claim the benefit is conferred upon the third party beneficiary at the time the contract is concluded (since the stipulation constitutes the important covenant thereof) and it may be withdrawn as long as the beneficiary does not communicate his acceptance thereof.[49] The *credit* is, however, established no sooner than at the notification of the issuing of the credit[50] and no acceptance by the beneficiary is required to make the bank's promise binding.[51]

Moreover, the credit is not a **delegation** (***la délégation***),[52] a three-party institution, by which a debtor gives his creditor another debtor, who enters into a commitment in favor of the creditor and assumes a direct and personal liability towards the creditor. The buyer might certainly be treated as the original debtor (*le délégant*, the delegator), the bank would be a secondary debtor (*le délégué*, the delegate) and the beneficiary would be the creditor (*le délégataire*, the delegatee). Here, the imperfect (incomplete) delegation could be used, where the creditor-beneficiary does not consent to discharging his original debtor (the buyer) from his debt; it does not result in *novation*. Although this second debt is absolutely independent and separate from the original one — which would finally preserve the *autonomy* of the documentary credit — in order to make the obligation of the

49. Article 1121 para. 2 C.C., article 1446 C.c.Q.

50. L.M. COSTA, *op. cit.*, note 1, at para. 319 and s. 320; F.P. DE ROOY, *op. cit.*, note 35, at 92 and 93 and in particular at fn 25; B. KOZOLCHYK, "The Legal Nature...", *loc. cit.*, note 9, p. 411; J.F. DOLAN, *op. cit.*, note 14, para. 5.01[1]; and the literature cited there.

51. See the discussion under Part II A below.

52. Article 1275 C.C., and article 1667 C.c.Q.

second debtor (*le delegué*) legally binding, the consent of the creditor (*le délégataire*) is required.[53]

Contrary to the Romanist *délégation*, however, the Germanic **delegation** (***Anweisung, l'assignation***) consists of a *double authorization* to demand and receive payment; no right (liability) is created yet.[54] The second debtor becomes bound towards the creditor, not upon the acceptance of the delegation by the latter, but upon the declaration of self as the debtor. Moreover, such *unilateral acceptance* of the delegation by the *délégué* is *abstracted* from any accompanying legal relationship that it has resulted from; there is no possibility for the *délégué* to utilize, against the *délégataire,* the exceptions available against the *délégant*, neither may the *délégué* avail him of the exceptions that the *délégant* has as against the *délégataire*. This concept would then perfectly match the credit's characteristic setup : the bank would become liable to the beneficiary upon the unilateral notification of the issuance of the credit (being re-conceptualized as the unilateral acceptance of the delegation), and this obligation would be independent of the ("abstract") relationships that it is functionally (or "chronologically") related to. Not surprisingly, according to almost unanimous opinion, the *Anweisung* is the true nature of the letter of credit.[55]

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53. F.P. DE ROOY, *op. cit.*, note 35, p. 94. See also L.M. COSTA, *op. cit.*, note 1, para. 328. However, according to article 1670 C.c.Q., the second debtor may utilize, against the creditor, all such defenses as the original debtor could have raised against the creditor. Translated into the credit's language, this would allow the bank to utilize, against the beneficiary, the defenses available to the buyer under the sales agreement.

54. Article 783 of BGB, article 466 of ZGB, article 1400 of the *Allgemeines Bürgerliches Gesetzbuch* (Austrian Civil Code) (ABGB).

55. In particular, see the literature extensively cited in S. TEVINI DU PASQUIER, *Le crédit documentaire en droit Suisse : Droits et obligations de la banque mandataire et assignée*, Bâle et Francfort-sur-le-Main, Helbing & Lichtenhahn, 1990, p. 69; N. DE GOTTRAU, *Le Crédit documentaire et la fraude : La fraude du bénéficiaire, ses conséquences et les moyens de protection du donneur d'ordre*, Bâle, Helbing & Lichtenhahn, 1990, p. 39. According to Kozolchyk, in order to legally bind the payor, the *Anweisung* must be combined with the other legal mechanism, namely, the *Schuldversprechen* (a promise of debt — § 780 BGB), which is the uniquely Germanic vehicle as well. However, he is of the opinion that the *Anweisung* could only explain the old "buyer's credit," and is of no use for the clarification of the nature of the modern commercial letter of credit. See B. KOZOLCHYK, "The Legal Nature...", *loc. cit.*, note 9, n° 49 and expanded in B. KOZOLCHYK, "Letters of Credit...", *loc. cit.*, note 9, para. 244. These concerns seem to be irrelevant for the others, see S. TEVINI DU PASQUIER, *ibid.*

3. Desperate Resorts : Function Over Formal Structure

The inadequacy of the non-Germanic contractual theories invited some authors to search for a proper conceptualization of the letter of credit in domains other than the law of contract, which are said to be justified by the functional similarity of the credit to these specific concepts.

For instance, the formal nature of **negotiable instruments** may resemble documentary credits : both typically engage at least three parties and both contain promises to pay that are *abstracted* from the underlying transactions that have given rise to their creation. Documentary credits were sometimes characterized as promises analogous to *aval*, as *acceptances* in advance of a draft to be drawn by the beneficiary (since credits very often consisted of the promise to accept the drafts presented by the beneficiary),[56] or as drafts themselves.[57]

According to the Geneva Convention[58] (binding in many civil law jurisdictions) however, such attempts have no sense, as there are strict formal requirements in this regard, and even though in common law jurisdictions where the Convention does not apply, the same arguments exclude this theory here as well. In either tradition aval must not be given *outside* the bill of exchange; to be valid, the aval must be formally signed *on* the bill.[59] The same refers to acceptance,[60] but what is more, the acceptance must be unconditional and

56. The acceptance necessarily had to be made *in advance* (or be "virtual", or "extrinsic"), as it had been made before the bill was drawn and it did not appear on the face of the document. J.F. DOLAN, *op. cit.*, note 12, para. 3.03 [1].

57. F.P. DE ROOY, *op. cit.*, note 35, p. 90ff.

58. *Convention portant Loi Uniforme concernant La Lettre de change et le billet à ordre*, concluded in Geneva on 7th June, 1930. The "Geneva system" is accepted in Continental Europe, Latin America, Japan and Russia.

59. Article 32 of the Convention. Moreover, "the guarantor (*donneur d'aval*) is liable in the same way as the one for whom he has stood surety."

60. Article 25 of the Convention. Although a separation of the acceptance (that also must be an unconditional promise to pay) from the draft frequently caused great doctrinal controversy, the English courts (but not the American) enforced such a virtual (extrinsic) acceptance nonetheless; J.F. DOLAN, *op. cit.*, note 14, at para. 3.03 [3]. See also F.P. DE ROOY, *op. cit.*, note 35, p. 96-97. Besides, although commonly used, drafts are not essential in the credit setup.

cannot modify the wording of the bill.[61] Under the Convention, the credit cannot be a bill either, as the text of the document must contain the words "bill of exchange" or "promissory note," which is equivalent to — again — an *unconditional* promise to pay.[62] Moreover, as De Rooy observes, "the draft is abstracted from the underlying relationship in any relationship in which a third party is involved, but not in the drawer/drawee relationship,"[63] and as per a functional analogy, under the common law *consideration* must be present as between the immediate parties to the instrument.[64]

If the credit were conceptualized as the common law **trust** arrangement, the structure would appear as follows: the settlor (the applicant) transfers a property to the trustee (the bank), who agrees to administer the property for the benefit of the beneficiary and to eventually vest it in the

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61. The only valid modification made in the acceptance to the wording of the bill of exchange is the limitation of the amount due, any other is tantamount to a refusal to accept the draft (article 26 and article 28 of the Convention).

62. The conditional character of the bank's promise should not be questioned, as only the proper tendering of specific documents makes this obligation due and effective. It is argued that the very meaning of *condition* is confusing, as this term might be subject to different interpretations. See B. KOZOLCHYK, "The Legal Nature...", *loc. cit.*, note 9, p. 417 and B. KOZOLCHYK, "Letters of Credit...", *loc. cit.*, note 9, para. 245. Indeed, a more exhaustive study should examine the nature of the *condition* that is meant by the Convention and by the UCP, and in particular, how the so-called *condition potestative* (i.e. the condition depending *solely* on the will of one party, here the beneficiary) could be classified in this respect.

63. F.P. DE ROOY, *op. cit.*, note 35, p. 98. And what is more, in order to obtain payment under the draft, the creditor must present the accepted bill to the payee, while the "letter of advice is irrelevant under the documentary credit"; *Ibid.*

64. As it is argued that "the effects of the law merchant on the common law is to make bills and notes negotiable but not to make promises binding without consideration;" MCCURDY, "Commercial Letters of Credit", cited in B. KOZOLCHYK, "The Legal Nature...", *loc. cit.*, note 9, p. 414. In common law jurisdictions this theory was eventually rendered obsolete as a result of legislative interventions (in England, by the adoption of the Bills of Exchange Act, 1882). In the United States, the existing case law was embodied in the UCC (§ 3-410); J.F. DOLAN, *op. cit.*, note 12, para. 3.03 [5]. As J.F. Dolan summarized this point, "[l]etters of credit are not negotiable instruments. They usually do not contain the language of negotiability; they often contain a conditioned promise; and negotiability is not necessary for, and perhaps would be harmful to, their effective operation. It is clear from the transfer rules that apply to credits, that a transferee stands in the shoes of the original beneficiary and does not enjoy good-faith-purchase protection"; *ibid.* The applicability of the *bona fide* purchaser exception (related to the *fraud* issue) is, however, confusing, which is rather not consistently dealt with by the jurisprudence.

beneficiary. As the trust is not, however, enforceable until properly constituted,[65] this theory would not apply to credits where the bank does not receive anything from the applicant but the obligation to reimburse the amounts given to the beneficiary; this "property" issue is absent under the letters of credit law.[66] Before constitution, the beneficiary may enforce the so-called executory trust only on the grounds of contract law : he must give valuable consideration to make the bank's promise binding and enforceable.[67] Aside from this, the trust theory would clearly distort not only the parties' intentions,[68] but also the very functions of either the trust or the credit.[69] It would also impose upon the parties the burden of expressly excluding the strict default trust regime (to the extent allowed), as provided by case law and the appropriate *Trustee Acts*. Such a proposition would be completely unacceptable for commercial practice.[70]

Employment of the **estoppel** theory could "prevent or estop [the bank] from going back on his word or repudiating his previous conduct when [the beneficiary] has relied upon

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65. This means that unless the trust property is properly vested in the trustee — i.e. unless the applicant bestows a certain amount of money on the bank. See *Re Schebsman*, [1944] Ch. 83, [1943] 2 All E.R. 768.

66. It may be the case of open credit lines, or paying the credit out of the bank's own funds and granting the credit to the applicant thereby. The English case, *Morgan* v. *Larivière*, [1875] rejected this theory; see L.M. COSTA, *op. cit.*, note 1, para. 417, n° 287.

67. A.H. OOSTERHOOF, E.F. GILLESE, *Text, Commentary and Cases on Trusts*, 5th ed., Scarborough, Carswell, p. 177, 196. This issue will be dealt with in Part II A, below. See also *Re Cook's Settlement Trust*, [1965] Ch. 902, [1964] 3 All E.R. 898, and *Re Ellenborough Towry Law* v. *Burne*, [1903] 1 Ch. 697.

68. The manifest and certain intent to create a trust is one of the so-called three certainties, the prerequisites for the establishment of a trust; A.H. OOSTERHOOF, GILLESE, *op. cit.*, note 67, p. 139 and 145ff.

69. On this issue see, in particular, H. HANSMANN, U. MATTEI, "The Functions of Trust Law : A Comparative Legal and Economic Analysis", (1998) 73 *N.Y.U.L.R.*, p. 434. Contrary to trusts, credits "simply" assure proper payment for merchandise transactions made at distance, by involving a professional intermediary dealing with the documentary aspects of the transaction.

70. Sarna finds little support for this theory in case law and comments by citing the same *Morgan* v. *Larivière*, *supra*, note 66, that "any banker ... would be very much surprised to find that it was held that a certain portion of the funds of his customer in his hands had been impressed with a trust, had been equitably assigned and had in fact ceased to be the moneys of the customer;" L. SARNA, *op. cit.*, note 8, p. 2-19.

it".[71] The protection that would be given to the interests of the beneficiary is, however, scarcely satisfactory. Estoppel, as an equitable vehicle, would grant the beneficiary only a "shield" and not a "sword," i.e. it would not bestow on him a direct cause of action against the bank.[72] Furthermore, under the credit, there is no detrimental reliance on the promisee (beneficiary) on a representation of fact.[73] Finally, estoppel provides no adequate explanation as to when the credit becomes irrevocable.[74]

As we see, the "legal frameworks" are indeed inappropriate. Specific *types* of contract recognized under respective legal traditions either were incompatible with the function of the credit, or these contracts required to be altered to the extent that their *nature* would become totally distorted. The credit, if explained in terms of the specific types of contract that exist in the respective legal traditions: (1) is either unavoidably intertwined with other relationships (the cover relationship or the value relationship) or, (2) the available concepts cannot not fully explain when the bank becomes obliged and *why* this is so, or (3) in order to make the bank's undertaking binding (irrevocable), they required the active cooperation of the beneficiary (either in the form of acceptance, consent, or consideration); any satisfactory theory for the letter of credit must then resolve all these issues. The apparent shortcomings of these contractual theories require a shift in the analysis towards a more general plan — a thorough study of *contract* as a source and the central concept of private law obligations.

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71. *Central London Property Trust Ltd.* v. *High Trees House Ltd.*, [1947] KB 130. See also M.H. WHINCUP, *Contract Law and Practice: The English System and Continental Comparisons*, 4th rev. and enl. ed., The Hague, Kluwer Law International, 2001, para. 3.57.

72. *Combe* v. *Combe*, [1951] 2 KB 215, 1 All E.R. 767.

73. For the representation of fact should then consequently be the notification of the establishment of the bank's undertaking. L. SARNA, *op. cit.*, note 8, p. 2-18. See also the "contractual" analysis in Part II A, below.

74. As there is definitely no representation made yet; L. SARNA, *op. cit.*, note 8, p. 2-19. Costa rejects this theory on the basis that subordination of the moment of the establishment of the credit to the purely factual condition the actual receipt is, would result in enormous uncertainty in this regard; L.M. COSTA, *op. cit.*, note 1, para. 410.

II. CONCEPTUALIZATION : A CONTRACT

We could probably ensure the autonomy of the credit if we conceived it as a *separate* contract between the bank and the beneficiary, and its establishment — in terms of contract formation; however, the documentary letter of credit also seems to break through the conceptual framework of traditional contract law. Shall we then place it outside the borders of contract law (II A)? Or, maybe the law of contract might embrace it anyway? In this last case, however, we will have to question and then revalue the very concept of what the contract is (II B).

A. THE EVASION : A NEW EXCEPTION TO THE FORM

1. Formation of Contract[75]

In general, a contract is validly concluded when the consent of the offeror matches that of the offeree, that is, upon the acceptance of the offer. Under **French civil law**, the credit, as a contract, will necessarily have a *consensual* nature : the cooperation of the beneficiary would be a must there.[76] What is more, to avoid the revocability of the credit, the bank should also expressly fix the period during which its "offer" will remain binding[77]; however, even then revocation

75. It goes far beyond the scope of this work to draw a complete picture of the rules governing the formation of contract. Here, only the aspects relevant to the discussion on the letter of credit will be considered : contract definition, the binding (or otherwise) character of the offer, the moment when the parties become contractually bound (as per wide range of particular "postal rules"), and the legal presumptions as to the interpretation of the parties' intentions, which would imply issuance of the offer or acceptance from their conduct, and sometimes even from their mere silence.

76. Article 1101 C.C. and article 1378 C.c.Q. Although a "contract is an agreement of wills," there must also be a valid and legal *causa* and object of the contract; otherwise, the contract is null and void (articles 1371, 1411 and 1413 C.c.Q.). See also M.H. WHINCUP, *op. cit.*, note 71, at para. 1.44 and 1.45.

77. Otherwise, the offer may be revoked at any time before acceptance is received by the offeror (article 1390 C.c.Q.; in France, this is a case law rule); K. ZWEIGERT, H. KÖTZ, *op. cit.*, note 34, p. 39. Under some other codes, if the period for acceptance has been specified, no withdrawal is possible, or, as in Italy, the law protects good faith (reliance interest) of the offeree. *Id.*, p. 41. And under the credit, although the bank always fixes a term for its validity, it indicates the moment its *obligation expires* rather than the term of the *validity of the offer*.

of the credit without any legal grounds would eventually entitle the beneficiary to damages only, and not to the amount of the credit.[78] A possible solution could be found in the tacit acceptance theory: as the letter of credit is to the exclusive interest of the beneficiary, then his acceptance could be deemed.[79]

Contrary to the above, the **Germanic** concept of the binding offer is much more convenient for the offeree.[80] "The offeror is not simply under a duty not to withdraw the offer, but actually has no power to do so; instead of giving rise to liability in damages, therefore, an attempted withdrawal simply has no legal effect at all."[81] Furthermore, as declarations of intent are here effective upon receipt, the contract is concluded when the acceptance "comes into the sphere of influence of the addressee".[82] It is also possible to conclude a contract by tacit consent: amongst other exceptions,[83] when "normal usage" provides so, or when the offer is made in the

78. For the offeree is unable to form the contract at this stage. *Ibid.*

79. B. MARKESINIS, *The German Law of Obligations*, in B.S. MARKESINIS, W. LORENZ, G. DANNEMANN (eds.), *Volume I: The Law of Contracts and Restitution: A Comparative Introduction*, Oxford: Clarendon Press, 1997, p. 58. Similarly R. SACCO, "Formation of Contracts," in A. HARTKAMP *et al.* (eds.), *Towards a European Civil Code*, 2nd rev. and exp. ed., The Hague, Ars Aequi Libri Nijmegen, Kluwer Law International, 1998, p. 194ff. Besides, within the Romanistic family, there is utter theoretical confusion (naturally resulting in inconsistent practical outcomes) as to what are the exact legal consequences for the offer. For a noteworthy review of different explanations as to the actual meaning of the binding force or irrevocability of the offer and its corollary, the possible effects of the revocation as well as the nature of the liability resulting from the revocation — see M. COIPEL, "La théorie de l'engagement par volonté unilatérale," Case comm. on the decision of the Belgian Cour de Cassation, 3rd chamber, December 18, 1974, (1980) 34 *Rev. Crit. Jurispr. Belge*, p. 80. See also at point (3) below.

80. § 145 BGB. It is also binding for instance in Denmark, Spain, Switzerland, Brazil and Greece; K. ZWEIGERT, H. KÖTZ, *op. cit.*, note 34, p. 41.

81. *Ibid.* See also: M. PÉDAMON, *Le contrat en droit allemand*, Paris, L.G.D.J., 1993, p. 31ff.

82. K. ZWEIGERT, H. KÖTZ, *op. cit.*, note 34, p. 42; A.T. VON MEHREN, "The Formation of Contracts", in P. SIEBECK (ed.), *International Encyclopedia of Comparative Law, Contracts in General*, vol. 7, ch. 9, Tübingen, J.C.B. Mohr, 1992, para. 182 on § 130 B.G.B.

83. The donation (§ 516 B.G.B.), the rule that common usage and good faith may attribute the effects to acts or omissions, including silence (§ 346 of the *Handel Gesetzbuch*, German Commercial Code, H.G.B.), the long-established business relationships between the partners (course of dealing) (§ 362 H.G.B.); B. MARKESINIS, *op. cit.*, note 79, p. 59.

sole interest of the offeree.[84] Here, the issuance of the credit would be easily re-conceptualized as a binding and irrevocable offer to the beneficiary, who would be able to *unilaterally* conclude the contract by the tendering of documents; his acceptance might be even presumed.[85]

And finally, **the common law** contract is formed not only by manifestation of assent by the parties thereto, but also a specific counterpart from the offeree is needed, namely a sufficient consideration.[86] As only the latter confirms the earnestness of the offeree (and by the same token, justifies the binding force of contractual offer), the common law offer is by principle revocable[87] until the moment the offeree dispatches his acceptance.[88] This also means that the discussion on the acceptance by mere silence is pointless here. In the United States, however, one can observe a movement towards recognizing the binding character of offers in some particular instances, especially when the offeror should reasonably have expected that the offer would induce action or forbearance of

84. R. SACCO, *loc. cit.*, note 79, p. 194 on § 151 B.G.B.

85. The consensual structure of a Germanic contract, however, encounters some other difficulties; see point (3) below.

86. A.T. VON MEHREN, *op. cit.*, note 82, para. 138. Even though its origins remain controversial, the modern rule was definitely established in *Dunlop Pneumatic Tyre Co. Ltd.* v. *Selfridge & Co. Ltd.*, [1915] A.C. 847. A consideration "cannot be past [...], must move from the promisee [and] must be sufficient, but need not be adequate;" M. WHINCUP, *op. cit.*, note 71, p. 64ff, who interprets the rule as a peculiarity of English law's definition of *acceptance*. See also R. JACK, *Documentary Credits : The Law and Practice of Documentary Credits Including Stand-by Credits and Demand Guarantees*, 2nd ed., London, Butterworths, 1993, para. 5.3. and M. FURMSTON, *Cheshire, Fifoot & Furmston's Law of Contract*, 14th ed., Butterworths, Lexis Nexis, at 82ff.

87. *Routledge* v. *Grant*, [1823] 4 Bing 653. And even if the offeror "has declared his readiness to be bound to his offer for a stated period... he is legally free quite capriciously to withdraw it before that period elapses;" K. ZWEIGERT, H. KÖTZ, *op. cit.*, note 34, p. 37.

88. *Payne* v. *Cave*, [1789] 3 Term Rep 148. According to the so-called "postal rules," as per the famous landmark decision in *Adams* v. *Lindsell*, [1818] 106 ER 250 under which the "mailbox theory" emerged; K. ZWEIGERT, H. KÖTZ, *op. cit.*, note 34, at 38; A.T. VON MEHREN, *op. cit.*, note 82, para. 183. The incompatibility of such a solution with the consensual nature of contract and with the rules on all other declarations of intent is pointed out by Zweigert & Kötz : "all other declarations... must reach the addressee before they are effective, yet a *contract* can come into existence without the offeror's knowledge." K. ZWEIGERT, H. KÖTZ, *ibid.*

a substantial character on the part of the offeree.[89] For all these reasons, the common law contractual interpretation of the documentary credit faces not only the civil law "acceptance obstacles" (acceptance must be express and not silent), but also needs to identify a consideration moving from the beneficiary to the bank. It also needs to reconcile the moment the credit is established, with its "mailbox theories."

2. "Contractual" Formation of the Credit

Contrary to the above, the UCP emphasizes the unilateral character of the bank's obligation ("a definite undertaking by the bank to pay") rather than a contractual one. United States laws seem to share this point of view.[90] In order to determine whether an explanation of the binding force of the irrevocable documentary credit, in terms of contractual theories, is possible and justified, the beneficiary's "co-operation" (his assent or counterpart) must be identified at any point in the formation of the credit.[91]

It cannot be found at the moment **the sales contract is concluded** — the beneficiary cannot communicate his consent to the bank's "offer" *prior* to the moment the offer is made and without knowledge of its terms and conditions.[92]

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89. Section 69 of the American Restatement of Contracts (2nd): Acceptance by Silence or Exercise of Dominion, provides that silence would amount to the assent in the case of existing usage to this end, according to the prior dealings between the parties, or in the specific factual circumstances of the individual case. Some authors may argue that in the particular situation the requirement of acceptance could be waived, for instance, in accordance with mercantile usage. Nonetheless, it still calls for an explanation as to *why* it should be so; E. ERRANTE, *The Anglo-American Law of Contracts: Le droit anglo-américain des contrats*, trans. by R. Devreux, 2nd ed., Paris, L.G.D.J. — Jupiter, E.J.A., 2001, p. 44. Anyway, even then the offer is regarded as legally "binding only to the extent to avoid injustice;" Restatement (2nd) of Contracts (1981), section 87 para. 2. The same wording is provided for in section 90, referring to *promises* in general; K. ZWEIGERT, H. KÖTZ, *op. cit.*, note 34, p. 38.

90. See section 5-102(10) of the UCC.

91. By the same token it would also justify (in part at least) the applicability of theories requiring the acceptance of the beneficiary, such as his consent to the delegation or consent to a stipulation in his favor.

92. As such, an "acceptance" would also form a part of the underlying contract; this would also involve credit with the value relationship and expose the formation of the credit to the risk of possible claims as to the validity or enforceability of the sales contract.

Neither can the beneficiary conclude a "credit contract" by **acting in reliance on the notification of the issuance of the credit**.[93] Such a proposition would cause unimaginable uncertainty and clearly go against the *autonomy* rule — it would force the bank to investigate factual issues such as for example, the moment the beneficiary starts production of the goods being ordered, or their shipment.[94] Moreover, it would also mean that the bank's promise could be revoked prior to shipment, which would deprive the credit of its actual strength. Moreover, even though this concept obviously would be particularly attractive for the common law family (sufficient consideration may be found in a detriment suffered by the offeree[95]), in fact, a beneficiary acting in reliance on the notification (i.e. preparing himself for the collection of goods or their shipment etc.), actually does nothing but perform a sales contract with the buyer. His consideration is "past" and does not amount to "value" that would render the promise firm.[96]

Furthermore, the beneficiary's **tacit acceptance** of the bank's offer can be recognized only under civil law. It either would be deemed made exclusively in the beneficiary's interest or, because the beneficiary has "provoked" the issuance of the offer, it would be right to assume that he accepts it when he does not immediately object to it.[97] But what if he does? It is argued that even then the beneficiary is still able to use the credit in accordance with its (being questioned) terms; such an

93. This would indeed sound fair under those legal systems that do not recognize binding offers, as a reasonable protection for the offeree (the beneficiary), or under those where even the offer may be revocable, but unjustified revocation does not confer a right upon the offeree to force the offeror to conclude the contract, as in the case of the French C.C.

94. As a premise — the bank should know the terms and conditions of the base contract as well, in order to be able to ascertain whether the beneficiary is performing in accordance with that contract; L.M. COSTA, *op. cit.*, note 1, para. 353.

95. See M. WHINCUP, *op. cit.*, note 71, para. 2.38. The "morals" argument could also supplement this concept, as morals and good faith would require the fulfillment of the expectations raised by the inducement of the other person to part with his property (documents); see J.F. DOLAN, *op. cit.*, note 12, para. 3.03 [1].

96. R. JACK, *op. cit.*, note 86, para. 5.10.

97. M. COIPEL, *loc. cit.*, note 79, p. 80.

attempt does not amount to a counter-offer.[98] Indeed, the beneficiary and the bank do not negotiate.[99] The conclusive counterargument is, however, that there is no indication whatsoever as to *when* the bank's obligation would become effective here (as no one knows exactly when the offer has been silently accepted); consequently, the inconsistency of possible outcomes and the degree of uncertainty would be apparent.[100]

If the beneficiary expressed his acceptance at the moment **the documents are presented to the bank**, it could amount to valuable consideration as well.[101] At this final stage of an *irrevocable credit* transaction, such a concept does not, however, have any practical utility.

The credit cannot be conceptualized as the **bank's acceptance of the beneficiary's offer** — presumably, expressed in the underlying contract — either. Despite the fact it would render the bank's commitment binding *before* any subsequent actions on the part of the beneficiary, the theoretical shortcomings of such a theory are evident. For instance, there might be no compatibility between the "offer" and the "acceptance".[102] What is more, if the seller's offer

98. B. KOZOLCHYK, "Letters of Credit...", *loc. cit.*, note 9, para. 236.

99. However, the impossibility to negotiate here might be explained by at least four reasons: (i) by the adhesionary character of this contract, (ii) by the bank's other obligation towards the applicant: he cannot amend the credit without the applicant's consent, for otherwise, he might be held liable for a breach of the contract in the cover relationship; (iii) by the wording of article 9(d)(i) of the UCP; (iv) last but not least, by the very fact it is the unilateral promise that produces the legal effects; the beneficiary's acts are therefore irrelevant.

100. As Kozolchyk rightly argues, "even if the beneficiary's consent could be implied from his silence... the irrevocable credit could only be deemed as established from the moment the silence actually commenced, at best a most uncertain rule." This argument, used against the delegation theory, is nevertheless still applicable to any theory requiring the beneficiary's consent, which purports to imply it from his silence; B. KOZOLCHYK, "Letters of Credit...", *loc. cit.*, note 9, para. 240.

101. R. Jack finds the *presentation* of the documents as the only moment where the beneficiary can be held as providing consideration to the bank. Thus, the offer and acceptance theory cannot explain why the bank becomes bound — or why the contract is established — prior thereto, i.e. "at the time the credit was first advised to him;" R. JACK, *op. cit.*, note 86, para. 5.7 and 5.11.

102. As the seller seldom knows which bank would be the issuing bank (the choice may be left to the buyer), or the underlying contract does not have to specify in detail the precise terms of the credit. The notification of the credit may also set conditions not previously agreed or introduce some changes to the existing ones.

constitutes an element of the underlying contract, its validity or effectiveness would be subject to the validity or effectiveness of that contract.[103]

Furthermore, there is **no consideration** perfecting the bank's promise to pay. The only consideration that moves to the bank would be the one given by the applicant. He is, however, a third party to the contract between the bank and the beneficiary.[104] In such a case, even though the credit would become binding from the very moment of its issuance (for it would be supported by consideration), consideration would move indirectly, from the buyer acting presumably as the seller's agent; and this again would undermine the autonomy of the credit.[105]

Finally, the credit cannot even be a **unilateral contract**; although "unilateral," the contract still needs the acceptance (by conduct) coming from the offeree.[106]

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103. L.M. COSTA, *op. cit.*, note 1, para. 367.

104. This is in fact the common law counterpart of the civil law *contract for the benefit of third party* theory.

105. For the consideration moved under the cover relationship, but to support the payment relationship. R. JACK, *op. cit.*, note 86, at para. 5.12. See also J.F. DOLAN, *op. cit.*, note 12, at para. 3.03[1] and in particular B. KOZOLCHYK, "Letters of Credit...", *loc. cit.*, note 9, at para. 237. It is likely that the bank, if able to prove the absence of such consideration, would be allowed to claim that the contract with the beneficiary was unenforceable or void. Secondly, this theory does not clarify why the beneficiary's acceptance is *not* required to make the contract binding, or "why could the beneficiary reject the terms of the contract or propose other terms and still, by complying with the original terms, enforce the bank's promise," *ibid.*

106. A contract is unilateral when "a promise on condition of performance on the part of the promisee, without a counter-promise, is considered an offer calling for an act, opposite to the offer calling for an acceptance;" R. SACCO, *loc. cit.*, note 79, p. 193. He argues, however, that as the performance of the promisee is silent and may represent several things (for instance, the fulfillment may be unintentional), a study as to his intention is not relevant, and as "the performance concludes the contract and the assent of the promisee is not necessary, *a contract is, therefore, reduced to a promise* [emphasis added], under a condition of performance by the offeree and followed by the fulfillment of the condition;" *ibid.* On the contrary, Errante alleges that the acceptance in a unilateral contract must be voluntary and done with the knowledge of the offer, and consequently, the offeree's intention should matter; E. ERRANTE, *op. cit.*, note 89, p. 50. The other controversial issue would be the duty to inform the offeror that the offeree has already started performing the contract. In a letter of credit, such a notification by the beneficiary is certainly not required either by practice, or by the UCP; L.M. COSTA, *op. cit.*, note 1, para. 359.

3. "Functional" Formation of the Credit: A Mercantile Specialty

It seems then, that instead of a discussion on how the letter of credit *should be* created according to theory, it is much more practical to figure out how it *is* created in practice, and in fact, according to the majority of legal commentators, the credit is established by a unilateral declaration on the part of the bank.[107] The only problem is the proper conceptualization of such a peculiarity.

As the "acceptance theories" have failed, the second ideal solution appears to be the **irrevocable offer** theory (admissible only under civil law). Setting aside all the controversies mentioned above, even if the offeror is somehow bound by his offer, his position should be and in fact is, different from the position he would have been in, had the contract been concluded. For his promise, to be perfected, still calls for acceptance on the part of the offeree, the beneficiary. On the other hand, however, it is said that "the beneficiary may express dissatisfaction with the terms or propose other terms but if he complies with the terms and conditions as stated, he is still entitled to payment under the credit".[108] So, if the beneficiary may change his mind without any immediate impact on

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107. Some authors may argue whether this means the moment when the bank *dispatches the advice of issuance*, for "this is the moment at which the bank loses the power to make any amendments to the contents of the credit" (F.P. DE ROOY, *op. cit.*, note 35, p. 82), or the moment the beneficiary *receives* the notification. Of other possible moments, "the time the beneficiary receives the credit instrument is the one most consistent with banking needs and practice;" B. KOZOLCHYK, "The Legal Nature...", *loc. cit.*, note 9, p. 411. Even though this discrepancy might be the result of different "postal rules" adopted in different legal systems, the latter seems to prevail; J.F. DOLAN, *op. cit.*, note 12, para. 5.01 [1]. See also the authors cited at note 50 above. Section 5-106(1) of the American UCC reaches a kind of compromise and stipulates that: Unless otherwise agreed, a credit is established a. as regards the customer, as soon as a letter of credit is *sent to him* or the letter of credit or an authorized written advice of its issuance is sent to the beneficiary; and b. as regards the beneficiary, when he *receives* a letter of credit or an authorized written advice of its issuance [emphasis added]. This solution is also controversial; De Rooy for instance criticizes the lack of logic, while Kozolchyk welcomes it with no objection at all. *Ibid.* See also article 42c and article 9d of UCP.

108. B. KOZOLCHYK, "Letters of Credit...", *loc. cit.*, note 9, para. 236, n° 792. For other counterarguments see also F.P. DE ROOY, *op. cit.*, note 35, p. 81ff. See also Sacco's similar discussion on the unilateral contract at note 106 above.

the bank's standing, it will mean that his intentions are indeed irrelevant. And thirdly, if we assume nonetheless that the beneficiary's consent is a prerequisite to create the bank's obligation, we have to analyze its quality in terms of the rules on declarations of intent. This would lead to possible deliberations as to whether the acceptance is sufficient, intended, clear, or valid, and whether there are some defects in it, etc.[109] In fact, the credit is most certain and predictable only when the beneficiary's intent is not relevant at all and when the only one that does matter is the will of the bank.[110]

The result is, in order to enhance the commercial utility of the documentary credit we shall admit it arises out of a **unilateral promise** of the issuing bank. Indeed, if the credit (or the UCP) expressly states that it is irrevocable, why should its irrevocability depend on any further action on the part of the beneficiary?[111]

Even though the unilateral formation of the credit seems to ensure practical results, it is not welcomed by legal theory. The most common doctrinal response (except from the Germanic legal tradition) is that "the documentary letter of credit is nothing more than a letter of credit,"[112] i.e. it constitutes a ***sui generis* contract** (*contrat innommé*, or the

109. This issue may not be of great practical value, as the possibility to question the validity of the acceptance usually serves to protect the interests of the *beneficiary* and since under the credit he is only entitled and not obliged to use it, there is little chance that such issues would ever be raised before the courts. The theoretical problem nevertheless exists.

110. R. JACK, *op. cit.*, note 86, para. 5.3.; B. KOZOLCHYK, "Letters of Credit...", *loc. cit.*, note 9, para. 241.

111. It is argued, however, that the unilateral promise theory would disregard the fact that the presentation of documents plays the essential role and it is a condition for the realization of the credit; it is not just one of the supplementary accessories to it; L.M. COSTA, *op. cit.*, note 1, para. 334, where she rejects the (contractual) delegation theory. This, however, is only a half-truth, as the documents are "essential" for the *operation* or *enforcement* of the credit and not necessarily indispensable at the stage of its *formation*. De Rooy similarly argues that "the assent of the beneficiary is not a prerequisite for the existence of the documentary credit;" F.P. DE ROOY, *op. cit.*, note 35, p. 81. Secondly, it is not surprising that the beneficiary must do something to get his payment; any creditor has to manifest his intention to enforce his right.

112. L.M. COSTA, *op. cit.*, note 1, para. 440.

common law equivalent — mercantile specialty[113]). *Sui generis* seems to provide a flexible yet accurate qualification in accordance with the parties' needs. The economic functions of the credit would delimit the parameters of such otherwise vague or amorphous concept; it is said that only this concept enhances the swift operation of the documentary transaction compliant with all the rules developed in practice.[114] Its other advantage would be the assurance of the unanimous international treatment of the credit, regardless of any particular conceptualization under domestic law. English case law, therefore, expresses no doubt that the letter of credit would be embraced by the domain of contract law, but would constitute an exception to the consideration rule[115]; U.S. law seems to take the same approach.[116]

Could, however, a simple labeling such as *sui generis* really dispense with all the obstacles considered above? Its protagonists usually emphasize the originality of the credit's objectives and mechanisms, but it is evident that this idea

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113. As per Kozolchyk, "[The irrevocable letter of credit] partakes of the nature of a contractual offer as much as it resembles an agency, third-party promise, delegation of debt, or suretyship arrangement, but under the influence of commercial practices these contractual ingredients have been mixed so thoroughly that the end product looks indeed *sui generis*. As a *sui generis* transaction it is still necessary to determine the reason for its binding effects." B. KOZOLCHYK, "The Legal Nature...", *loc. cit.*, note 9, p. 412.

114. L.M. COSTA, *op. cit.*, note 1, para. 430 and 269.

115. See the discussions of Dolan and Jack : J.F. DOLAN, *op. cit.*, note 14, para. 3.03[1]; R. JACK, *op. cit.*, note 86, para. 5.8. This is also the official position of the English Law Reform Commission; see THE LAW COMMISSION, *Privity of Contract : Contracts for the Benefit of Third Parties,* Consultation Paper N° 121, London, HMSO, 1991, p. 48. As to establishing the credit, the authors admit that the better solution is the moment when "the documentary credit reaches the seller's hands" rather than when "the seller has acted on the credit;" *ibid.*

116. See section 5-105 of the UCC. For Dolan, the credit is a "unique commercial device that is neither pure contract nor pure negotiable instrument but a little bit of each;" J.F. DOLAN, *op. cit.*, note 12, at para. 3.01. and 2.02. Another original and interesting concept, the credit as a new type of mercantile currency, is advocated by Kozolchyk; B. KOZOLCHYK, "The Legal Nature...", *loc. cit.*, note 9, 415ff; B. KOZOLCHYK, "Letters of Credit...", *loc. cit.*, note 9, para. 245ff. Dolan also summarizes the other differences between the credit and the contract under the American law : "Credits need no consideration, must be in writing, are peculiarly independent of contracts directly related to them, are transferable in only limited circumstances, have unique provisions for damages in the event of breach, and generally do not lend themselves to contract rules regarding performance. In short, the law does not treat them in the way it treats most contracts." J.F. DOLAN, *op. cit.*, note 12, para. 2.02.

regularly comes into play only when the theoretical analysis demonstrates that the credit cannot be formed as a (consensual) contract. Surprisingly indeed, the law of contract cannot embrace a legal phenomenon that is plainly *contractual in nature*,[117] even though *the contract* is so "natural" a concept explaining the way people trade.[118] Are we really unable to explain in a cohesive way the formation of legal obligations in private law — either contract or commercial? Is it possible to further develop and refine our conceptualizations of the law of contract, as they have proved to be inefficient or at least not adapted to the modern world?

B. THE PROBLEM : A NEW RULE ON SUBSTANCE

The most interesting issue is why actually the simplest and easiest conceptualization — the letter of credit as a binding unilateral and enforceable promise — is not argued at all. Notwithstanding the advantages of this model, we always attempt to weave the bank's promise into contractual relationships, in spite of the fact that this inevitably reduces the speed and certainty of the documentary transaction. The true reason is an indeed the ambivalent position of legal systems on the binding nature of a mere promise.

1. The Past : Promise and Contract

According to the findings of James Gordley,[119] an examination of the history of legal concepts proves that legal theorists have always disagreed on the most basic principles of the law of contract, such as : what this word exactly means, how the contract is formed, when it is concluded and binding

117. F.P. DE ROOY, *op. cit.*, note 35, p. 107.

118. And, therefore, the argument that the present-day banking practice is "autonomous" inasmuch to freely invent commercial instruments beyond the strict rules of the law of contract, does not seem to be sound either. See L.M. COSTA, *op. cit.*, note 1, para. 433.

119. J. GORDLEY, "Natural Law Origins of the Common Law of Contract," in J. BARTON (ed.), *Towards a General Law of Contract : Comparative Studies in Continental and Anglo-American Legal History, Band 8,* Berlin, Duncker, Humblot, 1990, p. 367ff.

and, finally, when the parties may enforce their rights before the courts. This kind of discussion necessarily focuses not only on the legal authorization to enforce promises (recognized as a core of contract) but also and above all, on its philosophical justifications. The answers given depend on the cultural background of the era, and mostly on the principles that govern our understanding of such phenomena as : commitments towards the others, keeping promises, the distinction between moral and legal responsibility for man's actions, the significance of one's free will and deliberate intent. These principles may be seen as a compromise between the requirements of both, justice — the virtue that permeates law — and pragmatism as a necessary condition to apply the above to real life and to render the rules operative in our *milieu social.*

A strong belief that morals and justice require that man should keep *all* promises and that pragmatic reasons make only some of them legally enforceable (those most certain) was always present in the both legal traditions, the common law and the civil law; throughout the history they diverged only in justifications given and the language used. The **civil law**, a successor to Roman law and Canon law[120] tended to employ philosophical rationales for the distinction between promises or contracts enforceable and not — hence the concept of Natural (as opposed to positive) law.[121] Natural law jurisprudence was in fact somehow vague or confusing on specific issues, and in particular on what actually makes the offer binding and irrevocable : the acceptance, or the promissory character of the

120. R.H. HELMHOLZ, "Contracts and the Canon Law," in J. BARTON (ed.), *Towards a General Law of Contract : Comparative Studies in Continental and Anglo-American Legal History, Band 8*, Berlin, Duncker, Humblot, 1990, p. 49ff.

121. Its systematic doctrinal structure, which drew on the Aristotelian virtues of commutative justice and liberality (as re-construed by Canon law and Thomas Aquinas), was formulated no sooner that in the 16th and 17th centuries by late scholastics (or the northern school of natural law); J. GORDLEY, *Contract in Pre-Commercial Societies and in Western History*, in P. SIEBECK (ed.), *International Encyclopedia of Comparative Law, Contracts in General*, vol. 7, ch. 2, Tübingen, J.C.B. Mohr, 1997, p. 13. Under Natural Law, all promises were binding and should be enforced (even *pacta nuda* or promises not yet accepted), but positive law enforced only part of them (for instance promises of gifts required special formalities as in the case of *pollicitatio*) or in some cases, prohibited revocation of a promise before acceptance; J. GORDLEY, "Natural Law Origins...", *loc. cit.*, note 119, p. 381-384.

offer itself.[122] Nineteenth-century positivism, supported by the "will theories" destroyed fine philosophical constructions and, as per Gordley, "purged the inherited contract law of the Aristotelian virtues and contented itself in the [sole] concept of will",[123] having no higher principles to explain it. Now, unless consensus was reached, nobody could be bound by his words.[124] A meeting of the minds (wills) of contracting parties became a simple threshold test for the enforceability of contracts, which necessarily led to the conclusion that "a contract is obligatory simply because it is... a contract".[125]

Similarly, under English **common law**, by the 18th century a dissatisfied promisee could sue in one of two forms of action — covenant (being a formal promise under seal) or assumpsit (available when the promise had consideration).[126] In the 17th century, the emerging courts of equity supplemented these two with the fundamental principles of conscience : promises ought to be performed, irrespective of whether the beneficiary had relied on the promise (in particular, to his detriment), or the promisor would be

122. "The late scholastics and natural lawyers such as Grotius and Pufendorf argued to the conclusion that offers are not binding before acceptance from the larger moral principles that explained why promises should be kept. The conclusion did not follow easily for if promises in principle ought to be kept, and an offer was a promise, it could be argued, and some of the late scholastics did argue, that an acceptance was unnecessary." J. GORDLEY, "Contract in Pre-Commercial...", *loc. cit.*, p. 426. See also the comments on the practice in France (J. BART, "Pacte et contrat dans la pratique française (XVIe-XVIIIe siècles)," in J. BARTON (ed.), *Towards a General Law of Contract : Comparative Studies in Continental and Anglo-American Legal History, Band 8*, Berlin, Duncker, Humblot, 1990, p. 125ff) and in the Low Countries (R. FEENSTRA, "Pact and Contract in the Low Countries from the 16th to the 18th Century," in J. Barton (ed.), *Towards a General Law of Contract : Comparative Studies in Continental and Anglo-American Legal History, Band 8*, Berlin, Duncker, Humblot, 1990, p. 197ff).

123. J. GORDLEY, "Contract in Pre-Commercial...", *loc. cit.*, note 121, p. 14.

124. And this is also a clear logical argument for all non-binding-offer theories.

125. J. GORDLEY, "Contract in Pre-Commercial...", *loc. cit.*, note 121, p. 18.

126. *Id.*, p. 19. In his fascinating study of the genesis and expansion of the privity rule, tracing the origins of the concept of consideration, V. V. Palmer also claims that the old English law enforced promises. The promise was deemed to create an enforceable benefit (then called a *use*), and "[t]he beneficiary's interest in the promise was thus conceived as his property." V.V. PALMER, *The Paths to Privity : A History of Third Party Beneficiary Contracts at English Law*, San Francisco, Austin & Winfield, 1992, p. 29.

otherwise enriched without due reason[127]; a favorite Chancery's device was the trust.[128] The 19th century brought the first common law treatises on the law of contract. In order to organize and reinterpret the practical and casuistic solutions of the case law, legal writers borrowed many concepts developed on the Continent; however, they were 're-tailored' in a very specific way. What was retained was what remained out of the civil law — i.e. the consensual form — but it was filled in with their own specific content, and above all with the idea of consideration; a useful vehicle that organizes almost the entire law of contract.[129] On a more distinctive note, the United States theory of consideration as a bargain-for-detriment, referred more to the motives of the contracting parties,[130] which later — having been generalized by Williston — led to the creation of the doctrine of promissory estoppel, subsequently included in section 90 of the First Restatement on Contracts.[131]

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127. P.W.M. WATERS, *The Constructive Trust : The Case for a New Approach in English Law*, London, Athlone Press, 1964, p. 39. Also by Palmer, "[i]f the beneficiary was allowed to enforce a promise exchanged between contracting parties, he must be viewed as having acquired a legal right whether the Chancellor conferred upon him the *name* of *cestui que trust*, assignee, or any other *name* [both emphases added]." V.V. PALMER, *op. cit.*, note 126, p. 85.

128. A promisee was simply renamed a trustee and, therefore, could recover damages [even] suffered by a third party. A. JON WATERS, "The Property in the Promise : A Study of the Third Party Beneficiary Rule", (1985) 98 *Harv.L.Rev.*, fn 158.

129. It seems that the idea "a contract is a bargain," somehow inherent in the requirement of consideration, reflected perfectly the doctrines of pragmatism, liberalism and capitalism that were shaping the intellectual environment of the 19th century, but as Gordley summarized the point, "[t]he Continental doctrine identified the reasons why, in principle or theory, a promise should be enforced. The Common Law doctrine was a pragmatic tool for limiting the enforceability of promises... the courts have said there was consideration because it seemed sensible to enforce them; the term was thus not one that could be defined". J. GORDLEY, "Contract in Pre-Commercial...", *loc. cit.*, note 121, para. 26, p. 20.

130. This was conceptualized as an inducement to change the position (Pollock), a justified action on the faith of the promise, the non-performance of which would cause injury — later reformulated as representation on which the promisee has acted (Parsons), or that subsequent facts (acting in reliance on the promise) justified holding the promisor liable (Corbin). J. GORDLEY, "Contract in Pre-Commercial...", *loc. cit.*, note 121, p. 20.

131. *Restatement (First) on Contracts § 90 (1932)*, preserved in *Restatement (Second) on Contracts § 90 (1981)*. In England this concept was introduced by Lord Denning's widely cited decision in the landmark *Central London Property Trust* v. *High Trees House*, [1947] KB 130 case, 1947. However, as per Gordley's comment,

2. The Present: Promise as a Contract

Now the intriguing doctrinal reluctance to justify enforcement or binding force of a unilateral promises — not only as unilateral acts but above all as unilateral engagements (upon which a legal obligation is created)[132] — seems to have its theoretical basis; however, the result is that the conceptualization of the documentary credit in terms of unilateral binding promise indeed appears to be barely possible.[133]

The **common law** standpoint is that in order for a promise to be enforceable, consideration is required (or special form — deed); without consideration, even an agreement cannot be transformed into a contract. A promise unsupported by consideration means a promise to do something for nothing and, as introducing an element of *inequality* between the parties, is therefore of no legal effect.[134] The documentary letter of credit, therefore, *must be a contract*, for this is a proper source of obligation; at the same time, it must be *a special kind of contract*, as the requirement of consideration is set aside.

A unilateral promise, as a source of legal obligation, is a highly controversial issue in **civil law jurisdictions** and no uniform solution has been adopted. Under the francophone codes, the problem of the enforceability of unilateral engagements is still not settled.[135] Taking into account, however, our

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"the Pollock/Holmes/Williston formula for consideration had lumped heterogeneous transactions together as bargains and declared them enforceable without explaining why bargains, in this artificial sense, should be enforced." J. GORDLEY, "Contract in Pre-Commercial...", *loc. cit.*, note 121, p. 22.

132. J.-L. BAUDOUIN, *Les obligations*, 4th ed., Cowansville, Québec, Yvon Blais, 1993, p. 313ff.

133. It must be emphasized here that in our attempts to explain the establishment of the documentary letter of credit we have already surveyed the legal effects of one of the instances of *promise* — an *offer*.

134. Even under the doctrine of promissory estoppel the kind of "compensatory" protection it gives to the promisee is definitely not as advantageous as under the common law contract in the case of a breach.

135. See the discussion of: BAUDOUIN, *op. cit.*, note 132, p. 314ff; J. PINEAU, D. BURMAN, *Théorie des obligations*, 2nd ed., Montréal, Les Éditions Thémis, 1988, p. 225ff; M. TANCELIN, *Sources des obligations : L'acte juridique légitime*, Montréal, Wilson & Lafleur, 1993, p. 233ff; J. FLOUR, J.-L. AUBERT, É. SAVAUX, *Droit civil. Les obligations. 1. L'acte juridique*, Paris, Armand Colin, 2000, p. 365ff. For example, under the law of Québec, some confusion may arise even by the very wording of article 1372 of the C.c.Q. : "An obligation arises from a contract *or from any act* or fact

conviction that the contract is indeed an agreement (as the codified law so provides), the recognition of a unilateral engagement creating rights of a *contractual* type, would initiate a doctrinal revolution. The Germanic tradition, however, founded upon the abstract general theory of legal acts and juristic acts (a sub-category of the former[136]) does recognize a unilateral act that legally binds its author, with no need to meet the intent of any other person,[137] and although this concept is routinely criticized for being too artificial and sophisticated,[138] its great advantage is in the enforceability of unilateral promises, where the law so provides.[139] Contrary to the other legal traditions, where traditional contract law struggles with the modern "inventions" of the commercial law, this one assures greater unity of the law of obligations and maintains both within the same conceptual framework, able to include not only the traditional *sale, mandate* or *tenancy*, but also such "mercantile specialties" as negotiable instruments or letters of credit.

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to which the effects of an obligation are attached by law [emphasis added]." As in France, the pivotal issue seems to be the offer of a reward (article 1396 C.C.); A.T. VON MEHREN, *op. cit.*, note 82, para. 12. According to M. Coipel, unilateral engagement can be justified first, by the "power of will" concept: as the promisor can actually make a promise he could also decide on its binding and irrevocable character. And secondly, in some cases, the certainty and security required by commercial law would serve as sufficient functional grounds. M. COIPEL, *loc. cit.*, note 79, p. 73. The revision of the most significant types of allegedly unilateral act, including the letter of credit, allows him, however, to reject this concept as not useful or able to be explained by the traditional consensual contractual mechanisms. Some other authors contend that there is no need for a unilateral-act theory, as long as the law protects the "reliance interest" on the part of the promisee, either by making binding those promises that have "reasonably" induced "foreseeable" reliance, or by finding implicit agreement there. The recognition of "strictly unilateral promissory acts... might well create more difficulties than it would solve." A.T. VON MEHREN, *op. cit.*, note 82, para. 14.

136. K. ZWEIGERT, H. KÖTZ, *op. cit.*, note 34, p. 4.

137. According to § 305 of BGB, when (and only when) the codes state so, may a unilateral promise be *the source* of ("contractual") obligations. Under BGB the other unilateral engagements are: the *Auslobung* (public promise of a reward for an action § 657 BGB), *Schuldversprechen* (a promise of debt § 780 BGB) or the acceptance of the delegation by the delegee (payor), being the conceptual vehicles for negotiable instruments or simple orders to pay; M. PÉDAMON, *op. cit.*, note 81, at 17; B. KOZOLCHYK, "Letters of Credit", *loc. cit.*, note 9, para. 244.

138. K. ZWEIGERT, H. KÖTZ, *op. cit.*, note 34, p. 6.

139. This would be another reason that the German tradition has no problem in recognizing *binding offers* (even though they are *not* classified as *unilateral juristic acts*, because of the specific limited legal effects of the offer) — the concept of binding unilateral promise would serve here as an ideological background.

3. The Future : Contract as a Promise?

At this point, we face the most fundamental issue. We have demonstrated that a contract cannot be the proper legal basis for the establishment of the credit, because the process of forming the credit cannot simply be squeezed into the ordinary offer-acceptance formula. The enhancement of the credit's functions requires it to be conceptualized rather as a unilateral promise, which, however (except for the Germanic laws) unless it constitutes part of a contract, is typically not recognized or enforced by law.

Why do we still interpret the credit in terms of contract and refer to the *type* of relationship between the bank and the beneficiary as nonetheless *contractual in nature*, and what in fact does it mean?

The interesting thing is that our ideas on the nature of contract, "imprinted" by positive law and the relatively well-developed legal traditions — or as per Sacco, our "innate conceptual genotypes"[140] are firstly, divergent, and secondly, not absolute. As historical surveys illustrate, they depend on the time and location at which they were formulated. Ultimately, they are nothing more than our *conceptualizations* of social practice; the same practice that has enjoyed letters of credit for ages.

The consensual formula for contract formation is simple and easily provable : the contract is concluded only when the parties have reached sufficient agreement. The counterarguments reveal, however, an apparent lack of logic in such a concept and the internal incoherence of non-binding offer theories, according to which, the acceptance purports to be a condition that makes the offer binding.[141] Besides, there is an inevitable *circulum in definiendo* in our thinking on what the contract is and why it is binding.[142] And finally, there is no

140. R. SACCO, *loc. cit.*, note 79, p. 195.

141. "Acceptance adds nothing decisive to the extent to which the other party intends to be legally bound, to the reasonable appearance assumed by the promise, or to the degree of reliance which must be protected." M. STORME, "The Binding Character of Contracts — Causa and Consideration," in A. HARTKAMP *et al.*, (eds.), *Towards a European Civil Code*, 2nd rev. and exp. ed., The Hague, Ars Aequi Libri Nijmegan, Kluwer Law International, 1998, p. 244.

142. R. SACCO, *loc. cit.*, note 79, p. 195.

sufficient explanation as to why the principle *pacta sunt servanda* should prevail over *a man ought to keep promises.*[143] Other authors emphasize the *functions* that contracts perform rather than the *ways in which they may be formed* (which we are used to focus on) and conclude that "the essence of contract lies not in the simple fact of agreement, but in the "promise" expressed by the parties to the contract",[144] as embraced by the open and functional definition of contract in section 1 of the American Restatement (Second) of Contracts (1981).[145] The genuine function of the law of contract is "contractual justice."[146]

Is there a solution that would reconcile all the above? At an **international level**, trade practice calls for the synchronization of the rules governing the law of contract. This has resulted in attempts to construe a common conceptual framework providing the same mechanisms and regulations, and although the 1980 Vienna Convention and the *1994 UNIDROIT Principles of International Commercial Contracts* are still a tribute to consensualism, by reducing formalities in the formation of contracts and by harmonizing the rules on its substance, the transformation of the law of contract has already commenced.[147] Another example of this harmonizing tendency can be seen in the research undertaken by comparative law institutes in order to put forward a common European Civil Code, for both continental and common law

143. As per Gordley, the modern law of contract lacks the organizing virtues, the concepts beyond mere formulas on the contract formation. The explanation that the offer does not yet constitute a contract may seem plain and obvious, but "no argument is made as to why contract should be defined in terms of mutual assent in the first place or why *promises that are not contracts* should be revocable [emphasis added]." J. GORDLEY, "Natural Law Origins...", *loc. cit.*, note 119, p. 426-427. By the same token, the rule that the acceptance is the promisor's *sine qua non* condition for being bound to his promise, although rather obvious, and repeated unanimously by the precedents, does not seem to be in fact well grounded. *Id.*, p. 428.

144. K. ZWEIGERT, H. KÖTZ, *op. cit.*, note 34, p. 6-7.

145. It reads as follows: "A contract is a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty." *Ibid.*

146. And not giving satisfaction to "the promisee's legitimate expectations of performance or to give him a guarantee against loss" as the common lawyers used to argue. K. ZWEIGERT, H. KÖTZ, *op. cit.*, note 34, p. 6-7.

147. See in particular articles 29(1), 14 and 16 of the Vienna Convention and articles 3.2 and 2.2-2.4 of the Principles.

traditions.[148] For many authors contributing to the project, the true substance of contract was "**a promise able to produce reasonable reliance**," as this is in fact the line followed by case law in both legal traditions; the similarity of outcome is indeed striking.[149] "Reasonable reliance" is also the basic concept under the common law doctrine of promissory estoppel. The protection of legitimate expectations of the offeree would probably become the civil law principle that justifies the binding force of the offer as well.

Is this concept, however, a good basis for reconciliation between commercial law and the traditional law of contract, and would such a theoretical investigation be relevant to an understanding of the nature of the documentary letter of credit and to a true harmonization of the respective domestic laws?

This study demonstrates that the most plausible reason for disagreement on the legal explanation for the credit is probably that we "subconsciously" project our well-known concepts of the nature of the contract, as we have been taught and take for granted. We treat the contractual schemes developed somewhere in the 18th or 19th centuries as sacred and we will never dare question them. Maybe the time has come when — instead of labeling the new phenomena as "mercantile specialties" — we should instead face the challenges of

148. The other harmonizing academic endeavor was the development of the *Principles of the European Law of Contract* by the first Commission on European Contract Law, under the direction of Lando and Beale, and published in 1995, which are at some points consistent with the results of the work carried out under the auspices of the United Nations (similar rules on offer and acceptance). Some of the proposals may indeed sound revolutionary, such as the Sacco's contract definition : "[a] contract enables the parties to contract obligations, according to the promises they have made. If [only] one party places obligations upon himself, the promise binds him, unless the promisee rejects it," R. SACCO, *loc. cit.*, note 79, p. 196.

149. *Ibid.* Sacco also comments, "[u]nfortunately, however, the decisions of the courts are couched in conventional textbook language. This, in turn, leads to the notion of the agreement being highlighted and subjects this notion to an adjustment making use of the instrument of tacit declaration [or] an implied promise not to revoke... [S]uch a promise could create reliance upon it and... therefore, it must produce an obligation, independent of the acceptance;" *Id.*, p. 196-197. Storme emphasizes that contract law protects legitimate expectation caused by the conduct of the other party, regardless of the actual detriment caused by the reliance on these expectations and conduct;" M. STORME, *loc. cit.*, note 141, p. 242. See also article 16(2)(b) of the Vienna Convention.

our era and make the same great theoretical effort that the scholars of the 12th and 17th centuries did when the theoretical basis for the law of contract was established.

This would certainly require us to reassess the sources of legal obligations in private law in order to embrace the greater number of "contractual" vehicles developed in trade practice, which have now been taken over by commercial law. Only then contract law would become a coherent basis for many mechanisms of "contractual nature", in particular those mechanisms, the core of which is a unilateral abstract promise, as in the case of the letter of credit. Until now, we have strived to look for its legal justification somewhere else: either in the "necessary" "co-operation" of the beneficiary (in the form of acceptance), or in other contractual relationships, inevitably involving the credit in either the cover relationship, or in the relationship of value. The real problem does not, however, lie in the justification of the irrevocability and autonomy of the credit; it rests in the justification of the binding force and enforceability of the unilateral promise.[150]

It may be that such proposals now seem too radical for this conservative phenomenon that the law is. What is more, they would disregard the rich legal cultures cultivated by respective legal traditions. We should probably be more modest in our requirements and confine ourselves only to the convergence of practical outcomes.[151] Does this, however, mean that the common understanding of the core of contract would remain in the field of theoretical or philosophical dissertations? Certainly not. Comparing inconsistent doctrines

150. And for this reason, eventual unification of the credit's rules by adoption of an international convention (such as *United Nations Convention on Independent Guarantees and Stand-by Letters of Credit* (January 26, 1996) A/RES/50/48) would not fully succeed. Naturally, it could provide that the *contractual* liability of the issuing bank arises out of his sole unilateral promise. It seems, however, the other problems of the credit's *nature* are so deeply rooted in the most fundamental principles of the respective laws of contract (under which credits are eventually enforced) that it would require rather a profound reform of the latter.

151. It must be noted that the recent adoption of so-called Docdex Rules by the International Chamber of Commerce would facilitate this task greatly. These *ICC Rules for Documentary Instruments Dispute Resolution Expertise* (first approved in October 1997, the present first revision is effective from 15 March 2002) establish another ICC arbitration court composed of experts in the field whose decisions are likely to gain international reverence.

would not only challenge our own understanding of the very fundamentals of contract, but may also provide a solid basis for subsequent harmonization of contract law. The research results may also provide some guidance to courts deciding documentary credit cases. They would also help to encounter the possible legal risks that may endanger the smooth operation of the letter of credit under particular laws. If we search for unity — and it seems in fact to be the idea that inspires our research — the task for legal theory, offering useful and accurate conceptualizations has not yet been completed. There is indeed a long way to go to reach the goal that has so far eluded our intellectual efforts.

CONCLUSION

This study has focused on explaining the apparent incompatibility between the rules governing contract law and those governing the letter of credit, which is conceived of as a "mercantile specialty," i.e., an original product of international trade. In our quest for a suitable legal conceptualization of the nature of the documentary letter of credit, we have demonstrated that contractual theories cannot ensure the unique features of the credit or secure the efficient operation of its functions.

In both the common law and civil law jurisdictions, we have encountered an obstacle that should either be avoided, or faced and dealt with. This obstacle is the great controversy surrounding the binding character of a unilateral promise and its role in the law of contract : it is in our legal tradition and is our routine practice that we automatically reinterpret any obligation of a *contractual nature* — including documentary credits — in terms of a bilateral (or consensual) structure. As further study has, however, demonstrated, this does not necessarily have to be so; the law of *contract* is only the law of *concepts*, subject to constant improvement in order to reach the best conceptualization of our legal practice. This research paper claims that there are three possible solutions that can be implemented in order to — as per Dworkin — support legal practice by suitable legal explanation.

In those legal traditions that do not recognize unilateral acts as a source of obligation, solution one — **letter of credit as a *sui generis* contract** — seems to be an acceptable compromise. The documentary credit could be characterized as a "contract," but without its vital features: neither consideration (common law), nor acceptance (common law, civil law), nor causa (civil law) is needed to make the bank's promise irrevocable, i.e., binding and enforceable. Nonetheless, even as *sui generis*, the documentary credit still needs a valid legal explanation.

The second solution — **letter of credit as a unilateral act** — requires the adoption of the Germanic concept of the unilateral act (unilateral promise) that is able to create a legally binding obligation; so often criticized, the abstract Germanic legal theory seems to succeed in explaining the letter of credit. It appears, however, that implementing such a peculiarity into systems that recognize only contracts as a valid source of legal rights, would rather fail, since there is a risk that the very fundamentals of the respective laws of obligations would be undermined.

The third possibility — **letter of credit as a new type of contract** — is not a conceptualization of the credit, but rather a new conceptualization of a contract, i.e. the creation of one comprehensive theory that would be compatible with many diverging legal systems and legal concepts. The creative legal families, founded on totally different conceptual bases, have developed a variety of means that can be used to explain the operation of credit; they reflect flourishing legal cultures and rich intellectual traditions. It might be that the unifying (or even reconciling) endeavors would threaten the doctrinal and systemic fundamentals of the laws in issue.

It would appear that the challenge of our era is to rethink the law of contract. Comparative studies carried out by prominent specialists in the area, appear to direct legal deliberations in a more functional direction: the core of a contract is a promise, its essence — the ability to induce reasonable reliance, the function — the enhancement of "contractual" justice (equality and freedom); such a new concept would also reconcile the doctrines of promissory estoppel and good faith. Nevertheless, we cannot escape the fundamental question:

What is *reasonable* reliance, and why are the expectations *legitimate*? We cannot avoid "the same underlying problem — how to develop a coherent doctrine of contract formation [...] without considering what *substantive purposes* were worthy of protection [emphasis added]."[152] In the 21st century, we still do not have any common understanding of what a contract is, or any "natural" justification beyond what is stated by positive law. It may seem strange indeed, as contracting — interacting with others — appears to be so important and natural for us. We definitely need a conceptualization of the law of contract that is based on more important, philosophical and theoretical grounds, and such a work would have not only a theoretical objective : coherence in the law of contract, it would also have an impact on practice. The case of the inextricable paradoxes in the letter of credit, which deal with exactly the same *conceptual* problems : the binding nature of the promise, the formation of contract, its essence and binding force, appears to be only one of the instances where, not only the boundaries, but also the very core of contract law is being tested.

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152. J. GORDLEY, "Contract in Pre-Commercial...", *loc. cit.*, note 121, p. 22.