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CONFIRMING BANK LIABILITY IN LETTER OF CREDIT TRANSACTIONS: WHOSE BANK IS IT ANYWAY?

INTRODUCTION

A letter of credit¹ is an engagement by an issuer,² usually a bank, to pay a specified amount of money upon presentation of documents³ that comply with the terms set forth in the letter.⁴ Often in interna-

1. For general definitions of a letter of credit, see *Bank of Newport v. First Nat'l Bank & Trust Co.*, 34 U.C.C. Rep. Serv. (Callaghan) 650, 655-56 (8th Cir. Sept. 10, 1982); *East Girard Sav. Ass'n v. Citizens Nat'l Bank & Trust Co.*, 593 F.2d 598, 601-02 (5th Cir. 1979); *Venzelos, S.A. v. Chase Manhattan Bank*, 425 F.2d 461, 464-65 (2d Cir. 1970); *Voest-Alpine Int'l Corp. v. Chase Manhattan Bank, N.A.*, 545 F. Supp. 301, 303-04 (S.D.N.Y. 1982); *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 393-95 (D. Md. 1982); *Intraworld Indus. v. Girard Trust Bank*, 461 Pa. 343, 356-57, 336 A.2d 316, 323 (1975); B. Clark, *The Law of Bank Deposits, Collections and Credit Cards* ¶ 8.2 (rev. ed. 1981); State of N.Y. Law Revision Comm'n, Report of the Law Revision Comm'n to the Legislature Relating to the Uniform Commercial Code, Legislative Doc. No. 65(A), at 5, 34-35 (1956), *reprinted in* State of N.Y. Law Revision Comm'n, Report and Appendices Relating to the Uniform Commercial Code 15, 44-45 [hereinafter cited as 1956 Report]; J. White & R. Summers, *Handbook of the Law Under the Uniform Commercial Code* § 18-2 (2d ed. 1980).

2. An issuer is defined as "a bank or other person issuing a credit." U.C.C. § 5-103(1)(c) (1977); H. Harfield, *Letters of Credit* 9 (1979) [hereinafter cited as H. Harfield I].

3. A document is "any paper including document of title, security, invoice, certificate, notice of default and the like." U.C.C. § 5-103(1)(b) (1977). The term document was intended by the drafters to be construed in an extremely broad manner. *See id.* § 5-103 official comment 2; *see, e.g., First Am. Nat'l Bank v. Alcorn, Inc.*, 361 So. 2d 481, 487 (Miss. 1978) (invoice held to be "documentary draft"); *Marfa Nat'l Bank v. Powell*, 512 S.W.2d 356, 359 (Tex. Civ. App. 1974) (bill of sale held to be a documentary draft). *But see Housing Sec., Inc. v. Maine Nat'l Bank*, 391 A.2d 311, 318 & n.9 (Me. 1978) (written notice of default not a "documentary draft").

4. The UCC is silent as to the requisite standard of compliance. *Transamerica Delaval Inc., v. Citibank, N.A.*, 545 F. Supp. 200, 203 (S.D.N.Y. 1982); *Far E. Textile, Ltd. v. City Nat'l Bank & Trust Co.*, 430 F. Supp. 193, 196 (S.D. Ohio 1977); *see* U.C.C. § 5-103(1)(a) (1977). The traditional view is that documents must strictly comply with the terms of the letter. *First Arlington Nat'l Bank v. Stathis*, 90 Ill. App. 3d 802, 814, 413 N.E.2d 1288, 1298 (1980); *Kozolchyk, Preface*, 24 Ariz. L. Rev. 235, 235 (1982) [hereinafter cited as *Kozolchyk I*]; *e.g., Marino Indus. Corp. v. Chase Manhattan Bank, N.A.*, 34 U.C.C. Rep. Serv. (Callaghan) 637, 640-42 (2d Cir. Aug. 11, 1982); *Insurance Co. of N. Am. v. Heritage Bank, N.A.*, 595 F.2d 171, 173-74 (3d Cir. 1979) (*per curiam*); *Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank*, 528 F.2d 802, 805-06 (4th Cir. 1975); *Voest-Alpine Int'l Corp. v. Chase Manhattan Bank, N.A.*, 545 F. Supp. 301, 304 (S.D.N.Y. 1982); *International Leather Distribs. v. Chase Manhattan Bank, N.A.*, 464 F. Supp. 1197, 1201 & n.9

tional transactions the services of a second bank, a confirming bank,⁵ are utilized. Because the beneficiary⁶ may not be familiar with the issuing bank, he will often require that a bank in his locale⁷ confirm the letter and thereby become "directly obligated on the credit . . . as though it were its issuer."⁸ The resulting liability of the confirming

(S.D.N.Y.), *aff'd mem.*, 607 F.2d 996 (2d Cir. 1979); AMF Head Sports Wear, Inc. v. Ray Scott's All-American Sports Club, Inc., 448 F. Supp. 222, 223 (D. Ariz. 1978); Lustrelon, Inc. v. Prutscher, 178 N.J. Super. 128, 140, 428 A.2d 518, 524 (App. Div. 1981). See generally Harfield, *Identity Crises in Letter of Credit Law*, 24 Ariz. L. Rev. 239 (1982) (discussing the rationale for the strict compliance rule and the independence principle) [hereinafter cited as Harfield II]. Some courts, however, have begun to require something less than "strict" compliance. See *Corporation de Mercadeo Agricola v. Mellon Bank Int'l*, 608 F.2d 43, 48 n.1 (2d Cir. 1979) (document must "strictly comply with the essential requirements of the letter of credit" (emphasis added)); *Banco Espanol de Credito v. State St. Bank & Trust Co.*, 385 F.2d 230, 237 (1st Cir. 1967) (enforceable compliance when the documentary draft "conformed in all significant respects"), *cert. denied*, 390 U.S. 1013 (1968); *Crocker Commercial Servs. Inc. v. Countryside Bank*, 538 F. Supp. 1360, 1362-63 (N.D. Ill. 1981) ("reasonable" compliance is sufficient). Still a third approach is to apply a bifurcated standard which depends upon whether the customer or the beneficiary is suing the issuer. When the customer sues the issuer for wrongful honor, the issuer need only establish substantial compliance. However, strict compliance is the standard when the issuer is sued by the beneficiary for wrongful dishonor. See *Transamerica Deleval, Inc. v. Citibank, N.A.*, 545 F. Supp. 200, 203-04 (S.D.N.Y. 1982); *Data Gen. Corp. v. Citizens Nat'l Bank*, 502 F. Supp. 776, 781 & n.5 (D. Conn. 1980); *Far E. Textile, Ltd. v. City Nat'l Bank & Trust Co.*, 430 F. Supp. 193, 196-97 (S.D. Ohio 1977); State of N.Y. Law Revision Comm'n, Study of Uniform Commercial Code: Article 5—Documentary Letters of Credit, Legislative Doc. No. 65(F), at 66 (1955), *reprinted in* 3 State of N.Y. Law Revision Comm'n, Report of the Law Revision Comm'n for 1955, at 1569, 1634-35 [hereinafter cited as 1955 Report]; J. White & R. Summers, *supra* note 1, § 18-6, at 731-32.

5. A confirming bank is defined as "a bank which engages either that it will itself honor a credit already issued by another bank or that such a credit will be honored by the issuer or a third bank." U.C.C. § 5-103(1)(f) (1977); see e.g., *Venizelos, S.A. v. Chase Manhattan Bank*, 425 F.2d 461, 465 (2d Cir. 1970); *Voest-Alpine Int'l Corp. v. Chase Manhattan Bank, N.A.*, 545 F. Supp. 301, 303 (S.D.N.Y. 1982); *Lustrelon, Inc. v. Prutscher*, 178 N.J. Super. 128, 139, 428 A.2d 518, 524 (App. Div. 1981); Comment, *Recent Extensions in the Use of Commercial Letters of Credit*, 66 Yale L.J. 902, 903 & n.7 (1957) [hereinafter cited as *Recent Extensions*]; cf. *Barclays Bank D.C.O. v. Mercantile Nat'l Bank*, 481 F.2d 1224, 1232 (5th Cir. 1973) (holding that a bank which "confirms" a letter of credit issued by a non-bank becomes directly obligated on the credit), *cert. dismissed*, 414 U.S. 1139 (1974).

6. A beneficiary is "a person who is entitled under [the letter's] terms to draw or demand payment." U.C.C. § 5-103(1)(d) (1977); see H. Harfield, *Bank Credits and Acceptances* 33 (5th ed. 1974) [hereinafter cited as H. Harfield III].

7. R. Braucher & R. Riegert, *Introduction to Commercial Transactions* 367 (1977); H. Harfield III, *supra* note 6, at 37; see J. White & R. Summers, *supra* note 1, § 18-1, at 710.

8. U.C.C. § 5-107(2) (1977).

bank provides an additional measure of security to the beneficiary.⁹ As the following hypothetical illustrates, however, in certain situations the presence of a confirming bank in a letter transaction places additional and unnecessary risks on the customer.¹⁰

On October 10th, PRS, a French corporation, entered into a contract for the purchase of \$700,000 worth of goods from GYP, a California corporation. To facilitate the purchase, the parties agreed that PRS would procure the issuance of a letter of credit in GYP's favor in the amount of the purchase price. The contract also specified that the letter was to be confirmed by GYP's bank,¹¹ Harley National Bank of California. On October 15th, PRS negotiated with Henri Bank of Paris for the issuance of the letter. Henri Bank, in accordance with its agreement with PRS, then engaged Harley Bank to confirm the letter.

Three days before the letter was to expire,¹² GYP presented documents purporting to conform to the terms of the letter. Upon review,

9. J. White & R. Summers, *supra* note 1, § 18-1, at 707; 42 Fordham L. Rev. 706, 710-11 (1974); 52 Tex. L. Rev. 578, 579 (1974); 19 Vill. L. Rev. 686, 688 (1974); *see* U.C.C. § 5-107 official comment 2 (1977).

10. A customer is defined as "a buyer or other person who causes an issuer to issue a credit. The term also includes a bank which procures issuance or confirmation on behalf of that bank's customer." U.C.C. § 5-103(1)(g) (1977). By nature of the customer-bank relationship, the customer has been found an indispensable party to an action for injunctive relief against an issuer. *Edgewater Constr. Co. v. Percy Wilson Mortgage & Fin. Corp.*, 44 Ill. App. 3d 220, 227-28, 357 N.E.2d 1307, 1313-14 (1976).

11. The confirming bank is usually a correspondent bank of the issuing bank, yet it can also often be the beneficiary's own bank. Halls, *The Uniform Commercial Code in Minnesota; Article 5—Letters of Credit*, 50 Minn. L. Rev. 453, 454 (1966); *cf.* Gillette, *Holder in Due Course in Documentary Letter of Credit Transactions*, 1982 Ann. Rev. of Banking L. 21, 33 (transferee is commonly the beneficiary's own bank).

12. In a letter of credit transaction, time is of the essence. *Liberty Nat'l Bank & Trust Co. v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 218 F.2d 831, 840-41 (10th Cir. 1955); *G. Jaris Co. v. Banque D'Athenes*, 246 Mass. 546, 549, 141 N.E. 576, 577 (1923); *see* *United Technologies Corp. v. Citibank, N.A.*, 469 F. Supp. 473, 480 (S.D.N.Y. 1979); *Hyland Hills Metro. Park & Recreational Dist. v. McCoy Enters.*, 38 Colo. App. 23, 26, 554 P.2d 708, 710 (1976); *Banco Tornquist, S.A. v. American Bank & Trust Co.*, 71 Misc. 2d 874, 874-75, 337 N.Y.S.2d 489, 489-90 (Sup. Ct. 1972); *H. Harfield I, supra* note 2 at 51. Therefore, a documentary demand for payment must occur, absent express waiver, before the letter of credit expires. *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 400-01 (D. Md. 1982); *see* *Flagship Cruises, Ltd. v. New Eng. Merchants Nat'l Bank*, 569 F.2d 699, 702-04 (1st Cir. 1978); *Chase Manhattan Bank v. Equibank*, 550 F.2d 882, 887 (3d Cir. 1977); *Barclays Bank D.C.O. v. Mercantile Nat'l Bank*, 481 F.2d 1224, 1237 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); *Colorado Nat'l Bank v. Board of County Comm'rs*, 634 P.2d 32, 41-42 (Colo. 1981); *Siderius, Inc. v. Wallace Co.*, 583 S.W.2d 852, 860 (Tex. Civ. App. 1979).

Harley Bank declined to honor the draft because the certificate of origin, a required document, had not been legalized by the French Embassy located in New York.¹³ GYP stated that it would return shortly with the certified stamp. At that time GYP authorized the bank to apply the proceeds of the letter to an outstanding loan. One hour later the certificate of origin, purportedly legalized, was again produced. The legalization stamp bore a New York address. Despite the impossibility of GYP's having obtained the required stamp in New York within one hour, Harley Bank honored the draft and applied the proceeds towards GYP's outstanding balance. Harley Bank then debited Henri Bank's account for the sum paid to GYP, plus its fee, and forwarded the documents to Henri Bank. Satisfied that the documents complied on their face with the terms of the letter, Henri Bank sent the documents to PRS and obtained reimbursement.¹⁴ The goods

13. The duty of an issuer is to "examine documents with care so as to ascertain that on their face they appear to comply with the terms of the credit." U.C.C. § 5-109(2) (1977); *see* *United States v. Sun Bank*, 609 F.2d 832, 833 (5th Cir. 1980) (*per curiam*); *Instituto Nacional de Comercializacion Agricola (Indeca) v. Continental Ill. Nat'l Bank & Trust Co.*, 530 F. Supp. 279, 282 (N.D. Ill. 1982); *Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank*, 387 F. Supp. 92, 100 (M.D.N.C.), *rev'd on other grounds*, 528 F.2d 802 (4th Cir. 1975); *First Arlington Nat'l Bank v. Stathis*, 90 Ill. App. 3d 802, 808, 413 N.E.2d 1288, 1293-94 (1980). The only other requirement is that the bank must exercise good faith in making that determination. *See Lustrelon, Inc. v. Prutscher*, 178 N.J. Super. 128, 143-45, 428 A.2d 518, 525-27 (App. Div. 1981); U.C.C. §§ 1-201(19), 5-109(1)-(2), 5-114(2)(b) (1977); H. Harfield I, *supra* note 2, at 57.

In examining the documents, the bank's function is purely ministerial. *Insurance Co. of N. Am. v. Heritage Bank, N.A.*, 595 F.2d 171, 173 (3d Cir. 1979) (*per curiam*); *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 395 (D. Md. 1982); *Bank of Newport v. First Nat'l Bank & Trust Co.*, 32 U.C.C. Rep. Serv. (Callaghan) 1572, 1577 (D.N.D. 1981), *aff'd*, 34 U.C.C. Rep. Serv. (Callaghan) 650 (8th Cir. Sept. 10, 1982); Harfield, *Letters of Credit and Documentary Drafts*, 1 U.C.C. L.J. 205, 207 (1969).

It is often said that with respect to letters of credit, banks deal in documents not in goods. *See Bank of Canton, Ltd. v. Republic Nat'l Bank*, 509 F. Supp. 1310, 1314 (S.D.N.Y.), *aff'd*, 636 F.2d 30 (2d Cir. 1980); *United Bank Ltd. v. Cambridge Sporting Goods Corp.*, 41 N.Y.2d 254, 259, 360 N.E.2d 943, 948, 392 N.Y.S.2d 265, 270 (1976); *see also* International Chamber of Commerce, Uniform Customs & Practices for Documentary Credits (UCP) art. 8(a) (Publication No. 290 rev. ed. 1974) (effective Oct. 1, 1975) ("In documentary credit operations all parties concerned deal in documents and not in goods") [hereinafter cited as U.C.P.]. Because a bank's duty in honoring a letter of credit is ministerial, its risks in the transaction are reduced, *see Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 395, 397-99 (D. Md. 1982), and its rate of compensation reflects this narrow duty, *see* U.C.C. § 5-109 official comment 1 (1977); H. Harfield III, *supra* note 6, at 58; Verkuil, *Bank Solvency & Guaranty Letters of Credit*, 25 Stan. L. Rev. 716, 720 (1973).

14. The issuer's right to reimbursement is conditioned upon its "duly honoring" the draft. U.C.C. § 5-114(3) (1977); *accord* U.C.P., *supra* note 13, art. 8(b); 12 C.F.R. § 7.7016(e) (1981); H. Harfield I, *supra* note 2, at 49-50.

never arrived in France, and consequently, PRS suffered a loss of \$700,000.

Non-performance of a sales contract is not an infrequent occurrence, and it was for precisely this reason that the letter of credit device was developed.¹⁵ Letters of credit derive their primary utility from the principle that an issuer's duty to pay the beneficiary is entirely independent of the other two contracts comprising the letter of credit transaction.¹⁶ If the documents presented by the beneficiary strictly comply with the terms of the letter, the bank may not raise any defenses that it may have against its customer,¹⁷ nor raise any defenses that the customer has against the beneficiary on the underlying sales contract.¹⁸ This independence principle assures the seller—beneficiary that once the goods have been shipped he will be paid.¹⁹

15. See *East Girard Sav. Ass'n v. Citizens Nat'l Bank & Trust Co.*, 593 F.2d 598, 601 (5th Cir. 1979); *Pringle-Associated Mortgage Corp. v. Southern Nat'l Bank*, 571 F.2d 871, 874 (5th Cir. 1978); *Venizelos, S.A. v. Chase Manhattan Bank*, 425 F.2d 461, 464 (2d Cir. 1970); *Bank of Newport v. First Nat'l Bank & Trust Co.*, 32 U.C.C. Rep. Serv. (Callaghan) 1572, 1576 (D.N.D. 1981), *aff'd*, 34 U.C.C. Rep. Serv. (Callaghan) 650 (8th Cir. Sept. 10, 1982).

16. *Harfield II*, *supra* note 4, at 241-42; see, e.g., *KMW Int'l v. Chase Manhattan Bank, N.A.*, 606 F.2d 10, 15 (2d Cir. 1979); *Bossier Bank & Trust Co. v. Union Planters Nat'l Bank*, 550 F.2d 1077, 1081 app. A (6th Cir. 1977) (*per curiam*) (adopting memorandum decision of lower court); *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 395 (D. Md. 1982); *Colorado Nat'l Bank v. Board of County Comm'rs*, 634 P.2d 32, 36-37 (Colo. 1981); *New York Life Ins. Co. v. Hartford Nat'l Bank & Trust Co.*, 173 Conn. 492, 498-99, 378 A.2d 562, 566 (1977).

17. E.g., *East Girard Sav. Ass'n v. Citizens Nat'l Bank & Trust Co.*, 593 F.2d 598, 602 (5th Cir. 1979); *Data Gen. Corp. v. Citizens Nat'l Bank*, 502 F. Supp. 776, 788 (D. Conn. 1980); *Baker v. National Blvd. Bank*, 399 F. Supp. 1021, 1024 (N.D. Ill. 1975); see *Chase Manhattan Bank v. Equibank*, 550 F.2d 882, 886 (3d Cir. 1977).

18. *East Girard Sav. Ass'n v. Citizens Nat'l Bank & Trust Co.*, 593 F.2d 598, 602 (5th Cir. 1979); see, e.g., *Pringle-Associated Mortgage Corp. v. Southern Nat'l Bank*, 571 F.2d 871, 874 (5th Cir. 1978); *Bossier Bank & Trust Co. v. Union Planters Nat'l Bank*, 550 F.2d 1077, 1081 app. A (6th Cir. 1977) (*per curiam*) (adopting memorandum decision of lower court); cf. *Housing Sec., Inc. v. Maine Nat'l Bank*, 391 A.2d 311, 320 (Me. 1978) (holding that settlement of underlying contract did not release the issuer from liability in damages for wrongful dishonor); *First Arlington Nat'l Bank v. Stathis*, 90 Ill. App. 3d 802, 808, 413 N.E.2d 1288, 1294 (1980) (holding that modification of underlying contract does not affect issuer's liability).

19. State of N.Y. Law Revision Comm'n, *supra* note 1, at 35, *reprinted in* 1956 Report at 45; see *East Girard Sav. Ass'n v. Citizens Nat'l Bank & Trust Co.*, 593 F.2d 598, 601 (5th Cir. 1979); *Pringle-Associated Mortgage Corp. v. Southern Nat'l Bank*, 571 F.2d 871, 874 (5th Cir. 1978); *Venizelos, S.A. v. Chase Manhattan Bank*, 425 F.2d 461, 464 (2d Cir. 1970); *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 394 (D. Md. 1982); *New York Life Ins. Co. v. Hartford Nat'l Bank & Trust Co.*, 173 Conn. 492, 498-99, 378 A.2d 562, 566 (1977); *Lustrelon, Inc. v. Prutscher*, 178 N.J. Super. 128, 139, 428 A.2d 518, 523 (App. Div. 1981); *Kingdom of Sweden v. New York Trust Co.*, 197 Misc. 431, 441-42, 96 N.Y.S. 2d 779, 788 (Sup. Ct. 1949); *Harfield II*, *supra* note 4, at 241.

Once a letter of credit is established²⁰ in his favor, the seller is protected against the risks of the buyer's insolvency or dishonesty,²¹ and in the event that a genuine dispute does exist, the seller becomes the stakeholder in any prospective litigation.²² The letter similarly reduces the risks to the buyer of seller insolvency or dishonesty, by enabling him to purchase goods without having to pay for them in advance of shipment.²³ Thus, the letter of credit provides the buyer

20. U.C.C. § 5-106(1)(a) (1977) provides that a letter of credit is established as to 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." *Id.* As to the beneficiary, the letter of credit is established when he has received the letter of credit or is advised of its issuance. *Id.* § 5-106(1)(b).

The Code provides that "[a] credit may be either revocable or irrevocable." *Id.* § 5-103(1)(a). In *West Va. Hous. Dev. Fund v. Sroka*, 415 F. Supp. 1107 (W.D. Pa. 1976), the court asserted that a revocable letter of credit is actually an illusory contract since it can be modified or revoked by the issuer without the parties' consent. *Id.* at 1111; *see Data Gen. Corp. v. Citizens Nat'l Bank*, 502 F. Supp. 776, 783 (D. Conn. 1980) (presumption in favor of irrevocability); U.C.C. § 5-106 official comment 2 (1977) (establishment of a revocable credit has "no legal significance" as to the beneficiary or the customer). *But see Beathard v. Chicago Football Club, Inc.*, 419 F. Supp. 1133, 1137-38 (N.D. Ill. 1976) (letter silent as to revocability deemed revocable); U.C.P., *supra* note 13, art. 1(c) ("In the absence of [any] indication the credit shall be deemed to be revocable."). If the letter is irrevocable and established as to either the beneficiary or the customer it cannot be modified without that party's consent. U.C.C. § 5-106(2) (1977); *see Goodwin Bros. Leasing v. Citizens Bank*, 587 F.2d 730, 733-34 (5th Cir. 1979) (holding that when the letter of credit left the issuer's control it was established as to the customer, and the bank was powerless to modify or cancel it even though the beneficiary had not yet received the letter); *West Va. Hous. Dev. Fund v. Sroka*, 415 F. Supp. 1107, 1113 (W.D. Pa. 1976) (customer's attempt to unilaterally cancel irrevocable letter held ineffective). *But see Chase Manhattan Bank v. Equibank*, 550 F.2d 882, 886-87 (3d Cir. 1977) (bank allowed to modify terms of an irrevocable letter). In addition, even if the customer and the beneficiary agree to modify the terms of the letter, the issuer may not be bound by that modification. *See AMF Head Sports Wear, Inc. v. Ray Scott's All-American Sports Club, Inc.*, 448 F. Supp. 222, 224-25 (D. Ariz. 1978).

21. *See* 1 A. Lowenfeld, *International Private Trade* § 1.2 (rev. ed. 1977); J. White & R. Summers, *supra* note 1, § 18-1, at 706-08; McLaughlin, *Standby Letters of Credit and Penalty Clauses: An Unexpected Synergy*, 40 Ohio St. L.J. 1, 5 (1982). *See supra* note 19 and accompanying text.

22. Weisz & Blackman, *Standby Letters of Credit After Iran: Remedies of the Account Party*, 1982 Ill. L. Rev. 355, 375; *see Insurance Co. of N. Am. v. Heritage Bank, N.A.*, 595 F.2d 171, 173 (3d Cir. 1979) (*per curiam*) (burden of bringing suit is shifted to the buyer).

23. *See Kingdom of Sweden v. New York Trust Co.*, 197 Misc. 431, 441-42, 96 N.Y.S. 2d 779, 788 (Sup. Ct. 1949); J. White & R. Summers, *supra* note 1, § 18-1, at 704-11. It should be noted that in a commercial letter of credit transaction the issuer is also protected against customer insolvency because it will usually demand a security interest in the goods. Therefore, it can always sell the goods should the buyer be unable to fulfill the duty of reimbursement. *See East Girard Sav. Ass'n v. Citizens Nat'l Bank & Trust Co.*, 593 F.2d 598, 602 n.1 (5th Cir. 1979); *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 394 (D. Md. 1982); McLaughlin,

some assurance of the seller's performance before his duty to reimburse the issuer arises.²⁴

Letters of Credit as Preferential Transfers in Bankruptcy, 50 Fordham L. Rev. 1033, 1037 (1982); Verkuil, *supra* note 13, at 721; *Recent Extensions*, *supra* note 5, at 905 n.12.

24. See *Housing Sec., Inc. v. Maine Nat'l Bank*, 391 A.2d 311, 319 (Me. 1978); *Kingdom of Sweden v. New York Trust Co.*, 197 Misc. 431, 441-42, 96 N.Y.S.2d 779, 788 (Sup. Ct. 1949); H. Harfield III, *supra* note 6, at 56-57; *State of N.Y. Law Revision Comm'n*, *supra* note 1, at 35, *reprinted in* 1956 Report at 45. The buyer is assured of performance only to the extent that the documents actually evidence the nature of the goods shipped. As a necessary result of the independence principle, the bank must pay upon presentation of complying documents even if the goods do not conform with the specifications of the underlying contract. *East Girard Sav. Ass'n v. Citizens Nat'l Bank & Trust Co.*, 593 F.2d 598, 602 (5th Cir. 1979); *Asociacion de Azucareros de Guatemala v. United States Nat'l Bank*, 423 F.2d 638, 641 (9th Cir. 1970); *Data Gen. Corp. v. Citizens Nat'l Bank*, 502 F. Supp. 776, 780 (D. Conn. 1980); *Weyerhaeuser Co. v. First Nat'l Bank*, 27 U.C.C. Rep. Serv. (Callaghan) 777, 780 (S.D. Iowa 1979); *Lustrelon, Inc. v. Prutscher*, 178 N.J. Super. 128, 140, 428 A.2d 518, 524 (App. Div. 1981); U.C.C. § 5-114(1) (1977); *cf. Banco di Roma v. Fidelity Union Trust Co.*, 464 F. Supp. 817, 824 (D.N.J. 1979) (even though terms of underlying contract were complied with, bank not required to honor draft since documents were non-complying). To guard against this result, the buyer may also require that a certificate of inspection, certifying the quality of the goods, accompany the documents that must be presented to the bank. See H. Harfield III, *supra* note 6, at 67-68.

Moreover, when there is "fraud in the transaction" the bank is permitted, but not required, to honor the draft. U.C.C. § 5-114(2) (1977); see *Bank of Newport v. First Nat'l Bank & Trust Co.*, 34 U.C.C. Rep. Serv. (Callaghan) 650, 655 (8th Cir. Sept. 10, 1982); *KMW Int'l v. Chase Manhattan Bank, N.A.*, 606 F.2d 10, 16 (2d Cir. 1979); *Scarsdale Nat'l Bank & Trust Co. v. Toronto-Dominion Bank*, 533 F. Supp. 378, 385 (S.D.N.Y. 1982); *Baker v. National Blvd. Bank*, 399 F. Supp. 1021, 1024 (N.D. Ill. 1975). There may be a fine line between "fraud in the transaction" and mere non-compliance. For example, in the leading pre-Code case of *Sztejn v. J. Henry Schroder Banking Corp.*, 177 Misc. 719, 31 N.Y.S.2d 631 (Sup. Ct. 1941), the seller, who was required under the contract to ship bristles to the buyer, instead sent "fifty crates with cowhair, other worthless material and rubbish with intent to simulate genuine merchandise." *Id.* at 720, 31 N.Y.S.2d at 633. The court, in holding that the bank was not required to honor the draft distinguished the fraud from "a mere breach of warranty regarding the quality of the merchandise." *Id.* at 722, 31 N.Y.S.2d at 634. Another court has drawn the line at the point "in which the wrongdoing of the beneficiary has so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served." *Intraworld Indus. v. Girard Trust Bank*, 461 Pa. 343, 359, 336 A.2d 316, 324-25 (1975).

Courts have reached conflicting conclusions as to the application of the "fraud in the transaction" defense. Some courts accept the defense only when there is fraud in the underlying transaction and no innocent parties are involved. See *Banco Espanol de Credito v. State St. Bank & Trust Co.*, 409 F.2d 711, 712 (1st Cir. 1969); *United Technologies Corp. v. Citibank, N.A.*, 469 F. Supp. 473, 478 (S.D.N.Y. 1979); *United Bank Ltd. v. Cambridge Sporting Goods Corp.*, 41 N.Y.2d 254, 259, 360 N.E.2d 943, 948, 392 N.Y.S.2d 265, 270 (1976). Other courts hold that the defense only applies when fraud is found with respect to the documents presented. See *Bossier Bank & Trust Co. v. Union Planters Nat'l Bank*, 550 F.2d 1077, 1082 app. A

In the hypothetical, the presence of Harley Bank in the transaction had the effect, under traditional analysis, of denying PRS the protection that a letter of credit is designed to provide. Even though the goods never arrived, PRS was required to reimburse Henri Bank for honoring the letter. The duties of a bank honoring a draft, as defined by the Uniform Commercial Code (Code),²⁵ are to examine the documents with care to determine that they comply on their face with the terms of the letter and to exercise good faith in making that determination.²⁶ The documents as forwarded to Henri Bank did comply on their face and because the bank could not have been aware of the "one-hour trip" to New York, it clearly acted in good faith in honoring the draft.²⁷ Accordingly, Henri Bank did not breach its duty to PRS in honoring the draft, and was therefore entitled to reimbursement.²⁸

The issue then presented is from whom may PRS seek relief. Clearly PRS can sue GYP on the underlying contract,²⁹ but such an action

(6th Cir. 1977) (per curiam) (adopting memorandum decision of lower court); *West Va. Hous. Dev. Fund v. Sroka*, 415 F. Supp. 1107, 1114 (W.D. Pa. 1976); *Shaffer v. Brooklyn Park Garden Apts.*, 311 Minn. 452, 463, 250 N.W.2d 172, 179 (1977). Neither approach conflicts with the principle that the bank need not go behind the documents when making the determination whether to honor the credit, because the bank is privileged to pay the draft. See U.C.C. § 5-114(2)(b) (1977). As long as the bank acts in good faith in making that determination it retains its right of reimbursement from the customer. See *id.*; *id.* § 5-114 official comment 2. See generally *H. Harfield I*, *supra* note 2, at 81-93 (analyzing the *Sztejn* case and its ramifications).

25. U.C.C. § 5-109 (1977).

26. *Id.* See *supra* note 11.

27. Good faith is defined as "honesty in fact in the conduct or transaction concerned." U.C.C. § 1-201(19) (1977). In some Articles of the Code additional requirements are added to the definition. See, e.g., *id.* §§ 2-103(1)(b), 7-404. However, the § 1-201(19) definition is controlling as to Article 5 transactions. See *Lustrelon, Inc. v. Prutscher*, 178 N.J. Super. 128, 143-44, 482 A.2d 518, 526 (App. Div. 1981); U.C.C. § 1-201(19) official comment (1977). Honesty in fact does not mean absence of negligence, *Funding Consultants, Inc. v. Aetna Casualty & Sur. Co.*, 187 Conn. 637, 643, 447 A.2d 1163, 1165-66 (1982); *Industrial Nat'l Bank v. Leo's Used Car Exch., Inc.*, 362 Mass. 797, 801-02, 291 N.E.2d 603, 606 (1973); *Community Bank v. Ell*, 278 Or. 417, 427-28, 564 P.2d 685, 691 (1977), and therefore the reasonable man test is not the standard to be applied when determining good faith, *Corporacion Venezolano de Fomento v. Vintero Sales Corp.*, 452 F. Supp. 1108, 1119 (S.D.N.Y. 1978); *Republic of Tex. Sav. Ass'n v. First Republic Life Ins. Co.*, 417 So. 2d 1251, 1255 (La. Ct. App. 1982); see *Lustrelon, Inc. v. Prutscher*, 178 N.J. Super. 128, 143, 428 A.2d 518, 526 (App. Div. 1981).

28. An issuer forfeits its right to reimbursement only when the documents do not comply on their face or when it has acted in bad faith in honoring the draft. *H. Harfield I*, *supra* note 2, at 57; see *Chase Manhattan Bank v. Equibank*, 550 F.2d 882, 886 (3d Cir. 1977) (issuing bank's waiver of a term jeopardizes its right of reimbursement); *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 389 n.8 (D. Md. 1982) (same).

29. See *KMW Int'l v. Chase Manhattan Bank, N.A.*, 606 F.2d 10, 15 (2d Cir. 1979) (preliminary injunction vacated because action on the underlying contract

may involve overcoming many of the risks that the use of the letter of credit was designed to avoid.³⁰ Harley Bank, as a confirming bank, has also breached a duty imposed upon it by the Code;³¹ it knowingly accepted forged documents and thereby did not act in good faith in honoring the draft.³² However, most courts have refused to entertain a direct action by a customer against a confirming bank, reasoning that such a bank owes a duty of care only to its customer—the issuing bank—and not to the ultimate customer.³³ When the confirming bank alone has breached a duty of good faith, the issuing bank may rightfully demand reimbursement if the documents comply on their face.³⁴ If the issuing bank then refuses to bring suit against the confirming bank, which may also be its correspondent bank,³⁵ the ultimate customer is effectively without a remedy. The confirming bank, therefore, under this traditional rule, has been allowed to escape liability.

negates the possibility of irreparable harm when fraudulent letter of credit is honored); U.C.C. § 5-109 official comment 1 (1977) (“[t]he customer will normally have direct recourse against the beneficiary if performance fails”); cf. J. White & R. Summers, *supra* note 1, § 18-6, at 728 (“[T]he beneficiary may still recover from the customer in an action on the underlying contract”).

30. See *supra* note 23 and accompanying text.

31. See U.C.C. § 5-107(2) (1977). Section 5-107(2) defines the duties of a confirming bank and states that “[a] confirming bank by confirming a credit becomes directly obligated on the credit to the extent of its confirmation as though it were its issuer and acquires the rights of an issuer.” *Id.*; see *Voest-Alpine Int’l Corp. v. Chase Manhattan Bank, N.A.*, 545 F. Supp. 301, 303 (S.D.N.Y. 1982); *Instituto Nacional de Comercializacion Agricola (Indeca) v. Continental Ill. Nat’l Bank & Trust Co.*, 530 F. Supp. 279, 282 (N.D. Ill. 1982); *Harfield I*, *supra* note 2, at 9-10.

32. See *Scarsdale Nat’l Bank & Trust Co. v. Toronto-Dominion Bank*, 533 F. Supp. 378, 386 (S.D.N.Y. 1982) (because bank had actual knowledge of fraud, it had acted in bad faith and was barred from drawing on the letter of credit).

33. See *Dulien Steel Prods. v. Bankers Trust Co.*, 189 F. Supp. 922, 929 (S.D.N.Y. 1960), *aff’d*, 298 F.2d 836 (2d Cir. 1962); *Linden v. National City Bank*, 12 A.D.2d 69, 70, 208 N.Y.S.2d 182, 184 (1960); *Courteen Seed Co. v. Hong Kong & Shanghai Banking Corp.*, 216 A.D. 495, 499, 215 N.Y.S. 525, 529 (1926), *aff’d*, 245 N.Y. 377, 157 N.E. 272 (1927); cf. *Oelbermann v. National City Bank*, 79 F.2d 534, 537 (2d Cir. 1935) (negotiating bank not liable to ultimate customer), *modified per curiam*, 298 U.S. 638 (1936); *Kunglig Jarnvagsstyrelsen v. National City Bank*, 20 F.2d 307, 309 (2d Cir.) (defendant bank, which issued letter of credit for its correspondent bank, not liable to ultimate customer), *cert. denied*, 275 U.S. 497 (1927); *Instituto Nacional De Comercializacion Agricola (Indeca) v. Continental Ill. Nat’l Bank & Trust Co.*, 530 F. Supp. 279, 282-85 (N.D. Ill. 1982) (under the Code confirming bank does not owe a duty to ultimate customer, but it might be liable in tort); *M. Golodetz Export Corp. v. Credit Lyonnais*, 493 F. Supp. 480, 487 (C.D. Cal. 1980) (remitting bank not liable to ultimate customer); *Samuel Kronman & Co. v. Public Nat’l Bank*, 218 A.D. 624, 631, 218 N.Y.S. 616, 622 (1926) (presenting bank not liable to the ultimate customer).

34. See *supra* note 14.

35. See *H. Harfield III*, *supra* note 6, at 37; *Halls*, *supra* note 11, at 454.

For transactions similar to the hypothetical, in which the only party to breach its Code-imposed duty of care is the confirming bank, this Note proposes that a direct action by the ultimate customer against that bank be allowed. Part I discusses cases in which intermediary banks have either facilitated a beneficiary's attempt to defraud the customer or have perpetrated a fraud of their own, and thus illustrates a myriad of factual settings in which the problem posed is likely to occur. Part II examines the traditional reasons advanced for denying a direct cause of action in these situations. Finally, in light of the clear need for such a cause of action, Part III assesses the various theoretical bases that can be found both within the Code and with reference to other areas of law to impose liability on the confirming bank.

I. A PROBLEM IN PRACTICE

The hypothetical presented is a compilation of facts gleaned from two recent cases. In *Instituto Nacional De Comercializacion Agricola (Indeca) v. Continental Illinois Bank & Trust Co.*,³⁶ a confirming bank had originally refused to honor a draft because one of the documents presented was missing a legalized certificate of origin.³⁷ A few hours later the beneficiary returned with a "legalized" document.³⁸ The confirming bank then honored the draft even though the bank was located in Chicago and the stamp bore a Miami address.³⁹ In *Pubali Bank v. City National Bank*,⁴⁰ an advising bank⁴¹ had a loan outstanding with the beneficiary.⁴² When the standby letter of credit was issued, the bank accepted an assignment of the proceeds of the letter and released the beneficiary's collateral securing the loan.⁴³ The customer, instead of relying on the letter of credit, paid the benefi-

36. 530 F. Supp. 279 (N.D. Ill. 1982).

37. *Id.* at 280-81.

38. *Id.* at 280-82.

39. *Id.*

40. 676 F.2d 1326 (9th Cir. 1982).

41. U.C.C. § 5-107(1) (1977), which defines the duty of advising banks, states that an advising bank "does not assume any obligation to honor drafts drawn or demands for payment made under the credit but it does assume obligation for the accuracy of its own statement." *Id.* In contrast, the confirming bank is directly liable on the credit to the beneficiary. See *supra* notes 5, 8 and accompanying text. Therefore, advising banks, and other intermediary banks, as mere conveyors of information for their principals, perform a different function in the letter of credit transaction than do confirming banks. See Kozolchyk I, *supra* note 4, at 235.

42. 676 F.2d at 1328.

43. *Id.* A letter of credit itself is not assignable unless "the credit is expressly designated as transferable or assignable." U.C.C. § 5-116(1) (1977); accord *Bank of Newport v. First Nat'l Bank & Trust Co.*, 32 U.C.C. Rep. Serv. (Callaghan) 1572.

ciary directly and advised the issuer that he had done so.⁴⁴ In addition, the customer sent proof of payment to both the issuing and advising banks.⁴⁵ The advising bank nevertheless honored the beneficiary's draft and simultaneously applied the proceeds to the outstanding balance on the loan.⁴⁶

Both cases illustrate that in either a commercial or standby letter of credit⁴⁷ situation, an intermediary bank may be provided with the

1578 (D.N.D. 1981), *aff'd*, 34 U.C.C. Rep. Serv. (Callaghan) 650 (8th Cir. Sept. 10, 1982); *Pastor v. National Republic Bank*, 76 Ill. 2d 139, 148, 390 N.E.2d 894, 897 (1979); *Shaffer v. Brooklyn Park Garden Apts.*, 311 Minn. 452, 458-59, 250 N.W.2d 172, 177 (1977); *see Watson v. Commissioner*, 613 F.2d 594, 598 (5th Cir. 1980). This rule provides additional protection for the customer in that he retains the right to prevent someone other than the party he has contracted with from presenting the documents. H. Harfield III, *supra* note 6, at 180-81; Weisz & Blackman, *supra* note 22, at 366. On the other hand, the proceeds of a letter of credit are assignable even if the letter is expressly non-assignable. *Bank of Newport v. First Nat'l Bank & Trust Co.*, 32 U.C.C. Rep. Serv. (Callaghan) 1572, 1578 (D.N.D. 1981), *aff'd*, 34 U.C.C. Rep. Serv. (Callaghan) 650 (8th Cir. Sept. 10, 1982); *Pastor v. National Republic Bank*, 76 Ill. 2d 139, 148-49, 390 N.E.2d 894, 898 (1979); *Shaffer v. Brooklyn Park Garden Apts.*, 311 Minn. 452, 458-59, 250 N.W.2d 172, 177 (1977); U.C.C. § 5-116(2) (1977); U.C.P., *supra* note 13, art. 47.

44. 676 F.2d at 1328.

45. *Id.*

46. *Id.*

47. A standby letter of credit is defined as "any letter of credit . . . which represents an obligation to the beneficiary on the part of the issuer . . . to make payment on account of any indebtedness undertaken by the account party, or . . . to make payment on account of any default by the account party in the performance of an obligation." 12 C.F.R. § 7.1160(a) (1982). Nearly identical definitions have been stated by the Federal Reserve Board, *id.* § 208.8(d), and by the FDIC, *id.* § 337.2(a). Although the same rules govern both commercial and standby letters of credit, they often serve different purposes. *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 393 (D. Md. 1982); *O'Grady v. First Union Nat'l Bank*, 296 N.C. 212, 231, 250 S.E.2d 587, 599 (1978); *see Colorado Nat'l Bank v. Board of County Comm'rs*, 634 P.2d 32, 36 (Colo. 1981). The commercial letter of credit is utilized as a mechanism of payment in sales contracts. *E.g.*, *Insurance Co. of N. Am. v. Heritage Bank, N.A.*, 595 F.2d 171, 173 (3d Cir. 1979) (*per curiam*); *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 393-94 (D. Md. 1982); *Housing Sec., Inc. v. Maine Nat'l Bank*, 391 A.2d 311, 318 (Me. 1978). In contrast, the standby letter of credit often functions as a means of ensuring performance in transactions not involving the sale of goods. *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 394 (D. Md. 1982); *O'Grady v. First Union Nat'l Bank*, 296 N.C. 212, 230-31, 250 S.E.2d 587, 599 (1978); *McLaughlin, supra* note 21, at 6. It has been adopted for use in a wide variety of financing situations, and as such, is a more versatile instrument than the commercial letter of credit. Kozolchyk, *The Emerging Law of Standby Letters of Credit and Bank Guarantees*, 24 *Ariz. L. Rev.* 319, 320 (1982) ("Standby credit can encompass virtually every obligation known to man."); *see, e.g.*, *Pringle-Associated Mortgage Corp. v. Southern Nat'l Bank*, 571 F.2d 871, 872 (5th Cir. 1978) (security to short-term financiers); *Chase Manhattan Bank v. Equibank*, 550 F.2d 882, 884 (3d Cir. 1977) (long-term financing); *Beathard*

opportunity to take advantage of its traditional insulation from liability to the ultimate customer.⁴⁸ Because the confirming bank deals directly with the beneficiary,⁴⁹ it is often in a better position than the issuer or customer to recognize forgery.⁵⁰ However, because of geographical proximity, the confirming bank is often closely allied with the beneficiary, and therefore may fail to fulfill the limited duty of

v. Chicago Football Club, Inc., 419 F. Supp. 1133, 1135 (N.D. Ill. 1976) (guarantee of salary payment); First Arlington Nat'l Bank v. Stathis, 90 Ill. App. 3d 802, 804, 413 N.E.2d 1288, 1291 (1980) (collateral for loan). See generally J. White & R. Summers, *supra* note 1, § 18-1, at 708-09 (outlining the various uses of letters of credit); Verkuil, *supra* note 13, at 721-24 (same); *Recent Extensions*, *supra* note 5, at 903-09 (same).

Another distinction is that the issuer of a standby letter of credit expects to pay only if the customer defaults. See Insurance Co. of N. Am. v. Heritage Bank, N.A., 595 F.2d 171, 173 (3d Cir. 1979) (*per curiam*); Consolidated Aluminum Corp. v. Bank of Va., 544 F. Supp. 386, 394 (D. Md. 1982). In contrast, the issuer of a commercial letter of credit fully expects to be presented with a demand for payment. *Id.*

48. See Oelbermann v. National City Bank, 79 F.2d 535, 537 (2d Cir. 1935), *modified per curiam*, 298 U.S. 638 (1936); Dulian Steel Prods. v. Bankers Trust Co., 189 F. Supp. 922, 929 (S.D.N.Y. 1960), *aff'd*, 298 F.2d 836 (2d Cir. 1962); Linden v. National City Bank, 12 A.D.2d 69, 70, 208 N.Y.S.2d 182, 184 (1960); Courteen Seed Co. v. Hong Kong & Shanghai Banking Corp., 216 A.D. 495, 499, 215 N.Y.S. 525, 530 (1926), *aff'd*, 245 N.Y. 377, 157 N.E. 272 (1927); Samuel Kronman & Co. v. Public Nat'l Bank, 218 A.D. 624, 631, 218 N.Y.S. 616, 622 (1926). *But see* Pubali Bank v. City Nat'l Bank, 676 F.2d 1326, 1330 (9th Cir. 1982) (advising bank liable to ultimate customer); Instituto Nacional de Comercializacion Agricola (Indeca) v. Continental Ill. Nat'l Bank & Trust Co., 530 F. Supp. 279, 282 (N.D. Ill. 1982) (ultimate customer has cause of action against confirming bank). In the leading pre-Code case of Szejn v. J. Henry Schroder Banking Corp., 177 Misc. 719, 31 N.Y.S.2d 631 (1941), the intermediary was not insulated from liability. The court declined to dismiss the complaint against the bank on the grounds that rather than being a holder in due course, the bank was a "mere agent for collection for the account of the seller charged with fraud." *Id.* at 723, 31 N.Y.S.2d at 635.

49. See, e.g., Barclays Bank D.C.O. v. Mercantile Nat'l Bank, 481 F.2d 1224, 1226-27 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); Voest-Alpine Int'l Corp. v. Chase Manhattan Bank, N.A., 545 F. Supp. 301, 302-03 (S.D.N.Y. 1982); Instituto Nacional de Comercializacion Agricola (Indeca) v. Continental Ill. Nat'l Bank & Trust Co., 530 F. Supp. 279, 280 (N.D. Ill. 1982); Kingdom of Sweden v. New York Trust Co., 197 Misc. 431, 442, 96 N.Y.S.2d 779, 788 (Sup. Ct. 1949); *cf.* Gillette, *supra* note 11, at 33 (transferee bank chooses to deal directly with the beneficiary).

50. *Cf.* Gillette, *supra* note 11, at 38-45. Professor Gillette posits that because transferee banks, such as advising or paying banks, are in the beneficiary's locale, they are better able to check the facts represented in the documents and thereby discourage fraud or forgery. *Id.* at 44. He suggests that the holder in due course doctrine should be eliminated because the transferee bank will have an incentive to detect fraud and forgery if it is forced to bear the loss. *Id.* at 44-45. He concludes that elimination of the doctrine will force the transferee banks to go behind the documents in order to ensure their rights of reimbursement, and thus, the dishonest beneficiary will be deterred from attempting to defraud the customer. *Id.* at 38.

good faith imposed upon every party in a transaction governed by the Code.⁵¹ Because the confirming bank is not amenable to suit by the ultimate customer, the customer assumes the risk of the confirming bank's bad faith.

An analogous situation illustrating the risks that can be imposed upon the customer arose in the Iranian letter of credit cases. Before the Shah fell from power, many American companies entered into service contracts with various branches of the Imperial Government of Iran.⁵² Often a unique two-tier guaranty/standby letter of credit scheme was employed to assure the American company's performance.⁵³ For example, in *Touche Ross & Co. v. Manufacturers Hanover Trust Co.*,⁵⁴ an accounting firm agreed to provide a guaranty issued

51. See *Pubali Bank v. City Nat'l Bank*, 676 F.2d 1326, 1329-30 (9th Cir. 1982) (advising bank, also assignee of proceeds of letter, knowingly accepted false documents and presented them for honor); *Bank of Newport v. First Nat'l Bank & Trust Co.*, 34 U.C.C. Rep. Serv. (Callaghan) 650, 660-61 (8th Cir. Sept. 10, 1982) (issuer did not have to honor draft presented by bank to which letter of credit had been assigned because bank not only knew that terms of letter had not been complied with, but had also participated in preventing the underlying contract from being performed); *Scarsdale Nat'l Bank & Trust Co. v. Toronto-Dominion Bank*, 533 F. Supp. 378, 386-88 (S.D.N.Y. 1982) (assignee bank presented documents for honor when it knew or should have known of the fraud in the transaction); *Instituto Nacional de Comercializacion Agricola (Indeca) v. Continental Ill. Nat'l Bank & Trust Co.*, 530 F. Supp. 279, 281-82 (N.D. Ill. 1982) (confirming bank knew or should have known that documents presented for honor were forged); *Sztejn v. J. Henry Schroder Banking Corp.*, 177 Misc. 719, 723, 31 N.Y.S.2d 631, 635 (1941) (correspondent bank knew of fraud in the transaction and was therefore "a mere agent for collection" for the beneficiary).

52. See, e.g., *Harris Corp. v. National Iranian Radio & Television*, 691 F.2d 1344, 1346 (11th Cir. 1982) (contract to manufacture and service broadcast transmitters); *KMW Int'l v. Chase Manhattan Bank, N.A.*, 606 F.2d 10, 12 (2d Cir. 1979) (contract to provide telephone poles to the Water and Power Authority); *Itek Corp. v. First Nat'l Bank*, 511 F. Supp. 1341, 1342 (D. Mass. 1981) (contract to manufacture high-technology optical equipment for Imperial Ministry of War); *Werner Lehara Int'l, Inc. v. Harris Trust & Sav. Bank*, 484 F. Supp. 65, 66 (W.D. Mich. 1980) (contract to provide machinery, equipment and consulting services in connection with government bakery project); *American Bell Int'l, Inc. v. Islamic Republic of Iran*, 474 F. Supp. 420, 421 (S.D.N.Y. 1979) (contract to provide equipment and consulting services to improve Iran's international communications system).

53. *Weisz & Blackman*, *supra* note 22, at 360-61; see, e.g., *Harris Corp. v. National Iranian Radio & Television*, 691 F.2d 1344, 1346-49 (11th Cir. 1982); *KMW Int'l v. Chase Manhattan Bank, N.A.*, 606 F.2d 10, 12 (2d Cir. 1979); *Itek Corp. v. First Nat'l Bank*, 511 F. Supp. 1341, 1342-43 (D. Mass. 1981); *Werner Lehara Int'l, Inc. v. Harris Trust & Sav. Bank*, 484 F. Supp. 65, 67-68 (W.D. Mich. 1980); *American Bell Int'l, Inc. v. Islamic Republic of Iran*, 474 F. Supp. 420, 421 (S.D.N.Y. 1979); *United Technologies Corp. v. Citibank, N.A.*, 469 F. Supp. 473, 475 (S.D.N.Y. 1979); *Stromberg-Carlson Corp. v. Bank Melli Iran*, 467 F. Supp. 530, 531-32 (S.D.N.Y. 1979).

54. 107 Misc. 2d 438, 434 N.Y.S.2d 575 (Sup. Ct. 1980).

by an Iranian bank securing the company's performance to the Iranian Ministry of War.⁵⁵ This Iranian bank guaranty was in turn supported by a standby letter of credit issued by an American bank in favor of the Iranian guarantor bank.⁵⁶ The court granted the plaintiff's preliminary injunction against honor,⁵⁷ stating that because the Iranian bank had been nationalized, and was owned by Khomeini's Islamic Republic of Iran, it "could not have legitimately paid on the guaranty, as [the bank] would be simply paying itself. Therefore, any call on the letter of credit would be fraudulent."⁵⁸ Numerous courts deciding the Iranian letter of credit cases have similarly recognized this increased likelihood of a fraudulent call under a letter of credit.⁵⁹

55. *Id.* at 440, 434 N.Y.S.2d at 577.

56. *Id.*

57. *Id.* at 443, 434 N.Y.S.2d at 578. The test for granting preliminary injunctions in the Second Circuit, in which many of the Iranian cases were decided, requires the plaintiff to show the possibility of irreparable harm and either 1) probability of success on the merits or 2) serious questions pertaining to the merits of a litigation and a balance of hardships that tips decidedly toward the party requesting the preliminary relief. *KMW Int'l v. Chase Manhattan Bank, N.A.*, 606 F.2d 10, 14 (2d Cir. 1979); *Jackson Dairy, Inc. v. H.P. Hood & Sons*, 596 F.2d 70, 72 (2d Cir. 1979) (per curiam); *Caulfield v. Board of Educ.*, 583 F.2d 605, 610 (2d Cir. 1978).

Harfield contends that injunctions against honor can be properly granted only when there is "egregious fraud," no adequate remedy at law and no innocent parties who will be harmed. Harfield, *Enjoining Letter of Credit Transactions*, 95 Banking L.J. 596, 614-15 (1978). Moreover, the California legislature has deleted the phrase "but a court of appropriate jurisdiction may enjoin such honor" in their version of § 5-114(2)(b). See Cal. Com. Code § 5114(2)(b) (West 1964). The rationale for this deletion is that allowing a customer to enjoin the issuer from honoring the letter would "erode the certainty [of payment to the beneficiary] that should accompany letter of credit transactions." *Agnew v. Federal Deposit Ins. Corp.*, 34 U.C.C. Rep. Serv. (Callaghan) 1304, 1309 (N.D. Cal. Oct. 15, 1982); see Cal. Com. Code § 5114(2)(b) comment 6 (West 1964).

58. 107 Misc. 2d at 442, 434 N.Y.S.2d at 578.

59. See, e.g., *Harris Corp. v. National Iranian Radio & Television*, 691 F.2d 1344, 1356 (11th Cir. 1982) ("Moreover, [the ultimate beneficiary's] demand was made in a situation that was subtly suggestive of fraud. Since [the beneficiary] and [the Iranian guarantor bank] had both become government enterprises, the demand was in some sense by Iran upon itself and may have been an effort by Iran to harvest undeserved bounty from [the issuer]."); *Itek Corp. v. First Nat'l Bank*, No. 80-58, slip. op. at 7 (D. Mass. May 25, 1982) ("Since the Iranian guarantor bank has been nationalized, it cannot be called an innocent bystander which simply responded to the papers which were issued."); *Collins Sys. Int'l v. Citibank, N.A.*, No. 82 Civ. 613 (S.D.N.Y. Feb. 25, 1982) ("The problem in this case . . . is that so far as the Iranian bank and the Iranian Navy are concerned, one hand is washing the other. The Iranian Bank cannot, as an agency of Iran, be innocently complying with a demand by the Iranian Navy or by Iran."). As acknowledged by both court and commentator alike, the standby letter of credit is merely a blank check that is, by its nature, heir to fraudulent abuse. See *Watkins-Johnson Co. v. Wells Fargo Bank*, No. C79-0121, slip

In these cases the Iranian banks were not confirming banks. They were beneficiaries of standby letters of credit as well as intermediary guarantors for the Iranian government. Although American banks are not permitted to issue guaranties,⁶⁰ letters of credit can perform a similar function.⁶¹ The Iranian bank's guaranty provided the Iranian government with the additional measure of security that a confirming bank provides to the beneficiary of a letter of credit; in both cases a bank, frequently of the recipient's choice, becomes directly obligated to pay the beneficiary. Moreover, such bank acquires the right of reimbursement from an issuer of a letter of credit.⁶² Therefore, while these cases are not directly on point, they are analogous to the dangers that a customer may encounter when a confirming bank is involved in a letter of credit transaction.

op. at 9 (N.D. Cal. Feb. 27, 1979); *American Bell Int'l, Inc. v. Manufacturers Hanover Trust Co.*, N.Y.L.J., Mar. 29, 1979, at 7, col. 6 (N.Y. Sup. Ct.), *aff'd mem.*, 70 A.D.2d 830, 418 N.Y.S.2d 551 (1979); *Weisz & Blackman*, *supra* note 22, at 366 & n.38.

60. *See* 12 U.S.C. § 24 (1976 & Supp. V 1981); *Kimen v. Atlas Exch. Nat'l Bank*, 92 F.2d 615, 617-18 (7th Cir. 1937), *cert. denied*, 303 U.S. 650 (1938); Lord, *The No-Guaranty Rule and the Standby Letter of Credit Controversy*, 96 *Banking L.J.* 46, 62 (1979).

61. *Weisz & Blackman*, *supra* note 22, at 358; *see Harfield, Code Treatment of Letters of Credit*, 48 *Cornell L.Q.* 92, 93 (1963) ("A letter of credit always serves as a guaranty. This does not mean that it is a guaranty. A letter of credit is an identical twin to a guaranty, but the fact that the two things look alike and may be used for the same purpose and are difficult to distinguish one from the other, does not mean that . . . there are not differences which, however subtle, are of major importance.") [hereinafter cited as *Harfield IV*]. Because of their similarities, a frequent source of litigation concerns whether the instrument is a standby letter of credit or an *ultra vires* bank guaranty. *Compare Wichita Eagle & Beacon Publishing Co. v. Pacific Nat'l Bank*, 493 F.2d 1285, 1286 (9th Cir. 1974) (*per curiam*) (instrument not a letter of credit because it required actual existence of customer's default before payment could be demanded) *and Robert Mallery Lumber Corp. v. B. & F. Assocs. Inc.*, 294 Pa. Super. 503, 509, 440 A.2d 579, 581 (1982) (instrument not called a letter of credit, nor was there a promise of payment upon presentation of documents, thus it was a guaranty) *with New Jersey Bank v. Palladino*, 77 N.J. 33, 39, 389 A.2d 454, 457-58 (1978) (standby letter of credit is an exception to the rule that banks cannot issue guaranties). The distinction between a standby letter of credit and a bank guaranty is that a guarantor becomes liable only after there has been an unsuccessful demand on the obligor for payment; under a letter of credit, however, the issuer is primarily liable on the credit. *E.g.*, *Barclays Bank D.C.O. v. Mercantile Nat'l Bank*, 481 F.2d 1224, 1236 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 394 & n.23 (D. Md. 1982); *International Leather Distribs. v. Chase Manhattan Bank*, 464 F. Supp. 1197, 1201 n.9 (S.D.N.Y.), *aff'd mem.*, 607 F.2d 996 (2d Cir. 1979); *Dubuque Packing Co. v. Fitzgibbon*, 599 P.2d 440, 441 (Okla. Ct. App. 1979); *see H. Harfield I, supra* note 2, at 2, 7.

62. *See* U.C.C. § 5-107(2) (1977).

II. FAILURE TO PROVIDE A CAUSE OF ACTION: THE PRIVITY CONCEPT

The majority of courts adjudicating suits by a customer against a confirming bank, or the related issue of suits against an intermediary bank, have denied the existence of the cause of action.⁶³ In pre-Code cases, the reason advanced to justify this result was that no privity⁶⁴ exists between a customer and an intermediary bank.⁶⁵ The customer's contract with its bank for the issuance of a letter of credit is entirely separate and distinct from the issuer's contract with the confirming bank.⁶⁶ The confirming bank performs its services at the request of the issuer and does not rely on the credit of the customer.⁶⁷ In addition, the confirming bank deals exclusively with the issuing bank in honoring the beneficiary's draft, and looks to that bank for reimbursement.⁶⁸

63. See *supra* notes 33, 48 and accompanying text.

64. Privity is defined as referring to "those who exchange the promissory words or those to whom the promissory words are directed." J. Calamari & J. Perillo, *The Law of Contracts* § 17-1, at 605 (2d ed. 1977). It is a basic contract principle that, with the exception of third party beneficiaries, those not in privity cannot sue to enforce a contract. See *id.* § 17-1, at 605-06.

65. See *Oelbermann v. National City Bank*, 79 F.2d 534, 535, 537 (2d Cir. 1935), *modified per curiam*, 298 U.S. 638 (1936); *Kunglig Jarnvagsstyrelsen v. National City Bank*, 20 F.2d 307, 308-09 (2d Cir.), *cert. denied*, 275 U.S. 497 (1927); *M. Golodetz Export Corp. v. Credit Lyonnais*, 493 F. Supp. 480, 487 (C.D. Cal. 1980); *Dulien Steel Prods. v. Bankers Trust Co.*, 189 F. Supp. 922, 929 (S.D.N.Y. 1960) (dictum), *aff'd*, 298 F.2d 836 (2d Cir. 1962); *Linden v. National City Bank*, 12 A.D.2d 69, 70, 208 N.Y.S.2d 182, 184 (1960) (dictum); *Kronman & Co. v. Public Nat'l Bank*, 218 A.D. 624, 631, 218 N.Y.S. 616, 622 (1926); *Courteen Seed Co. v. Hong Kong & Shanghai Banking Corp.*, 216 A.D. 495, 499, 215 N.Y.S. 525, 530 (1926), *aff'd*, 245 N.Y. 377, 157 N.E. 272 (1927); *cf. Kingdom of Sweden v. New York Trust Co.*, 197 Misc. 431, 439-40, 96 N.Y.S.2d 779, 786-87 (Sup. Ct. 1949) (plaintiff, Kingdom of Sweden, had capacity to maintain action against confirming bank because issuing bank was under the administration of the Swedish government). *But see Kozolchycyk, Letters of Credit*, in 9 *International Encyclopedia of Comparative Law* ch. 5, at 47 (finding "no valid impediment" in locating privity between the customer and the confirming bank) [hereinafter cited as *Kozolchycyk II*].

66. *Courteen Seed Co. v. Hong Kong & Shanghai Banking Corp.*, 216 A.D. 495, 498, 215 N.Y.S. 525, 529, (1926), *aff'd*, 245 N.Y. 377, 157 N.E. 272 (1927).

67. *Instituto Nacional de Comercializacion Agricola (Indeca) v. Continental Ill. Nat'l Bank & Trust Co.*, 530 F. Supp. 279, 283 (N.D. Ill. 1982); see *Kunglig Jarnvagsstyrelsen v. National City Bank*, 20 F.2d 307, 309 (2d Cir.), *cert. denied*, 275 U.S. 497 (1927).

68. *Kunglig Jarnvagsstyrelsen v. National City Bank*, 20 F.2d 307, 309 (2d Cir.), *cert. denied*, 275 U.S. 497 (1927); *Instituto Nacional de Comercializacion Agricola (Indeca) v. Continental Ill. Nat'l Bank & Trust Co.*, 530 F. Supp. 279, 282 (N.D. Ill. 1982); *Courteen Seed Co. v. Hong Kong & Shanghai Banking Corp.*, 245 N.Y. 377, 382, 157 N.E. 272, 274 (1927); *Recent Extensions, supra* note 5, at 903 & n.7. There

A strict reading of the Code has yielded the same result. In *Instituto Nacional De Comercializacion Agricola (Indeca) v. Continental Illinois National Bank & Trust Co.*,⁶⁹ the district court determined that section 5-107(2) of the Code,⁷⁰ which describes a confirming bank as a bank that "becomes directly obligated on the credit to the extent of its confirmation as though it were its issuer and acquires the rights of an issuer,"⁷¹ provides only that the confirming bank acquires the right of reimbursement from its customer, the issuing bank.⁷² The court supported this determination by reference to section 5-103(1)(g),⁷³ which expressly includes an issuing bank that has engaged the services of a confirming bank within its definition of a "customer."⁷⁴ Thus, the original issuer becomes a customer of the confirming bank. This construction is consistent with section 5-109,⁷⁵ which sets out the bank's duty of care under the heading "Issuer's Obligation to *Its* Customer."⁷⁶ Therefore, the confirming bank owes its duty of care solely to the original issuer, and the customer "cannot telescope those two contractual duties into one."⁷⁷

While acknowledging the absence of privity, the *Indeca* court proceeded to look beyond it in finding a basis for imposing liability.⁷⁸ The court found that the customer had a cause of action against the confirming bank in tort for either negligence or fraud.⁷⁹ Similarly, in *Pubali Bank v. City National Bank*,⁸⁰ the court held that the bank had occupied two roles in the transaction: first, as an advising bank and second, as "lender-creditor" of the beneficiary.⁸¹ The court allowed the direct action by reasoning that the bank could not "hide behind the cloak of a neutral advising bank."⁸² While acknowledging that there was no privity between the customer and the bank, the court stated that it was holding the bank jointly liable with the beneficiary because the bank had acted in its own self-interest.⁸³ However, it is

is authority, however, that the confirming bank may look to the ultimate customer for reimbursement. See *infra* note 113 and accompanying text.

69. 530 F. Supp. 279 (N.D. Ill. 1982).

70. U.C.C. § 5-107(2) (1977).

71. *Id.*

72. 530 F. Supp. at 282.

73. *Id.* at 283; see U.C.C. § 5-103(1)(g) (1977).

74. U.C.C. § 5-103(1)(g) (1977).

75. *Id.* § 5-109.

76. *Id.* (emphasis added); see *id.* § 1-109 (providing that "section captions are parts of this Act").

77. 530 F. Supp. at 283.

78. See *id.* at 282, 285.

79. *Id.* at 285.

80. 676 F.2d 1326 (9th Cir. 1982).

81. *Id.* at 1329.

82. *Id.* at 1330.

83. *Id.* at 1329-30 & n.5.

not clear whether the court was simply acknowledging the lack of privity and holding the bank liable for breach of warranty, or whether it was imposing liability in tort.⁸⁴

Once it is determined that a need exists for imposing liability in certain circumstances, the simplest approach would be to do away with the privity requirement. Because the letter of credit is a unique device,⁸⁵ traditional contract requirements are not always applicable.⁸⁶ For instance, section 5-105 expressly removes the requirement of consideration in the contract between the issuer and the customer.⁸⁷ More on point is the fact that the issuer is neither contractually liable to the beneficiary,⁸⁸ nor is the beneficiary technically a third party beneficiary of the issuer's contract with its customer.⁸⁹ Instead the

84. See *id.* at 1329 & n.5.

85. *E.g.*, H. Harfield III, *supra* note 6, at 53 ("No theory [of the validity of letters of credit] satisfies every intellectual requirement."); I A. Lowenfeld, *supra* note 21, § 5.53, at 103 ("Probably the best explanation is simply to call a letter of credit a transaction *sui generis*—a relationship with no perfect analogies but nevertheless a well defined set of rights and obligations." (footnote omitted)); Joseph, *Letters of Credit: The Developing Concepts and Financing Functions*, 94 *Banking L.J.* 816, 850 (1977) ("The letter of credit evolved as a mercantile specialty, and the only way to understand all its facets is to recognize that it is an entity unto itself.")

86. *Marino Indus. Corp. v. Chase Manhattan Bank, N.A.*, 34 U.C.C. Rep. Serv. (Callaghan) 637, 641-42 (2d Cir. Aug. 11, 1982); *East Girard Sav. Ass'n v. Citizens Nat'l Bank & Trust Co.*, 593 F.2d 598, 603 (5th Cir. 1979); *Data Gen. Corp. v. Citizens Nat'l Bank*, 502 F. Supp. 776, 784 (D. Conn. 1980) (dictum); see Note, *Letters of Credit: A Solution to the Problem of Documentary Compliance*, 50 *Fordham L. Rev.* 848, 854-55 (1982) ("application of contract principles must be selective and gauged entirely upon the effect such application will have on the letter transaction").

87. U.C.C. § 5-105 (1977) ("No consideration is necessary to establish a credit or to enlarge or otherwise modify its terms."); see *Toyota Indus. Trucks U.S.A. v. Citizens Nat'l Bank*, 611 F.2d 465, 469 (3d Cir. 1979); *Bank of N.C., N.A. v. Rock Island Bank*, 570 F.2d 202, 207 (7th Cir. 1978); *Barclays Bank D.C.O. v. Mercantile Nat'l Bank*, 481 F.2d 1224, 1239 n.22 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); *Schweibish v. Pontchartrain State Bank*, 389 So. 2d 731, 734, 736 n.20 (La. Ct. App. 1980), *cert. denied*, 396 So. 2d 885 (La. 1981).

88. *J. White & R. Summers, supra* note 1, § 18-2, at 711. White and Summers argue that there is no mutual assent between the beneficiary and the issuer. *Id.*: accord Joseph, *supra* note 85, at 850-51; Comment, *Letter of Credit: Current Theories and Usages*, 39 *La. L. Rev.* 581, 588-90 (1979) [hereinafter cited as *Current Theories*]; see Kozolchik II, *supra* note 65, at 135-36.

89. *J. White & R. Summers, supra* note 1, § 18-2, at 714; *Current Theories, supra* note 88, at 590. In a third party beneficiary contract, the rights and obligations of the third party depend upon the validity of the contract between the promisee and the promisor. *J. Calamari & J. Perillo, supra* note 64, § 17-9, at 628. The promisor can assert any defense against the third party beneficiary that he could assert against the promisee. *Id.* § 17-8, at 623; see *Rotermund v. United States Steel Corp.*, 474 F.2d 1139, 1142 (8th Cir. 1973). In the letter of credit transaction, however, the issuer must honor demands for payment that comply with the letter regardless of the

issuer is "statutorily obligated to honor drafts drawn by the beneficiary."⁹⁰ Therefore, it can be argued that the confirming bank, as a principal party in the letter of credit transaction, should also be deemed to be statutorily obligated to the customer.

In sum, although most courts continue to apply the contract principle of privity to deny a direct cause of action,⁹¹ when equitable notions demand a different result, some courts have found the basis for a cause of action in other areas of the law.⁹² Unfortunately, those that have imposed liability have done so on an ad hoc basis. Moreover, these courts have either been unclear as to the theory applied in imposing liability,⁹³ or when they have been clear, their reasoning has proven analytically defective.⁹⁴ Therefore, in addition to the need for a direct action, there is a need for the articulation of a clear basis for imposing liability, thereby providing certainty in recovery when a duty has in fact been breached.⁹⁵

validity of its contract with its customer. *E.g.*, *East Girard Sav. Ass'n v. Citizens Nat'l Bank & Trust Co.*, 593 F.2d 598, 602 (5th Cir. 1979); *Chase Manhattan Bank v. Equibank*, 550 F.2d 882, 886 (3d Cir. 1977); *Baker v. National Blvd. Bank*, 399 F. Supp. 1021, 1024 (N.D. Ill. 1975); *J. White & R. Summers*, *supra* note 1, § 18-2, at 713. Nevertheless, some courts continue to attempt to characterize the letter of credit as a third party beneficiary contract. *See West Va. Hous. Dev. Fund v. Sroka*, 415 F. Supp. 1107, 1109-10 (W.D. Pa. 1976); *Savage v. First Nat'l Bank & Trust Co.*, 413 F. Supp. 447, 451 (N.D. Okla. 1976) (quoting *Harvey Estes Constr. Co. v. Dry Dock Savings Bank*, 381 F. Supp. 271, 274 (W.D. Okla. 1974)); *Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank*, 387 F. Supp. 92, 98 (M.D.N.C.), *rev'd on other grounds*, 528 F.2d 802 (4th Cir. 1975); *cf. Data Gen. Corp. v. Citizens Nat'l Bank*, 502 F. Supp. 776, 785 (D. Conn. 1980) (letter of credit analogized to a third party beneficiary contract).

90. *J. White & R. Summers*, *supra* note 1, § 18-2, at 711; U.C.C. § 5-114 (1977).

91. *See supra* notes 63-68 and accompanying text. *See Kozolchyk II*, *supra* note 65, at 47. While American courts are unanimous as to denial of a direct cause of action, foreign court views differ sharply. *Id.*

92. *See supra* notes 78-84 and accompanying text.

93. *See supra* note 84 and accompanying text. Some courts have allowed the ultimate customer to sue the confirming bank, seemingly without recognition of the analytical problems involved. *See Lustrelon, Inc. v. Prutscher*, 178 N.J. Super. 128, 136, 428 A.2d 518, 522 (App. Div. 1981); *United Commodities-Greece v. Fidelity Int'l Bank*, N.Y.L.J., May 28, 1982, at 6, col. 4.

94. *See infra* notes 172-78 and accompanying text.

95. *See KMW Int'l v. Chase Manhattan Bank, N.A.*, 606 F.2d 10, 16 (2d Cir. 1979) ("The financial value of the letter of credit promise is predicated upon its degree of legal certainty.") (quoting *B. Kozolchyk, Commercial Letters of Credit in the Americas* § 18.04[1], at 394-95 (1966)); *Insurance Co. of N. Am. v. Heritage Bank, N.A.*, 595 F.2d 171, 176 (3d Cir. 1979) (per curiam) ("[E]ssential to the viability of [the letter of credit] is the certainty that it provides."); *East Girard Sav. Ass'n v. Citizens Nat'l Bank & Trust Co.*, 593 F.2d 598, 603 (5th Cir. 1979). ("If the letter of credit is to retain its utility as a commercial instrument, the rights and duties of the issuer, the beneficiary, and the procurer must remain clear.").

III. POSSIBLE SOLUTIONS

A. *Creating a Cause of Action by Analogy*

1. General Flexibility of Article 5

That Article 5 does not explicitly provide the ultimate customer with a remedy against the confirming bank should not by itself bar a direct action. The Code does not envision all possible problems, nor was it meant to.⁹⁶ The letter of credit is a flexible device and the drafters of Article 5 were acutely aware of this fact. Section 5-102(3)⁹⁷ codifies this notion of flexibility:

This Article deals with some but not all of the rules and concepts of letters of credit. . . . The fact that this Article states a rule does not by itself require, imply or negate application of the same or a converse rule to a situation not provided for or to a person not specified by this Article.⁹⁸

The official comment to this section states that its purpose was to make "explicit the court's power to apply a particular rule by analogy to cases not within its terms, or to refrain from doing so."⁹⁹

96. See *Barclays Bank D.C.O. v. Mercantile Nat'l Bank*, 481 F.2d 1224, 1231-32 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 399-400 (D. Md. 1982) (quoting U.C.C. § 5-102 official comment 2 (1977)); *Data Gen. Corp. v. Citizens Nat'l Bank*, 502 F. Supp. 776, 783 (D. Conn. 1980); *National Sur. Corp. v. Midland Bank & Trust Co.*, 408 F. Supp. 684, 689 n.7 (D.N.J. 1976), *rev'd on other grounds*, 551 F.2d 21 (3d Cir. 1977); *New York Life Ins. Co. v. Hartford Nat'l Bank & Trust Co.*, 173 Conn. 492, 500, 378 A.2d 562, 566 (1977); *New Jersey Bank v. Palladino*, 77 N.J. 33, 41, 389 A.2d 454, 458 (1978); *Harfield IV*, *supra* note 61, at 95-97; *cf.* U.C.C. § 5-102 official comment 2 (1977) (it would be unwise to codify all the possible law of letters of credit). In fact, the New York Law Revision Commission based its conclusion that "no . . . improvement would result from adoption of the Article, and that in fact its enactment would lead to technical deterioration of the law in this area," in part on their determination that the coverage in Article 5 was incomplete. State of N.Y. Law Revision Comm'n, *supra* note 4, at 148, *reprinted in*, 1955 Report at 1716. Moreover, New York bankers were vehemently opposed to the adoption of Article 5 because it was felt that the UCP was adequate for international transactions and was thus sufficient to regulate domestic letters of credit as well. See Penney, *New York Revisits the Code: Some Variations in the New York Enactment of the Uniform Commercial Code*, 62 Colum. L. Rev. 992, 1004-07 (1962). Because he feels that banks will continue to operate under the UCP, Harfield has concluded that "there is very little purpose for the student of bank credits to examine the Uniform Commercial Code at all." *Harfield IV*, *supra* note 61, at 96.

97. U.C.C. § 5-102(3) (1977).

98. *Id.*

99. *Id.* official comment 2.

A number of courts, recognizing the intended flexibility of Article 5, have extended its rules by analogy.¹⁰⁰ In *AMF Head Sports Wear, Inc. v. Ray Scotts All-American Sport Club, Inc.*,¹⁰¹ the court recognized that even though the Code provides only that an issuer owes a duty of good faith to its customer, the issuer owes a concomitant obligation to the beneficiary.¹⁰² In *Barclays Bank D.C.O. v. Mercantile National Bank*,¹⁰³ the Fifth Circuit bridged a different "gap" in the Code's treatment of letters of credit. The defendant bank had "confirmed" a letter of credit issued by a firm of mortgage consultants.¹⁰⁴ The bank subsequently refused to honor the letter arguing that it was not a confirming bank within the meaning of section 5-103(f),¹⁰⁵ which defines a confirming bank as one which confirms a letter issued by a "bank."¹⁰⁶ The court justified the imposition of liability, despite the wording of the Code, by reasoning that the drafters could not have intended to allow a bank in the defendant's position to escape liability.¹⁰⁷ The interpretations given to the Code's provisions by the *Barclays* and *AMF* courts provide a theoretical foundation for extending the issuer-customer duty¹⁰⁸ to the confirming bank by analogy.

2. Specific Analogy to the UCP

Further support for imposing liability by reading a duty into the provisions of the Code can be found in the Uniform Customs and Practices (UCP).¹⁰⁹ Article 7 of the UCP, which defines the duties of

100. See *Barclays Bank D.C.O. v. Mercantile Nat'l Bank*, 481 F.2d 1224, 1231-32 (5th Cir. 1973), cert. dismissed, 414 U.S. 1139 (1974); *AMF Head Sports Wear, Inc. v. Ray Scott's All-American Sports Club, Inc.*, 448 F. Supp. 222, 224 (D. Ariz. 1978); cf. *United Bank Ltd. v. Cambridge Sporting Goods Corp.*, 41 N.Y.2d 254, 261, 360 N.E.2d 943, 950, 392 N.Y.S.2d 265, 272 (1976) (applying § 3-307 provision concerning signatures on negotiable instruments to Article 5). But see *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 400 (D. Md. 1982) (refusing to extend § 3-511(1) concerning the reasonable diligence standard in late presentment of documents to Article 5).

101. 448 F. Supp. 222 (D. Ariz. 1978).

102. *Id.* at 224.

103. 481 F.2d 1224 (5th Cir. 1973), cert. dismissed, 414 U.S. 1139 (1974).

104. *Id.* at 1226-27.

105. U.C.C. § 5-103(1)(f) (1977).

106. 481 F.2d at 1229. Section 5-103(1)(f) defines a confirming bank as "a bank which engages either that it will itself honor a credit *already issued by another bank* or that such a credit will be honored by the issuer or a *third bank*." U.C.C. § 5-103(1)(f) (1977) (emphasis added).

107. 481 F.2d at 1230-32.

108. See U.C.C. § 5-109 (1977).

109. International Chamber of Commerce, *Uniform Customs and Practice for Documentary Credits* (Publication No. 290 rev. ed. 1974) (effective Oct. 1, 1975). Harfield distinguishes the UCP from the UCC by stating:

banks, is silent as to whom this duty is owed.¹¹⁰ Other provisions of the UCP, however, clearly suggest that obligations do run between the confirming bank and the ultimate customer. Article 12(a) states that "[b]anks utilising the services of another bank for the purpose of giving effect to the instructions of the applicant for the credit do so for the account and at the risk of the latter."¹¹¹ Additionally, Article 12(c) states that "[t]he applicant for the credit shall be bound by and liable to indemnify the banks against all obligations and responsibilities."¹¹² The implication of this section is that the confirming bank could obtain reimbursement from the ultimate customer.¹¹³ It follows, then, that the customer should have rights as against the confirming bank.

The key to the *Barclays* decision to reject a literal analysis of Article 5 was its determination that in order to justify the application of a rule, "that rule must advance the policy which gave birth to the rule in the first instance."¹¹⁴ Application of the rule that the confirming

the UCC undertakes to create a skeletal structure on or around which letters of credit may develop, whereas the UCP endeavors to describe the developments as they exist from time to time. Thus the difference is comparable to that between a summary of Gray's Anatomy and a family photo album.

H. Harfield I, *supra* note 2, at 4. The letter of credit itself will often provide that it is to be governed by the UCP. J. White & R. Summers, *supra* note 1, § 18-3, at 717. In certain states if the letter of credit states that it is subject to the UCP then Article 5 will not apply. *Id.* at 719; *see, e.g.*, *KMW Int'l v. Chase Manhattan Bank, N.A.*, 606 F.2d 10, 15 & n.3 (2d Cir. 1979); *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 400 (D. Md. 1982); *Hohenberg Co. v. Comitex Knitters Ltd.*, 104 Misc. 2d 232, 233, 428 N.Y.S.2d 156, 157 (Sup. Ct. 1980). Since the provisions of the UCP and the UCC are generally consistent, the parties can also stipulate that both will apply. J. White & R. Summers, *supra* note 1, § 18-3, at 719. In addition, courts will tend to look to the UCC or pre-Code law if the UCP is silent on an issue in question. *Id.* at 720; *see United Bank Ltd. v. Cambridge Sporting Goods Corp.*, 41 N.Y.2d 254, 258 n.2, 360 N.E.2d 943, 947 n.2, 392 N.Y.S.2d 265, 269 n.2 (1976).

110. *See U.C.P.*, *supra* note 13, art. 7. Article 7 states:

Banks must examine all documents with reasonable care to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit. Documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to be in accordance with the terms and conditions of the credit.

Id.; *Instituto Nacional de Comercializacion Agricola (Indeca) v. Continental Ill. Nat'l Bank & Trust Co.*, 530 F. Supp. 279, 283 (N.D. Ill. 1982) (because Article 7 is silent as to whom the duty of care is owed, it is to be construed as consistent with this court's interpretation of the UCC).

111. *U.C.P.*, *supra* note 13, art. 12(a).

112. *Id.* art. 12(c).

113. *See id.*; *see also Harfield II, supra* note 4, at 243 ("an issuer or confirmer who has paid against documents . . . is entitled to reimbursement from the party at whose instance the credit was established" (emphasis added)).

114. *Barclays Bank D.C.O. v. Mercantile Nat'l Bank*, 481 F.2d 1224, 1230 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); *see Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 400 (D. Md. 1982).

bank owes no duty to the ultimate customer may in many instances actually undermine the utility of the letter of credit as a payment mechanism designed to reduce risk.¹¹⁵

Even though the customer engages the services of the issuer,¹¹⁶ an issuer is not properly classifiable as an agent of the customer. In this situation a bank is not a fiduciary; rather, it is required to "maintain a . . . strict impartiality induced by the equal but diametrically opposed contractual pressures exerted by the beneficiary and by the account party."¹¹⁷ Both the beneficiary and the customer rely on the issuing bank's neutrality to reduce their risks in the underlying transaction.¹¹⁸ Similarly, both parties should be able to rely on the neutrality of any intermediary banks involved in the transaction. Realistically however, in many cases the bank engaged to confirm the letter of credit has other dealings with the beneficiary.¹¹⁹ It may therefore have an added interest in seeing the letter of credit honored.¹²⁰ Returning to the hypothetical, because Henri Bank had not incurred liability to PRS, it had no incentive to sue Harley Bank. Under traditional analysis the customer is denied a cause of action against the confirming bank; Harley Bank has been effectively insulated from liability even

115. See *supra* notes 15-24 and accompanying text.

116. See, e.g., *Bank of Newport v. First Nat'l Bank & Trust Co.*, 34 U.C.C. Rep. Serv. (Callaghan) 650, 655 (8th Cir. Sept. 10, 1982); *Baker v. National Blvd. Bank*, 399 F. Supp. 1021, 1024 (N.D. Ill. 1975); *Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank*, 387 F. Supp. 92, 98 (M.D.N.C.), *rev'd on other grounds*, 528 F.2d 802 (4th Cir. 1975); U.C.C. § 5-103(1)(g) (1977).

117. *H. Harfield III, supra* note 6, at 104; see U.C.C. § 5-117 official comment (1977); cf. *Banco di Roma v. Fidelity Union Trust Co.*, 464 F. Supp. 817, 823 (D.N.J. 1979) (customer's agent was not an agent of the issuing bank and his approval did not operate as a waiver of the issuing bank's objections). In addition, because the confirming bank is independently obligated on the letter of credit, it is not an agent of the issuer. See *Kingdom of Sweden v. New York Trust Co.*, 197 Misc. 431, 445-46, 96 N.Y.S.2d 779, 791 (Sup. Ct. 1949).

118. See *Bank of Newport v. First National Bank & Trust Co.*, 34 U.C.C. Rep. Serv. (Callaghan) 650, 656 (8th Cir. Sept. 10, 1982) ("The letter of credit would lose its commercial vitality if, before honoring drafts, the issuing bank were obliged to look beyond the terms of the letter."); *Marino Indus. Corp. v. Chase Manhattan Bank, N.A.*, 34 U.C.C. Rep. Serv. (Callaghan) 637, 641 (2d Cir. Aug. 11, 1982) ("It is the complete separation between the underlying commercial transaction and the letter of credit that gives the letter its utility in financing transactions."); *Intraworld Indus. v. Girard Trust Bank*, 461 Pa. 343, 357, 336 A.2d 316, 323 (1975) ("The great utility of letters of credit flows from the independence of the issuer-bank's engagement from the underlying contract between beneficiary and customer.").

119. *Halls, supra* note 11, at 454; cf. *Gillette, supra* note 11, at 33 (transferee is often beneficiary's bank).

120. See *Pubali Bank v. City Nat'l Bank*, 676 F.2d 1326, 1329 (9th Cir. 1982) (bank as lender-creditor had a direct interest in seeing the letter honored). *But see Oelbermann v. National City Bank*, 79 F.2d 534, 585 (2d Cir. 1935), *modified per curiam*, 298 U.S. 638 (1936) (fact that proceeds were applied to an outstanding balance not significant in the absence of a showing of fraud).

though it had wrongfully honored the credit.¹²¹ In this situation a literal reading of the Code does not encourage honest dealings;¹²² rather, it forces the customer to assume the risk of that bank's bad faith.

3. Specific Analogy to Article 4

Analogy to the section 4-207¹²³ warranties of collecting banks provides another basis for imposing liability directly on the confirming bank. In the case of forgery, under section 4-207(1),¹²⁴ the payor of a check can sue any collecting bank for breach of warranty.¹²⁵ Under section 4-207(2),¹²⁶ a collecting bank when sued can pass the loss further upstream to earlier collecting banks, and ultimately to the depository bank.¹²⁷ The rationale behind this progression is that the loss should be borne by the party who dealt with the forger and was therefore in the best position to prevent the forgery.¹²⁸ While the

121. See *supra* notes 31-35 and accompanying text.

122. Cf. Gillette, *supra* note 11, at 44-45 (since transferee, as holder in due course, is insulated from liability, it has no incentive to take advantage of its superior position to discourage fraud or forgery).

123. U.C.C. § 4-207 (1977).

124. *Id.* § 4-207(1).

125. See, e.g., Maddox v. First Westroads Bank, 199 Neb. 81, 89, 256 N.W.2d 647, 653 (1977); Clarkson v. Selected Risks Ins. Co., 170 N.J. Super 373, 383-84, 406 A.2d 494, 499 (Super. Ct. 1979); Atlantic Bank v. Israel Discount Bank, Ltd., 108 Misc. 2d 342, 345, 441 N.Y.S.2d 315, 317 (Sup. Ct. 1981) (per curiam); Bank of the W. v. Wes-Con Dev. Co., 15 Wash. App. 238, 241, 548 P.2d 563, 566 (1976); T. Quinn, Uniform Commercial Code Commentary and Law Digest ¶ 4-207[A][3] (1978); J. White & R. Summers, *supra* note 1, § 15-5, at 598.

126. U.C.C. § 4-207(2) (1977).

127. North Carolina Nat'l Bank v. Hammond, 298 N.C. 703, 708, 260 S.E.2d 617, 621 (1979); Bank of the W. v. Wes-Con Dev. Co., 15 Wash. App. 238, 241, 548 P.2d 563, 566 (1976); B. Clark, *supra* note 1, ¶ 6.4[4][a]; T. Quinn, *supra* note 125, ¶ 4-207[A][2]; J. White & R. Summers, *supra* note 1, § 15-5, at 601.

128. E.g., Perkins State Bank v. Connolly, 632 F.2d 1306, 1318 (5th Cir. 1980); First Nat'l Bank v. Trust Co., 510 F. Supp. 651, 655 (N.D. Ga. 1981); Thornton & Co. v. Gwinnett Bank & Trust Co., 151 Ga. App. 641, 654, 260 S.E.2d 765, 768 (1979); Maddox v. First Westroads Bank, 199 Neb. 81, 89, 256 N.W.2d 647, 653 (1977); Atlantic Bank v. Israel Discount Bank, 108 Misc. 2d 342, 345-46, 441 N.Y.S.2d 315, 317 (Sup. Ct. 1981) (per curiam); Bank of the W. v. Wes-Con Dev. Co., 15 Wash. App. 238, 241, 548 P.2d 563, 566 (1976); J. White & R. Summers, *supra* note 1, § 15-1, at 580; Note, *Drawer v. Collecting Bank for Payment of Checks on Forged Indorsements—Direct Suit under the Uniform Commercial Code*, 45 Temp. L.Q. 102, 106 (1971). Another purpose for the warranty is to speed up the collection process. Perkins State Bank v. Connolly, 632 F.2d 1306, 1318 (5th Cir. 1980); Menthor, S.A. v. Swiss Bank Corp., 34 U.C.C. Rep. Serv. (Callaghan) 1259, 1266-67 (S.D.N.Y. Oct. 15, 1982); Miller v. Federal Deposit Ins. Corp., 34 U.C.C. Rep. Serv. (Callaghan) 1640, 1643 (Ariz. Ct. App. Oct. 7, 1982); Sun 'n Sand, Inc. v. United Cal. Bank, 21 Cal. 3d 671, 685, 582 P.2d 920, 930, 148 Cal. Rptr. 329, 339 (1978); cf. Gillette, *supra* note 11, at 43-44 (transferee bank is in the best position to discourage fraud or forgery because it can threaten to harm the dishonest beneficia-

liability of a confirming bank in the case of forged documents is considerably more narrow,¹²⁹ this Article 4 principle is logically applicable to letter of credit transactions. In the hypothetical, for example, Harley Bank, because of its unique vantage point, was the only bank in a position to recognize the forgery.¹³⁰

In terms of its practical effect, allowing a direct action would not impose a greater standard of care on the confirming bank than already exists in its dealings with the issuer.¹³¹ Extending the express provisions of the Code by analogy would simply fill a gap left by the drafters, thereby providing the ultimate customer with a remedy when the confirming bank alone has breached a code-imposed duty in honoring the beneficiary's draft.

B. *Imposition of Tort Liability for Negligent Misrepresentation*

Section 1-103¹³² provides that "[u]nless displaced by the particular provisions of this Act, the principles of law and equity . . . shall supplement its provisions."¹³³ In contrast to extending the provisions of the Code by analogy, which essentially involves applying rules already set out in the Code to new situations,¹³⁴ this second form of gap filler involves applying rules found outside the Code to augment its provisions.¹³⁵ Many courts, for example, have applied general con-

ry's reputation and because it is easier and less expensive for such a bank to conduct an investigation).

129. Under U.C.C. § 4-207(2)(a), for example, collecting banks warrant that they have good title to the instrument. *Id.* § 4-207(2)(a) (1977). The rationale for imposing liability on the depository bank is that it should have exercised more care in checking the forged endorsement of the person cashing the check. B. Clark, *supra* note 1, at ¶ 6.4[4][a], at 6-45. In contrast, the confirming bank has no duty to make an independent investigation. *See* U.C.C. § 5-109 official comment 2 (1977) ("The purpose of the examination is to determine whether the documents appear regular on their face."). Additionally, the confirming bank must merely exercise good faith in making that determination. *See id.* §§ 5-107(2), 5-109(1) & official comment 1.

130. *See supra* note 50 and accompanying text.

131. By confirming a credit, the confirming bank acquires the rights and duties of an issuer. U.C.C. § 5-107(2) (1977). The duties assumed are the examination of documents with care to determine that they comply on their face and the exercise of good faith in making this determination. *Id.* § 5-109. Extending the provisions of the Code by analogy would not alter these duties, but rather would merely extend them to a different party.

132. U.C.C. § 1-103 (1977).

133. *Id.*

134. *See Barclays Bank D.C.O. v. Mercantile Nat'l Bank*, 481 F.2d 1224, 1230-32 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 400 (D. Md. 1982); *AMF Head Sports Wear, Inc. v. Ray Scott's All-American Sports Club, Inc.*, 448 F. Supp. 222, 224 (D. Ariz. 1978).

135. *See Girard Bank v. Mount Holly State Bank*, 474 F. Supp. 1225, 1239 (D.N.J. 1979) (While "[c]ourts should be hesitant to improvise new remedies outside the already intricate scheme of [the Code] . . . this new cause of action would not

tract principles such as waiver,¹³⁶ estoppel,¹³⁷ mitigation,¹³⁸ accord and satisfaction¹³⁹ and the rules of interpretation¹⁴⁰ to letter of credit

interfere with that scheme but extend its principles to a situation not specifically foreseen by the drafters. The Code cannot be read to preclude a common law action.”).

136. *See, e.g.*, *Barclays Bank D.C.O. v. Mercantile Nat'l Bank*, 481 F.2d 1224, 1236 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); *Bank of Canton, Ltd. v. Republic Nat'l Bank*, 509 F. Supp. 1310, 1317 (S.D.N.Y.), *aff'd*, 636 F.2d 30 (2d Cir. 1980); *International Leather Distribs. v. Chase Manhattan Bank, N.A.*, 464 F. Supp. 1197, 1201-02 (S.D.N.Y.), *aff'd mem.*, 607 F.2d 996 (2d Cir. 1979); *Northern Trust Co. v. Oxford Speaker Co.*, 34 U.C.C. Rep. Serv. (Callaghan) 1246, 1251 (Ill. App. Ct. Sept. 22, 1982); *Maurice O'Meara Co. v. National Park Bank*, 239 N.Y. 386, 397, 146 N.E. 636, 639 (1925).

137. *See, e.g.*, *Bank of N.C., N.A. v. Rock Island Bank*, 630 F.2d 1243, 1252 (7th Cir. 1980); *U.S. Indus. v. Second New Haven Bank*, 462 F. Supp. 662, 666 (D. Conn. 1978); *Schweibish v. Ponthcartrain State Bank*, 389 So. 2d 731, 737-38 (La. Ct. App. 1980), *cert. denied*, 396 So. 2d 885 (La. 1981). Application of estoppel is usually conditioned upon proof that the beneficiary could have cured the defect, not raised by the issuer, within the effective period of the letter. *Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank*, 569 F.2d 699, 703-04 (1st Cir. 1978). In *Flagship Cruises*, the court held that “confining protestors to their stated reasons is limited to situations where the statements may have mislead drawers, who could have remedied defects but relied on the statement . . . to their injury.” *Id.* at 703; *accord* *Marino Indus. Corp. v. Chase Manhattan Bank, N.A.*, 34 U.C.C. Rep. Serv. (Callaghan) 637, 646 (2d Cir. Aug. 11, 1982); *Corporacion de Mercadeo Agricola v. Mellon Bank Int'l*, 608 F.2d 43, 48-49 (2d Cir. 1979); *Wing On Bank, Ltd. v. American Nat'l Bank & Trust*, 457 F.2d 328, 328-29 (5th Cir. 1972) (per curiam); *Voest-Alpine Int'l Corp. v. Chase Manhattan Bank, N.A.*, 545 F. Supp. 301, 304-05 & n.1 (S.D.N.Y. 1982); *Siderius, Inc. v. Wallace Co.*, 583 S.W.2d 852, 862 (Tex. Civ. App. 1979). If cure is not possible, reliance is, by definition, not detrimental. *Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank*, 569 F.2d 699, 703-04 (1st Cir. 1978); *Chase Manhattan Bank v. Equibank*, 550 F.2d 882, 887 (3d Cir. 1977); *Colorado Nat'l Bank v. Board of County Comm'rs*, 634 P.2d 32, 41 (Colo. 1981). *But see* *Northern Trust Co. v. Oxford Speaker Co.*, 34 U.C.C. Rep. Serv. (Callaghan) 1246, 1250-51 (Ill. App. Ct. Sept. 22, 1982) (refusing to limit application of waiver and estoppel principles to circumstances in which the documents could have been cured before the expiration date of the letter of credit).

138. *See* *Beckman Cotton Co. v. First Nat'l Bank*, 666 F.2d 181, 184 (5th Cir. 1982) (customer's refund to beneficiary would be recoverable as an attempt to mitigate damages); *Banco di Roma v. Fidelity Union Trust Co.*, 464 F. Supp. 817, 826-27 (D.N.J. 1979) (advising bank could have sold the goods had the issuing bank turned the documents of title over to it and thereby mitigated its damages). *But see* *Bank of N.C., N.A. v. Rock Island Bank*, 630 F.2d 1243, 1254 (7th Cir. 1980) (Article 5 does not require that a beneficiary mitigate damages by attempting to recover from someone other than the issuer); *Toyota Indus. Trucks U.S.A. v. Citizens Nat'l Bank*, 611 F.2d 465, 473 (3d Cir. 1979) (“even if a duty to mitigate existed, [the beneficiary] could not be charged with that obligation as it is evident that [the bank] could itself have mitigated damages”).

139. *American Empire Ins. Co. v. Hanover Nat'l Bank*, 409 F. Supp. 459, 465-66 (M.D. Pa. 1976), *aff'd*, 556 F.2d 564 (3d Cir. 1977).

140. *See, e.g.*, *Marino Indus. Corp. v. Chase Manhattan Bank, N.A.*, 34 U.C.C. Rep. Serv. (Callaghan) 637, 641 (2d Cir. Aug. 11, 1982); *United States v. Sun Bank*,

transactions. Likewise, imposition of common-law principles of tort liability may provide an alternative means to a necessary end.¹⁴¹

Two cases have analyzed the tort of negligent misrepresentation in the context of a confirming bank's duty to the ultimate customer, and have reached conflicting conclusions.¹⁴² In *Courteen Seed Co. v. Hong Kong & Shanghai Banking Corp.*,¹⁴³ the issuer sent a telegram directing the defendant-confirming bank that if the letter of credit was not drawn down by its expiration date the amount of the credit was to be reduced and the expiration delayed for an additional nine days.¹⁴⁴ The confirming bank, which had negligently overlooked the expiration date, replied that it had already paid the full amount of the draft.¹⁴⁵ Because the goods arrived prior to the documents, the plaintiff-customer did not learn that the terms of the letter had not been complied with until after he had accepted the goods.¹⁴⁶ In an action based upon the defendant's negligent misrepresentation concerning the beneficiary's compliance with the terms of the letter, the court held that the defendant-confirming bank did not owe a duty of care to the plaintiff-customer.¹⁴⁷ The court concluded that the bank "ran all the risk of its negligent act in buying the draft after the expiry

609 F.2d 832, 833 (5th Cir. 1980) (per curiam); *Bossier Bank & Trust Co. v. Union Planters Nat'l Bank*, 550 F.2d 1077, 1082 app. A (6th Cir. 1977) (per curiam) (adopting memorandum decision of lower court); *Venizelos, S.A. v. Chase Manhattan Bank*, 425 F.2d 461, 466 (2d Cir. 1970); *Bank of Newport v. First Nat'l Bank & Trust Co.*, 32 U.C.C. Rep. Serv. (Callaghan) 1572, 1577 (D.N.D. 1981), *aff'd*, 34 U.C.C. Rep. Serv. (Callaghan) 650 (8th Cir. Sept. 10, 1982); *Far E. Textile, Ltd. v. City Nat'l Bank & Trust Co.*, 430 F. Supp. 193, 197 (S.D. Ohio 1977).

141. See *Instituto Nacional de Comercializacion Agricola (Indeca) v. Continental Ill. Nat'l Bank & Trust Co.*, 530 F. Supp. 279, 282, 285 (N.D. Ill. 1982); *cf.* *New Jersey Bank, N.A. v. Bradford Secs. Operations, Inc.*, 34 U.C.C. Rep. Serv. (Callaghan) 1057, 1069 (3d Cir. Sept. 30, 1982) ("Recognizing a remedy in tort furthers the policy of Article 8: it promotes the negotiability of securities by placing the risk of loss on the party most able to minimize that risk."); *Girard Bank v. Mount Holly State Bank*, 474 F. Supp. 1225, 1239 (D.N.J. 1979) (Article 4 of "the Code cannot be read to preclude a common law action" in tort by the depository bank against the drawer of a check.).

142. Compare *Instituto Nacional de Comercializacion Agricola (Indeca) v. Continental Ill. Nat'l Bank & Trust Co.*, 530 F. Supp. 279, 285 (N.D. Ill. 1982) ("[T]he confirming bank owes a duty to the ultimate customer as someone who might foreseeably be harmed.") with *Courteen Seed Co. v. Hong Kong & Shanghai Banking Corp.*, 245 N.Y. 377, 382, 157 N.E. 272, 274 (1927) (The confirming bank "could scarcely anticipate" that the ultimate customer would rely on its representation.).

143. 245 N.Y. 377, 157 N.E. 272 (1927).

144. *Id.* at 380, 157 N.E. at 273.

145. *Id.*

146. *Id.*

147. *Id.* at 382, 157 N.E. at 274.

date,"¹⁴⁸ and that "it was justified in assuming that if the information was inaccurate the draft would not be paid on presentation."¹⁴⁹ In contrast, a very different result was reached in *Indeca*.¹⁵⁰ Based on facts similar to those given in the hypothetical in the beginning of this Note,¹⁵¹ the court found that the confirming bank did indeed owe a duty of care in tort to the ultimate customer as one who would foreseeably be harmed by the misrepresentation.¹⁵²

The tort of negligent misrepresentation may be defined as a negligent misstatement of a material fact.¹⁵³ The plaintiff must have reasonably relied upon the misstatement,¹⁵⁴ and the defendant need not have been the sole cause of the harm.¹⁵⁵ More importantly, in cases involving invasion of economic interests as a result of representations that are negligently made, the plaintiff must further prove that the defendant owed a duty to convey the information accurately.¹⁵⁶ This requirement is particularly relevant when the parties are not in privity¹⁵⁷ because words, by their very nature, are so easily transmittable to so many.¹⁵⁸

148. *Id.*

149. *Id.*

150. Instituto Nacional De Comercializacion Agricola (*Indeca*) v. Continental Ill. Nat'l Bank & Trust Co., 530 F. Supp. 279, 285 (N.D. Ill. 1982).

151. *Id.* at 280-81. See *supra* notes 11-14 and accompanying text.

152. 530 F. Supp. at 285.

153. See W. Prosser, Handbook of the Law of Torts § 108, at 718-20 (4th ed. 1971).

154. See, e.g., First Nat'l Bank v. Collins, 44 Colo. App. 228, 232, 616 P.2d 154, 156 (1980); Neff v. Bud Lewis Co., 89 N.M. 145, 148, 548 P.2d 107, 110 (Ct. App.), *cert. denied*, 551 P.2d 1368 (N.M. 1976); Stanford v. Owens, 46 N.C. App. 388, 395, 265 S.E.2d 617, 622 (1980); Rempel v. Nationwide Life Ins. Co., 471 Pa. 404, 408-09, 370 A.2d 366, 368 (1977); W. Prosser, *supra* note 153, § 108, at 714-18.

155. W. Prosser, *supra* note 153, § 108, at 715.

156. See *White v. Guarente*, 43 N.Y.2d 356, 363, 372 N.E.2d 315, 319, 401 N.Y.S.2d 474, 478 (1977); *Ultramares Corp. v. Touche*, 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931); *Glanzer v. Shepard*, 233 N.Y. 236, 239, 135 N.E. 275, 276 (1922); W. Prosser, *supra* note 153, § 107, at 704; *cf.* Restatement (Second) of Torts § 552 comment a (1977) (limited liability when there is only pecuniary loss).

157. The law is unsettled as to whether a party not in privity can sue for negligence. In the area of negligent misrepresentation, the fear is that the defendant will be subjected to unlimited liability to an unforeseeable class of plaintiffs. *North Am. Co. For Life & Health Ins. v. Berger*, 648 F.2d 305, 306 n.2 (5th Cir.), *cert. denied*, 454 U.S. 1084 (1981). See *infra* notes 159-66 and accompanying text. The majority view is that absence of privity is not a barrier to suit. *Mallis v. Bankers Trust Co.*, 615 F.2d 68, 82 (2d Cir. 1980) ("The general rule that applies in the majority of American jurisdictions at the present time is that the critical factor in the relationship between the parties is their reasonable expectations, not their formal legal relationship."), *cert. denied*, 449 U.S. 1123 (1981); see, e.g., *North Am. Co. For Life & Health Ins. v. Berger*, 648 F.2d 305, 307-08 (5th Cir.), *cert. denied*, 454 U.S. 1084 (1981); *Biakanja v. Irving*, 49 Cal. 2d 644, 649-50, 320 P.2d 16, 19 (1958); *Williams v. Polgar*, 43 Mich. App. 95, 100, 204 N.W.2d 57, 59 (1972), *aff'd*, 391 Mich. 6, 215 N.W.2d 149 (1974); *White v. Guarente*, 43 N.Y.2d 356, 362, 372 N.E.2d 315, 319,

Mere foreseeability that words might reach another is not enough to establish a duty.¹⁵⁹ In *Ultramares Corp. v. Touche*,¹⁶⁰ a case involving an accounting firm's negligent preparation of a balance sheet,¹⁶¹ Justice Cardozo concluded that in order to impose liability "[s]omething more must . . . appear than an intention that the promise shall redound to the benefit of the public or to that of a class of indefinite extension."¹⁶² The narrow holding in *Ultramares* was founded upon a fear of imputing liability "in an indeterminate amount for an indeterminate time to an indeterminate class."¹⁶³ The Restatement of Torts (Second) section 552(2)¹⁶⁴ states that liability is limited to loss suffered

(a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and (b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.¹⁶⁵

Liability is thus limited to a "fixed, definable and contemplated"¹⁶⁶ class of plaintiffs who the defendant has special reason to anticipate will rely on the statement.

The elements of negligent misrepresentation can be neatly applied to a letter of credit transaction. The confirming bank's liability is

401 N.Y.S.2d 474, 478 (1977); *Glanzer v. Shepard*, 233 N.Y. 236, 239, 135 N.E. 275, 276 (1922); *Davidson & Jones, Inc. v. County of New Hanover*, 41 N.C. App. 661, 668-69, 255 S.E.2d 580, 585 (1979). See generally Prosser, *Misrepresentation and Third Persons*, 19 Vand. L. Rev. 231, 231-40 (1966) (examining factors that are relevant in determining whether a party not in privity can sue on the basis of a misrepresentation).

158. W. Prosser, *supra* note 153, § 107, at 706-07.

159. *Id.* § 107, at 707-08.

160. 255 N.Y. 170, 174 N.E. 441 (1931).

161. *Id.* at 173, 174 N.E. at 442.

162. *Id.* at 181, 174 N.E. at 445.

163. *Id.* at 179, 174 N.E. at 444.

164. Restatement (Second) of Torts § 552(2) (1977).

165. *Id.* For cases applying the Restatement test, see *North Am. Co. For Life & Health Ins. v. Berger*, 648 F.2d 305, 308 n.7 (5th Cir.), *cert. denied*, 454 U.S. 1084 (1981); *Mallis v. Bankers Trust Co.*, 615 F.2d 68, 83 (2d Cir. 1980), *cert. denied*, 449 U.S. 1123 (1981); *Seedkem, Inc. v. Safranek*, 466 F. Supp. 340, 343-44 (D. Neb. 1979); *First Nat'l Bank v. Collins*, 44 Colo. App. 228, 230, 616 P.2d 154, 155 (1980); *Davidson & Jones, Inc. v. County of New Hanover*, 41 N.C. App. 661, 669, 255 S.E.2d 580, 585 (1979); *Dugan v. Jones*, 615 P.2d 1239, 1249 (Utah 1980); *Wilber v. Western Props.*, 22 Wash. App. 458, 463-64, 589 P.2d 1273, 1276-77 (1979).

166. *White v. Guarente*, 43 N.Y.2d 356, 362, 372 N.E.2d 315, 319, 401 N.Y.S.2d 474, 478 (1977); *accord Hochfelder v. Ernst & Ernst*, 503 F.2d 1100, 1107 (7th Cir. 1974) (plaintiffs must be "members of a limited class whose reliance . . . is specifically foreseen"), *rev'd on other grounds*, 425 U.S. 185 (1976); *Seedkem, Inc. v. Safranek*, 466 F. Supp. 340, 343 (D. Neb. 1979) (could "specifically identify" the plaintiff); *Rusch Factors, Inc. v. Levin*, 284 F. Supp. 85, 93 (D.R.I. 1968) (statement

logically limited to two parties:¹⁶⁷ the issuing bank, with whom it is in privity of contract,¹⁶⁸ and the customer, who initiated the letter of credit transaction.¹⁶⁹ In addition, because the confirming bank is often the only bank that interacts with the beneficiary, it alone is "uniquely situated" to assess the situation fully.¹⁷⁰ Consequently, the customer is perfectly justified in relying on the representations of the confirming bank.¹⁷¹

Although the individual elements of negligent misrepresentation appear to bridge the gap left open by the Code, the wholesale application of the principles of this tort may conflict with express provisions

relied upon by "actually foreseen and limited classes of persons"); *Williams v. Polgar*, 43 Mich. App. 95, 100, 204 N.W.2d 57, 59 (1972) ("[a]bstracts are prepared for a limited class"). *aff'd*, 391 Mich. 6, 215 N.W.2d 149 (1974); *Glanzer v. Shepard*, 233 N.Y. 236, 242, 135 N.E. 275, 277 (1922) (plaintiff's reliance was the "end and aim" of the transaction).

167. *Instituto Nacional de Comercializacion Agricola (Indeca) v. Continental Ill. Nat'l Bank & Trust Co.*, 530 F. Supp. 279, 284 n.9 (N.D. Ill. 1982).

168. See *supra* notes 67-68 and accompanying text.

169. See, e.g., *Bank of Newport v. First Nat'l Bank & Trust Co.*, 34 U.C.C. Rep. Serv. (Callaghan) 650, 651 (8th Cir. Sept. 10, 1982); *Marino Indus. Corp. v. Chase Manhattan Bank, N.A.*, 34 U.C.C. Rep. Serv. (Callaghan) 637, 639 (2d Cir. Aug. 11, 1982); *Insurance Co. of N. Am. v. Heritage Bank, N.A.*, 595 F.2d 171, 172 (3d Cir. 1979) (per curiam); *East Girard Sav. Ass'n v. Citizens Nat'l Bank & Trust Co.*, 593 F.2d 598, 600 (5th Cir. 1979).

170. *Instituto Nacional de Comercializacion Agricola (Indeca) v. Continental Ill. Nat'l Bank & Trust Co.*, 530 F. Supp. 279, 284 (N.D. Ill. 1982); cf. *Scarsdale Nat'l Bank & Trust Co. v. Toronto-Dominion Bank*, 533 F. Supp. 378, 387-88 & n.16 (S.D.N.Y. 1982) (presenting bank knew of facts that should have alerted it to make further inquiry, and thus the bank "had the greatest opportunity to avoid the situation"); *Gillette*, *supra* note 11, at 44 (transferee bank is uniquely situated to discourage fraud).

171. See *Instituto Nacional De Comercializacion Agricola (Indeca) v. Continental Ill. Nat'l Bank & Trust Co.*, 530 F. Supp. 279, 285 (N.D. Ill. 1982). An analogy can also be made to the waiver and estoppel principles so frequently applied against the issuing banks. See *supra* notes 136-37 and accompanying text. Application of equitable waiver and estoppel is premised upon the beneficiary's justifiable reliance on the issuer representations as the sole indication of documentary compliance. *Barclays Bank D.C.O. v. Mercantile Nat'l Bank*, 481 F.2d 1224, 1236 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); *U.S. Indus. v. Second New Haven Bank*, 462 F. Supp. 662, 666 (D. Conn. 1978); *East Bank v. Dovenmuehle, Inc.*, 196 Colo. 422, 429, 589 P.2d 1361, 1366 (1978). But see *Northern Trust Co. v. Oxford Speaker Co.*, 34 U.C.C. Rep. Serv. (Callaghan) 1246, 1251 (Ill. App. Ct. Sept. 22, 1982) (In contrast to estoppel, application of waiver does not require reliance, but rather it requires only an intentional relinquishment of a known right.). Similarly, because the confirming bank is the only bank that actually deals with the beneficiary, the customer is justified in relying upon that bank's representations. See *supra* note 170 and accompanying text.

of the Code.¹⁷² In *Indeca*, the court isolated the duty owed to the plaintiff by holding that the defendant bank "represented to all who might foreseeably rely on such information that [the beneficiary] was honest in its [representations]." ¹⁷³ If it were later determined that the bank had negligently made this representation it could be liable on this basis. Unless the documents do not comply on their face, however, the Code clearly does not envision that a bank will incur liability for merely being negligent;¹⁷⁴ if the documents do appear to comply, the only duty owed is that of good faith.¹⁷⁵

Applying a negligence standard destroys the concept of the independence principle.¹⁷⁶ When the documents appear to comply, the bank has no duty to go behind the documents,¹⁷⁷ for if it did both its costs and the risk of wrongful honor would greatly increase.¹⁷⁸ Assuming the bank is acting in good faith, it must honor the draft. In the hypothetical, and arguably in *Indeca*, the bank was not negligent; rather, it acted in bad faith. If the bank has been merely negligent, under the principles espoused in the Code, liability should not be imposed.

172. See U.C.C. § 1-103 (1977) ("Unless displaced by the particular provisions of this Act, the principles of law and equity . . . shall supplement its provisions." (emphasis added)); *accord* Girard Bank v. Mount Holly State Bank, 474 F. Supp. 1225, 1240 (D.N.J. 1979) (gap fillers should not be used when the Code directly addresses a situation).

173. *Instituto Nacional de Comercializacion Agricola (Indeca) v. Continental Ill. Nat'l Bank & Trust Co.*, 530 F. Supp. 279, 284 (N.D. Ill. 1982).

174. See U.C.C. § 5-114 official comment 2 (1977) ("Documents, however, may appear regular on their face and apparently conforming to the credit whereas in fact they are forged or fraudulent [but] the issuer's duties to its customer are limited to examination of the documents with care.").

175. See U.C.C. § 5-109 & official comment 1 (1977); H. Harfield I, *supra* note 2, at 57.

176. See *supra* notes 16-18 and accompanying text.

177. *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 395 (D. Md. 1982) ("[T]he obligation of the issuer of the letter of credit to pay such a draft is determined solely by reference to the four corners of the letter of credit."); see *Insurance Co. of N. Am. v. Heritage Bank, N.A.*, 595 F.2d 171, 176 (3d Cir. 1979) (per curiam); *Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank*, 528 F.2d 802, 805-06 (4th Cir. 1975); *Data Gen. Corp. v. Citizens Nat'l Bank*, 502 F. Supp. 776, 780 (D. Conn. 1980); *United Bank Ltd. v. Cambridge Sporting Goods Corp.*, 41 N.Y.2d 254, 259, 360 N.E.2d 943, 948, 392 N.Y.S.2d 265, 270 (1976); U.C.C. § 5-109(2) & official comment 2 (1977); U.C.P., *supra* note 13, art. 8(a) & (c).

178. *Verkuil*, *supra* note 13, at 720 ("Naturally, the independence of the letter of credit from the underlying mercantile agreement does much to limit the bank's risks in entering into the transaction. Any additional obligation placed upon the bank will reallocate the risks, raise the cost of the credit and necessarily restrict its utility."); see *Bank of Newport v. First Nat'l Bank & Trust Co.*, 34 U.C.C. Rep. Serv. (Callaghan) 650, 656 (8th Cir. Sept. 10, 1982); *Insurance Co. of N. Am. v. Heritage Bank, N.A.*, 595 F.2d 171, 176 (3d Cir. 1979) (per curiam); *Consolidated Aluminum Corp. v. Bank of Va.*, 544 F. Supp. 386, 396 (D. Md. 1982).

While the concept of finding liability in tort is initially appealing, it raises serious and disturbing implications. On the other hand, since tort liability is imposed by law, it provides a basis for a duty by replacing the need for privity.¹⁷⁹ Accordingly, a hybrid could be employed by incorporating the duty as defined by tort law and applying the principles of the Code to develop the specific duty that is owed. Partial application of the tort of negligent misrepresentation would fill this gap and could be implemented in such a way as to supplement, rather than displace, the other provisions of the Code.

C. *Warranty Liability Under Section 5-111(2)*

Perhaps the best solution, although it has not yet been utilized by any court, would be to hold the confirming bank liable to the customer for breach of warranty.¹⁸⁰ Section 5-111(2)¹⁸¹ provides that "[u]nless otherwise agreed a negotiating, advising, confirming, collecting or issuing bank presenting or transferring a draft or demand for payment . . . warrants only the matters warranted by a collecting bank under Article 4 and any such bank transferring a document warrants only the matters warranted by an intermediary under Articles 7 and 8."¹⁸² In essence, the warranties of Articles 4, 7 and 8 are that of the bank's own good faith and authority.¹⁸³ Unfortunately, section 5-111(2) is not clear as to whom the warranty runs. Two interpretations of this section are possible. The warranty may run only to the immediate transferee, in which case the confirming bank's warranty of good faith would not inure to the benefit of the ultimate customer. The second possibility is that the warranty runs with the documents. Under this formulation, the customer would be the recipient of the confirming bank's warranty of good faith.

179. See *supra* notes 63-65 and accompanying text.

180. Section 5-111 contains two sets of warranties: § 5-111(1) defines the warranties given by the beneficiary and § 5-111(2) defines the warranties given by the banks. See U.C.C. § 5-111 (1977). The warranties of § 5-111(2) do not appear to have been addressed in any reported decisions. The § 5-111(1) warranties have been briefly mentioned in a few decisions. See *Pubali Bank v. City Nat'l Bank*, 676 F.2d 1326, 1329 n.5 (9th Cir. 1982); *Bossier Bank & Trust Co. v. Union Planters Nat'l Bank*, 550 F.2d 1077, 1081 app. A (6th Cir. 1977) (*per curiam*) (adopting memorandum decision of lower court); *Werner v. A.L. Grootemaat & Sons*, 80 Wis. 2d 513, 524 n.22, 259 N.W.2d 310, 315 n.22 (1977).

181. U.C.C. § 5-111(2) (1977).

182. *Id.*

183. *Id.* § 5-111 official comment; see *id.* §§ 4-207, 7-508, 8-306. The first official comment to § 3-417 states: "Warranty terms . . . are used with the intention of bringing in all the usual rules of law applicable to warranties, and *in particular the necessity of reliance in good faith* and the availability of all remedies for breach of warranty." *Id.* § 3-417 official comment 1 (emphasis added).

One factor favoring the position that the warranty runs only to the immediate transferee is that section 5-111(1),¹⁸⁴ which defines the beneficiary's warranties, expressly states that the beneficiary makes those warranties "to all interested parties."¹⁸⁵ Section 5-111(2), defining all bank warranties, contains a much more limited warranty.¹⁸⁶ The absence of the phrase "to all interested parties" from this section is a significant indication that such warranties do not run with the documents.

On the other hand, there is textual support for the theory that the warranties do run to the ultimate customer. By way of analogy, the section 4-207¹⁸⁷ warranties, which are referred to in section 5-111(2),¹⁸⁸ do run with the documents.¹⁸⁹ Therefore, each collecting bank remains liable to any other bank in the collection chain despite the absence of privity.¹⁹⁰ Moreover, the official comment to section 5-111(2)¹⁹¹ directs the reader to the official comment to section 5-114(2).¹⁹² This comment provides that "[t]he risk of the original bad-faith action of the beneficiary is thus thrown upon the customer who selected him rather than upon innocent third parties or the issuer."¹⁹³ This incorporation into Article 5 of the holder in due course doctrine¹⁹⁴ shields intermediary banks who purchase and transfer a draft in good faith; by implication, the customer need not assume the risk of

184. *Id.* § 5-111(1).

185. *Id.* & official comment. The beneficiary's warranty clearly runs to the customer for he is an interested party. *Werner v. A.L. Grootemaat & Sons*, 80 Wis. 2d 513, 524 n.22, 259 N.W.2d 310, 315 n.22 (1977); see *Pubali Bank v. City Nat'l Bank*, 676 F.2d 1326, 1329-30 & n.5 (9th Cir. 1982). In *Pubali*, the court stated that the customer had standing to sue the confirming bank on the basis of the § 5-111(1) warranty because it had indemnified the issuing bank. *Id.* at 1329 n.5. Although unclear, it appears that the court applied the beneficiary warranty to the advising bank based on the theory that the bank had acted in its own interest in accepting an assignment of the proceeds of the credit. Therefore, in light of said assignment, the advising bank became, in essence, the beneficiary of the letter of credit. See *id.* at 1329 & n.5.

186. Compare U.C.C. § 5-111(1) (1977) (beneficiary warrants that "the necessary conditions of the credit have been complied with") with *id.* § 5-111(2) and official comment (banks warrant only their own good faith and authority).

187. U.C.C. § 4-207 (1977).

188. See U.C.C. § 5-111(2) (1977).

189. U.C.C. § 4-207 official comment 2 (1977); T. Quinn, *supra* note 125, ¶ 4-207[A][2]-[3].

190. See *supra* notes 124-28 and accompanying text.

191. U.C.C. § 5-111(2) official comment (1977).

192. *Id.* § 5-114 official comment 2.

193. *Id.*

194. Section 3-302(1) provides: "A holder in due course is a holder who takes the instrument (a) for value; and (b) in good faith; and (c) without notice that it is overdue or has been dishonored or of any defense against or claim to it on the part of any person." *Id.* 3-302(1).

an intermediary bank acting in bad faith.¹⁹⁵ Employing a *Barclays* style analysis,¹⁹⁶ the Code should not be interpreted in a fashion that affords a bank acting in bad faith the same insulation from liability afforded intermediary banks that display "honesty in fact."¹⁹⁷ Thus, section 5-111(2) should be interpreted to run with the documents so as to provide a needed remedy for the unique situation in which a confirming bank facilitates a beneficiary's fraudulent conduct or perpetrates a fraud of its own.¹⁹⁸

Both interpretations are plausible, but in light of the "gap" perceived in the Code,¹⁹⁹ the position that the warranty runs with the documents is clearly the more desirable view. The warranty theory, though untested, provides the best solution to the problem posed in the hypothetical at the beginning of this Note.²⁰⁰ Because the warranty can be interpreted as running with the documents, the need for privity is eliminated.²⁰¹ Additionally, unlike the use of a gap filler by analogy²⁰² or the imposition of tort liability,²⁰³ the warranty of good

In letter of credit transactions the issuer must honor a draft presented by a holder in due course even if it has been alerted to the existence of fraud in the transaction. *Id.* § 5-114(2)(a); see *Scarsdale Nat'l Bank & Trust Co. v. Toronto-Dominion Bank*, 533 F. Supp. 378, 385 (S.D.N.Y. 1982) (when there is fraud in the transaction, the burden shifts to the party seeking honor to establish holder in due course status); *United Bank Ltd. v. Cambridge Sporting Goods Corp.*, 41 N.Y.2d 254, 259, 360 N.E.2d 943, 948, 392 N.Y.S.2d 265, 270 (1976) (customer may enjoin issuer from honoring a draft presented by one who is not a holder in due course).

195. Cf. U.C.C. § 1-102(3) (1977) (duty of good faith cannot be disclaimed); *id.* § 1-203 (every duty in the Code includes an obligation of good faith).

196. See *Barclays Bank D.C.O. v. Mercantile Nat'l Bank*, 481 F.2d 1224, 1230 (5th Cir. 1973) (before adopting a particular interpretation of a Code provision, it must be determined that the policy justifications for that provision will be advanced), *cert. dismissed*, 414 U.S. 1139 (1974). See *supra* notes 103-07 and accompanying text.

197. U.C.C. § 1-201(19) (1977). "The effect of provisions of this Act may be varied by agreement, except . . . that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed . . ." *Id.* § 1-102(3). Interpreting the § 5-111(2) warranty of good faith as running to the ultimate customer would provide him with a remedy if this justifiable reliance proves to be injurious.

198. The confirming bank, like the issuer, is a principal party in the transaction with a duty to honor the conforming drafts. Kozolchyk I, *supra* note 4, at 235; see H. Harfield I, *supra* note 2, at 33 (modification of credit not binding on confirmer without his consent). The customer must be able to rely on the assumption that the confirming bank is a neutral party acting in good faith. Cf. H. Harfield III, *supra* note 6, at 104 (the issuer must maintain "a position of Jovian impartiality" due to "equal but diametrically opposed" obligations to both the customer and the beneficiary).

199. See *supra* notes 34-35 and accompanying text.

200. See *supra* notes 11-14 and accompanying text.

201. See *supra* note 189 and accompanying text.

202. See *supra* note 100 and accompanying text.

203. See *supra* note 141 and accompanying text.

faith is expressly included in the Code.²⁰⁴ Moreover, it is a narrower remedy than those utilized by the courts. If a draft is honored when the documents do not comply on their face, both the issuing bank and the confirming bank will have breached a duty of care.²⁰⁵ In this situation, resolution of the issue will most easily and satisfactorily be obtained in a suit against the issuer. Imposition of a warranty limits the confirming bank's exposure to suit by the ultimate customer to the one situation in which it alone has breached the Code-imposed duty of good faith.

CONCLUSION

Under the present interpretation of the Code, the confirming bank is effectively shielded from liability and is therefore not encouraged to act in good faith toward the ultimate customer.²⁰⁶ The confirming bank deals directly with the beneficiary and is in the best position to recognize fraudulent conduct.²⁰⁷ As the hypothetical illustrated, the confirming bank may have additional business dealings with the beneficiary, leading to a natural alliance between the two.²⁰⁸ Despite the absence of privity, a number of legally supportable bases for imposing liability exist. Extension of the Code provisions by analogy, imposition of tort liability, or utilization of a warranty theory all present possible means of filling the gap that presently exists. Extending the duty of good faith owed by the confirming bank is clearly consistent with the general scheme of the Code.²⁰⁹ More importantly, interpreting that duty as running to the ultimate customer will have the necessary chilling effect on any inclination by the confirming bank to honor the credit wrongfully.

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204. See U.C.C. § 5-111(2) & official comment (1977).

205. See *id.* §§ 5-107(2), 5-109(2).

206. See *supra* note 122 and accompanying text.

207. See *supra* note 50 and accompanying text.

208. See *supra* note 51 and accompanying text.

209. See *supra* note 197.