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## Letters of Credit and the West Virginia Law\*

STANLEY E. DADISMAN\*\*

Article 5 of the Uniform Commercial Code relates to letters of credit.<sup>1</sup> Prior to the drafting of the Code seldom were letters of credit mentioned in statutes. One of the purposes of this Article, as explained in the comments thereto appended, is

“To define the transactions to which this Article applies and to indicate that the rules stated are not intended to be exhaustive of the law applicable to letters of credit.”<sup>2</sup>

At another point in the comments the draftsmen pointed out that this Article “is intended within its limited scope . . . to set an independent theoretical frame for the further development of letters of credit.”<sup>3</sup> This spirit is indorsed by a leading banking law authority when he writes:

“Since letters of credit are extensively employed in commerce, their widespread use and effectiveness should not be limited by narrowing legislative enactment or judicial dicta not essential to a particular decision. They should not be bound by definition so as to become incapable of growth and

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\* This is one of a series of studies of the Uniform Commercial Code and existing West Virginia law. References herein are to the 1958 official edition of the Uniform Commercial Code unless otherwise indicated. Hereinafter in footnotes the Code will be cited as U.C.C.

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<sup>1</sup> See U.C.C. §§ 5-101 through 5-117. Apart from U.C.C., California by statute defines a letter of credit in these words: “A letter of credit is a written instrument, addressed by one person to another, requesting the latter to give credit to the person in whose favor it is drawn.” CAL. CIV. CODE, § 2858 (1960). Later in this discussion the definitions and meanings of letters of credit will more fully appear.

<sup>2</sup> U.C.C. §5-102, Comment.

<sup>3</sup> U.C.C. § 5-101, Comment.

change in accordance with the development of legitimate business.”<sup>4</sup>

The absence of statutory invasion into this area of the commercial world does not indicate an absence of guiding and controlling rules, principles and practices. As one eminent banker writes,

“ . . . Over many generations procedures and performances, while subject to gradual development and change, have had to be pretty generally understood and accepted or letters of credit would never have succeeded in obtaining their world-wide use and usefulness. For a long time, nonetheless, a newcomer to the field was likely to have to learn what letters of credit would and would not do in the sometimes harsh school of experience and by a process of trial and error.”<sup>5</sup>

The Uniform Commercial Code, by including this article on letters of credit, does not attempt or purport to spell out in detail these many rules, principles and practices long employed in the commercial world, but does “set an independent theoretical frame for the further development of letters of credit.” This frame will permit desired growth and change and yet will provide a stabilized and stabilizing base on which veterans in and newcomers to the field of letters of credit will find fundamental principles recognized and established in statute law.

The discussion which follows will attempt to answer briefly these questions:

1. What is the meaning of the term “letters of credit”?
2. What historical significance do letters of credit have in the commercial world?
3. Apart from the Uniform Commercial Code, what is the status of law relating to letters of credit?
4. What significant changes will the Uniform Commercial Code make in the West Virginia law relating to letters of credit?

#### DEFINITIONS AND EXPLANATIONS

Section 5-103(1) (a) of the Code explains that

“‘Credit’ or ‘letter of credit’ means an engagement by a bank or other person made at the request of a customer and of a

<sup>4</sup> 8 ZOLLMAN, *BANKS AND BANKING* § 5101 (Perm ed. 1936).

<sup>5</sup> Chadsey, *Practical Effect of the Uniform Commercial Code on Documentary Letter of Credit Transactions*, 102 U. PA. L. REV. 618 (1954).

kind within the scope of this Article . . . that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit. A credit may be either revocable or irrevocable. The engagement may be either an agreement to honor or a statement that the bank or other person is authorized to honor.”

At least three parties will be involved in the routine letter of credit transaction. The “customer,” usually a buyer of goods or merchandise who needs credit or supporting credit, is the party who applies for a letter of credit and causes it to be issued. The “issuer” is the bank or other person issuing the letter of credit. The “beneficiary” of the transaction, generally a seller, is the person who is entitled under the terms of the letter of credit to rely thereon for payment for the goods or merchandise sold to the buyer “customer.” A statement from a leading case will be helpful. In *American Steel Co. v. Irving Nat'l Bank*,<sup>6</sup> the court explained:

“Letters of credit have long been known to the commercial law, and the principles which govern them are well established. A letter requesting one person to make advances to a third person on the credit of the writer is a letter of credit. The letters are general or special. They are general, if directed to the writer's correspondents generally. They are special, if . . . they are addressed to some particular person. If the letter is addressed to a particular person, who advances goods or money on it in accordance with its tenor, the letter becomes an available promise in favor of the person making the advance. When acted on, and the advance made in accordance with its terms, a contract is created between the writer of the letter and the party who has acted upon it, upon which an action can be maintained.”

It will be noted that the Code language quoted limits the letters of credit to “a kind within the scope of this Article,” which means that the Code intends to deal with commercial letters of credit as distinguished from traveler's letters and other types of credit. Note this credit may be revocable or irrevocable. Also it will be noted that the commercial letters are of two kinds, general or special.<sup>7</sup> Another usable distinction is between the “clean” or “open” and “documentary” letters of credit.<sup>8</sup>

“‘Clean letter of credit’ provides for acceptance or negotiation of draft unaccompanied by shipping documents, while

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<sup>6</sup> 206 Fed. 41, 43 (2d cir. 1920).

<sup>7</sup> See 1 MORSE, BANKS AND BANKING § 65 (6th ed. 1928). Compare Ufford, *Transfer and Assignment of Letters of Credit under the Uniform Commercial Code*, 7 WAYNE L. REV. 263, 268 (1960).

<sup>8</sup> See Comment 1, U.C.C., § 5-102.

'documentary letter of credit' provides for acceptance or negotiation of draft accompanied by shipping documents."<sup>9</sup>

This provision is found in substance in the Code, section 5-103(1)-(b), wherein "document" means "any paper including document of title, security, invoice, certificate, notice of default and the like."

While letters of credit are used extensively and advantageously in international trade,<sup>10</sup> let us, for practical reasons, consider a more local situation for illustrative purposes. A somewhat typical situation arose in the case of *Consolidated Sales Co. v. Bank of Hampton Roads*,<sup>11</sup> decided in 1952 by the Supreme Court of Appeals of Virginia. There the buyer or customer was a retail electrical appliance dealer of Newport News. The seller or beneficiary was a distributor of electrical appliances at Richmond. In transactions between buyer and seller a credit limit of 200 dollars had been established. Buyer decided to expand and to increase its purchasing ability and approached the bank, the issuer, in Newport News to write a letter to the seller in Richmond in support of buyer's credit. The bank's letter stated that buyer had been "granted a line of credit of a substantial amount with this bank" and explained:

"If you will draft on Holland Radio Company (the buyer) at this bank, attaching a bill of lading or invoice, drafts will be honored and remittance made on the day received, thus avoiding the necessity of your shipping on an open account."<sup>12</sup>

The letter concluded with the provision that the arrangements would continue in effect until the seller was notified to the contrary. While some nice legal questions arose in the case, the court held this was a commercial letter of credit binding on the bank in favor of the seller beneficiary.

*Dulien Steel Products, Inc. v. Bankers Trust Co.*,<sup>13</sup> a 1960 United States District Court decision in New York, illustrates a more complicated, interstate and international letter of credit situation involving sizable sums of money, a confirming bank, and irrevocable credit. The term "confirming bank" is defined in section 5-103(1)(f) of the Code as "a bank which engages either

<sup>9</sup> 6 MICHIE, BANKS AND BANKING ch. 12, § 28 at 366 (Perm. ed. 1952).

<sup>10</sup> Editorial Comment, 62 YALE L.J. 227 (1953); Note, 65 HARV. L. REV. 1420 (1952).

<sup>11</sup> 193 Va. 307, 68 S.E.2d 652 (1952).

<sup>12</sup> *Id.*, 68 S.E.2d at 654.

<sup>13</sup> 189 F. Supp. 922 (S.D. N.Y. 1960).

that it will itself honor a credit already issued by another bank or that such credit will be honored by the issuer or a third bank." Section 5-107(2) provides 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." Related is the term "advising bank" defined, in section 5-103(1)(3), as a "bank which gives notification of the issuance of a credit by another bank" but which, under section 5-107(1), ordinarily assumes no obligation under the credit other than responsibility for the accuracy of its own statement. As observed in the *Bankers Trust Co.* case, *supra*,

"When a bank confirms a letter of credit the letter evidences its irrevocable obligation to honor the drafts presented by the beneficiary upon compliance with the terms of the credit. The letter is quite independent of the primary agreement between the party for whose account it is issued and the beneficiary, or of any underlying transactions. . . .

"Moreover, once an irrevocable letter of credit has been established the consent of all parties, the party for whose account the credit was opened, the issuing bank, the confirming bank, and particularly the beneficiary, is necessary in order to modify the original terms and conditions of the credit. . . ."<sup>14</sup>

This statement prompts the observation that a letter of credit, while it must constitute an "engagement" and must be "in writing and signed," need not be in any particular form or follow any particular pattern.<sup>15</sup> Chief Justice Marshall, in a case arising in Virginia and decided by the Supreme Court of the United States in 1809, held in effect that a blank endorsement written on a blank piece of paper with intent to give a person credit was in effect a letter of credit.<sup>16</sup> As provide in section 5-104 of the Code, "no particular form of phrasing is required for a credit" and

"A telegram may be a sufficient signed writing if it identifies its sender by an authorized authentication. The authentication may be in code and the authorized naming of the issuer in an advice of credit is a sufficient signing."

#### HISTORICAL SIGNIFICANCE

Let us now consider briefly the historical significance of letters of credit in the commercial world.

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<sup>14</sup> *Id.*, at 927.

<sup>15</sup> U.C.C., § 5-104. See Annot., 30 A.L.R. 1310, 1312 (1924).

<sup>16</sup> *Violett v. Patton*, 5 Cranch (U.S.) 142, 150 (1809).

Much of today's commercial law comes from the law merchant. Holdsworth points out that

"The Law Merchant of primitive times comprised both the maritime and the commercial law of modern codes. . . . Both applied peculiarly to the merchants, who, whether alien or subject, formed in the Middle Ages a class very distinct from the rest of the community. . . . Both had in the Middle Ages an international character. . . ." <sup>17</sup>

The early maritime laws developed from local port customs which were subject to change and development to meet new trading circumstances and situations. They in time governed the coastal trade of mediaeval Europe.<sup>18</sup> Inland cities developed comparable special market customs at the fairs and in trading areas which in time developed into the law of merchants. Some communities were situated so as to employ both bodies of law and consequently practical considerations developed similarities in principles and provisions applicable to the foreign merchant and domestic trader, coastal or inland. Thus one writer is warranted in concluding that

"The law merchant is a body of rules, first of custom, then of law, that has been built up over the course of occidental civilization under the pressure of the needs of commerce and without constructive contribution by lawyers. From early times it was international in scope, or at least free from the bonds of local law. In fact, the law merchant became an independent system complete in itself, a system which has constituted an integral part of the foundation upon which our civilization has been erected. Among the great contributions made by the law merchant have been the bill of exchange, the promissory note, and the letter of credit. . . ." <sup>19</sup>

Professor Philip W. Thayer has noted that letters of credit "in their oldest form were in common use by the princes and rulers of the twelfth century to procure advances for their servants."<sup>20</sup> Consider even the New Testament Epistle of Paul to Philemon in behalf of Onesimus.<sup>21</sup> Buyers, traders and merchants noticed and employed this sort of credit. But an individual buyer's credit perimeter was generally limited to his immediate trading area and

<sup>17</sup> 1 HOLDSWORTH, A HISTORY OF ENGLISH LAW 526 (3d ed. rew. 1921).

<sup>18</sup> *Id.*, at 527.

<sup>19</sup> Trimble, *The Law Merchant and the Letter of Credit*, 61 HARV. L. REV. 981 (1948).

<sup>20</sup> Thayer, *Irrevocable Credits in International Commerce: Their Legal Nature*, 34 COLUM. L. REV. 1031, 1032 (1936); see also, Miller, *Problems and Patterns of the Letter of Credit*, 1959 U. ILL. L. F. 162.

<sup>21</sup> NEW TESTAMENT, *Philemon v.* 10-19.

was based on his own standing, reputation and credit. The need and practicalities of banker's credit dawned. The banker was known in distant markets and through employment of the banker's credit the buyer's buying and trading potential was greatly increased.

Real difficulties arose in adjusting and integrating the law merchant in common law structure. However, Holdsworth recognizes the commercial side of the law merchant as a branch of the common law<sup>22</sup> and Blackstone notes that, while the customs of merchants are different from the general rules of common law, they are "yet ingrafted into it, and made a part of it."<sup>23</sup> In any event, when America was settled, the colonists were greatly influenced by the common law of England and the customs of merchants and that influence is manifest in much of today's law.

So letters of credit, like other instruments and principles of law and commerce, grew in the fertile soil of need and expediency. Professor McCurdy paints the picture clearly in these words:

"The business problem is how to meet the desires of both the buyer and the seller; how to enable the seller to receive his money upon shipment; how to enable the buyer to postpone actual payment until the goods have been received and resold; how to enable a bank to lend its credit and not its funds; how to utilize the goods as security in the meantime. The instrumentality of the commercial letter of credit meets these requirements perfectly."<sup>24</sup>

Zollman gives color to the picture in these words:

"Most of the means of settling accounts between seller and buyer in use in the business world are unsatisfactory where buyer and seller are widely separated geographically and perhaps have had no previous dealings. Sending cash with the order or a money order or bank draft is unsatisfactory to the buyer, who may not have the ready cash or who has no particular reason to trust the seller. Shipping the merchandise on an open book account is unsatisfactory to the seller who will be forced to collect for the goods after they have arrived at their destination. A trade acceptance sent by the buyer to some agent at the seller's place of business to be exchanged for shipping documents for the goods is better than an open credit, but still leaves the burden of collecting the paper on the seller.

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<sup>22</sup> See note 17, *supra*, at 529.

<sup>23</sup> 1 BLACKSTONE, *COMMENTARIES* 75 (Lewis ed. 1902).

<sup>24</sup> McCurdy, *Commercial Letters of Credit*, 35 HARV. L. REV. 539, 542 (1922).



"A letter of credit procured by the buyer at his bank and sent to some bank in the territory of the seller enables the seller on the delivery of the shipping documents to obtain his money from such bank which thereupon charges the issuing bank and forwards the shipping documents to it. The issuing bank on receipt of the documents charges the seller or the credit opening bank. The seller obtains his goods by paying their price plus a percentage for the use of the money while the goods were in transit. The seller receives his money on the delivery of the goods. The buyer does not pay the purchase price until he receives the documents which entitle him to the goods. The banks fulfill their legitimate functions as instrumentalities of commerce and obtain compensation for the use of the money invested while the goods are in transit. The whole complicated transaction ordinarily results in complete satisfaction to every one concerned."<sup>25</sup>

#### STATUS OF LAW

Prior to development of the Uniform Commercial Code, letters of credit rested on customs and practices, case law, and an occasional statute. The principles of the law merchant were readily absorbable in the law of the civil law countries of Europe, but fusion thereof in the common law of England was somewhat difficult. Nevertheless, there was limited fusion into the common law which America inherited from England.<sup>26</sup> Without limitations of a code, the courts were free to implement and innovate. The "felt necessities of the time,"<sup>27</sup> experience and logic<sup>28</sup> have played their part in shaping the law.

Prior to enactment of the Federal Reserve Act<sup>29</sup> doubt existed as to whether national banks could issue letters of credit.<sup>30</sup> Corporations organized to engage in international or foreign banking are specifically authorized by law "to issue letters of credit," under rules and regulations of the Board of Governors of the Federal Reserve System.<sup>31</sup> A letter of credit is included in the definition of "securities" under the federal stolen property law.<sup>32</sup> But little

<sup>25</sup> See note 4, *supra*, at § 5102.

<sup>26</sup> FINKELSTEIN, *LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT* 1-4 (1930); POUND, *AN INTRODUCTION TO THE PHILOSOPHY OF LAW* 277 (1922); and Trimble, note 19, *supra*, at 986-993.

<sup>27</sup> HOLMES, *THE COMMON LAW* 1 (33d print. 1938).

<sup>28</sup> RADIN, *LAW AS LOGIC AND EXPERIENCE* 1 (1940).

<sup>29</sup> Act Approved Dec. 23, 1913, ch. 6, 38 Stat. 251.

<sup>30</sup> See FINKELSTEIN, *op. cit. supra* note 26, at 5, n. 7.

<sup>31</sup> 12 U.S.C. § 615(a) (1952).

<sup>32</sup> 18 U.S.C. § 2311 (1952).

federal legislation on the subject is found, although there is a considerable body of case law developed by federal decisions.<sup>33</sup>

Some states have enacted statutes on letters of credit prior to and apart from the Uniform Commercial Code. California,<sup>34</sup> North Dakota<sup>35</sup> and Oklahoma<sup>36</sup> are examples. On the other hand, some states, including Indiana,<sup>37</sup> Tennessee<sup>38</sup> and West Virginia,<sup>39</sup> briefly recognize letters of credit in statutes and authorize banks to issue them. The West Virginia statute, very similar to the others, provides:

“. . . Any banking institution may . . . issue letters of credit authorizing the holders thereof to draw drafts upon it or its correspondents, at sight or on time, not exceeding one year.”

However, apart from statute and case law, a body of special “common law” peculiar to commercial transactions has developed. Bankers and international traders call upon and apply this “law” in many credit transactions. While some of the “law” is unwritten, a great part thereof has been spelled out in considerable detail in Uniform Customs and Practice for Commercial Documentary Credits adopted by the International Chamber of Commerce in 1933 and later implemented and supplemented by a 1951 revision and other guiding provisions and principles.<sup>40</sup> This document contains a statement of many accepted and defined customs and practices, but a large part thereof is devoted to an explanation of legal relations, actual or speculative in the minds of the draftsmen.<sup>41</sup>

Obviously the Uniform Customs and Practice have served and will continue to serve a good purpose. They extend beyond the nature of statutes into the area of practices and precedents as guides, interpretations and applications particularly helpful and instructive in international trade. Moreover, while designed primarily for international transactions, they influence and affect banking and commercial transactions at home. Even skeletonized letter of credit statutes are given body and meaning by resort to

<sup>33</sup> *E.g.*, 7 MODERN FEDERAL PRACTICE DIGEST 368-373 (1960).

<sup>34</sup> CAL. CIV. CODE §§ 2858-2866 (1960).

<sup>35</sup> N.D. CENT. CODE §§ 22-04-01 to 09 (1960).

<sup>36</sup> OKLA. STATS. ANN. tit. 15 §§ 401-409 (1937).

<sup>37</sup> IND. STATS. ANN. § 18-1103 (Burns Repl. 1950).

<sup>38</sup> TENN. CODE ANN. § 45-404 (1955).

<sup>39</sup> W. VA. CODE, ch. 31, art 4, § 6 (Michie 1961).

<sup>40</sup> Note, 65 HARV. L. REV. 1420 (1952); Chadsey, note 5, *supra*, at 619.

<sup>41</sup> Mentschikoff, *Letters of Credit: The Need for Uniform Legislation*, 23 U. CHI. L. REV. 571, 572 (1956).

the Uniform Customs and Practice. Bankers and credit men live with them and many times certainly apply and abide by them as religiously as if they were formally enacted statutes. This situation has prompted arguments to the effect that uniform state legislation on letters of credit is unnecessary.<sup>42</sup> In any event it is to be recognized that, even though formal letter of credit statutes may have been scarce and sketchy until recent years, a practical and workable substitute has been developed.

In the absence of a letter of credit statute in West Virginia and without any body of state case law on the subject as precedents and guides, question arises as to whether the time has arrived to ask the Legislature to enact a letter of credit statute. "Upon this point a page of history is worth a volume of logic."<sup>43</sup> The state's commercial life is greatly different from what it was one hundred, fifty and even twenty-five years ago. Eighteen states<sup>44</sup> have now adopted the Uniform Commercial Code, including therein Article 5 relating to letters of credit. These adopting states include the neighboring states of Kentucky,<sup>45</sup> Ohio<sup>46</sup> and Pennsylvania.<sup>47</sup> Illinois<sup>48</sup> and Massachusetts<sup>49</sup> have adopted the Code and so, very recently, has New York.<sup>50</sup> Currents of commentary run strongly in favor of adoption of the Code and the letter of credit provisions. One able writer concludes his comments in these words: ". . . The letter of credit is a most useful financing device but one which is generally unknown to the bar. Only by a uniform statute will its services become truly available to the country at large. . . ."<sup>51</sup>

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<sup>42</sup> E.g., *Panel Discussion on the Uniform Commercial Code*, 12 BUS. LAW 49, at 60-68 (1956).

<sup>43</sup> *New York Trust Co. v. Eisner*, 256 U.S. 345, 349 (1921).

<sup>44</sup> New Jersey, New York, Michigan, Georgia and Alaska are among the latest to approve the Code.

<sup>45</sup> Ky. Acts of 1958, ch. 77.

<sup>46</sup> Anderson's U.C.C. of Ohio Supp. to PAGE'S OHIO REV. CODE (Supp. 1961).

<sup>47</sup> PA. STAT. ANN. tit. 12A (1954). Pennsylvania enacted the 1952 draft of the Code and in 1959 enacted the revised edition of 1958. See PA. STAT. ANN. tit. 12A (Supp. 1961).

<sup>48</sup> ILL. REV. STATS. ch. 26 (1961).

<sup>49</sup> Mass. Acts of 1957, ch. 765. See MASS. ANN. LAWS ch. 106 (Spec. supp. 1958).

<sup>50</sup> New York rejected the 1952 version of the Code. N.Y. LAW REVISION COMM'N REP. (1956). See note 42, *supra*, 12 BUS. LAW. 49, at 60. Many of the revisions embodied in the 1958 edition were the result of the detailed criticisms of the Code developed during its elaborate study by the New York Law Revision Commission.

<sup>51</sup> Mentschikoff, note 41, *supra*, at 619.

## SIGNIFICANT CHANGES IN LAW

If the Uniform Commercial Code, including Article 5 thereof, be enacted by the Legislature, what significant changes will be made in West Virginia law relating to letters of credit?

Most significant will be the addition of seventeen entirely new sections of law relating to letters of credit. This statute law will supercede and control over any common law repugnant thereto or in conflict therewith.<sup>52</sup> But since Article 5 intends "to set an independent theoretical frame for the further development of letters of credit," all of the law on the subject is not intended to be covered and included. In fact section 5-102(3) provides:

"This Article deals with some but not all of the rules and concepts of letters of credit as such rules or concepts have developed prior to this act or may hereafter develop. The fact that this Article states a rule does not of 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."

The Article does not attempt or purport to prescribe a specific rule for every phase of letter of credit transactions. It is recognized that "no statute can effectively or wisely codify all the possible law of letters of credit without stultifying further development of this useful financing devise."<sup>53</sup>

The Article does attempt to codify the fundamental principles of American letter of credit law. As a practical matter little change, if any, will in fact be made in the law. Whereas commercial practice in this area may have been largely by "ear," enactment of this Article will stabilize and make uniform the practice within the areas covered by the Code provisions.<sup>54</sup>

Comparison of the language of Article 5 with existing West Virginia law poses an impossibility since no statute or case law exists in the state with which to make a comparison. Consequently presentation of the complete text of Article 5 for reading and discussion may be the best service to be rendered at this point. The

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<sup>52</sup> W. VA. CONST. art. VIII, § 21.

<sup>53</sup> U.C.C., § 5-102, Comment 2.

<sup>54</sup> Mentschikoff, note 41, *supra*, at 574; Chadsey, note 5, *supra*.

seventeen sections of the Article will follow immediately hereafter. It is hoped that the foregoing discussion will be helpful to the reader.<sup>55</sup>

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<sup>55</sup> Readers unfamiliar with forms of instruments commonly used in letter of credit transactions may benefit by examining forms set out in 12A MODERN LEGAL FORMS, ch. 43 (1950), and in 6 AM. JUR. LEGAL FORMS 359-383 (1954). In considering these and other forms, the distinction between letters of credit and guaranties must be recognized. *Border Nat'l Bank v. American Nat'l Bank*, 282 Fed. 73 (5th cir. 1922).

## Appendix

### ARTICLE 5

#### LETTERS OF CREDIT

##### Section 5—101. Short Title.

This Article shall be known and may be cited as Uniform Commercial Code—Letters of Credit.

##### Section 5—102. Scope.

(1) This Article applies

- (a) to a credit issued by a bank if the credit requires a documentary draft or a documentary demand for payment; and
- (b) to a credit issued by a person other than a bank if the credit requires that the draft or demand for payment be accompanied by a document of title; and
- (c) to a credit issued by a bank or other person if the credit is not within subparagraphs (a) or (b) but conspicuously states that it is a letter of credit or is conspicuously so entitled.

(2) Unless the engagement meets the requirements of subsection (1), this Article does not apply to engagements to make advances or to honor drafts or demands for payment, to authorities to pay or purchase, to guarantees or to general agreements.

(3) This Article deals with some but not all of the rules and concepts of letters of credit as such rules or concepts have developed prior to this act or may hereafter develop. 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.

##### Section 5—103. Definitions.

(1) In this Article unless the context otherwise requires

- (a) "Credit" or "letter of credit" means an engagement by a bank or other person made at the request of a customer and of a kind within the scope of this Article (Section 5—102) that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit. A credit may be

either revocable or irrevocable. The engagement may be either an agreement to honor or a statement that the bank or other person is authorized to honor.

- (b) A “documentary draft” or a “documentary demand for payment” is one honor of which is conditioned upon the presentation of a document or documents. “Document” means any paper including document of title, security, invoice, certificate, notice of default and the like.
- (c) An “issuer” is a bank or other person issuing a credit.
- (d) A “beneficiary” of a credit is a person who is entitled under its terms to draw or demand payment.
- (e) An “advising bank” is a bank which gives notification of the issuance of a credit by another bank.
- (f) A “confirming bank” is 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.
- (g) A “customer” is 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.

(2) Other definitions applying to this Article and the sections in which they appear are:

“Notation of Credit”.	Section 5–108.
“Presenter”.	Section 5–112(3).

(3) Definitions in other Articles applying to this Article and the sections in which they appear are:

“Accept” or “Acceptance”.	Section 3–410.
“Contract for sale”.	Section 2–106.
“Draft”.	Section 3–104.
“Holder in due course”.	Section 3–302.
“Midnight deadline”.	Section 4–104.
“Security”.	Section 8–102.

(4) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

**Section 5—104. Formal Requirements; Signing.**

(1) Except as otherwise required in subsection (1) (c) of Section 5—102 on scope, no particular form of phrasing is required for a credit. A credit must be in writing and signed by the issuer and a confirmation must be in writing and signed by the confirming bank. A modification of the terms of a credit or confirmation must be signed by the issuer or confirming bank.

(2) A telegram may be a sufficient signed writing if it identifies its sender by an authorized authentication. The authentication may be in code and the authorized naming of the issuer in an advice of credit is a sufficient signing.

**Section 5—105. Consideration.**

No consideration is necessary to establish a credit or to enlarge or otherwise modify its terms.

**Section 5—106. Time and Effect of Establishment of Credit.**

(1) Unless otherwise agreed a credit is established

- (a) as regards the customer as soon as a letter of credit is sent to him or the letter of credit or an authorized written advice of its issuance is sent to the beneficiary; and
- (b) as regards the beneficiary when he receives a letter of credit or an authorized written advice of its issuance.

(2) Unless otherwise agreed once an irrevocable credit is established as regards the customer it can be modified or revoked only with the consent of the customer and once it is established as regards the beneficiary it can be modified or revoked only with his consent.

(3) Unless otherwise agreed after a revocable credit is established it may be modified or revoked by the issuer without notice to or consent from the customer or beneficiary.

(4) Notwithstanding any modification or revocation of a revocable credit any person authorized to honor or negotiate under the terms of the original credit is entitled to reimbursement for or honor of any draft or demand for payment duly honored or negotiated before receipt of notice of the modification or revocation and the issuer in turn is entitled to reimbursement from its customer.



**Section 5—107. Advice of Credit; Confirmation; Error in Statement of Terms.**

(1) Unless otherwise specified an advising bank by advising a credit issued by another 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.

(2) 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.

(3) Even though an advising bank incorrectly advises the terms of a credit it has been authorized to advise the credit is established as against the issuer to the extent of its original terms.

(4) Unless otherwise specified the customer bears as against the issuer all risks of transmission and reasonable translation or interpretation of any message relating to a credit.

**Section 5—108. "Notation Credit"; Exhaustion of Credit.**

(1) A credit which specifies that any person purchasing or paying drafts drawn or demands for payment made under it must note the amount of the draft or demand on the letter or advice of credit is a "notation credit".

(2) Under a notation credit

(a) a person paying the beneficiary or purchasing a draft or demand for payment from him acquires a right to honor only if the appropriate notation is made and by transferring or forwarding for honor the documents under the credit such a person warrants to the issuer that the notation has been made; and

(b) unless the credit or a signed statement that an appropriate notation has been made accompanies the draft or demand for payment the issuer may delay honor until evidence of notation has been procured which is satisfactory to it but its obligation and that of its customer continue for a reasonable time not exceeding thirty days to obtain such evidence.

(3) If the credit is not a notation credit

(a) the issuer may honor complying drafts or demands for payment presented to it in the order in which they are

presented and is discharged pro tanto by honor of any such draft or demand;

- (b) as between competing good faith purchasers of complying drafts or demands the person first purchasing has priority over a subsequent purchaser even though the later purchased draft or demand has been first honored.

**Section 5—109. Issuer's Obligation to Its Customer.**

(1) An issuer's obligation to its customer includes good faith and observance of any general banking usage but unless otherwise agreed does not include liability or responsibility

- (a) for performance of the underlying contract for sale or other transaction between the customer and the beneficiary; or
- (b) for any act or omission of any person other than itself or its own branch or for loss or destruction of a draft, demand or document in transit or in the possession of others; or
- (c) based on knowledge or lack of knowledge of any usage of any particular trade.

(2) An issuer must examine documents with care so as to ascertain that on their face they appear to comply with the terms of the credit but unless otherwise agreed assumes no liability or responsibility for the genuineness, falsification or effect of any document which appears on such examination to be regular on its face.

(3) A non-bank issuer is not bound by any banking usage of which it has no knowledge.

**Section 5—110. Availability of Credit in Portions; Presenter's Reservation of Lien or Claim.**

(1) Unless otherwise specified a credit may be used in portions in the discretion of the beneficiary.

(2) Unless otherwise specified a person by presenting a documentary draft or demand for payment under a credit relinquishes upon its honor all claims to the documents and a person by transferring such draft or demand or causing such presentment authorizes such relinquishment. An explicit reservation of claim makes the draft or demand non-complying.

**Section 5—111. Warranties on Transfer and Presentment.**

(1) Unless otherwise agreed the beneficiary by transferring or presenting a documentary draft or demand for payment warrants to all interested parties that the necessary conditions of the credit have been complied with. This is in addition to any warranties arising under Articles 3, 4, 7 and 8.

(2) Unless otherwise agreed a negotiating, advising, confirming, collecting or issuing bank presenting or transferring a draft or demand for payment under a credit 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.

**Section 5—112. Time Allowed for Honor or Rejection; Withholding Honor or Rejection by Consent; "Presenter".**

(1) A bank to which a documentary draft or demand for payment is presented under a credit may without dishonor of the draft, demand or credit

- (a) defer honor until the close of the third banking day following receipt of the documents; and
- (b) further defer honor if the presenter has expressly or impliedly consented thereto.

Failure to honor within the time here specified constitutes dishonor of the draft or demand and of the credit [except as otherwise provided in subsection (4) of Section 5—114 on conditional payment].

*Note: The bracketed language in the last sentence of subsection (1) should be included only if the optional provisions of Section 5—114(4) and (5) are included.*

(2) Upon dishonor the bank may unless otherwise instructed fulfill its duty to return the draft or demand and the documents by holding them at the disposal of the presenter and sending him an advice to that effect.

(3) "Presenter" means any person presenting a draft or demand for payment for honor under a credit even though that person is a confirming bank or other correspondent which is acting under an issuer's authorization.

**Section 5—113. Indemnities.**

(1) A bank seeking to obtain (whether for itself or another) honor, negotiation or reimbursement under a credit may give an indemnity to induce such honor, negotiation or reimbursement.

(2) An indemnity agreement inducing honor, negotiation or reimbursement

- (a) unless otherwise explicitly agreed applies to defects in the documents but not in the goods; and
- (b) unless a longer time is explicitly agreed expires at the end of ten business days following receipt of the documents by the ultimate customer unless notice of objection is sent before such expiration date. The ultimate customer may send notice of objection to the person from whom he received the documents and any bank receiving such notice is under a duty to send notice to its transferor before its midnight deadline.

**Section 5—114. Issuer's Duty and Privilege to Honor; Right to Reimbursement.**

(1) An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract for sale or other contract between the customer and the beneficiary. The issuer is not excused from honor of such a draft or demand by reason of an additional general term that all documents must be satisfactory to the issuer, but an issuer may require that specified documents must be satisfactory to it.

(2) Unless otherwise agreed when documents appear on their face to comply with the terms of a credit but a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (Section 7—507) or of a security (Section 8—306) or is forged or fraudulent or there is fraud in the transaction

- (a) the issuer must honor the draft or demand for payment if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course (Section 3—302) and in an appropriate case would make it a

person to whom a document of title has been duly negotiated (Section 7-502) or a bona fide purchaser of a security (Section 8-302); and

- (b) in all other cases as against its customer, an issuer acting in good faith may honor the draft or demand for payment despite notification from the customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honor.

(3) Unless otherwise agreed an issuer which has duly honored a draft or demand for payment is entitled to immediate reimbursement of any payment made under the credit and to be put in effectively available funds not later than the day before maturity of any acceptance made under the credit.

[(4) When a credit provides for payment [by the issuer on receipt of notice that the required documents are in the possession of a correspondent or other agent of the issuer

- (a) any payment made on receipt of such notice is conditional; and
- (b) the issuer may reject documents which do not comply with the credit if it does so within three banking days following its receipt of the documents; and
- (c) in the event of such rejection, the issuer is entitled by charge back or otherwise to return of the payment made.]

[(5) In the case covered by subsection (4) failure to reject documents within the time specified in sub-paragraph (b) constitutes acceptance of the documents and makes the payment final in favor of the beneficiary.]

*Note: Subsections (4) and (5) are bracketed as optional. If they are included the bracketed language in the last sentence of Section 5-112(1) should also be included.*

### **Section 5-115. Remedy for Improper Dishonor or Anticipatory Repudiation.**

(1) When an issuer wrongfully dishonors a draft or demand for payment presented under a credit the person entitled to honor has with respect to any documents the rights of a person in the

position of a seller (Section 2-707) and may recover from the issuer the face amount of the draft or demand together with incidental damages under Section 2-710 on seller's incidental damages and interest but less any amount realized by resale or other use or disposition of the subject matter of the transaction. In the event no resale or other utilization is made the documents, goods or other subject matter involved in the transaction must be turned over to the issuer on payment of judgment.

(2) When an issuer wrongfully cancels or otherwise repudiates a credit before presentment of a draft or demand for payment drawn under it the beneficiary has the rights of a seller after anticipatory repudiation by the buyer under Section 2-610 if he learns of the repudiation in time reasonably to avoid procurement of the required documents. Otherwise the beneficiary has an immediate right of action for wrongful dishonor.

#### **Section 5-116. Transfer and Assignment.**

(1) The right to draw under a credit can be transferred or assigned only when the credit is expressly designated as transferable or assignable.

(2) Even though the credit specifically states that it is non-transferable or nonassignable the beneficiary may before performance of the conditions of the credit assign his right to proceeds. Such an assignment is an assignment of a contract right under Article 9 on Secured Transactions and is governed by that Article except that

- (a) the assignment is ineffective until the letter of credit or advice of credit is delivered to the assignee which delivery constitutes perfection of the security interest under Article 9; and
- (b) the issuer may honor drafts or demands for payment drawn under the credit until it receives a notification of the assignment signed by the beneficiary which reasonably identifies the credit involved in the assignment and contains a request to pay the assignee; and
- (c) after what reasonably appears to be such a notification has been received the issuer may without dishonor refuse to accept or pay even to a person otherwise entitled to honor until the letter of credit or advice of credit is exhibited to the issuer.

(3) Except where the beneficiary has effectively assigned his right to draw or his right to proceeds, nothing in this section limits his right to transfer or negotiate drafts or demands drawn under the credit.

**Section 5—117. Insolvency of Bank Holding Funds for Documentary Credit.**

(1) Where an issuer or an advising or confirming bank or a bank which has for a customer procured issuance of a credit by another bank becomes insolvent before final payment under the credit and the credit is one to which this Article is made applicable by paragraphs (a) or (b) of Section 5—102(1) on scope, the receipt or allocation of funds or collateral to secure or meet obligations under the credit shall have the following results:

- (a) to the extent of any funds or collateral turned over after or before the insolvency as indemnity against or specifically for the purpose of payment of drafts or demands for payment drawn under the designated credit, the drafts or demands are entitled to payment in preference over depositors or other general creditors of the issuer or bank; and
- (b) On expiration of the credit or surrender of the beneficiary's rights under it unused any person who has given such funds or collateral is similarly entitled to return thereof; and
- (c) a charge to a general or current account with a bank if specifically consented to for the purpose of indemnity against or payment of drafts or demands for payment drawn under the designated credit falls under the same rules as if the funds had been drawn out in cash and then turned over with specific instructions.

(2) After honor or reimbursement under this section the customer or other person for whose account the insolvent bank has acted is entitled to receive the documents involved.