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# Contracting out of Revised UCC Article 5 (Letters of Credit)

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# CONTRACTING OUT OF REVISED UCC ARTICLE 5 (LETTERS OF CREDIT)

*James E. Byrne\**

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*As is appropriate for a statute governing an undertaking that is international in its scope, Revised Uniform Commercial Code (UCC) Article 5,<sup>1</sup> concerning Letters of Credit, liberally accommodates departures from its specific provisions. Fully embracing and even surpassing the UCC ideal of freedom to contract in its approach, UCC Article 5 eschews any limitation on the choice of an alternative system of law governing letters of credit to which it applies. It also permits variation of its provisions to the greatest extent consistent with the integrity of the letter of credit undertaking. Indeed, UCC Article 5 employs a novel approach of delineating those provisions that cannot be freely varied as exceptional. While limited non-variability of other provisions may be inferred from these provisions, statutory analysis should be grounded in principles of letter of credit law and practice as codified by Revised UCC Article 5; analysis grounded in common law principles of conflicts of law or public policy arguments is therefore less useful.*

## I. INTRODUCTION

Working with *Revised UCC Article 5 (Letters of Credit)* is an undertaking that is quintessentially international in both its genesis and use.<sup>2</sup> When combined with the statute's unique and extensive

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1. In this article, the 1957 version of the Model Code is referred to as "Prior UCC Article 5" and the 1995 version (including Article 9 amendments) as "Revised UCC Article 5." Unless otherwise indicated, a reference to either version signifies the Model Code. See JAMES G. BARNES, JAMES E. BYRNE & AMELIA H. BOSS, *THE ABCS OF THE UCC: ARTICLE 5: LETTERS OF CREDIT* (Am. Bar Ass'n 1998); JOHN F. DOLAN, *THE LAW OF LETTERS OF CREDIT* (A.S. Pratt & Sons rev. ed. 2003); James E. Byrne, *Fundamental Issues in the Unification and Harmonization of Letter of Credit Law*, 37 LOY. L. REV. 1 (1991) (materials on the Revised UCC Article 5); James G. Barnes & James E. Byrne, *Revision of UCC Article 5*, 50 BUS. LAW. 1449 (1995); JAMES J. WHITE & ROBERT S. SUMMERS, *UNIFORM COMMERCIAL CODE* (4th ed. West Publ'g Co. 1995); James J. White, *The Influence of International Practice on the Revision of Article 5 of the UCC*, 16 NW. J. INT'L L. & BUS. 189 (1995); James G. Barnes, *Internalization of Revised UCC Article 5 (Letters of Credit)*, 16 NW. J. INT'L L. & BUS. 215 (1995); Joseph D. Gustavus, *Letter of Credit Compliance Under Revised UCC Article 5 and UCP 500*, 114 BANKING L.J. 55 (1997); Milton R. Schroeder, *The 1995 Revision to UCC Article 5, Letters of Credit*, 29 U.C.C. L.J. 331 (1997).

2. UCC Section 5-102(a)(10) defines a letter of credit as:

A definite undertaking that satisfies the requirements of Section 5-104 by an issuer to a beneficiary at the request or for the account of an applicant or, in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or delivery of an item of value.

U.C.C. § 5-102(a)(10) (1995).

In other words, a letter of credit is a promise to pay that is conditioned on the presentation of specified documentary representations. *Id.* While there is no formal basis for a distinction, where the documentary representations relate to a current transaction for goods and services, the transaction is regarded as a "commercial letter of credit." See BLACK'S LAW DICTIONARY 923-24 (8th ed. 2004).

A commercial letter of credit is a contractual agreement between a bank, known as the issuing bank, on behalf of one of its customers, authorizing another bank, known as the advising or confirming bank, to make payment to the beneficiary. The issuing bank, on the request of its customer, opens the letter of credit. The issuing bank makes a commitment to honor drawings made under the credit. The beneficiary is normally the provider of goods and/or services. Essentially, the issuing bank replaces the bank's customer as the payee.

CREDIT RESEARCH FOUNDATION, UNDERSTANDING AND USING LETTERS OF CREDIT, PART I, <http://www.crfonline.org/orc/cro/cro-9-1.html> (last visited Nov. 23, 2006). This term stems from an older usage that is retained in the United States. WILBERT WARD, AMERICAN COMMERCIAL CREDIT 3 (1922). In Europe and other parts of the world, the term most commonly used is "documentary credit," which also has historical roots in letter of credit usage, but is inapt for describing a particular subcategory of letters of credit since all letters of credit are "documentary." RICHARD KING, GUTTERIDGE & MEGRAH'S LAW OF BANKERS' COMMERCIAL CREDITS 1 (8th ed. 2001). The term "commercial" more closely captures the unique feature of this subcategory, namely its use to pay the purchase price in a "live" commercial transaction. See *id.*

Letters of credit that are not so used can be generally classified as "standby" letters of credit. *Id.* As used here, standby letters of credit would include so-called independent guarantees that are also known as first demand or bank guarantees. U.N. Comm'n on Int'l Trade Law [UNCITRAL], *United Nations Convention on Independent Guarantees and Stand-By Letters of Credit*, Art. 2, U.N. DOC. A/RES/50/48 (Dec. 11, 1995) [hereinafter *UN LC Convention*], available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/payments/1995Convention\\_guarantees\\_credit.html](http://www.uncitral.org/uncitral/en/uncitral_texts/payments/1995Convention_guarantees_credit.html); see also *UN LC Convention*, *supra*, Explanatory Note, para. 2-3, available at <http://www.uncitral.org/pdf/english/texts/payments/guarantees/guarantees.pdf>. These undertakings derive from English and European usage and, at the abstract level of law, are the equivalent of standby letters of credit. The preferred term is "standby letter of credit" or "standby," not only because it is more familiar to American readers, but also because it avoids "guarantee" language. An "independent guarantee" is not a true guarantee (which is essentially a suretyship or accessory undertaking). RESTATEMENT (THIRD) OF SURSHIP & GUAR. § 4 cmt. c (1995); James G. Barnes & James E. Byrne, *Revision of U.C.C. Article 5*, 50 BUS. LAW. 1449, 1451 (1995). The uses of standby letters of credit are as varied as the plethora of human enterprises that require dependable money-like promises. Types of standby letters of credit include: (1) clean standbys (requiring only presentation of a draft or simple demand); (2) performance or bid bond standbys (available in the event that a contract is awarded and not signed or performed); (3) reinsurance standbys (supporting reinsurance undertakings); (4) commercial standbys (providing back up payment in the event that the seller is not paid in the ordinary course of business); (5) advance payment standbys (supporting an obligation to account for an advance payment made by the beneficiary to the applicant); (6) counter standbys (supporting the issuance of a separate standby or other undertaking by the beneficiary of the counter standby); (7) financial standbys (supporting an obligation to pay money); (8) including any instrument evidencing an obligation to repay borrowed money); (9) and direct pay standbys (supporting payment when due of an underlying payment obligation typically in connection with a financial standby without regard to a default). See Andrea G. Nadel, Annotation, *What is a Letter of Credit Under UCC § 5-102, 5-103*, 44 A.L.R.4th 172 (1986). They can also generally be distinguished as financial or performance standbys. These categories are not precise and, more importantly, have no bearing on the essential character of the undertaking.

As of the end of the first quarter of 2006, the top three hundred United States banks reported outstanding standby obligations of over \$382.7 billion and more than \$24.6 billion in commercial letters of credit. *Statistics: U.S. Banks*, DOCUMENTARY CREDIT WORLD July-Aug 2006, at 40, 45. While figures for outstanding amounts are published only for the United States, a conservative estimate would place the global volume of letters of credit at \$1.2 billion. For at least a decade, the use of amounts outstanding in standby letters of credit has been growing, while that of commercial letters of credit has been declining. *Id.*

body of codified practice rules, *Revised UCC Article 5* reaches a level of complexity and nuance that presents both users and their attorneys with a considerable array of challenges and opportunities.<sup>3</sup>

Following the demise of the hegemony of the London Clearing Banks in this field during World War I, the banking industry reestablished order by promulgating rules, first at the national level and then internationally, through the medium of the Commission on Banking Technique and Practice of the International Chamber of Commerce (“ICC”).<sup>4</sup> The current version of the rules designed for commercial letters of credit is the Uniform Customs and Practice for Documentary Credits (“UCP”).<sup>5</sup> Special rules have been drafted for standby letters of credit—the International Standby Practices (“ISP98”).<sup>6</sup>

The enactment of positive statutory law that followed the earlier codification of practice by several decades is limited. Apart from UCC Article 5’s treatment of letters of credit, the only other contemporary statutory scheme is the United Nations Convention on Independent Guarantees and Standby Letters of Credit (“UN LC

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3. The original Model UCC, which was approved in 1952, contained the UCC Article 5. In 1957, Model UCC Article 5 was revised extensively as a result of comments by the New York Law Revision Commission. See STATE OF NEW YORK LAW REVISION COMM’N, REPORT RELATING TO THE UNIFORM COMMERCIAL CODE 44–46 (1956). Although all fifty states eventually adopted this version, a non-conforming amendment, styled section 5-102(4), was adopted by Alabama, Arizona, Missouri, and New York. ALA. CODE § 7-5-102 (1966); ARIZ. REV. STAT. ANN. § 47-5102 (1984); MO. REV. STAT. § 400.5-102 (1965); N.Y. U.C.C. LAW § 5-102 (McKinney 1962). This amendment displaced UCC Article 5 where the letter of credit was determined to be subject to the Uniform Customs and Practices for Documentary Credits (“UCP”), published by the International Chamber of Commerce (“ICC”). A joint American Bar Association and Banking Industry Task Force recommended the revision of Prior UCC Article 5 in 1990. See The Task Force on the Study of U.C.C. Article 5, et al., *An Examination of UCC Article 5 (Letters of Credit)*, 45 BUS. LAW. 1527 (1990) [hereinafter *Task Force*]. All fifty states, the District of Columbia, and Puerto Rico adopted this version of UCC Article 5, which was completed in October 1995. See LC RULES AND LAWS: CRITICAL TEXTS 151 (James E. Byrne ed., Inst. of Int’l. Banking Law & Practice, 2d. ed. 2002) (providing an exhaustive table of dates of adoption, effective dates, and state citations).

4. See WILBERT WARD, *AMERICAN COMMERCIAL CREDITS*, 3 (1922) (providing a history of the American Commercial Credit market).

5. See generally *infra* note 233. The current version of the rules designed for commercial letters of credit is ICC Publication No. 500. INT’L CHAMBER OF COMMERCE, UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (1993) (ICC Publication No. 500) [hereinafter UCP500]. The UCP revision, which becomes effective July 1, 2007, will be the 2007 Revision, ICC Publication No. 600. INT’L CHAMBER OF COMMERCE, UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (2007) (ICC Publication No. 600) [hereinafter UCP600].

6. See generally *infra* note 251.

Convention”).<sup>7</sup> Nevertheless, judicial pronouncements by the Supreme People’s Court of China<sup>8</sup> and rules promulgated by some central banks<sup>9</sup> embody many of the principles espoused by the UCC and the UN LC Convention.

In light of the dynamic nature of the developing codification of letter of credit laws and regulations, the drafters of Revised UCC Article 5 faced challenging policy questions vis-à-vis the extent to which one might contract out of the statute.<sup>10</sup> The drafters have responded with a remarkably broad endorsement of both the principles of party autonomy and freedom of contract. Although limited exceptions to these liberal policies do exist, the net outcome is to give parties a wide variety of choices of alternative regimes.<sup>11</sup> Indeed, the Official Comment to section 5-101 indicates that the statute seeks to accommodate “further development of the efficient use of letters of credit by preserving flexibility through variation by agreement in order to respond to and accommodate developments in custom and usage that are not inconsistent with the essential definitions and substantive mandates of the statute.”<sup>12</sup> The extent to which Revised UCC Article 5 has fulfilled this goal will become

7. See generally discussion, *infra* Part III.E.1.a.

8. See generally discussion, *infra* Part III.E.1.b.

9. The Central Bank of Indonesia is currently considering regulations for letters of credit in a manner similar to that of the Chinese Supreme People’s Court. In the United States, the Office of the Comptroller of the Currency (“OCC”) has played a leading role in addressing safety and soundness concerns through its interpretative rulings. Specifically, the OCC has promulgated rules to insure that banks would prudently consider the importance of limits to the time frame of their exposure avoiding the vagaries of non-documentary conditions. In their present form, the OCC’s rulings are the most current approach to letter of credit regulation now in place and would serve well as a model for enlightened regulation in this field. See U.S. Office of the Comptroller of the Currency: Interpretive Rulings, 12 C.F.R. §§ 7.1016, 7.1017 (2006), reprinted in LC RULES AND LAWS: CRITICAL TEXTS, *supra* note 3, at 189.

10. Professor Bunn highlights the challenge faced by the UCC drafters:

The Uniform Commercial Code is not a “regulatory” law. Its central purpose is not to restrict free contract by imposing required terms (as e.g., usury laws, hour and wage laws or public utility laws necessarily do) but to facilitate commercial transactions by making the governing law simpler, clearer, more modern, and more uniform. Nevertheless, like any law at all concerning business, it must consider in some detail what bargains, in what circumstances, have to be permitted, forbidden, or denied effect.

Charles Bunn, *Freedom of Contract Under the Uniform Commercial Code*, 2 B.C. INDUS. & COM. L. REV. 59, 59 (1961).

11. As pointed out by Professor Bunn, the critical element of freedom of contract is “not simply freedom to sign papers or write letters to each other, but freedom to make agreements which the legal system will enforce.” *Id.*

12. U.C.C. § 5-101 cmt. (1995).

apparent by examining how the statute treats the ability of parties to contract out of its provisions: (1) with respect to choosing an altogether different regime than the otherwise applicable version of Revised UCC Article 5 and (2) modifying a discrete provision of Revised UCC Article 5.

This article focuses on a letter of credit obligation that falls within the purview of Revised UCC Article 5.<sup>13</sup> The First Part of this Article considers the notion common in some letter of credit banking circles that there is no need to select letter of credit law in an undertaking that selects appropriate practice rules. Part Two considers the possibility of selecting a different legal regime, while Part Three considers varying the effect of discrete provisions of Revised UCC Article 5. Part Four then addresses ethical considerations related to opting out of Revised UCC Article 5 and Part Five concludes with some observations regarding variations in Revised UCC Article 5.

## II. THE MYTH THAT “NO LETTER OF CREDIT LAW IS NECESSARY”

Due partly to the international and virtually universal use of the UCP for commercial letters of credit and to the widespread belief that the UCP displaces the need for “law,”<sup>14</sup> many bankers regard statutes dealing with letters of credit as incompatible with the UCP.<sup>15</sup>

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13. The fundamental choice of law principle is that unless otherwise provided, a letter of credit obligation is subject to the law applicable to the issuer at the indicated place of issuance or, in the case of a confirmer, the stated place of confirmation. See U.C.C. § 5-116(b) (1995) (“Failing a choice of law in accordance with article 21, the undertaking is governed by the law of the State where the guarantor/issuer has that place of business at which the undertaking was issued.”); see also, U.N. Comm’n on Int’l Trade Law [UNCITRAL], *United Nations Convention on Independent Guarantees and Stand-By Letters of Credit*, Art. 22, U.N. DOC. A/RES/50/48 (Dec. 11, 1995) [hereinafter *UN LC Convention*], available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/payments/1995Convention\\_guarantees\\_credit.html](http://www.uncitral.org/uncitral/en/uncitral_texts/payments/1995Convention_guarantees_credit.html). For purposes of this Article, the complexity introduced by the presence of a nominated bank is not addressed, since the application of a bank’s local law to its own undertakings does not affect the basic proposition addressed here, should that law be a version of Revised UCC Article 5.

14. While there are many instances of this notion, one of the most colorful is that ICC Council rules are assigned an “effective date”, which is assumed to be the date after which they may be used. PRACTICING LAW INSTITUTE, INTERNATIONAL CHAMBER OF COMMERCE: INTERNATIONAL COURT OF ARBITRATION, March 2006. However, as mere rules of practice (and not law), an undertaking may be issued subject to the rules of practice at any point, even in draft form. *Id.*

15. This notion was prevalent in the United States prior to the adoption of Prior UCC Article 5 and remains prevalent elsewhere throughout the world where there are no such statutes. See James E. Byrne, *The Revision of UCC Article 5: A Strategy for Success*, 56 BROOK. L. REV. 13, 19 (1990) [hereinafter Byrne, *Strategy for Success*]. One example of this phenomenon was the



As a result, some bankers and letter of credit users are under the mistaken impression that displacement of *law* by rules of practice is not merely an option, but in fact the norm, and that issuing a letter of credit subject to rules of practice such as the UCP effects such a displacement. While this notion may be correct insofar as the parties to a dispute believed it and did not seek legal redress, it would quickly be unmasked upon review by a judicial or arbitral tribunal. Reference to a court or arbitral tribunal would result in the application of “law” (although the source of part of that law may prove to be the UCP). In the United States, this notion was further fueled by nonconforming amendments to Prior UCC Article 5 in four states, including the commercially significant state of New York, which, in effect, ousted or displaced Prior UCC Article 5 whenever a letter of credit was deemed “by its terms or by agreement, course of dealing or usage of trade” to be subject to the UCP.<sup>16</sup> This provision resulted from the New York-centered banking community’s hostility to the enactment of a domestic letter of credit statute on the grounds that it was incompatible with the international rules of practice embodied in the UCP.<sup>17</sup>

Thus, one of the principal purposes of revising UCC Article 5 was to resolve the concerns of the banking community and to harmonize letter of credit law with international letter of credit practice.<sup>18</sup> Indeed, the New York Court of Appeals revealed the fallacy of the commonly held notion that the UCP could stand alone as law in the hallmark case of *United Bank Ltd. v. Cambridge*

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resistance of many members of the ICC Banking Commission to the endorsement by the ICC of the UN LC Convention. Specifically, the commission objected on grounds that such a statute was unnecessary (arguable), noting that it was a mistake to endorse a positive law whose effect would be to weaken the value of the UCP. In light of both the UN LC Convention’s express deference to rules of practice and the experience in the United States with its statute, these objections are not defensible. *Cf. id.* at 20.

16. New York’s UCC Section 5-103(4) states, in relevant part:

Unless otherwise agreed, this Article 5 does not apply to a letter of credit or a credit if by its terms or by agreement, course of dealing or usage of trade such letter of credit or credit is subject in whole or in part to the Uniform Customs and Practice for Commercial Documentary Credits fixed by the Thirteenth or by any subsequent Congress of the International Chamber of Commerce.

N.Y. U.C.C. § 5-103(4) (McKinney 1962). This provision was also enacted by Alabama, Arizona, and Missouri, which followed New York’s lead. *See* ALA. CODE § 7-5-102(4) (West 2002); ARIZ. REV. STAT. § 47-5102(d) (1988); MO. REV. STAT. § 400.5-102(4) (1994).

17. *See* Byrne, *Strategy for Success*, *supra* note 15, at 13–14, 17.

18. *Id.*

*Sporting Goods Corp.*. In *United Bank* the court considered whether to enjoin a transaction resulting from letter of credit fraud where New York's non-conforming amendment had ousted Prior UCC Article 5. Concluding that New York common law applied in the absence of Prior New York UCC Article 5, the New York Court of Appeals somewhat ironically drew on the provisions of Prior UCC Article 5 by analogy to reach a decision since it concluded that this provision was declaratory of the common law.<sup>19</sup>

The notion that the UCP dispenses with the need for letter of credit law is also based on the fact that courts regularly defer to it in stating the rule of law to resolve a dispute.<sup>20</sup> Such deference typically occurs where the letter of credit is issued subject to the UCP, which either effectively varies local law on the matter at issue or provides a rule where local law is silent. Since even Revised UCC Article 5, the most detailed formulation of letter of credit law, is silent on most issues relating to the compliance of documents with the terms and conditions of the letter of credit, it is not surprising that courts often invoke the UCP to resolve most letter of credit disputes regarding compliance. Where there is effectively no statute (everywhere except the United States, China, and the countries adopting the UN LC Convention), and, in many countries, no case law either (even in common law jurisdictions where courts are persuaded by prior decisions), the UCP may be the only coherent source of law. The other alternative would be to resort either to general principles of the law of obligations or commercial law. However, this source of law often leads to results that are wrong for international letter of credit practice.

Thus, although the notion that the UCP is "law" is a myth, it is powerful, and, like all myths, an expression of a fundamental truth in non-analytical terms.<sup>21</sup> In subsequent parts, this article will explore the possibility of opting out of Revised UCC Article 5 by making a letter of credit subject to rules of practice.

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19. See *United Bank Ltd. v. Cambridge Sporting Goods Corp.*, 360 N.E.2d 943, 947 n.2 (N.Y. 1976) ("However, even if the Uniform Customs and Practice were deemed applicable to this case, it would not, in the absence of a conflict, abrogate the pre-code case law (now codified in Uniform Commercial Code, § 5-114) and that authority continues to govern even where article 5 is not controlling . . .").

20. *E.g.*, *id.* at 947.

21. See MIRCEA ELIADE, *MYTH AND REALITY* (Ruth N. Anshen ed., Willard R. Trask trans., Harper & Rowe 1963).

After more than fifty years of letter of credit statutory experience, the relationship between rules of law and practice is somewhat better understood in the United States. However, the definitive analysis of this relationship has yet to be formulated. Taking the UCP as contract terms added by incorporation, which represents the only alternative conceptual model, does not adequately capture the central role of the UCP or similar rules with respect to letters of credit. To some extent, rules of practice do operate as an alternative, but concurrent system of law, as the drafters of Revised UCC Article 5 recognized when citing its treatment of the UCP and similar rules in Revised UCC section 5-116(c).<sup>22</sup>

### III. ANOTHER LEGAL REGIME

It is possible to contract out of Revised UCC Article 5 by the choice of any other system of law without regard to connectivity. This section considers the various options available and their impact.

#### *A. The Ability to Choose Another Legal Regime Under Revised UCC Article 5*

Prior UCC Article 5 did not contain its own choice of law rules. Instead, it was content to rely upon Prior UCC section 1-105(1), which limited the ability of parties to choose law where that law had a “reasonable relationship” with the forum.<sup>23</sup>

Recognizing that this limitation was ill-suited for international

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22. Revised UCC Section 5-116(c) provides:

Except as otherwise provided in this subsection, the liability of an issuer, nominated person, or adviser is governed by any rules of custom or practice, such as the Uniform Customs and Practice for Documentary Credits, to which the letter of credit, confirmation, or other undertaking is expressly made subject. If (i) this article would govern the liability of an issuer, nominated person, or adviser under subsection (a) or (b), (ii) the relevant undertaking incorporates rules of custom or practice, and (iii) there is conflict between this article and those rules as applied to that undertaking, those rules govern except to the extent of any conflict with the nonvariable provisions specified in section 5-103(c).

U.C.C. § 5-116(c) (2003).

23. Prior UCC Section 1-105(1) provided:

Except as provided hereafter in this section, when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties. Failing such an agreement this Act applies to transactions bearing an appropriate relation to this state.

U.C.C. § 1-105(1) (1952) (amended 2001).

undertakings (such as letters of credit involving commercial entities with multiple commercial reasons, and justifying the selection of a neutral commercial law) the drafters of Revised UCC Article 5 made a radical departure from the general UCC approach to choice of law.<sup>24</sup> For example, revised UCC section 5-116(a) provides that “[t]he jurisdiction whose law is chosen need not bear any relation to the transaction.”<sup>25</sup> Revised UCC section 5-116 Official Comment 1 demonstrates this paradigm shift by employing the following example:

two parties, an issuer and an applicant, both located in Oklahoma, might choose the law of New York. Unless they agree otherwise, the section anticipates that they wish the substantive law of New York to apply to their transaction and they do not intend that a New York choice of law principle might direct a court to Oklahoma law.<sup>26</sup>

Moreover, Revised UCC section 5-116(e) permits the choice of any forum in which any disputes are to be litigated, a provision that may be more significant than the choice of law provision<sup>27</sup> Of course, whether a chosen forum will choose to hear the case is another question, and the statute does not purport to confer jurisdiction to its own courts, much less those of other jurisdictions.<sup>28</sup>

These provisions are the centerpiece of the approach to variability in Revised UCC Article 5, which goes beyond notions that there is liberty to provide for contractual terms to permit complete freedom in the selection of law and forum. In fact, Revised UCC Article 5 even surpasses the subsequent revision of UCC

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24. *Id.*

25. U.C.C. § 5-116(a) (1995). Not all case law has been so restrictive. See, e.g., *Hellenic Lines, Ltd. v. Embassy of Pak.*, 307 F. Supp. 947, 954 (S.D.N.Y. 1969) (selecting English law, even though the transaction had no relation to England, and the application of English law led to a result contrary to New York law), *aff'd in part, rev'd in part on other grounds*, 467 F.2d 1150 (2d Cir. 1972).

26. U.C.C. § 5-116 cmt. 1.

27. *Id.* § 5-116(e) (“The forum for settling disputes arising out of an undertaking within this article may be chosen in the manner and with the binding effect that governing law may be chosen in accordance with subsection (a).”).

28. Although Subsection (e) may have little actual effect, it could be a factor in convincing another forum’s court to exercise jurisdiction. Revised UCC Section 5-116 official comment 5 recognizes that a selected forum may elect not to exercise jurisdiction and suggests that the selection clause be disregarded in such a case, unless another court that would otherwise have jurisdiction accepts the case due to the clause. *Id.* § 5-116 cmt. 5. To illustrate, the Official Comment compares such a situation to being in “eternal purgatory.” *Id.*

Article 1. It is therefore surprising that more than half of the states that have so far adopted Revised UCC Article 5 have yet to adopt Revised UCC Article 1 based on the fact that they prefer a more restricted approach to choice of law.<sup>29</sup>

As a result, under Revised UCC Article 5, letter of credit obligations can effectively be made subject to any system of law without regard to whether that jurisdiction is related in any manner to the transaction.<sup>30</sup> The remainder of this section considers the various choices that are available, assuming that Revised UCC section 5-116 applies to a letter of credit and its implications.

### B. Prior UCC Article 5

Until recently, issuing a letter of credit subject to Prior UCC Article 5 was relatively simple. Before all fifty states had adopted Revised UCC Article 5, a bank might have exercised this option by issuing a letter of credit subject to the law of a state that had not adopted Revised UCC Article 5.<sup>31</sup> Since this course is no longer

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29. Revised UCC Article 1 (adopted by twenty-two states as of August 1, 2006) creates a more complex matrix. Revised section 1-301(c) provides that in non-consumer "international transactions" (ones that bear a "reasonable relationship" to a country other than the United States), the parties can "agree" to the law of another state or another country regardless of whether there is a "relation" to the State or country chosen. *See* U.C.C. § 1-301(c). In non-consumer domestic transactions, the choice of the parties is limited to the law of another state. *See id.* The Official Comment states that Revised section 1-301 "affords greater party autonomy than former section 1-105, but with important safeguards protecting consumer interests and fundamental policies." U.C.C. § 1-301 cmt. 1. However, of the twenty-two states that have enacted Revised UCC Article 1, fourteen have retained the "reasonable relation" test of Prior UCC section 1-105 rather than change to the less restrictive rule. These states include: Alabama, ALA. CODE § 7-1-301 (Supp. 2006), Arkansas, ARK. CODE ANN. § 4-1-301 (Supp. 2005), Connecticut, CONN. GEN. STAT. § 42a-1-301 (Supp. 2006), Delaware, DEL. CODE ANN. tit. 6, § 1-301 (2005), Hawaii, HAW. REV. STAT. § 490:1-301 (Supp. 2005), Idaho, IDAHO CODE ANN. § 28-1-301 (Supp. 2006), Minnesota, MINN. STAT. § 336:1-301 (Supp. 2006), Montana, MONT. CODE ANN. § 30-1-301 (2005), Nebraska, NEB. REV. STAT. § 1-301 (Supp. 2005), Nevada, NEV. REV. STAT. § 104.1301 (Supp. 2005), New Mexico, N.M. STAT. § 55-1-301 (2005), Oklahoma, OKLA. STAT. tit. 12A, § 1-301 (Supp. 2005), Texas, TEX. BUS. & COM. CODE ANN. § 1.301 (Vernon Supp. 2006), and Virginia, VA. CODE ANN. § 8.1A-301 (Supp. 2006). This provision is not applicable to UCC Article 5. *See* U.C.C. § 1-301(g)(5).

30. As will be discussed in connection with Revised UCC section 5-103(c), Revised UCC section 5-116(a) expands the traditional formulation from one where the "agreement" of the parties controls to one where the terms of the letter of credit control. Here, the treatment of this provision focuses on the law chosen in the letter of credit as between the issuer and beneficiary; yet, the law applicable to an "issuer, nominated person, or advisor for action or omission" may be chosen "by a provision in the person's letter of credit, confirmation, or other undertaking." *See* U.C.C. § 5-116(a) (1995).

31. Wisconsin, the last state to have adopted Revised UCC Article 5, enacted it on March 27, 2006, published it on April 10, 2006, and it became effective on the first day of the third month following publication, July 1, 2006. *See* WIS. STAT. § 405.116 (Supp. 2006).

available, the question becomes significantly more complex and, in any event, one still must assess whether such a step is desirable and what implications it has.

If a letter of credit provided that it were issued subject to the statutory regime governing letters of credit prior to the adoption of Revised UCC Article 5, would such an instrument be enforceable?<sup>32</sup>

Assuming a state's enactment of Revised UCC Article 5 does not expressly permit or forbid selection of Prior UCC Article 5,<sup>33</sup> the question is whether a forum would give effect to the choice of a prior version of UCC Article 5 that the legislature had superseded by statute.

Although a court might be tempted to approach this question from a public policy perspective, choice of law considerations, or even theoretical notions of freedom of contract, it would be wise to resist such temptations. The answer lies in Revised UCC section 5-116. Unlike statutes in other areas of law, there exist no fundamental public policy reasons that would have prohibited the choice of Prior UCC Article 5 when it was in force in another state.<sup>34</sup> While Revised UCC Article 5 is a marked improvement over Prior UCC Article 5, the latter was a viable system of law supplemented by case law.<sup>35</sup> It would yield a principled decision in virtually every

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32. If so, it would be prudent to provide the citation of the prior version. A variation on this approach would be to issue the letter of credit subject to the 1957 Model UCC Article 5. The latter approach raises additional questions as to whether one can adopt a model code as the governing law. The question is rendered more complex because this model code has been superseded and replaced by its sponsors, the National Conference of Commissioners on Uniform State Laws and the American Law Institute. This approach is disfavored because of the additional problematic issues that it raises. Were this approach used, and if the forum state treated the prior model code as an alternative system of law, the same questions addressed in the text would also arise in addition to those delineated here.

33. The Revised UCC Article 5 repealer provision does not contain any limitation on the continued use of the prior statute. It states: "This [Act] [repeals] [amends] [insert citation to existing Article 5]." U.C.C. art. 5, Transition Provisions.

34. See Sandra Stern, *Varying Article 5 of the UCC by Agreement*, 114 *BANKING L.J.* 516, 522 (1997) (explaining that revised UCC Article 5 "may be rejected en gros in favor of a pre-revision Article 5 by an agreement that elects the law of a jurisdiction that has not adopted Revised Article 5").

35. Whether it is prudent to issue a letter of credit subject to Prior UCC Article 5 is a different question. On all counts, Revised UCC Article 5 attempts to, and does, capture modern letter of credit law and align it with international letter of credit practice in a manner that Prior UCC Article 5 was unsuccessful in accomplishing. It contains marked improvements in its definitional approach, its treatment of non-documentary conditions, its transfer by operation of law, and its transfer and assignment. The statute's gap-filling terms are generally consistent with current international letter of credit practice. It expressly refers to present and future "standard practice" as the place to look for answers, it allows complete freedom to choose applicable law

situation, even though a court may be forced to look to case law because the prior statute is skeletal.<sup>36</sup> In addition, letters of credit issued under Prior UCC Article 5 remain subject to it and courts will be required to use it to decide any litigation that occurs into the foreseeable future.<sup>37</sup> There is no reason why the universal adoption of the revision itself should change the ability to adopt the prior version. The policy of Revised UCC section 5-116, which favors complete freedom in the choice of a law and forum, compels such a conclusion.

### *C. Case Law Without a Statute in a United States Jurisdiction*

Another option would be to issue a letter of credit that eschewed any statutory treatment of letters of credit and was subject to case law of a state without the statute.

Prior to the adoption of Revised UCC Article 5, this option was available by adopting the law of one of the four states that had adopted Prior non-conforming UCC section 5-102(4): Alabama,

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and forum, and it allows nearly complete freedom to supplement and vary the effect of the provisions of revised Article 5 by incorporating rules of practice such as UCP500. *See generally* Barnes & Byrne, *supra* note 1, at 1449 (providing a detailed examination of the relative advantages of Revised UCC Article 5 over Prior UCC Article 5). Indeed, it is hard to imagine any general reason to prefer the Prior version of UCC Article 5 over Revised UCC Article 5. There may, of course, be discrete instances where the nature of the underlying transaction requires such an approach. In such a situation, the courts should give effect to the terms of the letter of credit.

36. In such a situation, a court may face the question of whether to look to the revision for a resolution of an issue addressed in the revision where Prior UCC Article 5 is silent. The answer may turn on whether or not the specific provision of Revised UCC Article 5 is declaratory of the common law. Where it is, it might be advisable for a court to turn to the revised statute by analogy. Some guidance exists in decisions made under Prior UCC Article 5 during the transition period. *See, e.g.,* Bank of Joliet v. Firststar Bank Milwaukee, No. 96C1145, 1997 WL 619875 (N.D. Ill. Sept. 30, 1997) (using the choice of law rule of Revised section 5-116 to apply the law of a jurisdiction where Prior UCC Article 5 was in force and governed the transaction); Studwell, Inc. v. Korean Exch. Bank, 64 Cal. Rptr. 2d 538 (Ct. App. 1997) (referring to Revised UCC Article 5, not yet in force in California at the time of the decision, for a definition of letter of credit).

37. This possibility raises another question, namely, what choice of law rule a court should apply where the letter of credit selects Prior UCC Article 5 as enacted in a given state, either the forum state, or a different state. The traditional rule is the law of the forum. *See* DOLAN, *supra* note 1, at 4-15. However, in this situation it is necessary to ask whether that rule is Revised UCC section 5-116, Prior UCC section 1-105, or general choice of law rules, (particularly a prior letter of credit law of the forum). Given its policy of freedom of choice of law and forum, a court should apply Revised UCC Section 5-116 unless the undertaking specifically adopted a different choice of law rule. Should Prior UCC Section 1-105(a)(i) be applied, the forum might refuse to permit the selection of another law where there is no "reasonable relation" to the forum.

Arizona, Missouri, or New York,<sup>38</sup> which ousted the statute in favor of case law. If enforced, these provisions would have the effect of making Prior UCC Article 5 inapplicable to most letters of credit.

Apart from the philosophical question of why a jurisdiction might prefer the authority of case law to that of a statute, and particularly, to Revised UCC Article 5,<sup>39</sup> the answer should be the same as with the adoption of any other version of Prior UCC Article 5. Under letter of credit policy, as manifested in Revised UCC section 5-116, the parties possess complete freedom to choose any prior version of UCC Article 5, including original 1952 version, which was enacted only in Pennsylvania.

A variation of this option would be to make the letter of credit “subject to the law of [state] with the exception of Revised UCC Article 5 [citation] or any prior statutory version of letter of credit law.” For the same policy reasons that would permit adoption of a prior version of the statute and of those versions of the prior statute that permitted its renunciation for a given letter of credit, such a provision should be given effect under Revised UCC Article 5.

#### *D. Other State Versions of Revised UCC Article 5 (The Differences)*

Another option is issuance of a letter of credit subject to the version of Revised UCC Article 5 in force in another jurisdiction. The selection of another state’s version of Revised UCC Article 5 raises questions involving both the relative differences between the various versions of Revised UCC Article 5 and the case law that has developed in that jurisdiction.<sup>40</sup>

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38. See N.Y. U.C.C. § 5-102(4) (McKinney 1962).

39. As a result of careful drafting and accommodation with standard international letter of credit practice, however, the conflicts (real and perceived) between law and practice that were present in Prior UCC Article 5 are not present in Revised UCC Article 5. Consequently, this argument has no merit. Moreover, after more than half a century under the UCC Article 5 regime, it is virtually impossible to distinguish case law from UCC Article 5. To obtain “pure” pre-code letter of credit case law, one might need to revisit the relevant cases from the first half of the twentieth century.

40. While there is little case law at this time on many of the issues addressed by Revised UCC Article 5, that situation will change over time. Moreover, many of the decisions under Prior UCC Article 5 remain applicable to Revised UCC Article 5, especially with respect to collateral issues such as the availability of injunctive relief. Indeed, in such situations, differences can exist between federal and state courts sitting in the same jurisdiction. Compare *Network Alliance Group, LLC v. Cable & Wireless*, No. CIV02-644DWF AJB, 2002 WL 1205734 (D. Minn. May 31, 2002) (denying applicant’s request for a preliminary injunction because of insufficient proof of fraud and irreparable injury), and *New Orleans Brass, LLC v. Whitney Nat’l Bank*, 2001-2308 (La. App. 4 Cir. 5/15/02); 818 So. 2d 1057 (denying injunctive relief based on insufficient



Compared to Prior UCC Article 5, there have been relatively few non-conforming amendments to Revised UCC Article 5. Of these few, only Alabama has adopted a non-conforming amendment that affects the non-variable provisions of the Model Law, namely the deletion of Revised UCC section 5-106(d) forbidding perpetual letters of credit. Within this exception, there exist two principal types of non-conforming amendments, namely (1) judicial determination of standard practice; and (2) mandatory assessment of attorney's fees regarding most letter of credit issues in favor of the prevailing party.<sup>41</sup>

Under Revised UCC section 5-116, the selection of the law of Alabama raises significant policy questions with respect to perpetual letters of credit, since any other state forum will inevitably have enacted a statute that prohibits the variation of this provision. As will be discussed, this decision represents a public policy determination that perpetual letters of credit are contrary to fundamental letter of credit policies and that the parties are not able to create such undertakings. In deciding whether to enforce as perpetual a letter of credit that selects the law of Alabama, the forum should weigh the letter of credit policies underlying Revised UCC section 5-116 against 5-107(d) and base its decision on these factors rather than general choice of law or policy issues.

Four states have adopted non-conforming amendments to variable Revised UCC section 5-108(e).<sup>42</sup> This subsection provides

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evidence of material fraud), *with* *Intrinsic Values Corp. v. Superintendencia De Administracion Tributaria*, 806 So. 2d 616 (Fla. Dist. Ct. App. 2002) (enjoining confirming banks from honoring their confirmations over the objection of the beneficiary on the basis that the applicant met the requirements of UCC section 5-109, and that principles of comity supported the requested relief).

41. Other significant non-conforming amendments include altering the length of the statute of limitations (Alabama, Louisiana, and Pennsylvania), and indicating whether a security interest under 5-118(a) is granted only in a documented collateral or also extends to "any identifiable proceeds of the collateral" (Louisiana, Montana, Nevada, New York, Oklahoma, Rhode Island, and South Carolina). The latter amendment is meant to clarify that security interests under Revised UCC Article 5 apply to the proceeds of collateral as well as the collateral itself in the same way they do in Revised UCC Article 9.

42. Revised UCC Section 5-108(e) provides: "An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer's observance of the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice." U.C.C. § 5-108(e) (2003). Alabama, New Jersey, New York, and Wyoming have made non-conforming amendments to Revised UCC Section 5-108(e). See ALA. CODE § 7-5-108(e) (2006); N.J. STAT. ANN. § 12A:5-108(e) (2006); N.Y. U.C.C. LAW § 5-108(e) (Consol. 2006); WYO. STAT. ANN. § 34.1-5-108(e) (2006). The amendments either omit the last two sentences (New York and Alabama), omit the second sentence (Wyoming), or omit the phrase "of the issuer's observance"

that issuers of letters of credit shall observe the standard practice of financial institutions and relegates interpretation of the issuer's observance of the standard practice to the interpretation of the courts. This provision ensures that courts will not confuse their ability under common law to interpret the terms of a "trade code" such as UCP500, its revision, or ISP98 with a finding of fact to be decided by a jury.<sup>43</sup> Unfortunately, in the four states listed above, this issue was confused with the constitutional question of the right to trial by jury.<sup>44</sup> Even in those states that have not adopted the model code text, the courts should reach the same result under common law.<sup>45</sup>

Five states have non-conforming amendments to variable Revised UCC section 5-111(e), which depart from the American rule regarding attorney's fees and awards it to the prevailing party.<sup>46</sup> These non-conforming amendments resulted from concerns that it would unduly discourage litigation, a concern that appears to have been justified since the volume of letter of credit litigation related

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from the second sentence (New Jersey).

43. The last sentence of Prior UCC Article 1-205(2) states that "[i]f it is established that . . . a usage is embodied in a written trade code or similar writing the interpretation of the writing is for the court." U.C.C. § 1-205(2) (1957). The last sentence of Revised UCC Article 1-303(3) states that "[i]f it is established that . . . a usage is embodied in a trade code or similar record the interpretation of the record is a question of law." U.C.C. § 1-303(c) (2004).

44. See Margaret L. Moses, *The Impact of Revised Article 5 on Small and Mid-Sized Exporters*, 29 UCC L.J. 390 (1997) (arguing that Revised UCC Section 5-108(e) attempts to eliminate the jury's role in determining issuer liability by assigning the fact finding function regarding standard practice to the court); Margaret L. Moses, *The Uniform Commercial Code Meets the Seventh Amendment: The Demise of Jury Trials Under Article 5?*, 72 IND. L.J. 681 (1997). But see James E. Byrne, *Revised UCC Section 5-108(e): A Constitutional Nudge to the Courts*, 29 UCC L.J. 419 (1997) (explaining how Revised UCC section 5-108(e) was intended to favor judicial resolution of matters only when judicial resolution is constitutionally permissible and arguing that the section will withstand constitutional scrutiny).

45. Recent cases have reinforced the importance of the clarification. See, e.g., *Blonder & Co. v. Citibank*, 808 N.Y.S.2d 214 (App. Div. 2006). *Blonder & Co.* upheld the trial court's exclusion of expert testimony as to standard banking practice under the UCP because

where such a usage is embodied in a trade code such as the UCP or other writing, 'the interpretation of the writing is for the court' (UCC 1-205[2]). Thus, any interpretation of the UCP was properly made by the motion court, which properly refused to allow the expert to usurp its function as the sole determiner of law . . . .

*Id.* at 217 (internal citation omitted).

46. U.C.C. § 5-111(e) (1995) ("Reasonable attorney's fees and other expenses of litigation must be awarded to the prevailing party in an action in which a remedy is sought under this article."). The subsection does not apply to actions brought on any of the underlying contracts related to letters of credit, but only disputes regarding the letter of credit itself. *Id.* The Alabama, Connecticut, New Jersey, and Texas versions state that reasonable attorney's fees "may" (Revised UCC section 5-111(e) says "must") be awarded, while New York omits Revised UCC section 5-111(e) altogether.

matters continues to drop in the United States.<sup>47</sup> In part it is thought that this decline has been fueled by the calculation in the mind of plaintiffs, who might have otherwise filed doubtful suits for purposes of leverage that they may have to bear additional costs in the event that they do not prevail.

While none of these provisions go to the essence of Revised UCC Article 5, careful thought should be given to subjecting a letter of credit to the law of jurisdictions that have adopted non-conforming amendments.<sup>48</sup>

Another question that arises due to these variable non-conforming amendments is whether the forum would classify the non-conforming amendments regarding judicial interpretation of documents, attorney's fees, and the statute of limitations as procedural rather than substantive and instead apply its own law. While such an argument is possible, these nominally procedural provisions are intended to reinforce the substantive allocations of risks so as to protect the independent character of the letter of credit and should be treated as integrated with the rest of the selected statute.<sup>49</sup>

### *E. The Law of Another Country*

As indicated, under Revised UCC section 5-116(a), a letter of credit can select the law of any country whether or not there is a relation between the letter of credit and that country.<sup>50</sup> There are,

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47. See *Who's Suing Whom?*, DOCUMENTARY CREDIT WORLD (Inst. Int'l Banking Law & Practice, Montgomery Village, Md.), February 2001–2006, available at <http://iiblp.org/dcw.asp>.

48. Indeed, it is likely that the previous preeminence of New York in letter of credit case law may be considerably diminished as practitioners who work with letters of credit come to realize the serious disadvantages of New York's unfortunate deviations from the UCC, particularly since most letter of credit processing by major banks has moved from New York to other states.

49. For example, they prevent parties from bringing actions in the hope of leveraging payment (e.g., the applicant seeking injunctive relief on the basis that it has nothing to lose or the beneficiary bringing an action for wrongful honor since the applicant must indemnify the issuer). The provisions regarding interpretation were also crafted to assure uniform judicial application of the common law rule of the interpretation of a written undertaking. The statute of limitations is also a part of the entire package of remedies connected with the particular version of Revised UCC Article 5 that goes with the choice of that state's law.

50. Revised UCC Section 5-116(a) states:

the liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction chosen by an agreement in the form of a record signed or otherwise authenticated by the affected parties in the manner provided in Section 5-104 or by a provision in the person's letter of credit, confirmation, or other undertaking. The jurisdiction whose law is chosen need not bear any relation to the

however, issues where the forum may look to its own law (including its case law) notwithstanding the selection of another law.<sup>51</sup> Such a situation may arise where the law chosen does not address discrete issues in the case before it, where the issue is deemed to be procedural, or where public policy issues are involved.<sup>52</sup> While it is not possible to address here the issues that may arise, one should consider whether the selected letter of credit law is systematic. In weighing the approach to take in such a situation, letter of credit policies should be given more weight than other more general policies, regardless of the forum or law selected.

While there are many ways in which other countries could be classified for purposes of discussing the effect and desirability of applying their laws to a letter of credit, the most obvious distinction is that between countries that codify letter of credit law and those that do not. This article will adopt such a distinction. The remainder of this section considers the various available legal options along those lines.

### 1. Codified Letter of Credit Law

The United States is the only country that has enacted a comprehensive statutory regime that addresses letters of credit on a national basis. Although some foreign codes make a passing reference to letters of credit, none have implemented a systematic formulation of letter of credit law.<sup>53</sup> Nevertheless, there exist two important formulations that codify letter of credit law, namely the

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transaction.

U.C.C. § 5-116(a) (1995); *see also* *Hellenic Lines, Ltd. v. Embassy of Pak.*, 307 F. Supp. 947 (S.D.N.Y. 1969) (applying English law, even though it led to a contrary result in American law, where parties to a contract had selected English law), *aff'd in part, rev'd in part on other grounds*, 467 F.2d 1150 (2d Cir. 1972); RESTATEMENT (SECOND) CONFLICT OF LAWS § 187 cmt. c (1971).

51. U.C.C. § 5-116 cmt. 1.

52. The forum court is also likely to require proof of the applicable law (where it differs from the law of the forum) and operate under the presumption that it is the same as the law of the forum unless proven otherwise.

53. During the formulation of the UN LC Convention, the delegates were informed of certain references in national commercial laws that mentioned letters of credit. *See The Commercial Code: Corporate Structures and Business Contracts (amended version) of the Czech Republic and Slovak Republic*, Act No. 513/1991 Coll., §§ 682–691 (Letters of Credit) (Trade Links trans., 1994). In addition, there are some regulatory provisions containing requirements about letters of credit. *See* LC RULES AND LAWS: CRITICAL TEXTS, *supra* note 3, at 195.

UN LC Convention and the Chinese Letter of Credit Rules.<sup>54</sup>a. *The UN LC Convention*

The United Nations Convention on Independent Guarantees and Standby Letters of Credit has been adopted by eight countries.<sup>55</sup> It is a systematic codification of letter of credit law.<sup>56</sup>

54. The Justice Committee of the Supreme People's Court of the People's Republic of China, in the court's 1368th session, adopted rules concerning Letter of Credit Cases on October 24, 2005, which were promulgated on November 14, 2005, and effective as of January 1, 2006. Rules of the Sup. People's Ct. Concerning Several Issues in Hearing Letter of Credit Cases, Fa Shi [2005] No.13 [hereinafter *Chinese Letter of Credit Rules*], translated in INST. OF INT'L BANKING LAW & PRACTICE, RECENT LC RULES OF THE SUPREME PEOPLE'S COURT OF THE PRC (2006).

55. Letter of credit law and practice had long been a matter of interest to the United Nations Commission on International Trade Law ("UNCITRAL"). See generally The Secretary-General, *Standby Letters of Credit and Guarantees: Report of the Secretary-General*, ¶¶ 1, 8–12, delivered to the commission on International Trade Law, U.N. Doc. A/CN.9/301 (Mar. 21, 1988) (detailing the history of UNCITRAL's involvement from its first session in 1968). It was not until 1988 that the Commission formally turned its attention to the area, asking the Working Group on International Contract Practices to consider whether an international codification on letters of credit and bank guarantees was feasible and/or desirable. U.N. Comm'n on Int'l Trade Law, *Report on the Work of its Twenty-First Session*, ¶ 22, U.N. Doc. A/43/17 (June 27, 1988) [hereinafter UN Int'l Trade Law]. After answering both questions in the affirmative as a result of the deliberations of its twelfth session in November 1988, the Commission decided to proceed with the formulation of an international statute. Working Group on Int'l Contract Practices, *Report on the Work of its Twelfth Session*, ¶ 174, U.N. DOC. A/CN.9/316 (Nov. 21–30, 1988). It was adopted and opened for signature by the General Assembly by its resolution on December 11, 1995. *UN LC Convention*, supra note 13. It was ratified by seven nations, including the United States, which signed it on December 11, 1997. It has been adopted by Belarus, Ecuador, El Salvador, Gabon, Kuwait, Liberia, Panama, and Tunisia and came into force on January 1, 2000. As of August 2006, the United States had not yet ratified the convention. See U.N. Comm'n on Int'l Trade Law, *Report on the Work of Its Twenty-second Session*, ¶¶ 236–44, U.N. Doc. A/44/17 (July 27, 1989); U.N. Comm'n on Int'l Trade Law, *Report of the Working Group on International Contract Practices on the Work of its Twelfth Session*, ¶ 174, U.N. Doc. A/CN.9/316 (Nov. 21–30, 1988). The deliberations of UNCITRAL on the draft Convention are reflected in the report on the work of its twenty-eighth session in 1995. U.N. Comm'n on Int'l Trade Law, *Report on the Work of its Twenty-Eighth Session*, ¶¶ 11–201, U.N. Doc. A/50/17 (May 2–26, 1995). *UN LC Convention*, supra note 13 (for the text of the International Guarantees Convention); see *Explanatory Note by the U.N. Secretariat, U.N. Convention on Indep. Guarantees and Stand-by Letters of Credit*, U.N. Doc. A/CONF.9/431 (July 4, 1996) (reviewing the International Guarantees Convention) [hereinafter *Explanatory Note*], available at <http://www.uncitral.org/pdf/english/texts/payments/guarantees/guarantees.pdf>.

56. There are a variety of considerations that should be taken into account in deciding whether or not to use the UN LC Convention. Where literature on the Convention lists its relative advantages and disadvantages, its two primary advantages are: (1) sound rules on letter of credit fraud and injunctive relief and (2) deference to standard international letter of credit practice. N.J. LAW REVISION COMM'N, FINAL REPORT, UNIFORM COMMERCIAL CODE, REVISED ARTICLE 5—LETTERS OF CREDIT 4–5 (1996). While United States bankers and lawyers will prefer a version of Revised UCC Article 5 because it is more comprehensive, and is supported by a body of case law, the UN LC Convention has a significant advantage over the law of a nation that does not have any codification of letter of credit law in situations where the luxury of choosing one's own

A letter of credit can be issued subject to the UN LC Convention by selecting the law of a country that has adopted it. In such a situation, this choice would be given effect under Revised UCC section 5-116(a) even though the United States has not as of August 1, 2006 adopted the UN LC Convention.<sup>57</sup> Since the legal systems of these countries are not well-known, there may be some discomfort in adopting their law apart from the UN LC Convention, especially since this may incorporate additional and unanticipated aspects of these legal systems.

To subject a letter of credit to the UN LC Convention, two possible courses of action, designed to address this concern, must be considered. One involves limiting the scope of the choice of law to the UN LC Convention and, with respect to matters not covered by the Convention, making another alternative choice of applicable law or deferring to the law of the forum. Such a multifaceted selection would be enforceable under Revised UCC Article 5.

An alternative course would be to make the undertaking expressly subject to the UN LC Convention without any reference to a national law. Under general conflicts principles, such an approach would be given effect as incorporation of contractual terms by reference.<sup>58</sup> The difficulty with such a provision would be whether

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law is not available. It provides courts with a legal framework within which to resolve letter of credit problems that are aligned with standard international letter of credit practice and modern letter of credit law. Absent such a framework, courts are adrift even in a common law system, where decisions are reported and easily accessible. It also has the considerable advantage of providing a neutral set of rules that were drafted simultaneously in all the languages of the United Nations. Thus, versions of the UN LC Convention in Arabic, Chinese, English, French, Russian, and Spanish are readily available. *UN LC Convention*, *supra* note 13, available at [http://www.uncitral.org/uncitral/en/uncitral\\_texts/payments/1995Convention\\_guarantees\\_credit.html](http://www.uncitral.org/uncitral/en/uncitral_texts/payments/1995Convention_guarantees_credit.html) (the language of the text can be changed by clicking the appropriate hyperlink near the top frame of the page).

57. U.C.C. § 5-115(a) (1995). In countries that have adopted the Convention a different question exists: namely, how to opt out of the UN LC Convention. This question is necessary for standby and independent guarantees that are issued to beneficiaries in countries that have adopted the Convention, since UN LC Convention Article 1 makes its terms applicable “unless the undertaking excludes the application of the Convention.” Therefore, it is necessary to expressly exclude the Convention rather than make it affirmatively subject to local law. As is, the Convention is local law for a standby or independent guarantee that is within its scope according to United Nations Convention Article 1 subsections 1(a) and (b) and 3 (referencing Articles 21 and 22). According to United Nations Convention Article 1 subsection 2, the UN LC Convention does not apply to commercial letters of credit unless they expressly invoke its terms. *UN LC Convention*, *supra* note 13, art. 1.

58. See RESTATEMENT (SECOND) CONFLICT OF LAWS § 187 cmt. c (1971) (“[Parties] may incorporate into the contract by reference extrinsic material which may, among other things, be the provisions of some foreign law. In such instances, the forum will apply the applicable

the UN LC Convention's variability would be determined by Revised UCC section 5-103 or not. Since the UN LC Convention does not address variability expressly, a court applying the UN LC Convention as law would be compelled to articulate rules regarding its variability. In applying the UN LC Convention as a contract, the forum would certainly defer to the limitations of Revised UCC section 5-103(c).<sup>59</sup>

Since the UN LC Convention could be chosen as another system of law by selecting it under Revised section 5-116(a), and since both the Convention and the Revised UCC Article 5 were drafted in coordination, its application raises no policy issues.<sup>60</sup> Its selection in the abstract should be given effect as law and not just as contractual provisions, an approach that is more consistent with the liberal treatment of choice of law in the Revised section 5-116.

#### *b. Chinese rules*

Chinese letter of credit law has emerged over the last twenty-

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provisions of the law . . .").

59. U.C.C. § 5-103(c).

60. UN LC Convention Article 1 generally provides for expansive application based on the place of issuance, the rules of private international law, and, by reference to article 21, party choice. *UN LC Convention*, *supra* note 13, art. 1. UN LC Convention Article 1 subsection 2, which was intended to expressly permit application of the Convention to commercial letters of credit, can be interpreted to provide for the application of its rules to commercial letters of credit regardless of whether or not they have a nexus to a contracting state. *Id.* Subsection 2 states "[t]his Convention applies also to an international letter of credit not falling within article 2 if it expressly states that it is subject to this Convention." *Id.* UN LC Convention Article 4 subsection 1 defines "international letter of credit" by stating "[a]n undertaking is international if the places of business, as specified in the undertaking, of any two of the following persons are in different States: guarantor/issuer, beneficiary, principal/applicant, instructing party, confirmer." *Id.* art. 4. The reference to "not falling within article 2" refers to United Nations Convention Article 2 subsection (1), which describes undertakings covered by the Convention, namely independent guarantees or standby letters of credit. *Id.* art. 2. Letters of credit "not falling within article 2" are therefore commercial letters of credit. *Id.* Thus, according to UN LC Convention Article 1 subsection 2, a commercial letter of credit that "expressly states that it is subject to" the United Nations Convention regardless of the presence of any of the parties in a contracting state will be, so long as it qualifies as an "international letter of credit." Qualification as an international letter of credit is necessary because that subsection does not make any requirements regarding Contracting States as does Article 1 subsection 1. *Id.* art. 1. Further, the Explanatory Note by the UN Secretariat states that "the Convention does recognize a right of parties to international letters of credit other than stand-by letters of credit to 'opt into' the Convention (article 1(2))." See *Explanatory Note*, *supra* note 55, at ¶16-17 (referring to choice of law rules worldwide and the general principle of choice of law). Of course, were this interpretation accepted, the decision as to whether or not the Convention could be applied is one that must be made under the choice of law rules of the forum.

five years.<sup>61</sup> Over the past twenty years, China has experienced a remarkable revolution in its approach to letter of credit law and practice that in many ways parallels its economic emergence.

Although there is no system of binding case law,<sup>62</sup> pursuant to the Chinese Constitution, the Supreme People's Court has promulgated *Rules of the Supreme People's Court Concerning Several Issues in Hearing Letter of Credit Cases* effective January 1, 2006.<sup>63</sup> They are, in effect, the letter of credit law of China since, they are binding on all Chinese courts and there is no statute or other legislative provision of the Chinese National People's Congress.<sup>64</sup>

In considering whether to select the Chinese Letter of Credit Rules in a Revised UCC Article 5 jurisdiction, there are several questions to consider. Indeed, the Chinese Letter of Credit Rules are likely to evolve. Unlike a statute, which is only likely to apply to letters of credit issued after the effective date of the statute, the Chinese Letter of Credit Rules would be applicable to any letter of

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61. Twenty-five years ago, Chinese commercial law was in a very basic formative stage, with arbitration as the normal means of settling civil disputes, due in large part to concerns about the judicial system. Chinese letter of credit law did not exist. Beginning with the important work of the Supreme People's Court, in recent years Chinese courts have rendered a series of decisions that reflect a maturing letter of credit jurisprudence. Such progress may be attributed to the Chinese government's willingness to provide its judges with opportunities for both education and interaction with legal colleagues in other legal systems. Nonetheless, many of the Chinese decisions were both contradictory and confusing. The texts of Chinese letter of credit decisions have also been widely circulated in China. Although the Chinese legal system is based on the civil law model, in which even the decisions of the Supreme People's Court are not binding on other courts in different cases, the opinions of the Supreme People's Court and certain intermediate appellate courts in letter of credit matters have been widely distributed and are of considerable guidance to trial and appellate courts. This work has largely been undertaken by Mr. Jin Saibo of the Beijing Zhonglun law firm, a leading member of the Chinese commercial bar. In addition to conducting seminars for judges throughout China, he has written three influential books on Chinese letter of credit law. *See, e.g.,* Provisions of the PRC Supreme People's Court Concerning Jurisdiction over Foreign-Related Civil and Commercial Cases, *translated in* Jin Saibo, *Institute of International Banking Law & Practice*, (2006) [www.iiblp.org](http://www.iiblp.org).

62. *See id.*

63. *See supra* note 54.

64. The Chinese Letter of Credit Rules address a number of important issues, including the independence of the letter of credit undertaking, the standard of compliance, deference to standard international letter of credit practice (permitting their application where the undertaking is issued subject to them and providing for their application as appropriate even where they are not expressly made applicable), the discretion of the issuer to approach the applicant for a waiver, the implications of a decision to waive discrepancies, what constitutes letter of credit fraud, and the criteria for issuance of orders freezing payment. The Chinese Letter of Credit Rules reflect the influence of the UN LC Convention and Revised UCC Article 5, providing a useful skeletal framework for the evolution of Chinese letter of credit law that should be the envy of most other legal systems, which must rely on erratic judicial decisions.



credit regardless of when the instrument was issued.

Furthermore, one must ask whether there is an intention to render the letter of credit subject to Chinese Letter of Credit law or merely make the Chinese Letter of Credit Rules applicable. The Chinese Letter of Credit Rules are linked to the application of Chinese law, and, apart from Chinese Law, they would operate as contractual rules under Revised UCC Article 5.<sup>65</sup> Under Revised UCC section 5-116, an undertaking can select Chinese law, and, by doing so, make the Chinese Letter of Credit Rules applicable. An undertaking could also be made subject to the Chinese Letter of Credit Rules in the same manner as rules of practice.<sup>66</sup>

## 2. The Law of Jurisdictions Without Codified Letter of Credit Law

As indicated, most countries do not have a codified system of letter of credit law.<sup>67</sup> In considering whether to issue a letter of credit subject to such a legal system, there exist a variety of factors that one should consider. One major question is whether or not the jurisdiction follows the civil or common law. Another question is what type of letter of credit undertaking it is, whether it is subject to a rule of practice and, if so, which one. A third question is the extent to which courts have considered letter of credit cases, and what the treatment of letter of credit issues has been—to the extent that it can be determined. A fourth question is whether treatises or other materials are available in a language that is accessible to the courts. A fifth question is whether local statutes that could affect the undertaking exist. As is often the case, the choice of forum may have greater impact on the outcome than the choice of applicable law.

As a general proposition, case law is not ideal for the

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65. It should also be noted that the Chinese courts have been fairly aggressive in exercising jurisdiction over letter of credit cases with any nexus to China. See INST. OF INT'L BANKING LAW & PRACTICE, 2006 ANNUAL SURVEY OF LETTER OF CREDIT LAW & PRACTICE 440–43 (2006) [*hereinafter* 2006 ANNUAL SURVEY] (abstracting Sichuan Emeishan Imp. & Exp. Co. v. Korea Shinho Corp., MIN SI ZHONG ZI No.28 (SUP. PEOPLE'S CT. GAZ., Sept. 28, 2004) (overturning an injunction in favor of a Chinese applicant against reimbursement by a Chinese issuer to a Korean negotiating bank)); *Litigation Digest*, DOCUMENTARY CREDIT WORLD, Sept. 2006, at 11 (abstracting Indus. Bank of Korea (Seoul) v. Lianyungang Kuchifuku Foods Co., SU MIN SAN ZHONG ZI No. 052 (JIANGSU PEOPLE'S HIGH CT., \_\_\_, 2003) (upholding judgment against a Korean issuer in favor of a Chinese beneficiary for wrongful dishonor

66. See U.C.C. § 5-116(a) (2003).

67. See *id.* § 5-116(e).

development of sound letter of credit law. By the end of the nineteenth century, it was clear that complex promises embodying commercial paper required a statutory framework, since case law was inadequate to address the various nuances involved without producing confusion and uncertainty.<sup>68</sup> It should therefore not be surprising that the same lesson applies even more pointedly to letters of credit.

The most apparent example of the inadequacy of the case law approach exists in English Letter of Credit law, a highly sophisticated commercial law system. Unlike the situation in many countries, there are a number of English Letter of Credit cases. The precedent embodied in English cases has proved to be problematic, since the courts have been compelled to build upon prior decisions, including *dicta*. In the past decade, the English courts have produced several decisions that not only disrupted letter of credit practice internationally, but also continue to represent a source of considerable confusion to this day.<sup>69</sup> The issues include: (1) whether a document must be marked as an original; (2) whether a confirming bank can be reimbursed where it discounts its deferred payment undertaking; (3) consequential damage remedies against transferring banks handling documents drawn under a letter of credit; and an abiding distortion of the law of letter of credit fraud and the protection of nominated banks.<sup>70</sup> Underlying much of this distortion is a serious misunderstanding of the role of law in interpreting letter

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68. WILLIAM E. BRITTON, *HANDBOOK OF THE LAW OF BILLS AND NOTES* 214 (West Publishing Co. 1943).

69. See, e.g., Adam Johnson, *Letters of Credit and Original Documents—Again*, J. INT'L BANKING L., Sept. 1999, at 287, *passim*.

70. See, e.g., *Glencore Int'l A.G. v. Bank of China*, [1996] 1 Lloyd's Rep. 135 (A.C.) (Eng.) (ruling that a wet ink signed document was not an original because it was not marked original); *Kredietbank v. Midland Bank, PLC*, [1999] 1 All E.R. (Comm.) 801 (A.C.) (Eng.) (ruling that an issuer was not entitled to reject a document that was clearly an original despite the fact that it was not marked as original); *Credit Industriel et Commercial v. China Merchants Bank*, [2002] 2 All E.R. (Comm.) 427 (Q.B.) (declining to apply the decision of the intermediate appellate *Glencore* court); *Banco Santander v. Banque Paribas* [2000] 1 All E.R. (Comm.) 776 (A.C.) (Eng.) (holding that issuer did not have to reimburse confirming bank that discounted because UCP 500 does not authorize discounting of deferred payment obligations, and legal protection for discounting of acceptances does not apply to deferred payment obligations); *Jackson v. Royal Bank of Scot.*, [2005] 1 Lloyd's Rep. 366 (H.L.) (Eng.) (holding that an issuer is liable for breach of an obligation of confidence where the issuer forwards a transferee beneficiary's pricing information to applicant instead of substituting the beneficiary's documents under a transferable credit); see also JAMES E. BYRNE, *THE ORIGINAL DOCUMENTS CONTROVERSY, FROM GLENCORE TO THE ICC DECISION* (1999).

of credit practice and in assessing the testimony of experts.<sup>71</sup>

Another specific issue that may escape notice is the presence of statutes in a jurisdiction that may impact the independence of guarantees or similar undertakings. While such provisions should not be applicable to commercial letters of credit or, hopefully, standby letters of credit, there is a possibility of confusion between dependent (suretyship or accessory) guarantees and independent ones. This confusion can be compounded by the name given to the undertaking and its terms. In such situations, it is ideal to issue the undertaking subject to rules of practice that establish its independent character.<sup>72</sup> Revised UCC Article 5 contemplates its application to independent guarantees.<sup>73</sup>

In any event, Revised UCC section 5-116(a) permits selection of the law of countries that have no statutory system of letter of credit law. Where there is no indication of that law, however, the forum is likely to presume that its version of Revised UCC Article 5 states the applicable law. If the intent is to avoid the application of a specific provision of Revised UCC Article 5 and the applicable law does not provide an alternative rule, the issue should be expressly addressed in the undertaking.

#### IV. VARYING SPECIFIC PROVISIONS OF REVISED UCC ARTICLE 5

Apart from opting out of Revised UCC Article 5 by the choice of another law, it is also possible to modify or exclude the effect of discrete provisions by the terms of the letter of credit.<sup>74</sup> This section examines how variation is treated in Revised section 5-103(c), listed exceptions to variation, additional qualifications, and the use of rules

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71. On the whole, the English courts tend to treat rules of practice as if lawyers drafted them instead of seeking to understand and effectuate their purposes. They also treat expert testimony as if it represents the individual and personal experience of the expert instead of using it to determine the purpose and system behind the practices involved. *See generally* Louis Blom-Cooper, *Experts and Assessors: Past, Present and Future*, 21 C.J.Q. 341 (2002).

72. *See* TTI Team Telecom Int'l Ltd. v. Hutchison 3G UK Ltd., [2003] 1 All E.R. (Comm.) 914 (Q.B.) (Eng.) (denying application for an interim injunction on a drawing where bond was an independent guarantee, because applicant failed to establish by clear evidence that it is likely to be able to prove fraud, abuse, or bad faith, or that the call is a nullity).

73. *See* 12 C.F.R. §§ 7.1016–.1017 (2006).

74. The term “vary” is retained as applicable to all categories. The term “modify” and its variations is used to describe changes in the application of a provision in Revised Article 5 without excluding it. The term “exclude” is used to describe a provision in a letter of credit that would make a provision of Revised UCC Article 5 non-applicable to that letter of credit.

of practice and letter of credit terms to vary its provisions.<sup>75</sup>

### *A. Generally*

#### 1. Explicit Non-Variability: Revised UCC Article 5 Approach to Variation

The general approach of the UCC to variation of its rules, as reflected in Revised UCC section 1-302 and its Official Comments, is to affirm the principle of freedom of contract.<sup>76</sup> Revised UCC section 5-103(c), however, does not offer freedom of contract as its rationale. The foundation of this provision is germane to the entire Revised UCC Article 5: that the primary source of interpretation of letter of credit law is letter of credit practice.<sup>77</sup> Under that practice, the limits to variability are, in effect, the limits of the undertaking operating as a letter of credit. Where the terms contained in various obligations are no longer those of a letter of credit, the response under letter of credit practice is not to “forbid” the variation, but instead to treat the undertaking as something other than a letter of credit. It may be enforceable as something else, but it is not a letter of credit. To a considerable extent, Revised UCC Article 5’s approach to variability reflects this theory.

The novelty of this approach is magnified because Revised UCC Article 5 was the first UCC Article to attempt to delineate provisions whose effect cannot be varied. Subsequently, the 1998 revision of UCC Article 9 took a somewhat similar, but more traditional approach.<sup>78</sup> The 1998 Version of UCC Article 9, adopted after

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75. See generally Stern, *supra* note 34, at 524–26 (explaining that parties modifying specific provisions by agreement must comply with revised UCC Section 5-103(c)).

76. Effects of UCC provisions may be varied by agreement “[e]xcept as otherwise provided in subsection (b) or elsewhere in [the Uniform Commercial Code].” U.C.C. § 1-302(a) (2003). This section “states affirmatively at the outset that freedom of contract is a principle of the Uniform Commercial Code.” *Id.* cmt. 1; see also U.C.C. § 1-102(3) (1952) (amended 2001); *id.* § 1-102 cmt. 2.

77. See U.C.C. § 5-103 cmt. 2 (1995).

78. The treatment of variation by UCC Article 9 has been complex. The original 1952 text provided that its provisions could not be varied unless expressly permitted. Section 9-501(3) (1952) provided: “(3) The enumeration of rights in subsections (1) and (2) does not purport to be exhaustive. The rules stated in this Part which give rights to the debtor and impose duties on the secured party may be waived or varied only as provided in this Part.” U.C.C. § 9-501(3) (1952) (amended 2003). Its Official Comment 4 stated:

In the area of rights after default our legal system has traditionally looked with suspicion on agreements designed to cut down the debtor’s rights and free the secured party of his duties: no mortgage clause has ever been allowed to clog the equity of

Revised UCC Article 5 was drafted, states that those 13 specific provisions may not be modified and explains the policies underlying these limitations in its Official Comments.<sup>79</sup>

The other Articles of the UCC rely on a loose combination of specific limitations in various provisions,<sup>80</sup> the application of general principles of reasonableness with respect to obligations,<sup>81</sup> and the application of common law rules and principles of statutory construction. Section 1-302 Official Comment 1 notes that “specific exceptions vary in explicitness: the statute of frauds found in section 2-201, for example, does not explicitly preclude oral waiver of the requirement of a writing, but a fair reading denies enforcement to such a waiver as part of the ‘contract’ made unenforceable . . . .”<sup>82</sup> This approach is consistent with the principle enunciated in Revised UCC section 1-103(b) that its provisions are to be supplemented by principles of law and equity “[u]nless displaced by the particular provisions . . . .”<sup>83</sup>

This approach is not surprising since the common law does not have a rigorous theoretical approach to mandatory and non-mandatory provisions. Unlike the civil law, its approach has been

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redemption. The default situation offers great scope for overreaching; the suspicious attitude of the courts has been grounded in common sense. Subsection (3) of this Section contains a codification of this longstanding and deeply rooted attitude: despite the provisions of Section 1-102 the rules of this Part which give rights to the debtor and impose duties on the secured party may be varied only as provided in this Part.

*Id.* § 9-501 cmt. 4. With lengthy adjustments allowing standards that were not manifestly unreasonable to be formulated for specific sections, this attitude continued through the 1972 Version. See U.C.C. § 9-501(3) & cmt. 4 (1972) (amended 2003) (restating the comments in the 1952 version).

79. See U.C.C. § 9-602 cmts. 2, 3 (1998) (amended 2003).

80. See U.C.C. § 4A-202(f) (1989) (“Except as provided in this section and in section 4A-203(a)(1), rights and obligations arising under this section or section 4A-203 may not be varied by agreement.”).

81. Revised UCC Section 1-302(b) limits the variability of the obligations of good faith, diligence, reasonableness, care, and reasonable time requirements, providing that they may not be disclaimed and requiring that any alternative standard be not manifestly unreasonable. See U.C.C. § 1-302(b) (2003); U.C.C. § 1-102 (1957) (amended 2003).

82. U.C.C. § 1-302 cmt. 1 (2003).

83. Revised UCC Section 1-103(b) provides in full “[u]nless displaced by the particular provisions of [the Uniform Commercial Code], the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause supplement its provisions.” U.C.C. § 1-103(b) (2003); see also U.C.C. § 1-103 (1957) (amended 2003).

pragmatic but nonetheless workable.<sup>84</sup>

On the other hand, Revised UCC section 5-103(c) does not rely on this general approach. Instead, it states that the effect of all its provisions can be varied with the exception of those provisions listed. While it requires some interpretation, this approach is intended to retain the focus on letter of credit issues when it comes to variability, and not to digress into general issues of commercial or common law. The result is a statute that is highly flexible and responsive to developments with basic minimal features necessary to preserve its integrity. Outside of the listed exceptions, common law courts applying letter of credit law are to police what is and is not a letter of credit, instead of worrying about public policy issues. With few exceptions, this innovative approach is effective. Even in those few areas where its application is not altogether smooth, it produces a result that is consistent with international letter of credit practice.

## 2. Other Features of Revised UCC Section 5-103(c)'s Approach to Variation

This section will study the features of Revised UCC section 5-103, its approach to variation, the specific items listed, and application of its approach to other provisions of Revised UCC Article 5.

### *a. "Agreement"*

Revised UCC section 1-302 speaks of variation "by agreement."<sup>85</sup> While this notion is apt for bilateral undertakings, it is inapt for undertakings such as letters of credit and obligations that are unilateral and whose terms do not represent an "agreement" in any usual sense of the word. Where a letter of credit's terms vary provisions of the UCC, it is because the terms are stated or contained in rules of practice to which the letter of credit is subject.

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84. U.C.C. § 1-103(b) (2004). One commentator explained:

Lawyers on the continent of Europe have been more clear than we have on this issue. They have known for a long time the general distinction between *jus dispositivum*, the rule that applies unless the parties agree otherwise, and *jus cogens*, the binding rule which the parties cannot set aside by contract. And they have sought, by provisions in their Codes and otherwise, to make clear which *jus* was which.

Bunn, *supra* note 10, at 62.

85. U.C.C. § 1-302 (2001); *see also* U.C.C. § 1-102 (1952) (amended 2001) (similar to revised section 1-302).

Recognizing this reality, Revised UCC section 5-103(c) (Scope) provides that the effect of the article “may be varied by agreement or by a provision stated or incorporated by reference in an undertaking.”<sup>86</sup>

*b. “Varied”*

The term “varied” is not defined in the UCC, and the common law does not have a sophisticated jurisprudence with respect to mandatory and non-mandatory provisions. While “vary” might be interpreted to mean “opting out” or “contracting out” of Revised UCC Article 5 by the choice of another law, it is not so used in Revised UCC Article 5. Rather, it is used to refer to an adjustment to the statute by modification or exclusion of a discrete portion, assuming that the statute otherwise applies. As used in this paper, where such variations are total, they are said to be “excluded,” and where they change the effect of the provision by deleting a portion while leaving it in effect or adding something, they are said to “modify” it.<sup>87</sup>

*c. What may be varied: the effect of the article*

Both Revised UCC Articles 1 and 5 do not admit variation of a statutory provision as such. Instead, they speak of variation of its effects. This approach reflects the technical reality that only a legislative amendment can “vary” the statute itself. Absent such an action, it remains as adopted.<sup>88</sup> Where permissible, what is varied is the effect that otherwise would have resulted from the application of the statute.<sup>89</sup>

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86. U.C.C. § 5-103(c) (1995). Revised UCC Section 5-116(a) reflects a similar approach, looking to the undertaking as an alternative to an agreement. *Id.* § 5-116(a); *see supra* note 25.

87. This distinction is of significance at least with respect to those obligations of good faith, reasonableness, care, and diligence that cannot be disclaimed (or excluded), but as to which standards of performance that are not manifestly unreasonable can be provided under Revised UCC Section 1-302(b). While the term disclaimed is used, an exclusion would be equally unwelcome and the latter term is broader than disclaimer but encompasses it. Moreover, there is no such precision in practice or in the cases and the precise sense in which the term is used must be determined from its context where this distinction would produce a different result.

88. U.C.C. § 1-302 cmt. 1 (2001) (“[T]he meaning of the statute itself must be found in its text, including its definitions, and in appropriate extrinsic aids; it cannot be varied by agreement.”); *see also* U.C.C. § 1-102 cmt. 2 (1952) (amended 2001) (making an identical statement).

89. According to Hawkland and Miller:

Thus private parties cannot make an instrument negotiable within the meaning of

*d. "Stated"*

Another question not fully addressed in Revised section 5-103(c) (Scope) is the degree to which an attempted variation of the effect of a variable provision of Revised Article 5 must be explicit. According to Revised section 5-103(c), the provision must be "stated" unless a contrary agreement or rule of practice, that has the effect of varying a provision of Revised UCC Article 5, is incorporated by reference.<sup>90</sup>

There is no requirement, however, that there be an express reference to the variation of the statute in the letter of credit or other document where a provision is stated that differs from that of a variable provision in Revised UCC Article 5. On the other hand, there may be some situations where the careful drafter will want to leave no possibility of doubt that the effect of the statute is to be varied.

*B. Non-Variable Provisions in Revised UCC Article 5*

Revised UCC Article 5 does not use one term or phrase for its provisions that may not be varied. Revised UCC section 5-103(c) lists them as exceptions to the general rule of variability. The term "exception" requires additional words in order to give it context.<sup>91</sup> Revised UCC section 5-116(c)(iii) refers to the exceptions of Revised UCC section 5-103(c) as "nonvariable provisions," a term also used in its Official Comment 3.<sup>92</sup> Other Official Comments use the term "invariable" or the phrase provisions "where variation is

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Article 3 except as provided in Section 3-104; nor can they change the meaning of such terms as "bona fide purchaser," "holder in due course," or "due negotiation," as used in the Uniform Commercial Code. But an agreement can change the legal consequences that would otherwise flow from the provisions of the Uniform Commercial Code. "Agreement" here includes the effect given to course of dealing, usage of trade and course of performance by Sections 1-201 and 1-303; the effect of an agreement on the rights of third parties is left to specific provisions of the Uniform Commercial Code and to supplementary principles applicable under Section 1-103. The rights of third parties under Section 9-317 when a security interest is unperfected, for example, cannot be destroyed by a clause in the security agreement.

1 WILLIAM D. HAWKLAND & FREDERICK H. MILLER, UNIFORM COMMERCIAL CODE SERIES § 1-302 (West 2002).

90. See U.C.C. § 5-103(c) (1995).

91. See *id.*

92. See *id.* § 5-116(c)(iii); see also *id.* § 5-116 cmt. 3 (referring to exceptions as "non-variable terms").



prohibited.”<sup>93</sup>

The starting point in assessing the extent to which Revised UCC Article 5 permits the effect of its provisions to be varied is the list of exceptions in Revised UCC section 5-103(c).<sup>94</sup>

Two questions must be asked of each of these provisions: (1) what is the scope of the exception, and (2) where applicable, what are the limits to the standards that may be set. Following this analysis, it will be asked whether or not there are implicit limitations of the variability of the effect of other provisions of Revised UCC Article 5 based on the nonvariable provisions.

### 1. Revised Section 5-103

Revised UCC section 5-103(c) provides that Subsections (a), (c), and (d) are exceptions to the rule that the effect of the provisions of Revised UCC Article 5 may be varied.<sup>95</sup>

#### *a. Revised UCC section 5-103(a) (scope of application)*

Revised section 5-103(a) states the scope of Revised UCC Article 5, limiting it to letters of credit<sup>96</sup> and transactions arising out of letters of credit.<sup>97</sup>

#### *b. Revised UCC section 5-103(c) (variation of the statute)*

Section 5-103(c) quite properly provides that the effect of the scope provision cannot be varied.<sup>98</sup> Since the statute represents the law applicable to independent and related undertakings, its application cannot be expanded or contracted by private agreement. If an undertaking is independent, then it falls under Revised UCC Article 5 unless another law is chosen.

These statements, however, disguise an important aspect of

93. *See id.* § 5-103 cmt. 2. “Invariable” references section 1-102(3) and “where variation is prohibited” references variation by issuing a credit subject to the UCP. *See id.*

94. *Id.* These exceptions are 5-103 (a) and (d): “Sections 5-102(a)(9) and (10), 5-106(d), and 5-114(d), and except to the extent prohibited in Sections 1-102(3) and 5-117(d) . . . .” *Id.*

95. *See id.*

96. “Letters of Credit” are defined in Revised UCC Section 5-102(a)(10) and include all letter of credit type undertakings, however described. *Id.* § 5-102(a)(10).

97. Transactions arising out of letters of credit would include those transactions covered by the Article such as advices, confirmations, and assignments as well as certain aspects of reimbursement undertakings. “This article applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit.” *Id.* § 5-103(a).

98. *See id.* § 5-103(c).

party choice, namely whether or not the undertaking is structured as independent.<sup>99</sup> In most cases, the status of the undertaking will be apparent. There are, however, a significant group of undertakings whose classification requires consideration and judgment. There are a variety of factors that affect this determination, none of which by themselves are decisive. They include the name used for the undertaking,<sup>100</sup> the presence and significance of non-documentary requirements, the form or format used, and whether the undertaking is issued subject to letter of credit rules of practice or statute. Because these factors are affected by the drafting of the undertaking and influence its classification, its formulation can, in effect, significantly affect whether or not it falls within the scope of Revised UCC Article 5.

For example, an undertaking labeled a “bond” that is issued subject to ISP98, but contains non-essential non-documentary conditions and recitals, would properly be treated as an independent undertaking.<sup>101</sup> Likewise, a statement in a so-called “guarantee” that it is subject to Revised UCC Article 5 would not be decisive but could be very influential. While the undertaking cannot effectively render itself subject to Revised UCC Article 5, doing so may signal that it was intended to be independent.

As a result, the effect of this limitation is retroactive. An undertaking cannot be rendered subject to Revised UCC Article 5 if it is decided that it is not subject to it. However, being issued subject to Revised UCC Article 5, or having other attributes that signal that it is intended to be, and is, independent may tip the scales in favor of (or against) its application.

To some extent, what falls within the definition of a letter of credit will also affect the question of scope. Although this definition

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99. Revised UCC Section 5-103 Official Comment 1 distinguishes dependent undertakings such as suretyship or accessory guarantees as a type of undertaking to which Revised Article 5 was not intended to be applied. *See id.* § 5-103 cmt. 1.

100. *Id.* § 5-102 cmt. 6 (observing that “[t]he label on a document is not conclusive”).

101. While such cases are more common in European courts because of the confusion there between suretyship (accessory) and independent guarantees that prevails in law and practice, they also occur in the United States on occasion. *See, e.g.,* *Hataway v. Estate of Nicholls*, 893 So. 2d 1054 (Miss. 2005) (concluding that a letter of guarantee was not a bid for cash because a condition that clear title be delivered could not be met); *J.P. Doumak, Inc. v. Westgate Fin. Corp.*, 776 N.Y.S.2d 1 (App. Div. 2004) (holding that the undertaking involved in the transaction was a standby letter of credit, notwithstanding its label, “guaranty”, and was subject to Revised UCC Article 5).

is listed as an exception to the provisions whose effects can be varied, it is subject to many of the same considerations as the scope provision. There is constant pressure to create letter of credit-like undertakings or to reduce the letter of credit qualities of those undertakings. Here, too, what is stated in the undertaking can influence this decision.<sup>102</sup>

*c. Revised UCC section 5-103(c) (variation of the statute)*

Revised UCC section 5-103(c) excepts itself from the provisions whose effect can be varied.<sup>103</sup> Given the internal logic that flows from its approach of listing section, such a provision makes sense although it ought to be obvious on consideration of its meaning and purpose.

*d. Revised UCC section 5-103(d) (independence)*

Section 5-103(d) is Revised UCC Article 5's clearest formulation of the independence principle, which is central to the notion of what constitutes a letter of credit.<sup>104</sup> The effects of the

102. It may, for example, be asked what difference exists between a straight revocable letter of credit and an undertaking that provides the applicant with the ability to revoke the authority of the bank to pay with notice to the beneficiary or to do so for stated reasons. Similarly, it may be asked whether a pre-advice or an irrevocable reimbursement undertaking is a letter of credit-type undertaking under this provision although UCP500 Article 11(c) treats it as such, as do UCP600 Article 11(b) and URR525 Article 2(g). Does this provision render it a UCC Article 5 instrument? Or does the provision in UCP500 Article 9(b) render a so-called "silent confirmation" not a letter of credit undertaking because the UCP teaches us that it is not a confirmation? UCP500 Article 9(b) states:

A confirmation of an irrevocable Credit by another bank (the "Confirming Bank") upon the authorisation or request of the Issuing Bank, constitutes a definite undertaking of the Confirming Bank, in addition to that of the Issuing Bank, provided that the stipulated documents are presented to the Confirming Bank or to any other Nominated Bank and that the terms and conditions of the Credit are complied with . . . .

UPC500, *supra* note 5; *see also* Dibrell Bros. Int'l v. Banca Nazionale del Lavoro, 38 F.3d 1571, 1578 (11th Cir. 1994) ("The UCC does not preclude common law recovery for breach of a contract to silently confirm a UCC-governed letter of credit."); *Evans v. Beogradaska Banka*, 46 U.C.C. Rep. Serv. 2d (CBC) 1083, 1090 (S.D.N.Y. 2002) (stating that an issuer is obligated to reimburse when it authorizes a bank to confirm and that bank honors or when it undertakes to reimburse on receipt of documents).

103. U.C.C. § 5-103(c) (1995).

104. UCC Section 5-103(d) states:

Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.

independence of the issuer's obligations under a letter of credit to a beneficiary or nominated bank cannot be varied.

While the limitation on variability does not expressly apply to a transferee beneficiary, its application may be inferred since "[b]eneficiary includes a person to whom drawing rights have been transferred under a transferable letter of credit" under Revised UCC section 5-102(a)(3).<sup>105</sup>

Although the formulation of the independence doctrine does not mention the documentary character of the letter of credit undertaking, this aspect of independence is also encompassed because it is so central. The provision of Revised UCC section 5-108(g), which provides that non-documentary conditions are to be disregarded, can be varied up to a point.<sup>106</sup> However, the core concept of the documentary character cannot be varied without also varying the independence doctrine. To provide that the obligation of the issuer turns on whether or not there is performance of a non-documentary condition makes the issuer dependent on an underlying obligation.

There are, however, other aspects of the reach of the of the independence doctrine's nonvariability that are less apparent. They include whether it can be inferred to apply to a confirmer, and the extent to which the fraud exception to the independence doctrine (codified in Revised UCC section 5-109) can be varied. These questions are considered in connection with the nonvariability of the term "letter of credit," and under the treatment of fraud and forgery below.

It should be noted that, as with other nonvariable provisions, the formulation of the obligations can itself affect whether it is

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*Id.* § 5-103(d).

105. *Id.* § 5-102(a)(3).

106. *See id.* § 5-108(g). For example, the issuer could obligate itself to pay against a document that fulfilled that condition. This option was an alternative proposed by the Joint United States Council on International Banking, Inc./American Bar Association (USCIB/ABA) Task Force Report. *See Task Force, supra* note 3, at 1546. Likewise, an issuer could obligate itself to go to a website and view data or even ascertain a fact. Such a step is possible under the Electronic Uniform Customs and Practice ("eUCP"), which contains rules formulated by the ICC to supplement the UCP to accommodate electronic presentations. INT'L CHAMBER OF COMMERCE, SUPP. TO THE UNIF. CUSTOMS & PRACTICE FOR DOCUMENTARY CREDITS FOR ELEC. PRESENTATION (EUCP) (2002) (ICC Pub. No. 500/3) [hereinafter EUCP], *reprinted in* LC RULES AND LAWS: CRITICAL TEXTS, *supra* note 3, at 25; *see also* JAMES E. BYRNE & DAN TAYLOR, ICC GUIDE TO THE EUCP (2002) (explaining the implications for independence of reference to an external source on the internet).

categorized as a letter of credit. Thus, an undertaking whose core obligations are dependent would not be classified as a letter of credit.

## 2. Revised Section 5-102 (Definitions) (a)(9) (“Issuer”) and (10) (“Letter of Credit”)

Revised UCC section 5-103(c) provides that subsections 5-109(a)(9) and (10) are exceptions to the rule that the effect of Revised UCC Article 5’s provisions may be varied.<sup>107</sup>

The inclusion of some but not all the definitions in Revised UCC section 5-102 as exceptions suggests that the effect of the other definitions can be varied. While discouraged, section 5-103 Official Comment 3 concedes as much.<sup>108</sup> The variability of the effect of definitions in Revised UCC Article 5 is discussed later.

### *a. Revised UCC section 5-102 (definitions) (a)(9) (“issuer”)*

Revised UCC section 5-102 (a)(9) defines “issuer” as a person who issues a letter of credit, excluding consumers.<sup>109</sup>

The reason for excepting the definition of “issuer” is apparent. This definition is the mechanism that prevents letters of credit from becoming tools, used against consumers to create letter of credit obligations (with their independence from defenses related to the underlying transaction), running from consumers for consumer purchases and thereby enmeshing letter of credit law in consumer credit issues.<sup>110</sup> For these strategic letter of credit policy reasons, a

107. See U.C.C. § 5-103(c).

108. According to UCC Section 5-103, comment 3:

Parties should generally avoid modifying the definitions in Section 5-102. The effect of such an agreement is almost inevitably unclear. To say that something is a “guarantee” in the typical domestic transaction is to say that the parties intend that particular legal rules apply to it. By acknowledging that something is a guarantee, but asserting that it is to be treated as a “letter of credit,” the parties leave a court uncertain about where the rules on guarantees stop and those concerning letters of credit begin.

*Id.* § 5-103 cmt. 3.

109. “‘Issuer’ means a bank or other person that issues a letter of credit, but does not include an individual who makes an engagement for personal, family, or household purposes.” *Id.* § 5-102(a)(9).

110. According to UCC Section 5-102, comment 5:

The exclusion of consumers from the definition of “issuer” is to keep creditors from using a letter of credit in consumer transactions in which the consumer might be made the issuer and the creditor would be the beneficiary. If that transaction were recognized under Article 5, the effect would be to leave the consumer without defenses against the creditor. That outcome would violate the policy behind the Federal Trade Commission Rule in 16 CFR Part 433. In a consumer transaction, an individual cannot

firm line had to be drawn against such a practice, and in view of the open approach to Revised UCC Article 5's variability, it had to be made nonvariable.

Inevitable questions that arise as to what constitutes a "consumer purpose" are left for judicial interpretation.<sup>111</sup> As with the scope provisions, recitals in the text of the letter of credit or related undertakings may influence how the transaction is classified and may indirectly affect its application.<sup>112</sup>

Does this limitation also apply to the situation where a consumer is said to be a confirmer?<sup>113</sup> As indicated, Revised section 5-107(a) provides that a confirmer "has the rights and obligations of an issuer to the extent of its confirmation,"<sup>114</sup> and its Official Comment 1 states that "unless the context otherwise requires, the terms 'confirmer' and 'confirmation' should be read into this article wherever the terms issuer' and 'letter of credit' appear."<sup>115</sup> In view of the strong letter of credit policy underlying the exclusion of consumers from those who undertake letter of credit obligations, it must be inferred that the limitation against variation of the provision restricting confirmers from issuance must also be applied to confirmers.<sup>116</sup> Otherwise, the policy decision reflected in the listing

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be an issuer where that person would otherwise be either the principal debtor or a guarantor.

*Id.* § 5-102 cmt. 5.

111. Revised UCC Section 1-201(b)(11) defines the term "Consumer" to mean "an individual who enters into a transaction primarily for personal, family, or household purposes." U.C.C. § 1-201(b)(11) (2003). This term was not defined in Prior UCC section 1-201. *See* U.C.C. § 1-201 (1957) (amended 2003). However, this definition is so commonly accepted that it would surely be applied whether or not a jurisdiction had enacted Revised UCC Article 1.

112. Would a deferred payment letter of credit issued by a purchaser of an airplane for business and recreational use that attempts to define these terms in light of Revised UCC section 1-201(b)(11) with an emphasis on "primary" be given effect? It is possible that the courts would take this term in a letter of credit into account but would not be bound by it. It would, however, be unfortunate if a court were to rely on the list in section 5-103(c) to exclude such a transaction from the classification of letter of credit without considering whether or not it was primarily (or something analogous) for such a consumer purpose.

113. For example, it is possible that a sale of a new Bentley for consumer use could be structured by setting up a solo corporation controlled by the consumer which issued a deferred payment letter of credit that was confirmed by the consumer in a personal capacity. This hypothetical, which also raises the question of the prohibition of the issuance of a letter of credit by a non-financial institution for its own account, also applies to a confirmation.

114. U.C.C. § 5-107(a) (2003).

115. *Id.* § 5-107 cmt. 1.

116. The same policy would also apply to a situation where the consumer was conscripted to act as a "paying bank" although it is unlikely that such a situation would ever arise because it

of “issuer” is defeated and Revised UCC Article 5 would become ensnared in consumer law issues.

*b. Revised UCC section 5-102  
(definitions) (a)(10) (“letter of credit”)*

Revised section 5-103(c) provides that the effects of the definition of “letter of credit” cannot be varied.<sup>117</sup> Revised UCC section 5-102 (a)(10), containing the definition of letters of credit, is the keystone of Revised UCC Article 5, impacting its scope.<sup>118</sup> If the undertaking is not a “letter of credit” as defined, Revised UCC Article 5 does not apply to it.

Because the definition of “letter of credit” is so central, it must be asked whether the definition’s components of are nonvariable. The answer must be affirmative to the extent that they are related to this doorkeeper function.

The term “documentary” is related to a concept already discussed in connection with the nonvariable formulation of the independence doctrine in Revised UCC section 5-103(d). While the application of this concept in the examination of documents can be varied (determining the manner in which objectivity in the data presented is obtained), the core concept (that the decision is to be based on objective data representing facts rather than the facts themselves) cannot be varied, as was explained with respect to non-documentary conditions.

The term “definite” purports to exclude undertakings that are so vague that they require investigation of the underlying transaction to determine basic terms of the obligation. Where an undertaking is not definite, it is not a letter of credit. What constitutes definiteness, however, will be influenced by the standard letter of credit practice and commercial reasonableness within the practice. Some flexibility in this concept permits the letter of credit to evolve to meet new market needs and changes while preserving the central core of the

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entails other difficulties.

117. See U.C.C. § 5-103(c) (1995).

118. A letter of credit is:

a definite undertaking that satisfies the requirements of Section 5-104 by an issuer to a beneficiary at the request or for the account of an applicant or, in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or delivery of an item of value.

*Id.* § 5-102(a)(10).

concept, a mechanism that the static and sterile definition of “negotiable instrument” did not possess under UCC Article 3 (Negotiable Instruments).<sup>119</sup>

Other terms and phrases in the definition are also important. The term “financial institution” is not defined in the UCC. Can the effect of the term’s meaning be varied? Because it is not a defined term, there is some flexibility in interpreting its meaning. In such circumstances, a provision in the undertaking that suggested, for example, that an insurance company was a financial institution should be persuasive to a common law court. On the other hand, a provision that brought a consumer within the definition of “financial institution” so that it could issue a letter of credit for its own account should not be given effect.<sup>120</sup> The same practical approach should be taken for other terms and phrases in the definition, whether defined or not, such as “for its own account,” “honor,” “delivery,” and “an item of value.”

Some of the provisions in the definition of “letter of credit” go beyond definitions. To be a letter of credit, an undertaking must satisfy the formality requirements of Revised UCC section 5-104.<sup>121</sup> This section is not included in the list of untouchables but it is generally thought that a statute of frauds cannot be varied.<sup>122</sup> Its inclusion avoids any need to resort to general principles of interpretation about the fundamental notion that an oral undertaking, or one that is not authenticated, is not a “letter of credit.”<sup>123</sup>

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119. A classic example of this definition includes Prior UCC section 3-106 where a fixed sum could not be stretched to encompass variable interest rates because the rates were not a “sum certain.” See U.C.C. § 3-106 (1957) (amended 2003); *Taylor v. Roeder*, 360 S.E.2d 191, 194 (Va. 1987). Conversely, in the letter of credit sphere, letters of credit have been construed to accommodate wild fluctuations in commodities such as oil through the mechanism of an oil fluctuation clause under which there is no final amount of the issuer’s obligation which must be calculated against an objective market average. See *infra* note 294.

120. The attempt to ensnare a consumer would also run afoul of the nonvariable definition of “Issuer” in Revised UCC section 5-102(a)(9) discussed above. See *supra* Part IV.B.2.a.

121. U.C.C. § 5-104 (setting forth formal requirements of the Revised UCC).

122. According to UCC Section 1-302, comment 1:

This principle of freedom of contract is subject to specific exceptions found elsewhere in the Uniform Commercial Code and to the general exception stated here. The specific exceptions vary in explicitness: the statute of frauds found in Section 2-201, for example, does not explicitly preclude oral waiver of the requirement of a writing, but a fair reading denies enforcement to such a waiver as part of the “contract” made unenforceable . . .

U.C.C. § 1-302 cmt. 1 (2004).

123. Since the formality requirements of UCC Section 5-104 are so flexible, there is little



Underlying Revised UCC Article 5's approach to variability is a certain duality that becomes apparent in its definition of "letter of credit." On the one hand, it adopts the conventional approach of making certain limited provisions nonvariable. On the whole, the reason for the selection is one of scope. An undertaking that fails to meet the definition is not a UCC Article 5 "letter of credit." In this sense, drafting of the undertaking can operate on the nonvariable provisions to "shift" the undertaking from a letter of credit into another type of undertaking.

But this possibility is not limited to the nonvariable terms. In this sense, there are definite limits to the variability of the variable provisions of Revised UCC Article 5. While there is considerable flexibility with respect to the variable provisions, there is a point beyond which the undertaking, whatever it is, is not a letter of credit. This point is to be determined, not by a mechanical listing of nonvariable provisions or by traditional policy analysis based on general common law and commercial law principles, but on principles centered in letter of credit law and practice.

Revised UCC section 5-103(c) attempts to capture this dualistic approach through its limited use of nonvariable provisions.<sup>124</sup> While not perfect, it provides flexibility without sacrificing certainty.

An apt illustration is its operation on the obligation of a confirmer. Is the obligation of a confirmer a "letter of credit" that cannot be varied? The provision in section 5-107(a), that a confirmer has the obligations of an issuer, is variable.<sup>125</sup>

In light of the variability of the obligation of a confirmer, can an undertaking that is called a "confirmation" provide that the confirmer

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difference between bringing the basic requirements of some manner of authentication and a non-oral manifestation under the definition of "letter of credit" and making Revised UCC section 5-104 nonvariable. U.C.C. § 5-104 (2003). The approach taken removes any doubt about the ability of the letter of credit to prescribe a means of authentication that is not in accord with standard international letter of credit practice. It does, however, leave the somewhat awkward question of whether the fundamental formality requirements for undertakings listed in Revised UCC section 5-104 in addition to "letter of credit" (namely confirmation, advice, transfer, amendment, or cancellation) can be varied. For example, can there be an oral confirmation? The answer must be negative. For purposes of the meaning of the term "letter of credit," the minimum formality requirement would apply to all letter of credit-like undertakings. While this extension is somewhat of a stretch, it is one that flows from letter of credit practice and is consistent with the spirit of Revised UCC Article 5. This approach is superior to one that resorts to vague principles of public policy apart from letter of credit policy for such a rule.

124. See U.C.C. § 5-103(c) (1995).

125. See *id.* § 5-107(a).

has no obligation to the beneficiary unless it is first reimbursed by the issuer? Can the undertaking be a “letter of credit” if a non-financial confirmer confirms for its own account? Can a confirmer provide itself with a right of recourse against the beneficiary?

Unlike the obligation of an issuer on a letter of credit, there is a certain amount of flexibility in the obligation of a confirmer on a confirmation.<sup>126</sup> Once it is determined that the undertaking is a letter of credit, certain consequences follow. In the case of a letter of credit, the question is one of scope. In the case of a confirmer or confirmation, the question is the obligation.<sup>127</sup> Whatever the undertaking of the confirmer (it might, for example, be an accessory guarantee or a contractual promise, and not a letter of credit-type promise), there is a letter of credit.

With the exception of the distortion of the meaning of the term “confirmer” to circumvent a nonvariable provision regarding non-financial institutions, the question is not one of permissible or impermissible variation, but of determining the scope and character of the obligation. What is important is that the process be centered in letter of credit policy. Courts should base their analysis on these grounds rather than making a decision and justifying it on procedural or evidentiary grounds in the manner that common law courts are supremely able. While this general approach may work individual justice, it distorts the legal regime that is meant to be ordered by a statute. There are a variety of tools at the disposal of the courts in making this determination, most of which hopefully will be drawn from letter of credit law and practice. In so doing, the courts should be able to draw on the nonvariable and unvaried provisions of Revised UCC Article 5 in fashioning a principled answer that is consistent with the reasonable commercial practices of the international letter of credit community.

The classification of the definition of “letter of credit” also poses some tests for what constitutes nonvariability. Embedded in the definition is the reference to it being issued at the request of, or for the account of, someone.<sup>128</sup> Is an undertaking a “letter of credit” if it does not state on its face the person for whose account it is issued?

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126. *See id.*

127. *See id.* § 5-107.

128. *See id.* § 5-102(10).

Can a court go beyond the face of the letter of credit to determine that the undertaking was issued by a non-financial institution on its own behalf or is a recital of the undertaking on its face binding? These questions touch not only on the nonvariable definition of letter of credit, but on the nonvariable doctrine of independence in Revised UCC Section 5-103(d) as well.

The answers to these questions can be readily found in the statute itself, and in letter of credit policy as reflected in Revised UCC Article 5 and in standard international letter of credit practice. While it is common that letters of credit be issued stating the name of the account party, the failure to do so in an undertaking that otherwise meets the definition of letter of credit would not change its status. The definition does not require that the name of the account party or applicant be stated in the instrument, and it goes without saying that the undertaking was issued at someone's request.<sup>129</sup>

As to whether a court can look beyond the face of the instrument to determine for whose account it is issued, the answer must also be in the affirmative. Whatever a "financial institution" is, the name of the applicant will not necessarily reveal that it is a financial institution. Because an undertaking of a non-financial institution for its own account is not a "letter of credit," a question of the scope of application of Revised UCC Article 5, a court must be able to act on evidence external to the letter of credit undertaking.<sup>130</sup>

### 3. Revised UCC Section 5-106(d) (Perpetual Letters of Credit)

Revised UCC section 5-103(c) provides that subsection 5-106(d) is an exception to the rule that the effect of the provisions of Revised UCC Article 5 may be varied.<sup>131</sup> Revised UCC section 5-106(d) provides that "[a] letter of credit that states that it is perpetual expires five years after its stated date of issuance, or if none is stated, after the date on which it is issued."<sup>132</sup>

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129. *See id.*

130. Of course, common law courts have tools by which a just result can be achieved outside of Revised UCC Article 5 without distorting its operation. For example the doctrine of estoppel might operate to protect a beneficiary that reasonably relied on an undertaking issued by a non-financial institution on its own behalf as if it were a letter of credit. A relevant question, but one that is beyond the scope of this paper, is whether there remains a common law concerning letters of credit after the enactment of Revised UCC Article 5.

131. *See* U.C.C. § 5-103(c).

132. *Id.* § 5-106(d).

This provision is included in the list of nonvariable provisions to prevent any alteration of the policy manifested in Revised UCC Article 5 against commercial obligations that expressly provide that they are not to terminate or are perpetual.<sup>133</sup>

In the interpretation of Revised UCC section 5-106(d), much turns on the meaning to be given to the term “perpetual.” It should be apparent that the policy underlying the provision was not fixed on a magic word, but rather on an undertaking that had no finite duration. Otherwise, this policy could be defeated and the subsection varied by the use of a different term that had the same meaning (for example, “eternal”), or a provision that the undertaking does not expire.

Although the non-expiration provision cannot be varied, it is possible to accommodate a beneficiary’s interest in an obligation that runs until it is needed. This concern can best be met by a properly structured letter of credit with a clause providing for the issuance of a notice of non-renewal and permitting a beneficiary to draw on receipt of that notice.<sup>134</sup>

Where a provision for termination is included, such as a provision empowering the issuer to terminate its obligation by making payment on its own initiative, that undertaking should not be regarded as being “perpetual” (even if, by its terms, it includes terminology that would be so regarded were it not otherwise qualified). Because its obligation can be terminated upon the issuer’s notice, there is no variation of this rule against perpetual letters of credit.<sup>135</sup> Likewise, an undertaking that has no expiration date but provides that the issuer can, at its discretion, pay the proceeds meets the same policy concerns. Of course, a letter of credit could be issued for a lengthy period should an issuer be

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133. See 12 C.F.R. § 7.1016 (b)(1)(iii) (2006). The United States Office of the Comptroller of the Currency has promulgated regulations regarding the safety and soundness of the banks that issue letters of credit. *Id.* at §§ 7.1016–.1017. In this regard, the United States office of the comptroller of the currency has played a leading role through these interpretative rulings by assuring that banks would prudently consider the importance of limits to the time frame of their exposure and not be exposed to the vagaries of non-documentary conditions. In their current form, the rulings are the most current approach to letter of credit regulation now in place and would serve well as a model for enlightened regulation of this field.

134. Such so-called evergreen letters of credit, while complex, serve an important need.

135. U.C.C. § 5-106 cmt. 4 (1995) (noting that “a letter of credit that may be revoked or terminated at the discretion of the issuer by notice to the beneficiary is not ‘perpetual’”).

prepared to give it, and should a beneficiary be prepared to take it.<sup>136</sup>

Because this distinction may be lost where there is no appreciation of the policy concerns underlying the exception, namely the need for a mechanism that effectively limits the obligation, it is vital that its interpretation be based on principles rather than a mechanical or formal approach. The exception, however, is straightforward and its policy basis is relatively apparent.

#### 4. Revised Section 5-114(d) (Assignment of Proceeds)

Revised UCC section 5-103(c) provides that subsection 5-114(d) is an exception to the rule that the effect of the provisions of Revised UCC Article 5 may be varied.<sup>137</sup> Revised UCC section 5-114(d) provides that while an issuer or nominated person is not obligated to give or withhold its consent to an assignment of proceeds, “consent may not be unreasonably withheld if the assignee possesses and exhibits the letter of credit and presentation of the letter of credit is a condition to honor.”<sup>138</sup>

This subsection must be understood in the context of letter of credit practice which requires the consent of a bank to obligate it to pay any proceeds that may be available to the assignee. As such, it is contrary to bilateral assignment law.<sup>139</sup> Revised UCC section 5-114 upheld this deviation from the general law of assignment because of the justified need for banks nominated under a letter of credit to control the process of assignment so as to reduce the risk of double payment.<sup>140</sup> This risk exists where payment is to be made against representations which can easily be forged or altered by a stranger. Controlling the process of assignment also avoids serious disruption to international practice, which would occur if banks—that may come under United States law—were forced to check various registries before being able to pay on their obligations in order to

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136. There are a host of practical considerations that discourage the issuance of long term obligations that cannot be ended, making them quite rare. While a “999 year” letter of credit may be indistinguishable from a perpetual one, there are supervisory controls with respect to safety and soundness that make such an undertaking unlikely.

137. U.C.C. § 5-103(c) (1995).

138. *Id.* § 5-114(d).

139. See RESTATEMENT (SECOND) OF CONTRACTS § 336 (defenses against an assignee). In a signal victory for letter of credit practice, Revised Article 9 recognizes the unique nature of an assignment of LC proceeds. See, e.g., U.C.C. § 9-107 (2001).

140. See U.C.C. § 5-114 (1995).

avoid the possibility that the beneficiary had assigned the same proceeds to more than one person.

With respect to a letter of credit that required presentation of the operative letter of credit instrument, however, it was concluded that this risk is “minimized.”<sup>141</sup> Therefore, in the limited situation where the operative letter of credit instrument is required and exhibited, the statute has taken the policy position that a bank ought not to refuse to acknowledge an assignment of proceeds unreasonably.

The statement in Revised UCC section 5-103 that this provision cannot be varied without any qualification, however, is somewhat of an overstatement. Like the provisions on limitations of obligations and reasonable time, nonvariability is tied to an assessment of reasonableness. To say that this provision cannot be varied can only mean that an issuer or nominated person cannot absolutely refuse to acknowledge an assignment of proceeds under these circumstances, but can impose qualifications on any consent, provided that the qualifications are reasonable.<sup>142</sup> In effect, this limitation on variance is only a limitation on its exclusion and unreasonable refusal, similar to the approach taken in Revised UCC section 1-302(b), which is

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141. Comment 3 to UCC Section 5-114 provides:

Where the letter of credit must be presented as a condition to honor and the assignee holds and exhibits the letter of credit to the issuer or nominated person, the risk to the issuer or nominated person of having to pay twice is minimized. In such a situation, subsection (d) provides that the issuer or nominated person may not unreasonably withhold its consent to the assignment.

*Id.* § 5-114 cmt. 3.

142. An example of qualifications that should be deemed reasonable is contained in ISP98 Rule 6.03, which provides:

An issuer of a transferable standby or a nominated person need not effect a transfer unless:

- a. it is satisfied as to the existence and authenticity of the original standby; and
- b. the beneficiary submits or fulfills:
  - i. a request in a form acceptable to the issuer or nominated person including the effective date of the transfer and the name and address of the transferee;
  - ii. the original standby;
  - iii. verification of the signature of the person signing for the beneficiary;
  - iv. verification of the authority of the person signing for the beneficiary;
  - v. payment of the transfer fee; and
  - vi. any other reasonable requirements.

INT’L CHAMBER OF COMMERCE, THE INT’L STANDBY PRACTICES (1998) (ICC Pub. No. 590) [hereinafter ISP98].

also nonvariable in Revised UCC Article 5.<sup>143</sup>

5. Except to the Extent Prohibited by  
Revised UCC Section 1-302 (Variation by Agreement)

*a. Generally*

Revised UCC section 5-103(c) provides that qualifications on variability contained in Revised UCC section 1-302 constitute a further limited exception to the general rule that the effect of the provisions of Revised UCC Article 5 may be varied. Variation is permitted “except to the extent prohibited” by this section.<sup>144</sup> Revised UCC section 1-302 contains a bifurcated approach to variation, prohibiting disclaimer of “[t]he obligations of good faith, diligence, reasonableness, and care prescribed by [the UCC].”<sup>145</sup> However, it provides that “[t]he parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable.”<sup>146</sup> It also contains a similar rule where an action is required to be performed within a reasonable time.<sup>147</sup>

Prohibited by the phrase “to the extent prohibited,” are (1) disclaimer of statutory obligations of good faith, diligence, reasonableness, care, and reasonable time, and (2) formulations of standards by which those obligations are to be measured that are manifestly unreasonable.

To determine the application of this limitation to Revised UCC Article 5, it is necessary to determine the “obligations of good faith, diligence, reasonableness, and care,” the extent to which they are

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143. U.C.C. § 5-103 cmt. 2 (1995) (“Neither the obligation of an issuer under section 5-108 nor that of an adviser under section 5-107 is an obligation of the kind that is *invariable* under section 1-102(3).” (emphasis added)).

144. U.C.C. § 5-103(c) (2001).

145. U.C.C. § 1-302(b) (2003).

146. *Id.*

147. UCC Section 1-302(b) provides:

[t]he obligations of good faith, diligence, reasonableness, and care prescribed by [the Uniform Commercial Code] may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of those obligations is to be measured if those standards are not manifestly unreasonable. Whenever [the Uniform Commercial Code] requires an action to be taken within a reasonable time, a time that is not manifestly unreasonable may be fixed by agreement.

*Id.* § 1-302(b) (alterations in original).

“prescribed,” what constitutes their disclaimer, and what standards are not manifestly unreasonable for these obligations and the requirements that action be undertaken within a reasonable time.

The definitive treatment of Revised UCC section 1-302 and its predecessor, Prior section 1-102(3), has yet to be written, and the impact of this section on Revised UCC Article 5 has scarcely been considered. In more than fifty years of applicability to the current and prior version of UCC Article 5, a case has yet to arise. Their practical import is most likely to arise in connection with general disclaimers and the terms contained in applications or reimbursement agreements. Consequently, these observations are tentative.

*b. Disclaimer or standardization*

While the distinction between disclaiming or excluding an obligation and determining its application by standards is readily stated, the application of this distinction to a given situation is not always apparent. At some point, a standard that renders the obligation unenforceable or the enforcement meaningless essentially disclaims it. Whether any obligation for a misrepresentation is excluded, damages for it are so limited as to be meaningless, or the burden of proof is raised so high as to make achievement virtually impossible. This is a nominal rather than a real difference. Consequently, the notion of manifest unreasonableness is an important tool for policing the outer limits of variability, whether under the rubric of disclaimer or ineffectiveness.

*c. The meaning of the terms*

*“good faith,” “diligence,” “reasonableness,” and “care”*

*i. Generally*

There is some literature on the general meaning of the concepts of “good faith,” “diligence,” “reasonableness,” and “care,” most of which is irrelevant to their application to letter of credit obligations because that application must be informed by letter of credit policy considerations. Including this subsection in the list of nonvariables conveys an indirect message, namely that its nonvariability stems not from general assumptions that operate in other UCC Articles but from Revised UCC Article 5.

Only some of these terms are defined. Where there is no



definition in Revised UCC Article 5, meaning should be derived from the context of Revised UCC Article 5. Reasonableness, for example, with respect to a letter of credit is not necessarily reasonable with respect to a contract for the sale of goods. In any event, there is considerable latitude for interpretation.

It should be noted that these notions do not exist as precise and distinct operations separate from one another. As will be seen, they overlap in many respects. It is difficult to distinguish precisely between an obligation of diligence and one of care. It is predicted that the courts will choose which approach to take depending on the issues before it. For example, the requirement of diligence may not be applied except where there is a requirement of action within a given time, whereas that of reasonableness may be applied in a liberal manner to every duty. Moreover, because we are dealing with obligations and not terms, there need be no mention of these or similar words.

Because the application of these terms is somewhat fluid, there is potential for abuse in unduly broadening the scope of the nonvariable provisions of Revised UCC Article 5. For that reason, they must be viewed as a secondary check on variability with respect to otherwise variable obligations, only in extreme situations, and then only in accord with letter of credit policy.

As a practical matter, a court has two options when faced with a provision that runs afoul of these provisions. It can rule that the attempt to vary the effect is unsuccessful because the standard is manifestly unreasonable. In that case, the standard will revert to that set by applicable rules of practice or by Revised UCC Article 5. Alternatively, it can decide that the attempt to vary the effect of the standard is so vital to the nature of the undertaking that the undertaking is no longer a letter of credit-type undertaking and should be treated under some other system of law (although it is not entirely clear whether such a transaction will render it enforceable under general principles of law even if it is swept outside the reach of the UCC). Which of these approaches is more appropriate depends on factors such as the terms of the undertaking, its form, any rules or references to standardization contained in it, and whether it would be understood or accepted as a letter of credit under standard international letter of credit practice.

## ii. The Revised UCC Article 5 Obligation of Good Faith

Revised UCC section 1-304 (Obligation of Good Faith) states that “[e]very . . . duty . . . imposes an obligation of good faith in its performance and enforcement.”<sup>148</sup> Revised UCC section 5-109(a)(2) expressly prescribes the duty of good faith.<sup>149</sup>

This duty of good faith applies not only where the duty of good faith is expressly prescribed but “applies generally.”<sup>150</sup> Thus, the obligation of good faith cannot be disclaimed for any duty appearing in Revised UCC Article 5. The duties include the duty of an issuer,<sup>151</sup> a confirmer,<sup>152</sup> an adviser,<sup>153</sup> a nominated person,<sup>154</sup> an applicant,<sup>155</sup> a beneficiary,<sup>156</sup> and a successor beneficiary.<sup>157</sup> A transferee beneficiary would also have the good faith obligations of a beneficiary. Official Comment 1 to Revised UCC section 1-304 states that the obligation of good faith “is further implemented by section 1-303 on course of dealing, course of performance, and usage of trade.”<sup>158</sup> It is unclear whether it applies to obligations that arise under rules of practice to which the letter of credit is subject.

Contrasted with the sweeping application of the obligation of good faith throughout Revised UCC Article 5, the actual duty of good faith is minimal. Revised UCC section 5-102(a)(7) provides that good faith “means honesty in fact and in the conduct or transaction concerned.”<sup>159</sup> Official Comment 3 to this section

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148. *Id.* § 1-304 (“Every contract or duty within [the Uniform Commercial Code] imposes an obligation of good faith in its performance and enforcement.”).

149. *See* U.C.C. § 5-109(a)(2) (1995).

150. *See* U.C.C. § 1-304 cmt. 1 (2003) (“While this duty is explicitly stated in some provisions of the Uniform Commercial Code, the applicability of the duty is broader than merely these situations and applies generally, as stated in this section, to the performance or enforcement of every contract or duty within this Act.”).

151. *See* U.C.C. §§ 5-106, 5-108, 5-109(a)(1), 5-113(b), 5-114(d) (1995).

152. *See id.* § 5-107.

153. *See id.*

154. *See id.*; *see also id.* § 5-114(d).

155. *See id.* § 5-108(i).

156. It is unclear, but arguable, that the implied warranties given by the beneficiary under Revised UCC Section 5-110 are a “contract” within the meaning of Revised UCC section 1-304. *See id.* § 5-110 (1995); U.C.C. § 1-304 (2003).

157. *See* U.C.C. § 5-113 (1995) (transfer by operation of law).

158. U.C.C. § 1-304 cmt. 1 (2003).

159. U.C.C. § 5-102(a)(7) (1995). As noted in Official Comment 3 to Revised UCC Section 5-102, “[o]bservance of reasonable standards of fair dealing’ has not been added to the definition.” *Id.* § 5-102 cmt. 3. Actually, this addition had not been made to the UCC Article 1

suggests the scope of the definition:

The narrower definition of “honesty in fact” reinforces the “independence principle” in the treatment of “fraud,” “strict compliance,” “preclusion,” and other tests affecting the performance of obligations that are unique to letters of credit. This narrower definition—which does not include “fair dealing”—is appropriate to the decision to honor or dishonor a presentation of documents specified in a letter of credit. The narrower definition is also appropriate for other parts of revised Article 5 where greater certainty of obligations is necessary and is consistent with the goals of speed and low cost.<sup>160</sup>

### iii. The Revised UCC Article 5 Obligations of Diligence, Reasonableness, and Care

Unlike “good faith,” the obligations of diligence, reasonableness, and care are not made generally applicable to all duties. Therefore, it is necessary to determine where they are “prescribed” in Revised UCC Article 5.

#### *(a.) The Revised UCC Article 5 obligation of diligence*

“Diligence” is not defined in the UCC nor is there any indication of its meaning in the Official Comments. In general usage, “diligence” means a determined and sustained effort.<sup>161</sup> In legal usage, it can also signify care or the degree of care required in a given situation.<sup>162</sup> Since the term “care” is already used in the list of obligations, it is reasonable to think that courts would draw on the former definition in applying UCC section 3-302(b). Under this approach, it is reasonable to conclude that with respect to an

definition of “good faith” when Revised UCC Article 5 was drafted. It had, however, been added to Revised UCC Articles 3 and 4, and the limited definition was inserted in Revised UCC Article 5 in anticipation of the broader definition being inserted into the revision of UCC Article 1.

160. U.C.C. § 5-102 cmt. 3.

161. OXFORD ENGLISH DICTIONARY 665 (James A.H. Murray et al. eds., Oxford University Press 1989) (defining diligence as “constant and earnest effort to accomplish what is undertaken”); WEBSTER’S UNABRIDGED DICTIONARY, 511 (2d ed. Collins World 1978) (defining diligence as “constant effort to accomplish what is undertaken”).

162. See BLACK’S LAW DICTIONARY 468 (7th ed. 1999) (defining diligence as “[a] continual effort to accomplish something”); WEBSTER’S UNABRIDGED DICTIONARY, 511 (2nd ed. Collins World 1978) (defining legal diligence as “the degree of care and caution required by the circumstances of a person”).

obligation, diligence means that the person obligated to perform will be required to do so in a persistent manner without delay or diminution of effort. If this approach is incorrect, the comments made below with respect to the obligation to exercise care would also apply to diligence.

There is no place in Revised UCC Article 5 where the obligation of diligence is expressly prescribed. There are, however, a number of situations in which a duty is prescribed. Should a court imply an obligation to perform these duties diligently, the requirement would apply to the obligation of an adviser to notify the beneficiary of the issuance or transfer of the credit;<sup>163</sup> to the obligation of an issuer or confirmer to examine a presentation and determine whether or not to honor it;<sup>164</sup> to the obligation of an issuer, confirmer, or nominated paying bank to give notice of a decision to refuse a presentation;<sup>165</sup> to the obligation of the issuer and confirmer to observe standard practice of financial institutions that regularly issue letters of credit;<sup>166</sup> to the obligation of the issuer and confirmer to return dishonored documents or otherwise appropriately dispose of them, giving due notice;<sup>167</sup> to the obligation of the applicant to reimburse the issuer or confirmer that has honored a complying presentation;<sup>168</sup> to the obligation of an issuer to honor a presentation by a protected person notwithstanding the presence of letter of credit fraud;<sup>169</sup> to the obligation of an issuer or confirmer to recognize a disclosed successor by operation of law of the beneficiary;<sup>170</sup> and to the obligation of an issuer or nominated person to not unreasonably withhold consent to an assignment of proceeds where the assignee possesses the operative letter of credit instrument and it is required for compliance.<sup>171</sup>

To the extent that rules of practice reflect course of performance, course of dealing, or usage of trade, the obligations of

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163. *See* U.C.C. § 5-107(c), (d).

164. *See id.* § 5-108(a).

165. *See id.* § 5-108(b).

166. *See id.* § 5-108(b)(2).

167. *See id.* § 5-108(h).

168. *See id.* § 5-108(i)(1).

169. *See id.*; *see also id.* § 5-109(a)(1).

170. *See id.* § 5-113(b).

171. *See id.* § 5-114(d).

diligence that they prescribe also cannot be disclaimed.<sup>172</sup> It is unclear whether this limitation also affects rules of practice to which the letter of credit may be subject, but it could readily be applied to duties not already detailed in Revised UCC Article 5.

Given the fact that no duty of diligence is prescribed as such, if at all, courts should only apply this limitation on variability in extreme situations where there is no commercial justification for a restriction on diligence.

*(b.) The Revised UCC Article 5 obligation of reasonableness*

Reasonableness is not defined or explained in Revised UCC Article 5. In general usage, reasonableness indicates moderateness under the circumstances, or a lack of excessiveness.<sup>173</sup> In applying an obligation of reasonableness at law, reasonableness necessarily entails a context. With respect to letters of credit, Revised UCC Article 5 makes it clear that reasonableness is to be understood in the context of standard international letter of credit practice.<sup>174</sup> Under general common law principles, the determination of reasonableness is the responsibility of the trier of fact.

Revised UCC Article 5 does not explicitly require reasonableness. There are, however, a number of duties imposed by Revised UCC Article 5 which could readily be said to imply an obligation of reasonableness in the sense that it cannot be disclaimed and that any standard by which it is to be measured cannot be manifestly unreasonable.<sup>175</sup> These duties would encompass all of the

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172. In this context, it may be asked whether provisions in UCP500 that are mandatory but which are not accompanied by a sanction, such as Article 10(a), are subject to this duty. See UCP500, *supra* note 5, art. 10(a) ("All Credits must clearly indicate whether they are available by sight payment, by deferred payment, by acceptance or by negotiation.").

173. BLACK'S LAW DICTIONARY 1272 (7th ed. 1999) (defining reasonable as "[f]air, proper, or moderate under the circumstances").

174. Not only does Revised UCC Article 5 expressly exclude the possibility of its application in consumer finance, but it is also drafted in the context of and to accommodate standard international letter of credit practice and with express deference to that practice where a letter of credit is subject to rules of practice. U.C.C. § 5-116(c). Even where deference exists, the letter of credit is not subject to rules of practice. See *id.* § 5-108(e); U.C.C. § 1-303 (2003).

175. Whether a court should imply such a standard is debatable. There are a number of provisions in letter of credit law and practice that appear unreasonable from the perspective of bilateral contracts or general principles of commercial law. The best example is the rule of preclusion by which a bank is precluded from asserting that the documents are not in compliance with the terms and conditions of the letter of credit. See, e.g., *Phila. Gear Corp. v. Central Bank*, 717 F.2d 230, 234 (1983). Requiring an issuer to pay where this rule applies, even where the beneficiary could not have cured the discrepancy and did not reasonably rely on the absence of

obligations detailed above with respect to good faith and diligence.<sup>176</sup> The obligation of reasonableness, however, does not reach the terms and conditions of the letter of credit or any provision of Revised UCC Article 5 other than those linked to obligations prescribed by the statute.

*(c.) The Revised UCC Article 5 obligation of care*

Care is not defined in Revised UCC Articles 1 or 5. Revised UCC section 3-103(a)(9) defines “ordinary care” as the “observance of reasonable commercial standards.”<sup>177</sup> To the extent that there is an obligation of care prescribed, that definition is adequate.

As with the other obligations, Revised UCC Article 5 does not prescribe an obligation of care, but such an obligation could be implied with respect to the duties discussed with regard to the other obligations.<sup>178</sup>

iv. Revised UCC Article 5 requirements of reasonable time

Revised UCC section 1-204(2) provides that “[w]hat is a reasonable time for taking any action depends on the nature, purpose and circumstances of such action.”<sup>179</sup>

Within Revised UCC Article 5, the only reference to “reasonable time,” and the only stated time frame within which an action must take place, appears in Revised UCC section 5-108(b) and Official Comment 2 with respect to the time within which documents must be examined and notice of refusal given (which cannot exceed seven business days after the issuer’s receipt of the documents).<sup>180</sup>

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timely notice, could be held unreasonable unless the rule is considered from the perspective of reinforcing the integrity of the letter of credit and its procedures. It is, however, unlikely that a common law court will enforce a provision that it deems to be unreasonable. The task then, is to show that the various duties are not manifestly unreasonable, something which can be done for all aspects of letter of credit practice which is, almost without exception, founded on its own internal logic.

176. See discussion *supra* Part III E.1.a.

177. U.C.C. § 3-103(a)(7) (1995) (“‘Ordinary care’ in the case of a person engaged in business means observance of reasonable commercial standards, prevailing in the area in which the person is located, with respect to the business in which the person is engaged.”).

178. See discussion *supra* Part III.E.1.a.

179. U.C.C. § 1-204(2) (2001).

180. UCC Section 5-108(b) provides:

An issuer has a reasonable time after presentation, but not beyond the end of the seventh business day of the issuer after the day of its receipt of documents:

(1) to honor,

Under Revised UCC section 5-103(c), this requirement that the action be done within a reasonable time cannot be varied, but the time given (seven banking days) can be adjusted, provided that the time given is not manifestly unreasonable.<sup>181</sup> Since the time stated operates against the issuer, a court would not be likely to consider a claim that a lesser time is unreasonable. These inquiries would be reserved for attempts at lengthening the time.<sup>182</sup> The test would be whether a time was so long as to be unfair to the beneficiary given the circumstances of the letter of credit transaction.

v. Scope of application; manifestly unreasonable; commercial reasonableness

Due to the lack of precision used with the terms "scope of applications," "manifestly unreasonable," and "commercial reasonableness" and the uncertainty of the extent of their application to obligations in Revised UCC Article 5, there is considerable scope for discretion in the application of the limitations. There are three possible approaches to the exercise of this discretion that might immediately commend themselves: (1) minimalist, i.e., only where an express obligation is mandated using these terms; (2) strict, i.e., only where there is a duty that, strictly construed, imposes an obligation to act reasonably, diligently, or with care; and (3) liberal, i.e., wherever there is any duty unless it is apparent that the requirements of diligence, reasonableness, or care do not apply.

The danger of these formulae is that they can be too broad or too narrow, depending on the issue and circumstances. This issue is not one that can be solved readily by a simple formula. While there is a certain comfort in this overall approach, it misses an important

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(2) if the letter of credit provides for honor to be completed more than seven business days after presentation, to accept a draft or incur a deferred obligation, or

(3) to give notice to the presenter of discrepancies in the presentation.

U.C.C. § 5-108(b) (1995).

181. *Id.* § 5-103(c).

182. Comment 1 to Revised Section 1-302 provides:

Subsection (b) also recognizes that nothing is stronger evidence of a reasonable time than the fixing of such time by a fair agreement between the parties. However, provision is made for disregarding a clause which whether by inadvertance or overreaching fixes a time so unreasonable that it amounts to eliminating all remedy under the contract. The parties are not required to fix the most reasonable time but may fix any time which is not obviously unfair as judged by the time of contracting.

U.C.C. § 1-302 cmt. 1 (2003).

dimension of the problem, namely, the purpose of these limitations. Since we are working with a commercial setting absent consumer issues, the proper test is one of commercial reasonableness (or lack thereof) for letters of credit.

A standard for an obligation is not manifestly unreasonable if it is commercially reasonable. Thus, for example, a provision in a letter of credit that eschews any examination of documents would be commercially reasonable under circumstances where there were virtually no documents and an undertaking to make payment within a matter of hours. Such a provision may also be commercially reasonable where the applicant requested a lower level of processing and intended to sort out difficulties with the documents directly with the beneficiary. On the other hand, a provision that exonerates a bank from misrepresenting facts about the time when documents were received would be commercially unreasonable.

Thus, even if these obligations are deemed to be at issue, a court will not err by asking whether the provision is commercially reasonable, taking into account all of the factors involved. Under this approach, the scope of the limitation will be restricted to those provisions that so depart from the minimum of what is acceptable as to warrant reaction. The complex operation of these provisions as limitations on variability can be seen in several illustrations.

An attempted limitation by the issuer of its undertaking to the beneficiary to pay only if the issuer was reimbursed by the applicant would be a prime candidate for reaction on several grounds. The undertaking might not be considered a letter of credit because it is not an undertaking to honor (as defined in Revised UCC section 5-102(a)(8)),<sup>183</sup> or it might be regarded as a manifestly unreasonable limitation on the issuer's obligations of reasonableness pursuant to Revised UCC section 5-108.<sup>184</sup> In either case, the court could, in effect, reform the obligation by excising the offensive provision. This result could also be achieved indirectly by the use of common law rules such as estoppel. On the other hand, the court could conclude that the undertaking was a collection and not a letter of credit. Because the result is so fact-intense, a general rule cannot be laid down.

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183. See U.C.C. § 5-102(a)(8) (1995).

184. See *id.* § 5-108.



On the other hand, an undertaking to pay five banking days following presentation or receipt of funds from the applicant—whichever comes first—is not a manifestly unreasonable standard of performance of the issuer's obligation or adjustment of the meaning of "honor."

A similar attempted limitation by the confirmer, of its undertaking to the beneficiary to pay only if it is reimbursed by the issuer, would produce a different result. The overall undertaking would be regarded as a letter of credit, but the obligation of the so-called confirmer could either be regarded as a non-letter of credit dependent guarantee (where the limitation could be excised as a manifestly unreasonable limitation on the obligation of reasonableness in Revised UCC section 5-107(a)) or the confirmer could be estopped from asserting the limitation. On the other hand, less drastic limitations on the beneficiary's right of recourse (e.g., currency risk) would neither alter the character of the undertaking nor be manifestly unreasonable.

6. Except to the Extent Prohibited by Section 5-117(d)  
(Subrogation of Issuer, Applicant, and Nominated Person)

Revised UCC section 5-103(c) provides that variability is limited "to the extent prohibited" in section 5-117(d).<sup>185</sup> Revised UCC section 5-117(d) limits rights of subrogation to post-honor situations.<sup>186</sup> This provision results from a public policy determination that, while post-honor subrogation is appropriate in some circumstances, to the extent that it would otherwise be permitted under applicable rules of equity and should not be refused due to an overly nice appreciation of the doctrine of independence when it is no longer applicable. The principle of finality of payment and independence operates with respect to the letter of credit obligation and that the issuer, confirmer, or a nominated paying bank cannot recover proceeds mistakenly paid based on rights founded in the obligations of those banks as such.<sup>187</sup>

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185. *See id.* § 5-103(c).

186. *See id.* § 5-117(d).

187. The provision is intended to reverse the results in pre-revision cases where the courts have mistakenly refused to permit subrogation where there were no conflicting equities on the ground that to do so would contradict the independence principle. *See, e.g., Carol Ruth, Inc. v. Provident Life & Accident Ins. Co.*, 101 F.3d 683 (2d Cir. 1996) (unpublished table decision); *Mead Corp. v. Dixon Paper Co.*, 907 P.2d 1179 (Utah Ct. App. 1995).

It should be noted that the limitation is not on the right of subrogation itself. Being, in effect, an “equitable assignment” where the parties have not otherwise assigned rights, subrogation is a right that can be disclaimed by agreement. Revised UCC section 5-117(d) does not change that rule. Rather, it prevents the expansion of the right of subrogation to a pre-honor situation. An issuer or confirmer that has not honored, and a nominated bank that has not acted pursuant to its nomination, is not entitled to be subrogated to the rights of another. Furthermore, in no case can these parties assert rights to reimbursement based on their own claims because, as to them, payment is final (with the exception of a nominated negotiating bank that does not give up its right of recourse). Presumably, one might have reached this conclusion on the basis of a public policy analysis, taking into account fundamental principles of letter of credit law; however, given the record of the courts with the basic principle of subrogation, the drafters obviously thought it prudent to make the limitation express.

#### 7. Disclaimers of Liability or Remedies for Failure to Perform Obligations

In addition to identifying specific provisions that are exceptions to the rule that Revised UCC Article 5’s effects may be varied, Revised UCC section 5-103(c) states that “[a] term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this article.”<sup>188</sup>

Revised UCC Article 5 covers the obligations of the issuer,<sup>189</sup> the confirmer,<sup>190</sup> the adviser,<sup>191</sup> the transferring bank,<sup>192</sup> the applicant,<sup>193</sup> and, to a lesser extent, other nominated persons.<sup>194</sup>

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188. U.C.C. § 5-103(c).

189. *See id.* § 5-108; *see also id.* §§ 5-106, 5-109.

190. These provisions are contained in Revised UCC Section 5-107(a) but, since the confirmer has the “obligations of an issuer to the extent of its confirmation,” it is also necessary to consider the obligations of an issuer. *Id.* § 5-107(a).

191. *See id.* §§ 5-107(c), 5-111, 5-116.

192. *See id.* § 5-107(c), (d). The obligation of a transferring bank is addressed in Revised UCC Section 5-107(d), but since the transferring bank’s obligation is that of an adviser, it is also necessary to take into account Revised UCC section 5-107(c). *Id.* § 5-107(c).

193. *Id.* § 5-108(i)(1). The applicant is required to reimburse the issuer according to Revised UCC section 5-108(i) which states: “[a]n issuer that has honored a presentation as permitted or required by this article: (1) is entitled to be reimbursed by the applicant in immediately available

Warranties are addressed in Revised UCC section 5-110.<sup>195</sup> Remedies and damages are addressed in Revised UCC section 5-111.<sup>196</sup>

The limitation in Revised UCC section 5-103(c), addressing general excuses or limitations, captures generic disclaimers but permits specific limitations, such as a qualification of a confirmer's liability to situations where the documents are presented at its counters, or a disclaimer of the accuracy of a given advise of a letter of credit where the adviser is unable to check its apparent authenticity. The limitation should not encompass general statements about liability that are based on, or reflect, the provisions of Revised UCC Article 5 or standard rules of letter of credit practice. Such statements are helpful to those affected by them and should not be discouraged.

This impression is reinforced by the examples given in Official Comment 2 to Revised UCC section 5-103(c).<sup>197</sup> The test is "whether the disclaimer or limitation is sufficiently clear and explicit in reallocating a liability or risk that is allocated differently under a variable Article 5 provision."<sup>198</sup> Reinforcing this impression is the statement that the basis of the provision goes to the procedural rather than substantive unfairness, which means that a variation is

funds not later than the date of its payment of funds . . ." *Id.*

194. *See id.* § 5-107(b) (providing that a nominated person who has not added its confirmation has no obligation on the undertaking; as a result, any liability or remedies that arise, result from action by the nominated bank pursuant to its nomination).

195. *See id.* § 5-110.

196. *See id.* § 5-111.

197. *Id.* § 5-103 cmt. 2.

198. Comment 2 to Revised Section 5-103 provides:

What the issuer could achieve by an explicit agreement with its applicant or by a term that explicitly defines its duty, it cannot accomplish by a general disclaimer. The restriction on disclaimers in the last sentence of subsection (c) is based more on procedural than on substantive unfairness. Where, for example, the reimbursement agreement provides explicitly that the issuer need not examine any documents, the applicant understands the risk it has undertaken. A term in a reimbursement agreement which states generally that an issuer will not be liable unless it has acted in "bad faith" or committed "gross negligence" is ineffective under section 5-103(c). On the other hand, less general terms such as terms that permit issuer reliance on an oral or electronic message believed in good faith to have been received from the applicant or terms that entitle an issuer to reimbursement when it honors a "substantially" though not "strictly" complying presentation, are effective. In each case the question is whether the disclaimer or limitation is sufficiently clear and explicit in reallocating a liability or risk that is allocated differently under a variable Article 5 provision.

*Id.*

acceptable if it is sufficiently explicit. In this perspective, a general disclaimer by the issuer of liability for beneficiary fraud would not run afoul of this prohibition because it does not reallocate liabilities.

Another sentence in Official Comment 2 to Revised UCC section 5-103(c), however, seems to add another factor to the scope of this limitation. It states that it “limits the power of the issuer to achieve [adjustment of the obligations of the issuer] by a non-negotiated disclaimer or limitation of remedy.”<sup>199</sup> As indicated, Revised UCC Article 5, and section 5-103 in particular, has been nuanced in its recognition that the terms and conditions of a letter of credit are not negotiated in any normal sense of the term. They represent the unilateral terms of the issuer’s undertaking which the beneficiary has not negotiated, and as to which it bears no obligation to the issuer to perform.

The notion of a negotiated term as opposed to a unilateral term not only raises the specter of substantive unfairness as a criteria, but does so in a manner that is out of sync with the letter of credit itself. If there is to be a test based on substantive unfairness, it should be expressly stated in the text of the UCC in a manner that can be realistically applied. As it is, this editorial comment is without basis in the text of Revised UCC Article 5.

#### 8. Exceptions in Addition to Those Listed in Revised UCC Section 5-103(c)

In view of the novel approach of Revised UCC Article 5 to variability, it is necessary to ask whether it is fully successful or whether additional inferences have to be made for certain aspects not included in the list. There are three prime candidates for such consideration: (1) other definitions besides “Letter of Credit” and “Issuer,” fraud and forgery; (2) the statute of limitations; and (3) security interests in letters of credit.

##### *a. Other definitions in Revised section 5-102 (definitions) besides “letter of credit” and “issuer”*

Since Revised UCC section 5-103(c) only prohibits variation of the effects of the definitions of the terms “issuer” and “letter of credit,”<sup>200</sup> it is apparent that the drafters believed that the effects of

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199. *Id.*

200. *See id.* § 5-103(c).

the other definitions could be varied. What is unusual here is that the approach is more restrictive than that taken in Revised UCC Article 1.

Official Comment 1 to Revised section 1-302 suggests that the meaning of the phrase “the effect of provisions of [the Uniform Commercial Code] may be varied by agreement” is that the “effect” of the statute may be varied and not the meaning of its provisions themselves which “must be found in its text, including its definitions . . . .”<sup>201</sup> It is suggested that the effect of negotiability and “bona fide purchaser” and “holder in due course” as used in the UCC cannot be changed, but that “an agreement can change the legal consequences that would otherwise flow from the provisions of the Uniform Commercial Code.”<sup>202</sup> Official Comment 2 to Prior UCC section 1-102(3) similarly states “[t]he meaning of the statute itself must be found in its text, including its definitions . . . it cannot be varied by agreement.”<sup>203</sup> Moreover, the 1998 Revision of UCC Article 9, which also lists nonvariable provisions in a manner similar to Revised UCC Article 5, does not suggest that the effect of its definitions cannot be varied.<sup>204</sup>

In addition to considering what it means to say that the effects of the definitions of “letter of credit” and “issuer” cannot be varied and why such a restriction is appropriate, it is necessary to ask whether there is any limitation on the variation of the effects of the variable definitions of Revised UCC Article 5.

Revised section 5-103 Official Comment 3 introduces some confusion by warning that “[p]arties should generally avoid modifying the definitions in section 5-102” for fear that lack of clarity that would follow.<sup>205</sup> This reference (which must be to the variable definitions, since the effects of the nonvariable ones cannot be varied) is either abbreviated or an error because Revised UCC section 5-103(c) makes it apparent that only the effects of the provisions of Revised UCC Article 5 can be varied and not its provisions themselves. This distinction would also apply to the variable definitions.

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201. See U.C.C. § 1-302 cmt. 1 (2003).

202. *Id.*

203. U.C.C. § 1-102 cmt. 2 (1958) (amended 2001).

204. See U.C.C. § 9-602 (1998) (amended 2001).

205. U.C.C. § 5-103 cmt. 3 (1995).

However, the example given to illustrate this warning is also confusing. It is suggested that a provision in a letter of credit that a true domestic guarantee (suretyship, accessory undertaking, or dependent guarantee) is a “letter of credit” is an example of a modification that would leave a court “uncertain about where the rules on guarantees stop and those concerning letters of credit begin.”<sup>206</sup> This example may support inclusion of the definition of the term “letter of credit” in the list of nonvariable provisions, but it does not illustrate why the effects of other definitions should not be varied.

Not only are there good reasons why the effects of the definitions should not be varied, the question must be asked whether limitations on their variability can be inferred. Since the definitions do not represent prescribed obligations, the general limitations that the effect may not be varied in a manner that is manifestly unreasonable imported from Revised UCC section 1-302(b) are not applicable.

For example, can an undertaking provide that effect of the term “confirmer” is that the party undertakes only to check the accuracy and apparent authenticity of the undertaking that it confirms? Both the definitions of “advisor” and “confirmer” and the obligations attributed to them in Revised UCC section 5-107 are variable.<sup>207</sup>

This drastic variation is troublesome because it distorts well-known and understood terminologies and their consequences. While it may be possible to limit the consequences of the undertaking of an advising bank or a confirming bank, conflation of the terms should not be permitted.<sup>208</sup> It is most unlikely that a court would give effect to such a variation. There are a variety of grounds on which it could base such a result. It could conclude that the effect of the provision was not being varied but that its meaning was being changed. It could also impute a rule that the variations may not be manifestly unreasonable. Provided that this determination was made in light of

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206. *Id.*

207. *See id.* § 5-107.

208. *See, e.g., Apex Pool Equip. Corp. v. Lee*, 419 F.2d 556, 561 n.9 (2d Cir. 1969) (“However, it is clear to us that the parties did not have the Code definition in mind . . . . Attributing a different meaning to their language would be foreign to the spirit of the Code.” (citing UCC § 1-102(3))); *In re Phoenix Pipe & Tube, L.P.*, 38 U.C.C. Rep. Serv. 2d (CBC) 28, 31 (E.D. Pa. 1993) (holding that under Pennsylvania’s version of § 1-102(3), parties were barred “from varying the substantive definition of ‘security agreement’”).

letter of credit considerations, such an imputation would not be particularly troublesome.

However, it would be inappropriate to name a general importation of common law or commercial notions regarding what is appropriate or the range of minimum variability, or to conclude that Revised UCC Article 5 does not compel the conclusion that the parties may modify the effects of its definitions simply because two are listed as nonvariable.

*b. The statute of limitations*

Revised UCC section 5-115 is not included in section 5-103(c)'s list of nonvariables.<sup>209</sup> Revised UCC section 5-115 provides for a one year limitations period after expiration or accrual regardless of knowledge.<sup>210</sup>

It is not uncommon for statutes of limitations to be expressly downsized to a lesser period of time, and, since it is not listed as nonvariable, a court would permit the one year period to be lessened. It is unlikely, however, that a court would permit this period to be so reduced as to render it meaningless. This result might be justified as a manifestly unreasonable standard of good faith, diligence, or reasonableness based on letter of credit principles. It might also be based on the public policy underlying the statute of limitations.<sup>211</sup>

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209. Revised UCC Section 5-115 provides:

An action to enforce a right or obligation arising under this article must be commenced within one year after the expiration date of the relevant letter of credit or one year after the [claim for relief] [cause of action] accrues, whichever occurs later. A [claim for relief] [cause of action] accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

U.C.C. § 5-115 (1995) (alteration in original).

210. *Id.*

211. *See* Order of United Commercial Travelers v. Wolfe, 331 U.S. 586, 608 (1947) (finding that parties to a contract may validly limit the statute of limitations absent a controlling statute and provided the shorter period is reasonable); *N. Am. Foreign Trading Corp. v. Mitsui Sumitomo Ins. USA, Inc.*, 413 F. Supp. 2d 295, 301 (S.D.N.Y. 2006) (finding that under New York law, "parties to a contract may designate a reasonable period of limitations within which a claim arising out of the contract is to be commenced, even if that period is shorter than the statutory period"); *In re Global Indus. Tech., Inc.*, 333 B.R. 251, 259 (Bankr. W.D. Pa. 2005) (noting that under Ohio law, "[t]he contractual limitations period will be upheld by the court as long as its terms are reasonable"); *Rumsey Elec. Co. v. Univ. of Del.*, 358 A.2d 712, 714 (Del. 1976) (noting that "in the absence of an express statutory provision to the contrary, a statute of limitations does not proscribe the imposition of a shorter limitations period by contract" (citations omitted)); *Inc. Village of Saltaire v. Zagata*, 720 N.Y.S.2d 200 (App. Div. 2001) (finding that under New York law, "[p]arties to a contract may agree to limit the period of time within which an action must be commenced to a shorter period than that provided by the applicable Statute of

Similarly treated would be radical variations of the time from which the period runs (e.g. issuance of the letter of credit as opposed to its expiration).

It is also unclear whether the length of the one year limitation can be extended. Section 5-114 evidences an interest in a relatively short limitations period by the choice of a one year period and the accrual of an action regardless of notice. Generally, courts have resisted extension of the period of limitations.<sup>212</sup> Given this policy, it is likely that such an attempt will be regarded with hostility by courts. However, since the provision is variable, the terms of Revised UCC Article 5 should control over general policy considerations with respect to its own statute of limitations.<sup>213</sup>

### *c. Letter of credit fraud*

Revised UCC section 5-109 (Fraud and Forgery) reflects Revised UCC Article 5's policy regarding letter of credit fraud, what it is, the duties of issuers and confirmers, protected persons, and injunctions.<sup>214</sup> Since this section is not included in the list of

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Limitations”).

212. See *E. L. Burns Co. v. Cashio*, 302 So.2d 297, 297 (La. 1974) (holding that “parties’ stipulation that suit could be brought on performance bond within two years, in contravention of statutory one-year prescription, constituted an anticipatory renunciation of prescription and could not be given effect”); *Burlew v. Fid. & Cas. Co. of N.Y.*, 122 S.W.2d 990, 995 (Ky. 1938) (noting that the courts should “not be cluttered up with stale claims . . . to the extent of refusing to enforce a contract limitation fixing a *longer* period than that prescribed by statute”); *Soviero Bros. Contracting Corp. v. City of N.Y.*, 142 N.Y.S.2d 508 (App. Div. 1955) (noting “a waiver of statute of limitations is illegal as against public policy, whereas an agreement containing a reasonable limitation period is valid and enforceable”).

213. Given the position taken here, it would follow that the parties can agree to toll the statute of limitations. However, this question is more within the realm of procedural, rather than letter of credit law, and there is no letter of credit policy that would prevent such an agreement from being given effect. See *SEC v. DiBella*, 409 F. Supp. 2d 122 (D. Conn. 2006).

214. Revised UCC Section 5-109 provides:

(a) If a presentation is made that appears on its face strictly to comply with the terms and conditions of the letter of credit, but a required document is forged or materially fraudulent, or honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant:

(1) the issuer shall honor the presentation, if honor is demanded by (i) a nominated person who has given value in good faith and without notice of forgery or material fraud, (ii) a confirmer who has honored its confirmation in good faith, (iii) a holder in due course of a draft drawn under the letter of credit which was taken after acceptance by the issuer or nominated person, or (iv) an assignee of the issuer's or nominated person's deferred obligation that was taken for value and without notice of forgery or material fraud after the obligation was incurred by the issuer or nominated person; and



nonvariables, the drafters intended that the effect of its provisions could be varied.

This approach challenges longstanding notions about the nonvariability of matters grounded in public policy. Consequently, it must be asked how the variability of the provisions of Revised UCC section 5-109 can be reconciled with these policy issues.

Can Revised UCC section 5-109 be excluded from an undertaking? Because it is a fundamental matter of public policy that courts will not allow the legal system to be used to facilitate fraud, courts will be hostile to such a provision. Of course, they could avoid it by means of construing it not to so provide. Assuming that it was construed to exclude the section, courts could take one of two fundamental approaches. On the one hand, courts could rule that such a variation is not enforceable either as being manifestly unreasonable, a violation of letter of credit policy, or a violation of general principles of public policy. On the other hand, they could simply resort to the common law remedies that predated UCC Article 5, and which are embodied in the *Sztejn v. J. Henry Schroder Banking Corp.* decision.<sup>215</sup> Since Revised UCC section 5-109 is largely declaratory of the common law that has evolved as a result of this case, the result would not differ much. Indeed, if the experience of the New York courts with New York Non-Conforming Prior section 5-102(4) is any indication, the courts may well refer to the

(2) the issuer, acting in good faith, may honor or dishonor the presentation in any other case.

(b) If an applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, a court of competent jurisdiction may temporarily or permanently enjoin the issuer from honoring a presentation or grant similar relief against the issuer or other persons only if the court finds that:

(1) the relief is not prohibited under the law applicable to an accepted draft or deferred obligation incurred by the issuer;

(2) a beneficiary, issuer, or nominated person who may be adversely affected is adequately protected against loss that it may suffer because the relief is granted;

(3) all of the conditions to entitle a person to the relief under the law of this State have been met; and

(4) on the basis of the information submitted to the court, the applicant is more likely than not to succeed under its claim of forgery or material fraud and the person demanding honor does not qualify for protection under subsection (a)(1).

U.C.C. § 5-109 (1995).

215. *Sztejn v. J. Henry Schroder Banking Corp.*, 31 N.Y.S.2d 631 (Sup. Ct. 1941) (holding that an injunction can be issued against beneficiary/seller that shipped rubbish instead of goods).

statute by analogy even where the letter of credit ousts that provision of the statute. Because matters related to letter of credit fraud are not exclusively within the ability of private parties to affect, such a result would be sound. It may be wondered, however, what is achieved by this circularity.

The same considerations will apply where the undertaking provides that payment will be made notwithstanding the existence of letter of credit fraud or an injunction.

Less clear, however, would be the result where the terms of the letter of credit attempted to modify provisions of Revised UCC section 5-109. While not exhaustive, some of the candidates for such modification are the test of letter of credit fraud, the duty of the issuer or confirmer, the exceptions for the issuer, confirmer, transferee beneficiary, a non-confirming nominated bank, and a non-nominated bank, and the requirements for injunctive or other extraordinary relief.

While no definitive analysis has been made of the variability of these provisions, and the issue has not been addressed in any reported case, several observations are in order:

- 1) Courts will be reluctant to give effect to any modification that impacts public policy without providing equal or better protection for the public policy concerns affected. It would be more consistent with the scope of the variability rule if courts based their decisions on letter of credit policy and recognize that the parties may have had another enforceable non-letter of credit obligation in mind.
- 2) It is unlikely that an attempt to expand the definition of letter of credit fraud to include matters such as misrepresentation would be given effect because it would change the nature of the letter of credit transaction from an independent to a dependent one. Also, it is unlikely that it could be contracted effectively.<sup>216</sup> There are a variety of bases on which refusal could be based, including its impact on the definition of a letter of credit (which is nonvariable), general public policy concerns, or the scope of Revised

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216. One possible exception might be to exclude from letter of credit fraud a situation where the beneficiary did not have knowledge of the forged or fraudulent document. While not a sound rule, there is no fundamental reason that the parties could not shift this risk, particularly since it operates against the issuer.

UCC Article 5. On the other hand, an explanatory statement in a letter of credit that reflects the provisions of Revised UCC section 5-109 would probably be referenced in a decision to the extent that it stated accepted law.

3) A readjustment of allocations of the risk of letter of credit fraud, on the other hand, would be allowed provided that it does not have the effect of distorting the balance achieved under standard international letter of credit law and practice. If an issuer assumed the risk of certain types of letter of credit fraud as to the applicant, that provision would probably be enforced. On the other hand, if the terms of the letter of credit seek to shift that risk to the confirmer or other nominated banks that have duly acted pursuant to their nomination, it is unlikely that such a provision would be enforced. It is also doubtful if a provision shifting to the applicant the risk of letter of credit fraud as to a nominated negotiating bank that has notice of a claim of fraud when it negotiates would be given effect even if it were clearly stated in the letter of credit. On the other hand, a provision that extended such protection to banks that were not nominated provided that they gave value in good faith and without notice of the letter of credit fraud might be enforced since the restriction of innocent third party protections to nominated persons is not a fundamental notice that cannot be expanded to other innocent parties. It is unclear whether the extension of third party protection to an assignee of proceeds who is also an innocent purchaser for value would be given effect. While arguments can be made in support of reallocation of relative risks and losses as between nominated banks, the issuer, and the applicant, such a serious distortion of the fundamental alignment of parties will not be welcomed. Apart from questions of notice, there are questions of the rights of third persons in specific and general, and public policy concerns. Any such attempt will meet with considerable difficulty and resistance notwithstanding its apparent variable statutes.

4) United States courts are likely to be very selective in allowing private agreements to affect the standards for

injunctive or other extraordinary relief. Strengthening or weakening the standards would upset a very delicate balance that operates to restrict situations in which such relief can be granted for public policy and letter of credit policy reasons. On the other hand, courts are likely to enforce a provision that requires a party seeking an injunction to post a bond covering the amount of the letter of credit, attorney's fees, costs, and consequential damages available under the underlying transaction.

*d. Revised UCC section 5-118 security interests*

Revised UCC section 5-118 is not included in Revised UCC section 5-103(c)'s list of nonvariable provisions.<sup>217</sup> Revised UCC section 5-118 creates a perfected security interest in a document presented under a letter of credit in favor of an issuer or nominated person who has honored or negotiated the presentation for value. Therefore, the question is whether these provisions can be varied.<sup>218</sup>

The answer is complex. Certainly, the majority of its provisions can be varied. The issuer or nominated person can surely agree to subordinate or waive their interest and so provide in the letter of credit or at the time of honor or negotiation. They could also obtain a security agreement even though it is unnecessary.

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217. U.C.C. § 5-103(c). See also Revised UCC Section 5-118, which provides:

(a) An issuer or nominated person has a security interest in a document presented under a letter of credit to the extent that the issuer or nominated person honors or gives value for the presentation.

(b) So long as and to the extent that an issuer or nominated person has not been reimbursed or has not otherwise recovered the value given with respect to a security interest in a document under subsection (a), the security interest continues and is subject to Article 9, but:

(1) a security agreement is not necessary to make the security interest enforceable under Section 9-203(b)(3);

(2) if the document is presented in a medium other than a written or other tangible medium, the security interest is perfected; and

(3) if the document is presented in a written or other tangible medium and is not a certificated security, chattel paper, a document of title, an instrument, or a letter of credit, the security interest is perfected and has priority over a conflicting security interest in the document so long as the debtor does not have possession of the document.

*Id.* § 5-118.

218. None of the provisions relating to security interests in letters of credit is included in the 1998 Revision of UCC section 9-602 list of nonvariable provisions. See U.C.C. § 9-602 (1998).

There are, however, some outer limits. It is highly doubtful that the issuer or nominated person could effectively expand the circumstances that give rise to a security interest by, for example, providing that honor or due negotiation for value is not necessary for a security interest to arise or by providing that perfection continues even after reimbursement. One basis for this conclusion might be that it distorts the scheme of Revised UCC Article 9. However, Revised UCC section 5-118 is itself an exception to Revised UCC Article 9 and Revised UCC section 5-116(d) provides that, in the event of conflict, Revised UCC Article 5 controls.<sup>219</sup> A more compelling argument is that permitting a security interest to arise in situations where there was no commercial situation is a violation of public policy.

#### 9. Some Reflections on Listing Variable Provisions in Revised UCC Article 5.

The attempt of Revised UCC section 5-103(c) to add certainty by an exclusive list of nonvariable provisions focuses attention on the issues that should be considered. While not perfect, it is reasonably successful in its attempt to do so, which is an impressive result in light of the radical departure that it represents.

Nonetheless, an appreciation of the nonvariability of Revised UCC Article 5 must include not only those sections listed but also those that are implicit in it. For the reasons discussed, any implication of nonvariability must be founded on fundamental letter of credit policies. Revised UCC section 5-103(c) is sufficiently crafted to permit a common law court to make such judicial determinations where appropriate. As indicated, in the definitions, the provisions on letter of credit fraud (section 5-109), the Statute of Limitations (section 5-117), and the scope provisions regarding security interests in letter of credit documents (section 5-118) must be given careful consideration in this regard.

More explanation of this radical departure from the traditional approach would have been helpful and desirable and would have added to the certainty that the approach would be given judicial effect. Nonetheless, the text of section 5-103(c) itself is sufficiently clear once one grasps the breadth of its approach and distinguishes it

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219. U.C.C. § 5-116(d) (1995).

from the general UCC approach. Thoughtful courts will follow the guidance of the Revised Article 5 approach, being informed in their judgments by the principles underlying Revised UCC Article 5 and the nature of the letter of credit, including the policy evidenced by Revised UCC section 5-103(c) of a liberal approach in favor of variability to the widest extent possible.

*C. Variation of Other Laws Affecting  
Revised UCC Article 5 Letters of Credit*

Because Revised UCC Article 5 is not an exhaustive treatment of legal issues related to letters of credit,<sup>220</sup> it is sometimes necessary to refer to other statutes or case law in resolving issues that are otherwise subject to Revised UCC Article 5. In addition, issues that are addressed in Revised UCC Article 5 are also addressed in other statutes and in case law that is unrelated to letter of credit law. In such a situation, it is possible that a given provision can be variable under one legal regime and not the other one or that neither addresses the question of variability.

In considering the variability of these provisions, it is necessary to identify the statutes and common law rules that are affected to determine whether or not there is a hierarchy with respect to Revised UCC Article 5, and if so, what it is, and to what extent these provisions can be excluded or modified. Since the comprehensive treatment of these questions itself warrants an independent study, this Article only identifies the issues in general, and attempts to outline factors that must be taken into account in any definitive approach.

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220. *Id.* § 5-103(b) (“The statement of a rule in this article does not by itself require, imply, or negate application of the same or a different rule to a situation not provided for, or to a person not specified, in this article.”); *see also* U.C.C. § 5-102(3) (1957) (amended 2003) (“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.”). Official Comment 2 to UCC Section 5-102 notes that application of then UCC Article 5 to a situation not covered by the statute “is to follow the canon of liberal interpretation to promote underlying purposes and policies. Since the law of letters of credit is still developing, conscious use of that canon and attention to fundamental theory by the court are peculiarly appropriate.” *Id.* § 5-102 cmt. 2.

## 1. Where Other Legal Regimes Are Involved in Letter of Credit Disputes

### *a. Other articles of the Uniform Commercial Code*

The starting point for connectivity with other articles of the Uniform Commercial Code should be Revised UCC Article 3. To the extent that letters of credit had any historical statutory basis, it was as a promise to accept a bill of exchange or draft that was not yet issued or a virtual acceptance. Such undertakings were recognized by the United States decisional law<sup>221</sup> and embodied in section 135 of the Negotiable Instruments Law.<sup>222</sup> Apart from this theoretical commonality, letter of credit law and practice originally looked to the draft or bill of exchange as an undertaking quite different from other documents to be presented, and drew from the law relating to drafts many of the principles related to protection of innocent third parties. Prior UCC Article 5 deferred to UCC Article 3 with respect to the entitlement to and rights of a holder in due course.<sup>223</sup> While there were parallels, there were major differences as well, especially since there was no necessary requirement for presentation of a negotiable instrument,<sup>224</sup> and a non-negotiable draft or demand could as readily be “negotiated.”<sup>225</sup>

221. In England in *Pillans & Rose v. Van Mierop & Hopkins*, (1765) 97 Eng. Rep. 1035, Lord Mansfield gave effect to a promise to accept, which was later rejected in a series of decisions and codified by statutes. See *Pierson v. Dunlap*, (1777) 98 Eng. Rep. 1246; Bills of Exchange Act, 1882, 45 & 46 Vict., c. 61, § 17 (Eng.) (English statute following court decisions rejected giving effect to promises to accept); Mercantile Law Amendment Act, 1856, 19 & 20 Vict., 97, § 6 (Eng.), repealed by Bills of Exchange Act, 1882, 45 & 46 Vict., c. 96, Sched. 2; *accord Coolidge v. Payson*, 15 U.S. 66 (1817) (United States decision following Lord Mansfield).

222. JOSEPH BRANNAN, *THE NEGOTIABLE INSTRUMENTS LAW ANNOTATED* § 135 (Zechariah Chafee, Jr. ed., 4th ed. The W.H. Anderson Co. 1926). Section 135 of the Negotiable Instruments Law provides “[a]n unconditional promise in writing to accept a bill before it is drawn is deemed an actual acceptance in favor of every person who, upon the faith thereof, receives the bill for value.” *Id.*

223. U.C.C. § 5-114(2)(a) (1957) (amended 1995). Section 5-114(2)(a) affords HIDC status “under circumstances that would make it a holder in due course (section 3-302).” *Id.*

224. Of course, a letter of credit, being a conditional promise, is not itself a negotiable instrument since it is not unconditional. See U.C.C. § 3-104(a) (2003).

225. This state of affairs is implicitly recognized in Prior UCC section 5-114 which speaks of a “draft or demand.” U.C.C. § 5-114(1) (1957) (amended 1995). UCP400 Article 21(c) is the first appearance in the UCP of the word demand in relation to negotiation. It provides “[t]he issuing bank will be responsible to the paying, accepting or negotiating bank for any loss of interest if reimbursement is not provided on first demand made to the reimbursing bank, or as otherwise specified in the credit, or mutually agreed, as the case may be.” INT’L CHAMBER OF COMMERCE, UNIF. CUSTOMS & PRACTICE FOR DOCUMENTARY CREDITS art. 21(c) (1984) (ICC

Revised UCC section 5-116(d) has settled the question of the relative hierarchy of Articles 3 and 5 with respect to letter of credit questions, providing that Article 5 prevails in the event of any conflict.<sup>226</sup> But it should be recognized that where one of the required documents is a UCC Article 3 draft, especially where it is accepted, a person may have two separate (but not necessarily parallel) and somewhat similar rights under the letter of credit and the bill of exchange.

There are cross-references remaining between UCC Articles 3 and 5. Revised UCC section 5-102(b) draws on Article 3 for the definitions of “accept” and “value.”<sup>227</sup> In particular, it is with respect to an acceptance that the linkage is strongest, but it is also strong with respect to the meaning of “value.” Revised UCC Article 5 does not directly address the issue, but a United States court would not accord protected status to a nominated bank that had not given value as it is understood in light of Revised UCC section 3-303 and, in particular, would confer this status with respect to a promise to give value only to the extent that the promise had been performed or constituted a negotiable instrument or an independent undertaking.<sup>228</sup> Revised UCC section 5-108(i) also refers to UCC Article 3 with respect to recourse even though the concept in letter of credit law is not tied to the presence of a negotiable instrument.<sup>229</sup>

There is some connectivity between letters of credit and other articles of the UCC. Revised UCC Article 4 is also mentioned in Revised UCC section 5-102(b) in connection with the definition of “value.”<sup>230</sup> It is also relevant for issues of the rights and duties of correspondent banks and documentary collections. The mechanism of payment or reimbursement can overlap with UCC Article 4A (Fund Transfers). When required documents include documents of

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Pub. No. 400] [hereinafter UCP400].

226. U.C.C. § 5-116(d) (1995).

227. *Id.* § 5-102(b).

228. *Id.* Revised UCC section 5-102(b) does cross-reference Revised UCC sections 3-303 and 4-211 with respect to the meaning of “value.” See U.C.C. §§ 3-303(a)(1), (4), (5). This issue is of current interest because UCP600 Article 2 has deleted the term “value” from the definition of “negotiation” in UCP500 Article 10 and stated that negotiation includes a promise to pay. See UCP600, *supra* note 5. While making a promise to pay may be a basis for negotiation in the sense of transferring the right to be paid under the documents, it is not “value” nor a basis for protected status and it is likely that this issue will cause some confusion as the cases emerge.

229. See U.C.C. § 5-108(i).

230. See *id.* § 5-102(b).



title or securities, Articles 7 and 8 could be involved. There are also provisions of Revised UCC Article 9 that address obtaining and perfecting a security interest in a letter of credit.<sup>231</sup> To some extent, the underlying contract could impact letter of credit issues, particularly where terms such as “FOB” and the like are used, terms that are defined in Prior UCC Article 2.<sup>232</sup> In addition, the question of what constitutes an acceptance letter of credit in the underlying contract can involve letter of credit and sales issues.<sup>233</sup> The notion of warranty permeates the UCC and may well overlap with issues that arise in connection with letters of credit.

In addition, Prior and Revised UCC Article 1 (General Provisions) have provisions that are applicable to Revised UCC Article 5, including definitions and general principles of commercial law. They include the principles of construction, interpretation, treatment of terms such as notice and receipt of notice, and evidentiary rules. There is no provision in Revised UCC Article 5 that preempts UCC Article 1 which, by its terms, applies to a transaction “to the extent that it is governed by another article of [the Uniform Commercial Code].”<sup>234</sup>

*b. Other statutes and case law*

Since the UCC is not an exhaustive treatment of commercial law, there are other statutes outside the UCC that could impact letter of credit issues. Where the issue is also governed by or, to an extent, preempted by federal law, there are also federal statutes or international conventions that must be considered. Thus, with respect to warehouse receipts, bills of lading, bank collections, successors by operation of law, and securities, there are relevant federal statutes. Many of these issues are also governed by other state statutes as well.

Perhaps the most important non-UCC statutory scheme that regularly intersects with letter of credit issues is that related to

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231. See, e.g., U.C.C. §§ 9-107, 9-312(b)(2), 9-314 (2001).

232. See U.C.C. §§ 2-320 to 2-324 (1957) (amended 2003). Revised UCC Article 2 deletes references to these terms which conflict with the approach of INCOTERMS as matters for private rulemaking or terms of the contract and not as matters for statutory concern.

233. See *id.* § 2-325. This provision is modified in Revised UCC section 2-325. See U.C.C. § 2-325 (2003).

234. U.C.C. § 1-102 (2004).

insolvency, and bankruptcy in particular. There have been numerous turf wars between bankruptcy and letters of credit<sup>235</sup> including the treatment of subrogation,<sup>236</sup> and most recently, the landlord lease cap.<sup>237</sup>

Beyond these statutes, there are issues that are addressed by case law, including those matters recognized in Revised UCC section 1-103 (b) such as the law merchant, capacity, agency, estoppel, and mistake,<sup>238</sup> and other general issues that are not such as restitution, injunctive relief, damages, and remedies.

Apart from these commercial matters is the issue of illegality or similar public policy concepts which, by virtue of statute or administrative rule, affect letters of credit and the application of Revised UCC Article 5.<sup>239</sup>

## 2. Relationship Between Revised UCC Article 5 and Other Statutes and Case Law

The relationship between Revised UCC Article 5 and other articles of the UCC is largely governed by Revised UCC section 5-

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235. See *In re Twist Cap, Inc.*, 1 B.R. 284, 285 (Bankr. M.D. Fla. 1979) (holding that the bankruptcy court had subject matter jurisdiction over suit by debtor seeking to restrain bank from honoring letters of credit and that payment amounted to “impermissible preferential treatment of unsecured creditors”). But see *In re N. Shore & Cent. Ill. Freight Co.*, 30 B.R. 377, 379 (Bankr. N.D. Ill. 1983); *In re Clothes, Inc.*, 35 B.R. 487, 489 (Bankr. D. N.D. 1983); *Lower Brule Constr. Co. v. Sheesley’s Plumbing & Heating Co., Inc.*, 84 B.R. 638, 645 (Bankr. D. S.D. 1988); *In re A.J. Lane & Co., Inc.*, 115 B.R. 738, 741 (Bankr. D. Mass. 1990).

236. See *Tudor Dev. Group, Inc. v. U.S. Fid. and Guar.*, 968 F.2d 357, 364 (3d Cir. 1992) (noting that a bank which was satisfying its own, rather than another’s liability when it made payment under letter of credit could not avail itself of common law remedy of equitable subrogation). But see *id.* at 364–71 (Becker, J., dissenting); U.C.C. § 5-117 cmt. 1 (1995); *In re Slamans*, 175 B.R. 762 (N.D. Okla. 1994).

237. *Mayan Networks Corp. v. Mayan Networks Corp.*, 306 B.R. 295 (B.A.P. 9th Cir. 2004) (holding landlord’s draw on letter of credit must be reduced from landlord’s allowed unsecured claim); Carter Klein, *Mayan Networks: Cause for Concern for Bankruptcy Caps on Leases (and Issuers)?*, DOCUMENTARY CREDIT WORLD, Sept. 2004, at 27.

238. U.C.C. § 1-103(b) (2004) (“Unless displaced by the particular provisions of [the Uniform Commercial Code], the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy, and other validating or invalidating cause supplement its provisions.”).

239. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, H.R. 3763 (July 30, 2002); Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act), H.R. 3162, 107th Cong. (1st Sess. 2001) (enacted); Office of Foreign Assets Control, Interpretive Rulings, OFAC Interp. Ruling 020416-FACRL-CU-01 (Apr. 16, 2002), available at <http://www.treas.gov/offices/enforcement/ofac/rulings/index.shtml> (follow “computerized reservations systems (Cuba Travel)” hyperlink).

116(d) which provides that, in the event of conflict, Revised UCC Article 5 governs over Articles 3, 4, 4A, and 9.<sup>240</sup> The possibility of direct conflict with the other substantive articles, Article 2, 2A, 6, 7, and 8 is minimal. Notably missing is a reference to UCC Article 1.<sup>241</sup>

With respect to other non-UCC statutes and case law, the relative hierarchy is less clear. Where the issue involves a letter of credit issue, it is likely that Revised UCC Article 5 would control as to letter of credit implications. The issues become more complex where there is federal law preemption although some federal statutes are interpreted to defer to state law on commercial matters.

On the issue of illegality, there are public policy factors at issue. However, from the perspective of letter of credit law, exceptions to the obligations of parties to letters of credit should be statutory and narrowly construed.

### 3. Can Non-UCC Provisions Be Varied?

It is not possible at this stage of Revised UCC Article 5 letter of credit jurisprudence to give a definitive answer or even identify the principles that should govern the answer to this question. These questions will have to be approached on an *ad hoc* basis.

Some rough indication of the approach of Revised UCC Article 5 itself to these questions can be discerned from its treatment of three discrete issues addressed in Revised UCC section 5-108(i)(3), (4), and (5).<sup>242</sup> Since these subsections are not listed in Revised UCC section 5-103(c),<sup>243</sup> they are variable unless they can be linked to one of the provisions listed or otherwise are determined to be nonvariable.

Under Revised UCC section 3-414, an endorser undertakes to pay the amount of a draft to a person entitled to enforce the instrument or a subsequent endorser who paid.<sup>244</sup> Where the issuer honored a presentation that included a draft drawn on the applicant,

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240. See U.C.C. § 5-116(d) (1995).

241. See *id.*

242. *Id.* § 5-108(i). Revised UCC section 5-108(i) provides “[a]n issuer that has honored a presentation as permitted or required by this article: . . . (3) is precluded from asserting a right of recourse on a draft under sections 3-414 and 3-415 . . . .” *Id.*

243. *Id.* § 5-103(c).

244. U.C.C. § 3-414 (2003).

Revised UCC section 5-108(i)(3) precludes an issuer from claiming against anyone who has endorsed the draft or the beneficiary for its non payment under UCC Article 3. While the right to recourse can be varied under UCC Article 3 by endorsing without recourse, the Revised UCC Article 5 rule provides for non-recourse. To vary this provision would significantly alter the undertaking of the issuer, namely to entitle it to escape its obligations in contravention of the obligations of an issuer. A court could refuse to allow it to be varied under public policy grounds, because it contradicted what constituted a letter of credit (nonvariable), because it was manifestly unreasonable (or bad faith), or because it violated the independence principle (also nonvariable). Even if the letter of credit attempts to vary the rule under Revised UCC section 3-414 on recourse, such a variation would not alter the letter of credit conclusion that it should not be varied. Also, because Revised UCC Article 5 controls over UCC Article 3, it would not trump.

The question of whether an issuer can obtain restitution from a beneficiary where it has mistakenly honored notwithstanding the presence of discrepancies on the face of the documents presents similar issues. Revised UCC section 5-108(i)(4) represents a policy determination that defeats the equitable law of mistake.<sup>245</sup> Whether this provision can be varied by making the law of mistake control presents a difficult question. For similar policy reasons tied to the nature of the letter of credit undertaking, the result would probably be similar to that suggested for recourse.

If a letter of credit provided that the beneficiary bore the risk that a stranger would forge documents under the letter of credit, assuming that the provision were conspicuous, such a provision would be more likely to be enforced. While an unusual provision that most beneficiaries would not accept, it is a risk allocation that could be made. The difficulty in its enforcement is that a common law court would have several general grounds on which it could refuse enforcement if it believed that the beneficiary had been overtaken by surprise.

While none of these provisions are definitive, they do illustrate issues on which Revised UCC Article 5 has spoken. How a court would or should approach issues on which it has not spoken is not

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245. U.C.C. § 5-108(i)(4) (1995).

clear and little can be gathered from these issues.

At the most, several factors can be identified and stated in general terms:

- 1) The general principle of Revised UCC Article 5 in favor of liberal variability should apply to all provisions regarding letters of credit. In addition, other policy considerations underlying restrictions on variability of Revised UCC Article 5 provisions should also be noted.
- 2) In addition to attending to Revised UCC Article 5's policies towards variability, other fundamental policies of Revised UCC Article 5 should be considered and furthered to the extent possible, in particular the alignment of the law with mercantile practice and the concern for the integrity of the undertaking.
- 3) Where there are dual obligations, one under the law of letter of credit and the other under another legal regime, the variability of the letter of credit obligations should be determined by letter of credit policy without undue regard for whether different results are produced.
- 4) Whether there is a statutory restriction or statement regarding the variability of these provisions or case law on the question, and, if so, its policy underpinnings.

#### *D. Variation by Adopting Rules of Practice*

As indicated previously, one of the means of varying the law under letters of credit subject to Revised UCC Article 5 is to issue a letter of credit subject to rules of practice such as UCP500,<sup>246</sup>

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246. The Uniform Customs and Practice for Documentary Credits (UCP) is promulgated by the Commission on Banking Technique and Practice of the International Chamber of Commerce headquartered in Paris, France. It articulates standard international commercial letter of credit practice. The current revision, ICC Publication No. 500 (UCP500), became effective January 1994. UCP500, *supra* note 5, reprinted in LC RULES AND LAWS: CRITICAL TEXTS, *supra* note 3, at 1. Prior versions were issued in 1933 (UCP74), 1951 (UCP151), 1962 (UCP222), 1974 (UCP290), and 1983 (UCP400). Although UCP500 has been translated into virtually every language in which international commerce is conducted, the official version is in English and care must be taken with translations as it is reported that they are of uneven quality. See generally JAMES E. BYRNE, *ISP98 & UCP500 COMPARED* (2000); Katherine A. Barski, *Letters of Credit: A Comparison of Article 5 of the Uniform Commercial Code and the Uniform Customs and Practice for Documentary Credits*, 41 LOY. L. REV. 735 (1996); Ross P. Buckley, *The 1993 Revision of the Uniform Customs and Practices for Documentary Credits*, 28 GEO. WASH. J. INT'L L. & ECON. 265 (1996); James E. Byrne, *Ten Major Stages in the Evolution of Letter of Credit Practice*, DOCUMENTARY CREDIT WORLD, Nov./Dec. 2003, at 28; Dan Taylor, *The*

UCP600,<sup>247</sup> or ISP98.<sup>248</sup> Unlike the regime in effect under Prior non-conforming UCC section 5-102(4), under which the adoption of rules of practice operated to oust the applicability of the statute,<sup>249</sup> the issuance of a letter of credit subject to rules of practice would generally have the effect of supplementing Revised UCC Article 5, and varying its variable provisions to an extent.

### 1. True Conflicts Between Revised UCC Article 5 and Rules of Practice

Because many of the provisions of Revised UCC Article 5 are variable and its scope of coverage is modest, particularly with respect to issues of documentary compliance, there is limited scope for true conflicts between rules of practice and the statute. Even where there is an apparent conflict, the rules of practice will supplant

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*History of the UCP*, DOCUMENTARY CREDIT WORLD, Dec. 1999, at 11.

247. The revision of UCP500, the 2006 Revision of *Uniform Customs and Practice for Documentary Credits* (ICC Publication No. 600) will be effective July 1, 2007. See UPC600, *supra* note 5; see also John F. Dolan, *Discounting Deferred Payment Obligations*, DCINSIGHT, Oct.–Dec. 2005, reprinted in 2006 ANNUAL SURVEY, *supra* note 65, at 62; Jeremy Smith, *Documentary Credits: What Law Should Apply?*, DCINSIGHT, Oct.–Dec. 2005, reprinted in 2006 ANNUAL SURVEY, *supra* note 65, at 62; Bojan Zidar, *Another Take on Negotiation*, DCINSIGHT, Oct.–Dec. 2005, reprinted in 2006 ANNUAL SURVEY, *supra* note 65, at 62; Donald R. Smith, *Reasonable Time—A US Perspective*, DCINSIGHT, Oct.–Dec. 2005, reprinted in 2006 ANNUAL SURVEY, *supra* note 65, at 62; E.P. Ellinger, *The UCP-500: Considering A New Revision*, LLOYD'S MAR. AND COM. L. Q., Feb. 2004, reprinted in 2006 ANNUAL SURVEY, *supra* note 65, at 101.

248. Rules for standby letters of credit, the International Standby Practices (ISP), were drafted in 1997. The text was finalized and adopted by the International Financial Services Association (formerly the United States Council on International Banking), and by the International Chamber of Commerce in 1998, to become effective on January 1, 1999 (“ISP98”). ISP98, *supra* note 142. ISP98 is published in ICC Pub. No. 590. *Id.*; see JAMES E. BYRNE, THE OFFICIAL COMMENTARY ON THE INTERNATIONAL STANDBY PRACTICES (1998) [hereinafter BYRNE, OFFICIAL COMMENTARY] (explaining the ISP98 rules); see also James E. Byrne, *Separate Rules for Standby Letters of Credit: Fall 1997 Draft ISP (International Standby Practices)*, DOCUMENTARY CREDIT WORLD, Dec. 1997, at 30; James E. Byrne, *Standby Rulemaking: A Glimpse at the Elements of Standardization and Harmonization of Banking Practice*, in NEW DEVELOPMENTS IN INTERNATIONAL COMMERCIAL AND CONSUMER LAW 135 (1998). Information on the text of the ISP98 and educational tools may be obtained from The Institute of International Banking Law & Practice, Inc., P.O. Box 2235, Montgomery Village, MD 20886 or at [www.iiblp.org](http://www.iiblp.org). There are also rules that have been drafted by the ICC for independent guarantees, namely, the Uniform Rules for Demand Guarantees or URDG. INT’L CHAMBER OF COMMERCE, ICC UNIFORM RULES FOR DEMAND GUARANTEES (1992) (ICC Publication No. 4580) [hereinafter URDG]; see also ROY GOODE, GUIDE TO THE ICC UNIFORM RULES FOR DEMAND GUARANTEES (1992) (providing supplementary information on the URDG); Georges Affaki, ICC UNIFORM RULES FOR DEMAND GUARANTEES: A USER’S HANDBOOK TO THE URDG (2001).

249. U.C.C. § 5-102(4) (1957) (amended 1995).

variable provisions of the statute in most situations. Only two types of rules of practice raise issues of this type. Section 5-116(c)(iii) provides that applicable rules of practice “govern except to the extent of any conflict with the nonvariable provisions specified in section 5-103(c).”<sup>250</sup> Official Comment 3 to this section states the inverse of this proposition, namely that “incorporation of the UCP or other practice does not override the nonvariable terms of Article 5.”<sup>251</sup>

#### a. Definitions

UCP500, UCP600, and ISP98 contain definitions of terms that are also defined in Revised UCC Article 5. Most notably, UCP600 Article 2 contains definitions of the terms “issuer” and “letter of credit,” terms that are expressly stated in Revised UCC section 5-102(c) to be an exception to the rule that the provisions of Revised UCC Article 5 may be varied even if other definitions can be revised by rules of practice.<sup>252</sup>

Any conflict here, however, is more apparent than real. The “definitions” in UCP500, ISP98 Rule 1.09 (Defined Terms), and UCP600 Article 2 (Definitions) are more often explanations of the meaning of the term in practice rather than true definitions. Even where they are definitions, they apply to the use of these terms in their respective rules and not to their absolute meaning or their meaning insofar as the terms are used in Revised UCC Article 5.<sup>253</sup>

Thus, the definition of a “credit” as an “irrevocable” undertaking in UCP600 Article 2 (Definitions) (Paragraph 8) does not mean that a letter of credit which is issued in revocable form is not a “credit” for purposes of Revised UCC Article 5.<sup>254</sup> Because UCP600 is a rule

250. U.C.C. § 5-116(c)(iii) (1995).

251. *Id.* § 5-103 cmt. 2 (“Where the UCP are adopted but conflict with Article 5 and except where *variation* is prohibited, the UCP terms are permissible contractual modifications under sections 1-102(3) and 5-103(c).” (emphasis added)).

252. *See id.* § 5-102(c).

253. For example, ISP98 Rule 1.01(d) (Scope and Application) defines the term “standby” as an undertaking that is subject to the ISP. This “definition” does not pretend to have any effect beyond the interpretation of ISP98. ISP98, *supra* note 142.

254. Revised UCC Section 5-102(a)(10) provides:

“Letter of credit” means a definite undertaking that satisfies the requirements of Section 5-104 by an issuer to a beneficiary at the request or for the account of an applicant or, in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or delivery of an item of value.

U.C.C. § 5-102(a)(10).

of practice and not law, its scope provisions can be varied by agreement and made applicable to any undertaking.<sup>255</sup> Nor does it mean that the term “definite” in the definition of “credit” in UCP600 has the same meaning as the same term used in Revised section 5-102(a)(10) (“Letter of Credit”). As defined in UCP600, “definite” connotes the notion of irrevocability,<sup>256</sup> whereas in Revised UCC Article 5, it means undertakings that are otherwise too vague to be enforced as letter of credit undertakings. Thus, even where it is irrevocable, an undertaking that was denominated a letter of credit would not be a letter of credit were it to lack any mechanism for determining the amount due, the identity of the beneficiary, or the identity of the issuer.

Thus, although there may be differences in definitions, there is no conflict between those in the statute and the rules.

#### *b. Disclaimers*

As indicated, section 5-103(c) provides that obligations prescribed by it are not sufficient to vary by “[a] term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations . . . .”<sup>257</sup>

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255. On a practical level, it would be preferable to use UCP500 for a revocable letter of credit since UCP600 does not contain any practical rules that address issues raised by revocable letters of credit, whereas UCP500 Articles 6 (Revocable v. Irrevocable Credits) and 8 (Revocation of a Credit) do. Compare UCP500, *supra* note 5, with UCP600, *supra* note 5.

256. UCP600 Article 2 (Definitions) Paragraph 8 (“Credit”) states: “[c]redit means any arrangement, however named or described, that is irrevocable and thereby constitutes a definite undertaking of the issuing bank to honour a complying presentation.” UCP600, *supra* note 5. This approach is similar to UCP500 Article 2 (Meaning of Credit) which provides:

For the purposes of these Articles, the expressions “Documentary Credit(s)” and “Standby Letter(s) of Credit” (hereinafter referred to as “Credit(s)”), mean any arrangement, however named or described, whereby a bank (the “Issuing Bank”) acting at the request and on the instructions of a customer (the “Applicant”) or on its own behalf,

- i. is to make a payment to or to the order of a third party (the “Beneficiary”), or is to accept and pay bills of exchange (Draft(s)) drawn by the Beneficiary, or
- ii. authorises another bank to effect such payment, or to accept and pay such bills of . . . exchange (Draft(s)), or
- iii. authorises another bank to negotiate, against stipulated document(s), provided that the terms and conditions of the Credit are complied with.

For the purpose of these Articles, branches of a bank in different countries are considered another bank.

UCP500, *supra* note 5.

257. U.C.C. § 5-103(c).



This provision raises the question of whether the disclaimers appearing in UCP500, ISP98, and UCP600 are enforceable.

While the provisions contained in UCP500 Article 15, UCP600, and ISP98 Rule 1.08 may arguably be classified as an attempt at a general excuse of liability, they reflect the independence principle established in Revised UCC sections 5-103(d) and 5-109 and should be given effect as supplementing the provisions of Revised UCC Article 5.

On the other hand, the disclaimers in UCP500 Articles 16, 17, and 18 are general and not reflected in Revised UCC Article 5. Even apart from the provision in Revised UCC section 5-103(c), it may be doubted whether a court would permit a bank to excuse its liability for the translation of a document that it undertook, particularly where the letter of credit did not require that documents be presented in a particular language.<sup>258</sup> It may also be doubted that a bank could disclaim losses resulting from a loss, or delay resulting from its own negligence simply based on these formulae. Under Revised UCC section 5-103(c), it is doubtful that they could be enforced as written without more specific provisions in the letter of credit. The question for a UCP500 credit is whether the court would be prepared to interpret them in order to enforce them in situations where the loss, error, or other problem was caused by another person.

However, Force Majeure provisions, such as those contained in UCP500 Article 17 (Force Majeure) and UCP600 Article 36 (Force Majeure), are typically enforced where they relate to the actions of another person since they represent a generally accepted allocation of risk.

The disclaimer for the acts of instructed persons contained in

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258. ISP98 Rule 4.04 provides "The language of all documents issued by the beneficiary is to be that of the standby." ISP98, *supra* note 142. Following this provision, ISBP Paragraph 26 provides:

Under international standard banking practice, it is expected that documents issued by the beneficiary will be in the language of the credit. When a credit states that documents in two or more languages are acceptable, a nominated bank may, in its advice of the credit, limit the number of acceptable languages as a condition of its engagement in the credit or confirmation.

INT'L CHAMBER OF COMMERCE, INTERNATIONAL STANDARD BANKING PRACTICE para. 26 (2003) [hereinafter ISBP]. These provisions make it clear that a letter of credit must require that a document be in a specific language in order to refuse to take (and translate) a document in another language. Whether or not an issuer or confirmer translates such a document, it is responsible for its content.

UCP500 Article 18 and UCP600 Article 37 are probably enforceable, with the exception of a situation where the instructing party is directed to ask a certain person to perform an action and requests a different person to perform the action without any compelling reason.

UCP600 Article 35 limits the scope of the disclaimer regarding the loss of documents. While this disclaimer could not be enforced against a beneficiary that can prove that it has presented complying documents in a timely manner, it should be enforceable by a bank claiming reimbursement.

These disclaimers are significantly restricted in ISP98 Rule 1.08 (Limits to Responsibilities)<sup>259</sup> and 8.01 (Right to Reimbursement)<sup>260</sup> in a manner intended to make them enforceable under Revised UCC section 5-103(c).

## 2. Variable Provisions of Revised UCC Article 5 That Are Varied by the Issuance of a Letter of Credit Subject to Rules of Practice

The adoption of rules of practice can affect or supplement discrete provisions of Revised UCC Article 5. These rules include:

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259. ISP98 Rule 1.08 provides:

An issuer is not responsible for:

- a. performance or breach of any underlying transaction;
- b. accuracy, genuineness, or effect of any document presented under the standby;
- c. action or omission of others even if the other person is chosen by the issuer or nominated person; or
- d. observance of law or practice other than that chosen in the standby or applicable at the place of issuance.

ISP98, *supra* note 142, R. 1.08.

260. ISP98 Rule 8.01 provides:

- a. Where payment is made against a complying presentation in accordance with these Rules, reimbursement must be made by: i. an applicant to an issuer requested to issue a standby; and ii. an issuer to a person nominated to honour or otherwise give value.
- b. An applicant must indemnify the issuer against all claims, obligations, and responsibilities (including attorney's fees) arising out of: i. the imposition of law or practice other than that chosen in the standby or applicable at the place of issuance; ii. the fraud, forgery, or illegal action of others; or iii. the issuer's performance of the obligations of a confirmer that wrongfully dishonours a confirmation.
- c. This Rule supplements any applicable agreement, course of dealing, practice, custom or usage providing for reimbursement or indemnification on lesser or other grounds.

*Id.* R. 8.01.

*a. Effectiveness of a letter of credit or an amendment*

Revised UCC section 5-106(a) states the general rule that a letter of credit is issued and becomes enforceable “when the issuer sends or otherwise transmits it to the person requested to advise or to the beneficiary.”<sup>261</sup> Since there are situations where it is intended that a standby letter of credit not come into effect at the time that it is delivered, ISP98 Rule 2.03 varies this rule by providing that terms in a standby clearly specify that “it is not then ‘issued’ or ‘enforceable.’”<sup>262</sup>

*b. Amendment without beneficiary consent*

One of the characteristics of an irrevocable letter of credit is that it cannot be cancelled or amended without the consent of any person who is entitled to rely on its terms (at least insofar as his rights are affected). This provision is stated in Revised UCC section 5-106(b) which provides:

[a]fter a letter of credit is issued, rights and obligations of a beneficiary, applicant, confirmer, and issuer are not affected by an amendment or cancellation to which that person has not consented except to the extent the letter of credit provides that it is revocable or that the issuer may amend or cancel the letter of credit without that consent.<sup>263</sup>

ISP98 contains two situations where the issuer may amend without consent: (1) where there is a transfer by operation of law and (2) where the issuer is closed on the deadline for presentation that falls on a banking day that it would otherwise be open. These provisions supplement Revised UCC section 5-106(b) and should be enforced because they provide an alternative means of presentation that would not otherwise be available and both are expressly limited by a rule of reasonableness.

Under ISP98 Rule 3.14, the issuer is empowered to name another place for presentation if the place for presentation is closed on the last business day for presentation.<sup>264</sup> To protect the

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261. U.C.C. § 5-106(a).

262. ISP98, *supra* note 142, R. 2.03. This general rule stated in Revised UCC Section 5-106(a) is also reflected in UCP600 Articles 7(b) and 8(b). UCP500 does not address this issue but assumes and remains consistent with the provision in Revised UCC Article 5.

263. U.C.C. § 5-106(b).

264. ISP98 Rule 3.14 provides:

beneficiary, it must have received the communication informing it of the change, and the alternative place selected must be reasonable. In such a situation, there are at least thirty calendar days available within which the beneficiary can make presentation.

Under ISP98 Rule 6.12, a claimed successor to the beneficiary is required to present a document regarding its claim in addition to those documents required under the terms of the letter of credit.<sup>265</sup> While this provision is similar to Revised UCC section 5-113 and does not displace it, Rule 6.12 supplements Section 5-113 by specifying the documents that are to be presented and that may be required.<sup>266</sup>

UCP600 Article 10(c) also contains a provision that purports to effect an amendment without the beneficiary's consent.<sup>267</sup> Insofar as

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a. If on the last business day for presentation the place for presentation stated in a standby is for any reason closed and presentation is not timely made because of the closure, then the last day for presentation is automatically extended to the day occurring thirty calendar days after the place for presentation re-opens for business, unless the standby otherwise provides.

b. Upon or in anticipation of closure of the place of presentation, an issuer may authorise another reasonable place for presentation in the standby or in a communication received by the beneficiary. If it does so, then

i. presentation must be made at that reasonable place; and

ii. if the communication is received fewer than thirty calendar days before the last day for presentation and for that reason presentation is not timely made, the last day for presentation is automatically extended to the day occurring thirty calendar days after the last day for presentation.

ISP98, *supra* note 142, R. 3.14.

265. ISP98 Rule 6.12 provides:

A claimed successor may be treated as if it were an authorised transferee of a beneficiary's drawing rights in their entirety if it presents an additional document or documents which appear to be issued by a public official or representative (including a judicial officer) and indicate:

a. that the claimed successor is the survivor of a merger, consolidation, or similar action of a corporation, limited liability company, or other similar organization;

b. that the claimed successor is authorised or appointed to act on behalf of the named beneficiary or its estate because of an insolvency proceeding;

c. that the claimed successor is authorized or appointed to act on behalf of the named beneficiary because of death or incapacity; or

d. that the name of the named beneficiary has been changed to that of the claimed successor.

*Id.* R. 6.12. ISP98 also entitles the issuer to require additional information and documentation although these documents need not be presented prior to the expiration of the letter of credit. *Id.* R. 6.13.

266. *See* U.C.C. § 5-113.

267. UCP600 Article 10(c) provides:

this provision implies consent from an action that unambiguously indicates acceptance of the amendment, it is unobjectionable. Where, however, it is applied to a presentation that could operate under the credit with or without the amendment, it seeks to imply consent from an ambiguous situation.

If given effect, this provision would operate to amend an irrevocable UCP600 letter of credit.<sup>268</sup> Accordingly, it should not be given effect where the beneficiary's presentation is ambiguous as to consent because the provision undermines the irrevocable character of the letter of credit.

*c. Obligation of adviser to advise accurately*

Revised UCC section 5-107(c) provides that an "[a]dviser undertakes to the issuer and to the beneficiary accurately to advise the terms of the letter of credit . . . ."<sup>269</sup> While ISP98 and UCP600 also refer to the accuracy of advice,<sup>270</sup> UCP500 Article 7(a) only

The terms and conditions of the original credit (or a credit incorporating previously accepted amendments) will remain in force for the beneficiary until the beneficiary communicates its acceptance of the amendment to the bank that advised such amendment. The beneficiary should give notification of acceptance or rejection of an amendment. If the beneficiary fails to give such notification, a presentation that complies with the credit and to any not yet accepted amendment will be deemed to be notification of acceptance by the beneficiary of such amendment. As of that moment the credit will be amended.

UCP600, *supra* note 5.

268. For example, if under a letter of credit for 1000 units of X product with partial shipments permitted and a latest shipment date of July 1, an amendment is proposed altering the latest date for shipment to July 15 to which the beneficiary does not respond, it is ambiguous whether a shipment by the beneficiary of 500 units of X product under the credit constitutes acceptance of the amendment. However, under UCP600 Article 10(c), as of August 2006, such a shipment would in fact constitute acceptance of the amendment. *Id.*

269. Revised UCC Section 5-107(c) provides:

A person requested to advise may decline to act as an adviser. An adviser that is not a confirmer is not obligated to honor or give value for a presentation. An adviser undertakes to the issuer and to the beneficiary accurately to advise the terms of the letter of credit, confirmation, amendment, or advice received by that person and undertakes to the beneficiary to check the apparent authenticity of the request to advise. Even if the advice is inaccurate, the letter of credit, confirmation, or amendment is enforceable as issued.

U.C.C. § 5-107(c).

270. ISP98, *supra* note 142, R. 2.05. ISP98 Rule 2.05(a) provides: "Unless an advice states otherwise, it signifies that: (i) the advisor has checked the apparent authenticity of the advised message in accordance with standard letter of credit practice; and (ii) the advice accurately reflects what has been received. *Id.* UCP600 Article 9(b) provides: By advising the credit or amendment, the advising bank signifies that it has satisfied itself as to the apparent authenticity of the credit or amendment and that the advice accurately reflects the terms and conditions of the

refers to taking “reasonable care to check the apparent authenticity of the Credit which it advises.”<sup>271</sup>

While the better interpretation of “check the apparent authenticity” includes the accuracy of the data that is being communicated,<sup>272</sup> it could be argued that the phrase excludes liability for the accuracy of an advice. If this argument is given effect, it would vary Revised UCC section 5-107(c) (Confirmers, Nominated Person, and Adviser) and, as such, should be given effect since it is not manifestly unreasonable even if it touches on matters of the reasonableness, diligence, or care of an obligation.<sup>273</sup>

*d. Time within which to examine documents*

Revised UCC section 5-108(b) provides for a reasonable time within which to examine documents not beyond the seventh banking day following the day of presentation.<sup>274</sup> This rule reflects that of UCP500 Articles 13(a) and 14(d).<sup>275</sup>

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credit or amendment received. UCP600, *supra* note 5, art. 9(b).

271. UCP500 Article 7(a) provides:

An Credit may be advised to a Beneficiary through another bank (the “Advising Bank”) without engagement on the part of the Advising Bank, but that bank, if it elects to advise the Credit, shall take reasonable care to check the apparent authenticity of the Credit which it advises. If the bank elects not to advise the Credit, it must so inform the Issuing Bank without delay.

UCP500, *supra* note 5, art. 7(a).

272. It is a preferable argument that in its context “apparent authenticity” includes not only the authenticity of the sender, but also that the data has been apparently transmitted without error or disruption.

273. The outcome, however, might be even more unfavorable to the advising bank. A common law court, for example, might impose a judicial rule to the same effect in the absence of an express provision excluding any liability for the accuracy of an advice. More fundamentally, the court might interpret the transmission as a letter of credit issued by the advising bank (since it is not the letter of credit issued by the issuer), exposing the advising bank to the strict liability of the issuer rather than liability for reasonably foreseeable damages that were caused by the misadvice as permitted under the regime of Revised UCC section 5-107(c). *See* U.C.C. § 5-107(c) (1995).

274. Revised UCC Section 5-108(b) provides

An issuer has a reasonable time after presentation, but not beyond the end of the seventh business day of the issuer after the day of its receipt of documents:

- (1) to honor,
- (2) if the letter of credit provides for honor to be completed more than seven business days after presentation, to accept a draft or incur a deferred obligation, or
- (3) to give notice to the presenter of discrepancies in the presentation.

*Id.* § 5-108(b).

275. UCP500 Article 13(a) provides:

This time frame, however, is qualified and effectively varied by ISP98 Rule 5.01(a) which provides for a three business day “safe harbour,” and the seven business day maximum.<sup>276</sup> It is also qualified by ISP98 Rule 3.14 in a situation where the place for presentation is closed on the latest business day for presentation.<sup>277</sup>

UCP600 Article 14(b), on the other hand, takes a different approach. It provides:

[a] nominated bank acting on its nomination, a confirming bank, if any, and the issuing bank shall each have a maximum of five banking days following the day of presentation to determine if a presentation is complying. This period does not depend on any upcoming expiry date

Banks must examine all documents stipulated in the Credit with reasonable care, to ascertain whether or not they appear, on their face, to be in compliance with the terms and conditions of the Credit. Compliance of the stipulated documents on their face with the terms and conditions of the Credit, shall be determined by international standard banking practice as reflected in these Articles. Documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to be in compliance with the terms and conditions of the Credit.

500Documents not stipulated in the Credit will not be examined by banks. If they receive such documents, they shall return them to the presenter or pass them on without responsibility.

UCP500, *supra* note 5, art. 13(a).

UCP500 Article 14(d) provides:

- i. If the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf, decides to refuse the documents, it must give notice to that effect by telecommunication or, if that is not possible, by other expeditious means, without delay but no later than the close of the seventh banking day following the day of receipt of the documents. Such notice shall be given to the bank from which it received the documents, or to the Beneficiary, if it received the documents directly from him.
- ii. Such notice must state all discrepancies in respect of which the bank refuses the documents and must also state whether it is holding the documents at the disposal of, or is returning them to, the presenter.
- iii. The Issuing Bank and/or Confirming Bank, if any, shall then be entitled to claim from the remitting bank refund, with interest, of any reimbursement which has been made to that bank.

*Id.* art. 14(d).

276. ISP98 Rule 5.01(a) provides that a standby expressly states that it is subject to “*automatic amendment*” by an increase or decrease in the amount available, an extension of the expiration date, or the like, the amendment is effective automatically without any further notification or consent beyond that expressly provided for in the standby. Such an amendment may also be referred to as becoming effective “*without amendment*”. BYRNE, OFFICIAL COMMENTARY, *supra* note 248.

277. See ISP98, *supra* note 142. In this sense, both ISP98 Rule 3.13 and UCP500 Article 43 expand the seven day expiration date although in a more limited sense in that they carry it to the next business day. ISP98 operates with the same effect on any deadline.

or last day for presentation.<sup>278</sup>

Instead of referring to a reasonable time not to exceed seven banking (or business) days, it provides for five banking days. It also contains no mention of the phrase “reasonable time.”<sup>279</sup>

*e. Notice of refusal*

Revised UCC section 5-108(b)(3) requires that there be a notice of refusal, and provides in section 5-108(c) that the bank is precluded “from asserting as a basis of dishonor any discrepancy if timely notice is not given, or any discrepancy not stated in the notice if timely notice is given.”<sup>280</sup> A UCC Article 5 notice of refusal must indicate that the documents are being refused, state at least one discrepancy, and be timely.

UCP500 Article 14(d)(ii) also requires that the notice “must state all discrepancies in respect of which the bank refuses the documents . . . .”<sup>281</sup> UCP600 Article 16 also requires that the notice state “each discrepancy in respect of which the bank refuses to honour or negotiate.”<sup>282</sup> These provisions expand the scope of Revised UCC Article 5 and, in effect, vary it.

*f. Standard of compliance*

Revised UCC section 5-108(e) requires observance of the “standard practice of financial institutions that regularly issue letters of credit.”<sup>283</sup>

UCP500, UCP600, and ISP98 all provide extensive detail on what constitutes standard international letter of credit practice and

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278. UCP600, *supra* note 5.

279. *Id.*

280. U.C.C. § 5-108(b)(3), (c), (d) (1995).

281. UCP500 Article 14(d)(ii) provides “[s]uch notice must state all discrepancies in respect of which the bank refuses the documents and must also state whether it is holding the documents at the disposal of, or is returning them to, the presenter.” UCP500, *supra* note 5, art. 14(d)(ii).

282. ISP98 Rule 5.03 does not invoke the preclusion rule for failure to state the disposition of the documents. In a sense, by not providing for a sanction, it may vary the requirement of Revised UCC section 5-108(h) which provides “[a]n issuer that has dishonored a presentation shall return the documents or hold them at the disposal of, and send advice to that effect to, the presenter.” *Compare* ISP98, *supra* note 142, R. 5.03, with U.C.C. § 5-108(h) (1995).

283. U.C.C. § 5-108(e) (1995) (“An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer’s observance of the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice.”).



each has or, in the case of UCP600, anticipates a system by which standard international letter of credit practice is unfolded.<sup>284</sup>

These systems provide a detailed gloss on what constitutes standard international letter of credit practice and, in effect, vary the provisions of Revised UCC Article 5.

*g. Fraud and forgery*

The provisions in UCP500 and UCP600, and the disclaimers in UCP500 Article 15 (Disclaimer on Effectiveness of Documents) and UCP600 Article 34 (Disclaimer on Effectiveness of Documents) do not exclude or vary the fraud and forgery provisions of Revised UCC section 5-109. The latter provisions constitute a systematic statement of letter of credit law on the issue of letter of credit fraud and incorporate standard international letter of credit practice with respect to protected parties. ISP98 Rule 1.05(c) expressly defers to applicable law for these matters.<sup>285</sup>

*h. Other rules*

This article focuses on the effects of UCP500, ISP98, and UCP600 because these rules are the most significant rules that impact Revised UCC Article 5. It must be noted, that other rules, not addressed here, may also impact Revised UCC Article 5. These include the SWIFT protocols that govern the transmission and advice of letters of credit, amendments, and bank to bank messages.<sup>286</sup> To some extent, these protocols will impact bank communications between members of SWIFT and the beneficiary. Unlike letter of

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284. For UCP500, this system of standard international letter of credit practice consists of the rules of the UCP itself, their meaning in light of prior revisions of the UCP, the International Standard Banking Practices (ISBP), the Decisions and Opinions of the ICC Banking Commission, DocDex opinions, and relevant court decisions. It is likely that a similar system will come into place for UCP600. ISP98 is supported by The Official Commentary on the International Standby Practices. BYRNE, OFFICIAL COMMENTARY, *supra* note 248. It has not been necessary to issue any opinions interpreting it.

285. ISP98 Rule 1.05 provides: "These Rules do not define or otherwise provide for: (a) power or authority to issue a standby; (b) formal requirements for execution of a standby (e.g. a signed writing); or (c) defenses to honour based on fraud, abuse, or similar matters. These matters are left to applicable law." ISP98, *supra* note 142, R. 1.05.

286. SWIFT is the financial industry-owned co-operative supplying secure, standardized messaging services and interface software to 7,800 financial institutions in more than 200 countries. SWIFT's worldwide community includes banks, broker/dealers, and investment managers, as well as their market infrastructures in payments, securities, treasury and trade. Most letters of credit are communicated by means of SWIFT's 700 message series. *See generally* SWIFT-Home, <http://www.swift.com> (last visited Nov. 23, 2006).

credit rules, letters of credit are not issued subject to the SWIFT protocols which are only binding on members of SWIFT. In most cases, these protocols will not impact non banks but there are some situations where they could. The Uniform Rules for Demand Guarantees (“URDG”) could also impact standbys or independent guarantees issued subject to them and within the scope of Revised UCC Article 5. However, virtually none have been so issued to date.<sup>287</sup> The eUCP also impacts Revised UCC Article 5 with respect to electronic presentations.<sup>288</sup>

*i. Observations*

Even where the letter of credit is also subject to rules of standard practice, the court should also have reference to Revised UCC Article 5 where it more accurately reflects that standard of practice.<sup>289</sup>

3. Variation by Application of Rules of Practice as Usage of Trade

Even where a letter of credit is not issued subject to rules of

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287. Effective April 1, 1996 United States banks have been expressly authorized to issue bank or first demand guarantees provided that they are independent. See 12 C.F.R. §§ 7.1016–.1017 (2000). The regulation suggests that the independent character of the undertaking can be made apparent by application of “rules of practice recognized by law.” The footnote to that statement provides:

Examples of such laws or rules of practice include: The applicable version of Article 5 of the Uniform Commercial Code . . . or revised Article 5 of the UCC . . . ; the Uniform Customs and Practice for Documentary Credits . . . ; the International Standby Practices . . . ; the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit . . . ; and the Uniform Rules for Bank-to-Bank Reimbursements Under Documentary Credits . . . ; as any of the foregoing may be amended from time to time.

*Id.* § 7.1016 n.1.

288. Faced with increasing emphasis in commercial circles on the utilization of electronic data in lieu of paper documents, the letter of credit community, acting through the Commission on Banking Technique and Practice of the ICC, formulated a supplement to the Uniform Customs and Practice for Documentary Credits (UCP) to accommodate electronic presentations. The rules, known as the eUCP, themselves incorporate UCP500 and supplement its rules and definitions with respect to electronic presentations under credits that are expressly issued subject to the eUCP. eUCP, *supra* note 106, *reprinted in* LC RULES AND LAWS: CRITICAL TEXTS, *supra* note 3, at 25. There are 12 numbered eUCP Articles identified with an “e” preceding them so as to prevent confusion when citing them in contrast to the articles of UCP500. See BYRNE & TAYLOR, *supra* note 106.

289. One clear example would be a question regarding assignment for a standby that is subject to ISP98. The provisions in Prior UCC Section 5-116 are unworkable and misstate letter of credit practice. This issue is clarified in ISP98 Rule 6.08. If a court in such a situation cannot base its decision solely on these provisions, it should have recourse to Revised UCC section 5-114(d) even if the standby were also subject to Prior UCC Article 5.

practice, they may result in variation of Revised UCC Article 5 where the court draws on them to interpret the terms and conditions of the letter of credit as usage of trade.

In UCC jurisprudence, the term “agreement” would be applied to a letter of credit.<sup>290</sup> In order to determine the meaning of an agreement, one would look not only to the agreement in fact (in the case of a letter of credit, its express terms), but also to the context of that agreement including the course of performance of the agreement, prior dealings between the parties, and usages in the trade in which the parties are involved.<sup>291</sup> Usage of trade includes rules of practice. Where the undertaking is expressly subject to these rules, they are relevant as a provision of the undertaking and not by being inferred by a rule of interpretation. In the hierarchy of Revised section 1-303(e), the relative priority of an inferred usage of trade is lower than course of performance and course of dealing, and all are

290. U.C.C. § 1-201(b)(3) (2004) (“‘Agreement,’ as distinguished from ‘contract,’ means the bargain of the parties in fact, as found in their language or inferred from other circumstances, including course of performance, course of dealing, or usage of trade as provided in section 1-303.”). Prior UCC Section 1-201(3) is similar, stating:

“Agreement” means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this Act (sections 1-205, 2-208, and 2A-207). Whether an agreement has legal consequences is determined by the provisions of the Act, if applicable; otherwise by the law of contracts (section 1-103).

U.C.C. § 1-201(3) (1957).

291. U.C.C. § 1-303 (2004). Revised UCC section 1-303 defines all three terms and provides rules for their application to an undertaking. It provides the definitions in subsections a–c, which state:

(a) A “course of performance” is a sequence of conduct between the parties to a particular transaction that exists if:

(1) the agreement of the parties with respect to the transaction involves repeated occasions for performance by a party; and

(2) the other party, with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection.

(b) A “course of dealing” is a sequence of conduct concerning previous transactions between the parties to a particular transaction that is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

(c) A “usage of trade” is any practice or method of dealing having such regularity of observance in a place, vocation, or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage must be proved as facts. If it is established that such a usage is embodied in a trade code or similar record, the interpretation of the record is a question of law.

*Id.* These provisions are similar to those of Prior UCC Sections 1-205 and 2-208.

subject to express terms.

As a result, even where a letter of credit was not issued subject to rules of practice, a court could look to rules of practice to interpret its provisions, assuming that it concluded (as is reasonable) that they represented a usage of trade. Moreover, the court could draw on these rules as a usage of trade to vary variable provisions of Revised UCC Article 5. The question is whether such an approach is appropriate.

With respect to letters of credit, the answer is “not always.” The difficulty with the indiscriminating application of general rules of interpretation to letters of credit is that, unlike many general areas of commercial law, there is a general practice of issuing letters of credit, particularly commercial letters of credit, subject to rules of practice.<sup>292</sup> If the letter of credit was not issued subject to rules of practice in order to avoid their application, reference to them in interpreting the terms of the letter of credit would produce a distortion especially where they operated to vary the provisions of Revised UCC Article 5. The problem is how to identify such situations.

Where the letter of credit indicates that it is not intended to be subject to rules of practice, they should not be applied.<sup>293</sup> Furthermore, if there is persuasive proof that the issuer intended that rules of practice not be applied, they should not be applied.<sup>294</sup>

In the absence of persuasive proof of the intent of the issuer regarding the application of rule of practice, the following considerations should be taken into account where the applicable rules are silent.

There is a difference between commercial letters of credit and

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292. It should be noted that the absence of an agreement to that effect is not a difficulty. As noted, the terms of a letter of credit are not themselves agreements. It has long been recognized that when a person uses a specialized commercial instrument, it is taken subject to its specialized practices regardless of whether the person knew of them or consented. *See Mills v. Bank of the U.S.*, 24 U.S. 431, 436 (1826) (“[W]hen a note is made payable or negotiable at a bank, whose invariable usage it is to demand payment and give notice on the fourth day of grace, the parties are bound by that usage whether they have a personal knowledge of it or not.”); *see also* U.C.C. § 4A-501(b) (1995) (funds-transfer system rule can be effective even though it affects rights of other parties without their consent who elect to use a funds transfer).

293. Although, notwithstanding such a provision, a particular provision of a rule of practice may by analogy assist the court in interpreting the meaning of a term in a letter of credit.

294. In this limited respect, parol evidence, including the application, communications with the issuer, and internal communications of the issuer, should be applicable to interpret the terms of the letter of credit.

standbys with respect to issuance subject to applicable rules. Since it is virtually unheard of for a commercial letter of credit not to be issued subject to some version of the UCP, issuance without reference to the UCP is likely to be the result of an error. In such a case, a court would be justified in looking to the UCP as an applicable usage of trade to vary provisions of Revised UCC Article 5,<sup>295</sup> unless application of the particular provision works an unfair surprise to the beneficiary or transferee beneficiary who had relied on the application of the UCC rule instead of the UCP rule.

On the other hand, the absence of a clause referring to rules of practice in a standby may represent a deliberate choice of the issuer since the practice of issuing standbys subject to rules of practice is not universal.<sup>296</sup> Where a standby is expressly issued subject to the UCC and does not refer to rules of practice, rules of practice should not be used to vary provisions of the UCC, but may be useful to state a standard international standby letter of credit practice.

In such a situation, the applicable rules would be ISP98 because they were drafted for standby letters of credit and reflect international standby practice. This is in contrast to the UCP, which reluctantly recognizes standby letters of credit, but is actually

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295. The Chinese letter of credit rules permit application of international practice to cases involving letters of credit even where the undertaking is not issued subject to them. *See supra* note 54; *see also* *Indus. Bank of Korea (Seoul) v. Lianyangang Kuchifuku Foods Co.*, Civil Judgment Su Min San Zhong Zi No. 052 (Jiangsu People's High Court [China], 2003), *abstracted at* 2006 ANNUAL SURVEY, *supra* note 247, 359; *Bundesgericht [BGE] [Federal Court]* June 1, 2004, 130 *Entscheidungen des Schweizerischen Bundesgerichts [BGE]* III 462 (Switz.) (taking "into account" UCP500 although the record did not reveal whether the credit was subject to it, since "these rules find an application in the letter of credit relationship between the two banks").

296. Prior to the development of ISP98, there was disagreement about whether standbys should be issued subject to any rules of practice. Some letter of credit lawyers were of the opinion that the UCP was more trouble for standbys than it was helpful. *See* Alan L. Bloodgood, Janis Penton-Soshuk, & Micheal E. Avidon, *Standby Letters of Credit and the UCP*, LETTER OF CREDIT UPDATE, Jan. 1993, at 9, 9. While commercial letters of credit tend to be issued by major banks with extensive operational experience since seller/beneficiaries in other countries require an issue of international standing (as of the 1st quarter 2006, the top ten US banks accounted for 75.8% by dollar amount of letters of credit outstanding in the United States, Jul/Aug 2006 *Documentary Credit World* 42.), standby letters of credit can be and are issued by small banks and other financial institutions with little or no letter of credit experience or understanding. Some of the recent letter of credit case law in the United States is illustrative of issuers who do not know what they are doing. *See Avery Dennison Corp. v. Home Trust & Sav. Bank*, No. 02-2007 LRR, 2003 WL 22697175 (N.D. Iowa Nov. 7, 2003) (issuer took seven days to give a notice of refusal which is probably an unreasonable time, especially since the bank officer apparently made his decision to dishonor before the presentation was even made); *DBJJJ, Inc. v. Nat'l City Bank*, 19 Cal. Rptr. 3d 904 (Ct. App. 2004) (seven banking days is not an automatically reasonable time for notice of refusal).

designed for commercial letters of credit. Not only does the UCP contain traps, but it fails to accommodate standby practices.

Where a standby is not expressly subject to rules of practice or local law, the application of general rules of letter of credit practice as stated in the rules is appropriate in most other cases, even where they operate to vary Revised UCC Article 5. In such a situation, the standby rules can be understood as articulating the commonly understood usages of trade, unless application of the particular provision works an unfair surprise on the beneficiary, or transferee beneficiary, who relied on the application of the UCC rule instead of the ISP rule.<sup>297</sup>

#### *E. Contracting Out Via Discrete Provisions in LCs*

Revised UCC section 5-103(c) provides that “the effect of this article may be varied . . . by a provision stated . . . in an undertaking.”<sup>298</sup> There are a wide variety of letter of credit terms that effectively vary the provisions of Revised UCC Article 5, many of which would require extensive separate treatment to discuss adequately. They represent attempts to address concerns or needs arising from the underlying transaction.

Some of the provisions, such as so-called silent confirmations, do not represent variations of Revised UCC Article 5, but require careful drafting if they are to be brought within the scope of the statute.<sup>299</sup> Other provisions, such as the desire for a letter of credit

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297. The application of specialized ISP provisions would probably be inappropriate unless they represent standard letter of credit or standby practice for that type of letter of credit undertaking. An example of specific rules that might not be aptly applied without an undertaking being issued subject to specific rules is ISP98 Rule 3.14(a). On the other hand, the rules in ISP98 Rule 6 regarding transfer, assignment, and transfer by operation of law state international letter of credit practice. The provision regarding inconsistency in ISP98 Rule 4.03 (Examination of Inconsistency), on the other hand, presents a more difficult and closer question. This provision reflects the nature of standby letters of credit and the expectation of the parties that there is no generic notion of consistency with respect to documents presented under a standby. Since it does not operate against the beneficiary, it would probably be appropriate to apply it. See BYRNE, OFFICIAL COMMENTARY, *supra* note 248.

298. Revised UCC Section 5-103(c) provides:

With the exception of this subsection, subsections (a) and (d), Sections 5-102(a)(9) and (10), 5-106(d), and 5-114(d), and except to the extent prohibited in Sections 1-102(3) and 5-117(d), the effect of this article may be varied by agreement or by a provision stated or incorporated by reference in an undertaking. A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this article.

U.C.C. § 5-103(c) (1995).

that runs perpetually, cannot be achieved within the framework of the statute although it is possible to attain something functionally similar.<sup>300</sup> Some of the standards discussed above, such as the standard of examination, or the time permitted for examination that is varied by various rules of practice, can also be varied by terms of the letter of credit itself.<sup>301</sup> It is common for credit terms regarding the transfer of drawing rights, and the forms used for transfer and assignment of the proceeds of a letter of credit, to either supplement or vary the provisions of Revised UCC sections 5-112 and 5-114. The terms of a letter of credit could also vary the provisions of Revised UCC sections 5-111 and sections 5-111 regarding attorney's fees or other provisions regarding damages.

It is also possible to vary the terms of a confirmation, advice, or a negotiation. Although there are outer limits where the resulting undertaking is no longer a confirmation, advice, or a negotiation, it may nevertheless be enforceable, but not as a letter of credit.<sup>302</sup> Revised UCC section 5-106(a) itself invites variation of the general rule that a letter of credit is irrevocable by expressly stating that it is revocable.<sup>303</sup> Likewise, it may be possible to vary the rule of Revised UCC section 5-108(g) that requires a bank to disregard

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299. While there are various types of undertakings to which this name could be applied, an undertaking to purchase documents with limited rights of recourse against the beneficiary is an independent undertaking and a "letter of credit." While it is not a confirmation within the meaning of UCP500 or Revised UCC Article 5, its status as a separate independent undertaking unfortunately escaped the notice of the courts who have considered its status.

300. See U.C.C. § 5-106(c), (d). The letter of credit could, for example, run for 999 years (or whatever time period). Were such a letter of credit to contain a so-called "evergreen" clause permitting the bank to give notice of non-renewal and permitting a drawing in such an event, it would be functionally similar to a perpetual undertaking.

301. See U.C.C. § 5-108(a), (b). A letter of credit could provide a different standard of examination (i.e. that the document must literally replicate the terms and conditions of the letter of credit) or that the documents would not be examined. It could also undertake to honor within a shorter or longer period of time.

302. Where these limits lie is not entirely clear and there is little case law on point. The question typically arises where a bank seeks to claim the status of a nominated bank—usually a negotiating bank. In this context, the question is whether a bank that merely inspects the documents gratuitously or for a nominal fee is entitled to the protections of a negotiating bank in the face of beneficiary fraud. Even if the nominated bank were to seek to vary the terms of the statute regarding what constitutes negotiation, it is unlikely that such a person would qualify as a protected party.

303. U.C.C. § 5-106(a) ("A letter of credit is issued and becomes enforceable according to its terms against the issuer when the issuer sends or otherwise transmits it to the person requested to advise or to the beneficiary. A letter of credit is revocable only if it so provides.").

nondocumentary conditions.<sup>304</sup> For example, a letter of credit could provide that the bank require a document to represent the condition presented, even though not stated (although such a provision in a letter of credit would be odd; it would be easier to turn the nondocumentary condition into a documentary one). At some point, however, if the condition is central to the undertaking and requires that a non-documentary fact be ascertained, the undertaking is no longer an independent undertaking, but a dependent one.<sup>305</sup>

A current issue regarding variation involves letters of credit that are issued without a final amount because their amount is linked to an index. Such variable rate letters of credit are used to pay for volatile commodities such as oil, in which the price can fluctuate radically over short periods of time.<sup>306</sup> Since there is no requirement of a fixed amount in Revised UCC Article 5, the question would be whether such a letter of credit was sufficiently “definite” for the purposes of Revised UCC section 5-102(a)(10), a nonvariable provision.<sup>307</sup>

#### V. POLICING LETTER OF CREDIT LAW AND PRACTICE: ETHICAL LIMITATIONS TO FREEDOM OF CONTRACT

Numerous struggles have occurred regarding the shape of limitations of “freedom of contract” in the drafting of the Uniform Commercial Code, and it comes as no surprise that these issues have surfaced in Revised UCC Article 5. Notably, on the whole, the radical character of the resolution is in favor of variability. Having

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304. *Id.* § 5-108(g) (“If an undertaking constituting a letter of credit under section 5-102(a)(10) contains nondocumentary conditions, an issuer shall disregard the nondocumentary conditions and treat them as if they were not stated.”).

305. Comment 9 to Revised Section 5-108(g) provides:

Where the nondocumentary conditions are central and fundamental to the issuer’s obligation (as for example a condition that would require the issuer to determine in fact whether the beneficiary had performed the underlying contract or whether the applicant had defaulted) their inclusion may remove the undertaking from the scope of Article 5 entirely. See section 5-102(a)(10) and Comment 6 to section 5-102.

U.C.C. § 5-108 cmt. 9.

306. See, e.g., *Korea Exch. Bank v. Standard Chartered Bank*, [2006] 1 S.L.R. 565 (Sing.) (a claim under an oil price fluctuation clause that is linked to a published table, operates without amendment, and controls over a specific amount and a specific tolerance stated in the appropriate SWIFT Fields so that the amount available under the credit can be greater or lesser than that stated in the letter of credit is not an overdrawn or underdrawn).

307. See discussion *supra* Part IV.B (explaining the treatment of this term in Revised UCC Article 5).



striven to limit variability to those provisions listed in Revised UCC section 5-103(c), it must be asked whether this approach will restrict common law courts with respect to issues not expressly addressed in the text or comments, especially where courts have been prone to police undertakings by enforcing perceived minimum standards.

Apart from the questions of public policy and illegality already considered,<sup>308</sup> limitations in UCC jurisprudence typically revolve around two notions: (1) fairness to those thought to deserve protection, and (2) prevention of undue surprise. However, it is not always apparent which policy predominates in any given case since they sometimes overlap.

The first of these concerns focuses on classes of persons thought to deserve special protection. It has little scope in letter of credit law and in Revised UCC Article 5 because there are few widows and orphans who are involved with letters of credit as obligors. Furthermore, the nonvariable definition of "letter of credit" ensures that this abstract device will not be used as a mechanism by which consumers issue or confirm<sup>309</sup> letters of credit. Moreover, Revised UCC Article 5 includes a structural limitation on the issuance or confirmation of letters of credit by nonbanks so that even merchants have important protection against inadvertent letter of credit

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308. While illegality sometimes enters into consideration in letter of credit issues (although it can often be characterized as a public policy concern), its basis is to be in an external source, i.e. sovereign compulsion based on either a lack of consideration of the letter-of-credit-independence principal or the sovereign consideration of it and decision to override it. Only the latter should be indulged and only when the sovereign's law otherwise applies. Accordingly, illegality as applied to an letter of credit obligation should be narrowly interpreted and applied. *See, e.g., J. Zeevi & Sons, Ltd. v. Grindlays Bank (Uganda) Ltd.*, 37 N.E.2d 168, 174 (N.Y. 1975) ("Defendant urges that enforcement of the letter of credit contract would violate the foreign exchange laws of Uganda in disregard of a treaty . . . . Contrary to defendants' position, the agreement . . . fails to bring the letter of credit within its scope, since said letter of credit is not an exchange contract.").

309. "'Issuer' means a bank or other person that issues a letter of credit, but does not include an individual who makes an engagement for personal, family, or household purposes."). U.C.C. § 5-102(a)(9). The official comment to UCC Section 5-106 further states:

The exclusion of consumers from the definition of "issuer" is to keep creditors from using a letter of credit in consumer transactions in which the consumer might be made the issuer and the creditor would be the beneficiary. If that transaction were recognized under Article 5, the effect would be to leave the consumer without defenses against the creditor. That outcome would violate the policy behind the Federal Trade Commission Rule in 16 CFR Part 433. In a consumer transaction, an individual cannot be an issuer where that person would otherwise be either the principal debtor or a guarantor.

*Id.* § 5-106 cmt. 5.

obligations.<sup>310</sup>

Despite the fact that letter of credit obligors are not in special need of protection, there is often a disparity in letter of credit transactions between the expertise available to a bank issuer and an applicant or beneficiary. Such claims have not been particularly successful under Prior UCC Article 5 and Revised UCC Article 5 offers no reason to suggest that its jurisprudence will differ in this regard. If anything, its more precise treatment will lessen the areas to which it might apply. If a beneficiary or applicant makes a business decision to rely on letters of credit for payment without hiring or training staff with knowledge commensurate with their business and letter of credit needs, banks should not be indirectly taxed with this assumed risk.

Whatever policing that is to occur under Revised UCC Article 5 is most likely to fall under the general rubric of the prevention of surprise rather than fairness, and is likely to be impacted to some degree by the relative familiarity of the parties with letter of credit practice. The word “surprise” is not altogether satisfactory to explain this phenomenon, and the notion encompasses a variety of concerns. One of the problems in identifying the application of these principles is that courts do not always state the underlying motive for their decision or action, leaving one to guess at the real motive behind their ruling.

In addition, the manner in which this policing will occur will not primarily rely on the notion of nonvariability. Common law courts have a variety of alternative policing tools.

Policing will (and should) occur with respect to letter of credit terms where they are ambiguous (not where they are clear, but impossible to perform) under the letter of credit version of the traditional rule of construing a writing against its drafter (with respect to letters of credit, its issuer). By giving effect to any reasonable interpretation of a letter of credit term, issuers and confirmers are prevented from abuse of discretion in a tight situation and the integrity of the instrument is enhanced.

In more rare situations, policing of rules of practice will also occur. The focus should be the neutrality of the rules. Where

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310. The definition of “issuer” provides that only a financial institution can issue a letter of credit for its own account. *See* U.C.C. § 5-102(a)(9).

required, it will occur through construction, interpretation, or application (or non application) of the rules.

It is a fundamental and important axiom (and one that often is a device by which neutrality can be ensured by a court) that an ambiguous term in a letter of credit should be construed against the issuer.<sup>311</sup> While the terms of a letter of credit could conceivably attempt to rearrange this balance in favor of the bank, it is unlikely that such a term would be given such effect. There are several grounds for such a decision, most notably the principle that matters of contract construction are within the provenance of the court.<sup>312</sup>

One aspect of nonvariability that could attract policing action is the limitation contained in Revised UCC section 1-302(a) (Variation By Agreement) of the disclaimer of obligations of good faith, diligence, reasonableness, and care prescribed by Revised UCC Article 5 (and made nonvariable by Revised section 5-103(c)). While these obligations may not be disclaimed, the standards by which they are to be measured should be judged in the context of an undertaking involving relatively sophisticated businesses. Within this constraint, the use of these concepts to prevent extreme provisions in letters of credit, applications, or other letter of credit-related agreements within the scope of Revised UCC Article 5 will enhance the integrity of the letter of credit system.

One aspect of policing is primarily focused on notice. While many, if not most, of the provisions of Revised UCC Article 5 can be varied, a letter of credit that does so should be sufficiently clear about the variation. The importance of clarity increases with the degree of change caused by the variation. These changes also determine who will ultimately be affected by the letter of credit. In this respect, a provision that lessens the time within which examination of documents must take place requires less exposure than one that attempts to limit the damage available for wrongful

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311. UCP500 Article 5(b) requires that conditions be stated precisely. UCP500, *supra* note 5, art. 5(b). The failure to do so means that the condition may be interpreted by the beneficiary in any commercially reasonable manner. *See* Bath Iron Works Corp. v. WestLB, No. 02 Civ 2272 (RCC), 2004 U.S. Dist. LEXIS 6212, at \*9 (S.D.N.Y. Apr. 12, 2004) (“When an ambiguity exists in a letter of credit, it is to be construed against the drafter.”), *reconsideration denied and claim dismissed* by Bath Iron Works Corp. v. WestLB, No. 02 Civ 2272 (RCC), 2004 U.S. Dist. LEXIS 19206 (S.D.N.Y. Sept. 8, 2004).

312. *See* Temple-Eastex, Inc. v. Addison Bank, 672 S.W.2d 793, 798 (Tex. 1984); *Homestate Sav. Ass’n v. Westwind Exploration, Inc.*, 684 S.W.2d 788, 790 (Tex. App. 1985).

dishonor to the actual damages suffered, rather than the face amount of the letter of credit. The former provision does not, absent unusual circumstances, adversely affect the beneficiary whereas the latter does.

Another aspect relates to protecting the rights of third parties. Some of these parties can rely on their own system of law, such as parties to a bankruptcy or secured parties seeking priority with respect to letter of credit rights or funds. Here, any conflict is in the statutory arena and the question is the extent to which letter of credit policies are to be respected in other commercial arenas.<sup>313</sup> As already indicated, provisions in a letter of credit that attempt to expand the rights of protected parties in the event of letter of credit fraud are unlikely to receive favorable treatment on public policy grounds. Another basis for rejecting such attempts is the doctrine of surprise: it may not be thought that longstanding principles of common law jurisprudence can be upset by a statement in a letter of credit, even if it is acceptable to the issuer and beneficiary, and even if it is clearly stated in the letter of credit. For the same reason, attempts to limit these rights will likely receive little encouragement.

Another dimension of this principle is the maintenance of the integrity of the letter of credit undertaking as an international payment device. On this ground, provisions in a letter of credit that unbalance the neutrality of the letter of credit should be discouraged. One historical example is the provision in UCP400 Article 7 that made a credit revocable unless it stated that it was irrevocable.<sup>314</sup>

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313. There have been problems with respect to both areas in the case law. One significant issue is the willingness of bankruptcy courts to recognize the post honor right of subrogation. *See Redback Networks, Inc. v. Mayan Networks Corp. (In re Mayan Networks Corp.)*, 306 B.R. 295 (B.A.P. 9th Cir. 2004). The majority held that the letter of credit was in the nature of a security deposit and should be treated just as a cash security deposit for purposes of the cap on allowed damages for future rent under United States Bankruptcy Code 11 U.S.C. § 502(b)(6). *Id.* at 300–01. The concurrence agreed with the result on the grounds that a letter of credit issuer should be treated similar to a guarantor of the obligations of the tenant. *Id.* at 307–10 (Klein, J., concurring). Revised UCC section 5-117 should have sorted this matter out. Likewise, Revised UCC section 5-118 has addressed the relative priorities between letter of credit law and that of Secured Transactions.

314. UCP400 Article 7 provides:

- a. Credits may be either
  - i revocable, or
  - ii irrevocable.
- b. All credits, therefore, should clearly indicate whether they are revocable or irrevocable.

This provision was not neutral because banks were in a better position than were beneficiaries to understand the importance of the significance of the magic term "irrevocable". Because of the success and impression attending the letter of credit, most beneficiaries assumed that all letters of credit were irrevocable. For that reason, there was a justifiable reluctance to give full and unstinting effect to this provision.<sup>315</sup>

A contemporary example of this phenomenon is the use of applicant controlled provisions. Such clauses can be apparent or hidden but they undermine the independence of the letter of credit since they require applicant cooperation or waiver for the beneficiary to make a complying presentation. A similar provision is one that is impossible to perform. Examples include the requirement that the beneficiary present a document containing the signature of the applicant (e.g. a delivery receipt). If the letter of credit required the signature of a named person who, unknown to the beneficiary, is under the control of the applicant; this requirement would be hidden. Faced with such provisions, courts have been properly reluctant to revise the terms of the letter of credit. While such provisions are distasteful, it is ultimately the beneficiary's responsibility to decide whether or not to act on the letter of credit, a decision that includes the judgment as to whether or not it can perform the conditions set forth in the letter of credit.<sup>316</sup>

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c. In the absence of such indication the credit shall be deemed to be revocable.

UCP400, *supra* note 225, art. 7; *see* *Beathard v. Chicago Football Club, Inc.*, 419 F.Supp. 1133 (N.D. Ill. 1976) (holding that the credits securing professional football players salary payments were revocable under the UCP which provided that in the absence of any contrary indication the credit was revocable); James E. Byrne, *The 1983 Revision of the Uniform Customs and Practice for Documentary Credits*, 102 BANKING L.J. 151 (1985).

315. Byrne, *supra* note 301, at 172; HENRY HARFIELD, BANK CREDITS AND ACCEPTANCES 231 (5th ed. 1974) (urging that the revision of UCP make letters of credit irrevocable as a default). Florida's enactment of Prior UCC Article 5 contained a nonconforming amendment that changed the definition of "credit" in Prior UCC section 5-103(1)(a) from stating, "[a] credit may be either revocable or irrevocable," to, "[a] credit shall clearly state whether it is revocable or irrevocable and in the absence of such statement shall be presumed to be irrevocable." FLA. STAT. § 675.103(i)(9) (1966) (revised 1999).

316. These provisions are to be distinguished from ones that are ambiguous. The approach suggested here is that taken by ISP98 Rule 4.10 which provides: "[a] standby should not specify that a required document be issued, signed, or counter-signed by the applicant. However, if the standby includes such a requirement, the issuer may not waive the requirement and is not responsible for the applicant's withholding of the document or signature." ISP98, *supra* note 142; *accord* ISBP, *supra* note 258, para. 4. Whether this approach to business on the part of the applicant is prudent is another question apart from whether it should be enforced. The answer is that it does not make good long term business sense to distort a payment mechanism that is

## VI. CONCLUSION

UCC jurisprudence regarding variance is incomplete. There are several options available with respect to variation of Articles of the Uniform Commercial Code:

- i. to articulate principles by which mandatory and non-mandatory provisions can be determined or assessed;
- ii. to exclusively identify those provisions that can be varied;
- iii. to leave the question entirely to the courts;
- iv. to identify some provisions that can be varied by the text (“unless otherwise agreed”) and also to identify some unvariable provisions, leaving the balance to the judgment of the courts with general directions in favor of freedom of contract (the general UCC approach);
- v. to make a non-exclusive list of provisions that cannot be varied and to leave it to the courts to determine others;
- vi. to list unvariable provisions coupled with principles to be applied to the other provisions; and
- vii. to provide an exclusive list.

Over its various revisions, the drafters of the UCC have incorporated each approach into at least one UCC Article. The problem with exclusive approaches is that while some provisions are amenable to absolute limits, others must be configured around minimums outside of which variation is permitted. Regardless of what the statute says, variations that are deemed unreasonable, in bad faith, or in violation of minimum notions of diligence or care will not be enforced by common law courts. Public policy considerations also must be taken into account, as well as provisions essential to the integrity of the particular statutory scheme.

In this respect, the Revised UCC Article 5 approach is radical. Even the 1998 Version of UCC Article 9, drafted after the 1995 revision of UCC Article 5, which lists mandatory provisions, allows

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neutral by inserting hidden or “silent” conditions that can be triggered on the sole discretion of the applicant. In most cases, it is better to negotiate different payment terms such as a collection. Once beneficiaries have been inconvenienced or lost money due to such a clause, they tend to require that conditions be inserted into the underlying contract that will operate against the applicant, such as submission of a pre-signed document by the applicant. In the end, the applicant is worse off than if they had not used the condition in the first place.

for judicial interpretation in the text and Official Comments.<sup>317</sup>

Revised UCC Article 5 is an important tribute to and example of the principle that variation of sophisticated commercial statutes must be controlled by the statute itself and that any expansion of these limitations by interpretation or reliance on general common law principles should only occur within the policies manifested within that statute. That consumer-related limitations are inapt makes this approach more feasible.

However, in its attempt to identify exclusively those matters that cannot be varied by listing specific sections, an approach previously unknown in UCC jurisprudence, Revised UCC Article 5 may have been overly minimalist.<sup>318</sup> While a definitive list of mandatory provisions adds desirable precision, it does so only if and to the extent that the completeness of its definitive character of the list is apparent.

The list contained in Revised UCC section 5-103(c) does identify many of the provisions that should not be variable. Many of the remaining provisions that are not reached by the partial limitation on variability of obligations are swept up by the inclusion of critically defined terms (especially "Letter of Credit"). However, considerable interpretation, a process always fraught with the possibility of different results, is required. This requires: (1) inferring the inclusion of the Article 5 statute of frauds; (2) deciding which rights and obligations have minimally variable limits with respect to reasonableness, good faith, diligence, and care; and (3) deciding to what extent, and on what basis, letter of credit fraud provisions and injunctions cannot be varied. In this process, a more detailed explanation of the overall approach and some principled guidance for the courts would be useful.

An optimal approach to variation in Revised UCC Article 5 would take into account the following:

1. The list in Revised UCC section 5-103(c) is intended to be definitive and any expansive inference beyond the listed exceptions must be severely limited.
2. Any expansive inference must be based on the letter of

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317. See *supra* note 79.

318. See generally James J. White, *The Influence of International Practice on the Revision of Article 5 of the UCC*, 16 NW J. INT'L L. & BUS. 189 (1995).

credit policies manifested in Revised UCC Article 5.

3. Interpretation of Revised UCC section 5-103(c) must be consistent with the policies underlying the selection of the provisions to be limited, reinforce the integrity of the letter of credit as a mechanism for the assurance of payment, and enhance the certainty and uniformity of interpretation of Revised UCC Article 5.

4. Limitations on variability should not be used to interfere with the reasonable commercial evolution or growth of letters of credit.

5. Scope provisions cannot be varied in any manner except as expressly provided by the statute interpreted in light of its purposes and drafting history.

6. In determining the scope of permissible variation, considerable deference should be given to standard international letter of credit practice.

7. Variations that are commercially unreasonable given the commercial nature of the transactions involved should not be enforced. A manifestly unreasonable variation includes the misuse of the statute to achieve unfair surprise, as understood in the context of the sophisticated nature of the users of letters of credit. In considering the commercial reasonableness of a variation or exclusion, the courts should take into consideration international practice, the effect of the variation, any alternative and its functional equivalency, regulatory considerations, and the fact that a variation is not commercially unreasonable if it has any reasonable commercial purpose.

8. While the effect of definitions in the statute can be expanded or restricted in a manner that is not commercially unreasonable, the definitions themselves cannot be varied since they indicate the meaning given to these terms in the statute itself.

9. Public policy considerations should be narrowly interpreted and applied to restrict the variability of the effect of the statutory provisions only to the minimum extent necessary to provide for the integrity of the undertaking or the statutory scheme of regulation.

While these considerations may be overly complex, they attempt



to capture a complex reality. There is no need for a revision of Revised UCC section 5-103(c) in order to achieve the ends suggested here. Although a future revision of the Official Comments might add useful clarity, the courts are currently able to apply them.

In view of the fact that Revised UCC Article 5 is declaratory of the common law, at least to a considerable extent, and in view of the power of the common law courts to interpret statutes in light of their purpose and public policy considerations, most courts would so interpret statutes as a matter of course.

This delineation is offered to forestall the assumption that listing nonvariable provisions is intended to be supplemented by general principles of UCC jurisprudence, and to provide some considered guidance as to interpretation of those few interstitial matters not expressly addressed in Revised UCC section 5-103(c) and its Official Comments that may cause concern. Such an appreciation and approach enables courts to give full effect to Revised UCC Article 5's unique approach to variation while permitting limited flexibility where necessary.