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LETTERS OF CREDIT—A COMPARISON OF ARTICLE 5 OF THE UNIFORM COMMERCIAL CODE AND THE WASHINGTON PRACTICE

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[Ed. Note: This article will be published in two segments. The segment here presented covers *UCC* sections 5-102 through 5-108. The second segment will be published in the Winter, 1963 issue of the *Review*, and will cover *UCC* sections 5-109 through 5-117.]

INTRODUCTION

The title attached to this discussion is not inadvertent. Our primary concern is with the customs and expectations of that part of the Washington business community which deals with letters of credit, rather than with the Washington law. The latter is for the most part undeterminable. Only three cases concerned with letters of credit have reached our supreme court¹ and there is but limited Washington statutory coverage. Although the decisions of other American jurisdictions are not binding here, the Washington court may be expected to accept such of the existing precedents as in its estimation reach sound results. It is accordingly necessary to review those decisions. Under the discussion heading "The Present Law—in General," we have attempted to assemble a full and representative (rather than exhaustive) coverage of the American decisions which provide the background for article 5. Since the *Uniform Commercial Code* has been enacted in eighteen states, it is in actuality the "present law" in those jurisdictions.²

Insofar as it can effectively operate,³ trade usage is a highly signifi-

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¹ *Bank of East Asia v. Pang*, 140 Wash. 603, 249 Pac. 1060 (1926) (cited below at n.115, to be published Winter, 1963); *National City Bank v. Seattle Nat'l Bank*, 121 Wash. 476, 209 Pac. 705 (1922) (cited below at n.114, to be published Winter, 1963); *Kelley v. Greenough*, 9 Wash. 659, 38 Pac. 158 (1894) (cited below at n.39).

² Alaska, Arkansas, Connecticut, Georgia, Kentucky, Illinois, Massachusetts, Michigan, New Hampshire, New Jersey, New Mexico, New York, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Wyoming. In New York, however, §5-102 (1) was enacted with a deviation from the text as promulgated by the sponsors of *UCC*. Under this deviation, Article 5 will not apply to a credit which "is by its terms or by agreement or by custom 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...."

³ The function of usage as an aid to interpretation is well established. See *RESTATEMENT, CONTRACTS* § 245 *et seq.* (1932), and the discussion in Shattuck, *Contracts in Washington, 1937-1957: Part II*, 34 WASH. L. REV. 345, 385 (1959). Also important is the possibility that usage will actually add an undertaking to a contract. See *RESTATEMENT, CONTRACTS* § 246(b) (1932); 3 *CORBIN, CONTRACTS* § 556 (1950). *UNIFORM NEGOTIABLE INSTRUMENTS LAW* § 135 (RCW 62.01.135) makes an unconditional written promise to accept work like an acceptance, as to one who in reliance takes the draft for value. This proposition is not applicable to documentary credits, which are by definition conditional. It is applicable to a clean credit payable unconditionally, *i.e.*

cant factor in an area such as this, where rigid legal principles have not crystalized and the understanding of the parties is important in determining the solution of many of the problems. Trade usage then is of interest not only because it sets a pattern with which the practice demanded by article 5 must be compared, but also because it is important in an evaluation of the probable course of the Washington court in the event of litigation.

In Washington, letters of credit are issued by banks,⁴ and bankers are the only practicable source of information about the customs and expectations of banks and their customers relevant to our inquiry. We have been much helped in our effort to ascertain this information by Mr. C. Ron Johnson, Vice-President, and Mr. Richard W. Soderquist, Assistant Vice-President, Seattle-First National Bank, and Mr. Clarence L. Hulford, Vice-President, National Bank of Commerce. We very much appreciate their assistance in supplying background and technical data.

It is the practice of Washington banks to include in their documentary letter of credit forms (but not in the applications taken from customers)⁵ a phrase making the undertaking subject to the *Uniform Customs and Practices for Commercial Documentary Credits* promulgated by the Thirteenth Congress of the International Chamber of Commerce.⁶ It is therefore necessary to consider these statements of custom and practice with some care. There will be a number of references to them. The relevant publication will be referred to as *UCP*. Insofar as the *Uniform Customs* limit, define and condition the issuer's undertaking to the beneficiary, there is no reason to expect that their incorporation into the letter of credit is not accomplished by the phrase now used.⁷ On successful incorporation by reference they oper-

without surrender of the credit. There is not, in the *Uniform Commercial Code* article dealing with negotiable instruments, a comparable provision. *UNIFORM COMMERCIAL CODE* § 3-410 (1) requires that an acceptance be written on the draft, and thus would abolish the virtual acceptance.

⁴ See the discussion of § 5-102(1) below.

⁵ As will become evident in the discussion of § 5-114(3) (to be published Winter, 1963), some of the provisions of the *Uniform Customs* bear on the relations between issuer and customer. It has been deemed expedient however, in the drafting of application forms, to state in explicit terms propositions which might be derived from the *Uniform Customs*, and to expand the obligation of the customer.

⁶ *INTERNATIONAL CHAMBER OF COMMERCE BROCHURE* No. 151 (1951). It contains 49 "Articles," which are described as "provision, definitions, interpretations, etc." and which purport to be "uniform directions applying to all commercial documentary credits." As this paper is being prepared the International Chamber of Commerce is considering adoption of a revision of the *Uniform Customs*. Document No.470/105 9.III.1962, ICC, will be referred to as *Proposed Revision*.

⁷ No case has been found in which the incorporation was put in issue. In several decisions the court without discussion regarded the *UCP* provisions as a part of the

ate as though set out in the letter of credit and hence become a part of it. What their function would be as to a letter of credit which does not incorporate them, or in a relationship such as between issuer and customer, is debatable. That there is sufficient adherence even by banks to the propositions set out in the *Uniform Customs* to establish an operative trade usage in foreign trade is doubtful.⁸ In domestic transactions, *i.e.* those in which both issuer and beneficiary are within the United States, adherence of banks to the *Uniform Customs* could probably be established but the existence of the requisite adherence to or awareness of the *Customs* by the non-banker party⁹ might be hard to establish. The *Uniform Customs* do not appertain to non-documentary credits, and no reference is made to them in the forms used by Washington banks for clean credits such as those issued for travelers.

It is our hope that this discussion will serve a dual purpose: (1) provide a basis for evaluating the desirability of Article 5 and so aid in an over-all evaluation of the *Uniform Commercial Code* in this period of pre-enactment consideration of the *Code's* merits, and (2) provide a point of departure for Washington bankers and lawyers who become concerned with letter of credit problems after enactment of the *Code*. The first of these objectives seems better served if we undertake with each section a critique of its operation in light of the existing practice. This we have done.

Among the periodical citations are several which deal with interim drafts of article 5. These must be read with care. The article was considerably amended in the final 1958 formulation of the *Code*.

The enactment in Washington of article 5 is, in our opinion, highly desirable. It will provide a much-needed legal sanction for letters of credit and will accomplish this with little change in existing practices. The supporting data for these conclusions will appear in the section-to-section discussion. Cumulatively, that discussion will demonstrate a remarkable fact. The letter of credit has gained wide use in the United States without the support of a comprehensive and determinable legal foundation. Continued development and, in particular, wider use in domestic trade, require a legal environment in which interested parties

credit. For example: *Eriksson v. Refiners Export Co., Inc.*, 264 App. Div. 525, 35 N.Y.S.2d 829 (1942). See, however, note 63 *infra*.

⁸ See the discussion, Mentschikoff, 23 U. CHI. L. REV. 571, at 572 *et seq.* (1956).

⁹ A usage is operative only where the parties agree that it shall apply, or one of them so intends and the other knows or should know he does, or the usage is known to or should be known to both parties and neither expresses dissent from its application. RESTATEMENT, CONTRACTS § 247 (1932); CORBIN, CONTRACTS § 557 (1950). A comparable provision is contained in UNIFORM COMMERCIAL CODE § 1-205.

and their counsel can estimate with greater certainty than is now possible the legal relations produced by a letter of credit.

The existing uncertainty in American letter of credit law results from a combination of factors. One factor is the failure of courts to achieve consensus concerning basic theory. Another factor is the absence of any significant volume of appellate litigation save in New York and Massachusetts and the pertinent federal courts. A third factor is the appearance of some conflicts in the decisions. The end result in a state like Washington is that estimating the probable position of our court on many of the problems which can arise is but guesswork.

There is a reason for the present confusion about letter of credit theory. Although promises by prospective drawees, to accept drafts drawn in connection with transactions in which the promisors were buyers or otherwise directly concerned, were an early commercial development,¹⁰ the now-familiar documentary irrevocable credit issued by a bank did not come into general use until the nineteenth century.¹¹ By that time the American law of contracts and particularly the mutual assent and consideration¹² requirements for contract formation had settled into a pattern with which the irrevocable letter of credit does not fit. Fortunately, the courts which first encountered letters of credit were not hostile. Had they been, the letter of credit would have died aborning as did the common law trust receipt. Unfortunately, in ignoring theory, the decisions have left a vacuum. Into it writers have rushed in some number, and the volume of periodical discussion of letter of credit theory has reached astonishing proportions.¹³ The ideas

¹⁰ Trimble, *The Law Merchant and the Letter of Credit*, 61 HARV. L. REV. 981 (1948); Hershey, *Letters of Credit*, 32 HARV. L. REV. 1 (1918).

¹¹ Thayer, *Irrevocable Credits in International Commerce: Their Legal Nature*, 36 COLUM. L.R. 1031, 1032, n. 6 (1936).

¹² See the discussion of § 5-105 below.

¹³ There is of course general agreement that the issuer's promise falls within the broad sweep of contract law. The disagreement comes in connection with details. Is the letter of credit a kind of guaranty, or perhaps some other variety of suretyship? Is it a commercial specialty? Do the usual mutual assent and consideration principles apply? To what extent is the beneficiary's reliance a legally relevant factor? Does the doctrine of estoppel supply the answers? No attempt will be made here to pursue the ramifications of these inquiries. The important point is the disagreement about theory displayed in the literature. See the following: Hershey, *Letters of Credit*, 32 HARV. L. REV. 1 (1918); Note, *Commercial Letters of Credit*, 21 COLUM. L. REV. 176 (1921); 34 HARV. L. REV. 533 (1921); McCurdy, *Commercial Letters of Credit*, 35 HARV. L. REV. 539, 563 *et seq.* (1922); Mead, *Documentary Letters of Credit*, 22 COLUM. L. REV. 297, 300 *et seq.* (1922); McCurdy, *Commercial Letters of Credit*, 35 HARV. L. REV. 715, 737 (1922); Comment, *Letters of Credit—Negotiable Instruments*, 36 YALE L.J. 245 (1926); Thayer, *Irrevocable Credits in International Commerce: Their Legal Nature*, 36 COLUM. L. REV. 1031 (1936); Campbell, *Guaranties and the Suretyship Phases of Letters of Credit*, 85 U. PA. L. REV. 175, 188 *et seq.* (1936); Campbell, *Guaranties and the Suretyship Phases of Letters of Credit*, 85 U. PA. L. REV. 261 (1936);

advanced in periodicals and texts are on occasion interesting but hardly have the force of law. There is probably no category of American common law which will accommodate the irrevocable letter of credit without distortion, and none which will produce consistently sound results even for the revocable credit.

Analysis of an irrevocable credit, issued by a third person on behalf of a buyer or debtor, as a contract promise supported by the customer's payment or promise of reimbursement to the issuer, is inadequate because it opens failure-of-consideration defenses for an issuer which are incompatible with the understanding of the business community about the duties of the issuer to the beneficiary.¹⁴ So long as a theoretic hiatus exists letters of credit are vulnerable, and the vulnerability is especially acute in a jurisdiction which has few appellate decisions of the type which can be argued to have impliedly recognized an irrevocable credit to be a legal obligation when issued. The only cure is legislation. A statute can declare the desired legal relationships without concern for theory. This is a major contribution of article 5.

A revocable credit issued by a third person on behalf of a buyer or debtor can be too facilely classified as an offer, ending all inquiry into theory. Certainly some of the problems which arise from revocable credits can properly be disposed of by resort to ordinary revocation-of-offer principles. That these principles should always govern is doubtful. The requirement of revocation-communication, for instance, may not be compatible with commercial understanding of the revocable credit.¹⁵ Application of the usual rejection propositions to a revocable credit might well lead to undesirable results.¹⁶ Moreover, there is just as

Trimble, *The Law Merchant and the Letter of Credit*, 61 HARV. L. REV. 981, 994 *et seq.* (1948); Comment, *Recent Extensions in the Use of Letters of Credit*, 66 YALE L.J. 902, 911 *et seq.* (1957). The texts are equally diverse. See CORBIN, CONTRACTS §§ 68,76 (1950); FINKELSTEIN, LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT 28, *et seq.* 274 *et seq.* (1930); WARD AND HARFIELD, BANK CREDITS AND ACCEPTANCES 33, *et seq.* (4th ed. 1958); WILLISTON, CONTRACTS § 32 (3rd ed. 1957), §§ 1011C, 1011D, 1011E (2nd ed. 1936); WILLISTON, SALES §§ 469c 469e (1948). American Jurisprudence covers letters of credit in its *Guaranty* chapter and gives a definition which is not distinguishable from that of an offer for a suretyship contract. 24 AM. JUR. *Guaranty* § 20 (1939). Corpus Juris demonstrates a fine impartiality, giving several contradictory definitions of "letter of credit." 9 C.J.S. *Banks & Banking* § 175 (1938); 10 C.J.S. *Bills & Notes* § 23(d) at 431 (1938); 38 C.J.S. *Guaranty* § 7 at 1142 (1943). The American Digest System has assigned *Banks and Banking* § 191 to most phases of letter of credit transactions, including the issuer-customer agreement. The attorney who happens to be working with a letter of credit issued by a finance company might have difficulty in getting on the trail. An occasional letter of credit case is also to be found under Dec. Dic. *Sales* § 191.

¹⁴ See the discussion of § 5-105 below.

¹⁵ See the discussion of § 5-106 below, and the discussion of revocability in note 26 *infra*.

¹⁶ An offeree's expression of intent not to accept, whether by words or conduct, is

much value behind a revocable credit, in the form of a payment or promise of reimbursement by the customer, as there is behind an irrevocable credit. Such a credit seems better analyzed as a contract, the issuer's promise being terminable. One thing is clear. A statute is needed to declare the desired legal relationships and put a period to discussions like this about theory. Article 5 will also provide assurance about the operation of a revocable credit which is not revoked, an area in which counsel must now for the most part rely on decisions involving irrevocable credits.

Section 5-102. Scope

(1) This Article applies

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

UCP—The beginning three paragraphs of *UCP*, entitled "General Provisions," state propositions of broad applicability. The first paragraph, reading: "The provisions, definitions, interpretations etc. contained in the following Articles are understood as uniform directions applying to all commercial documentary credits including authorities to pay, accept, negotiate or purchase, unless otherwise expressly agreed," is in essence a statement of scope. Nowhere does *UCP* undertake to cover credits issued by non-banks. Some of the language, particularly in articles 4 and 5, suggest that only banks can issue credits, so far as *UCP* is concerned. (The *Proposed Revision*, General Provisions and Definitions, defines a credit as an "arrangement . . . whereby a Bank. . .") There has never been any support, either in custom or in law, for such a limitation. *UCP* appertains only to documentary credits.

a rejection which destroys an offer. See RESTATEMENT, CONTRACTS §§ 36, 37, 38, 39 (1932), and *Moss v. Old Colony Trust Co.*, 246 Mass. 139, 140 N.E. 803 (1923), in which application of this rejection principle to a credit was assumed to be necessary.

The present law—In general: Under Anglo-American law the issuance of credits is not exclusively a bank function. Banks and non-banks are probably bound by the same substantive letter of credit principles. That national banks have implied power to issue letters of credit has been judicially recognized.¹⁷ Some state banking codes expressly authorize banks to issue credits.¹⁸ Whether state banks in other states have a like power by implication is unsettled.¹⁹

Washington law: There is no Washington statute, so far as we have found, which mentions letters of credit.

RCW 30.08.140 authorizes a state bank to make contracts and to accept drafts "having not more than six months sight to run," the latter activity being extensively regulated. It can be argued with some force that authority to accept necessarily includes authority to contract to accept and that the Washington statute amply supports the issuance of credits by state banks, provided the demands of the statute as to the details are satisfied. It can also be argued that authority to accept drafts, to run for not more than a stated period, includes authority to contract to pay either sight or time drafts. The state Supervisor of Banking has not, so far as we can ascertain, questioned, or indeed had the occasion to consider, the power of a bank to issue letters of credit.

Washington practice: We have found no evidence that credits are

¹⁷ In *Border Nat'l Bank v. American Nat'l Bank*, 282 Fed. 73 (5th Cir. 1922), cert. denied, 260 U.S. 701 (1922), the court said, without discussion, that "... a national bank is bound by its letter of credit." *Decatur Bank v. St. Louis Bank*, 21 Wall. 294, (1875), was cited. It is hardly authority, since the issue of bank power was raised on appeal but not considered because it had not been raised below. The Comptroller of the Currency has ruled that national banks have the implied power to issue credits. He found that credits calling for acceptances of drafts were impliedly permitted by § 13 of the Federal Reserve Act, 38 Stat. 263 (1913), 39 Stat. 754 (1916), as amended, 12 U.S.C. §§ 372, 373 (1946), and that credits calling for payment fell within general banking operations. Par. 1170, Digest of Opinions of the Office of the Comptroller of the Currency (1960 Revision). This administrative ruling, and the resulting bank examiner clearance of those phases of the letter of credit which come under their scrutiny, has been impliedly approved by Congress in its failure to vary it by amendment of the national banking legislation. Congress has also recognized the propriety of banks engaging in this activity, by expressly providing that federal banks organized to carry on a foreign banking business can issue letters of credit. 41 Stat. 378 (1919), as amended, 49 Stat. 704 (1935), 12 U.S.C. § 615 (1946). Writers who have addressed themselves to the question of the implied power of national banks to issue credits have in general found the power to exist. Trimble, *The Implied Power of Nat'l Banks to Issue Letters of Credit and Accept Bills*, 58 YALE L.J. 713 (1949); Harfield, *Nat'l Bank Act and Foreign Trade Practices*, 61 HARV. L. REV. 782, 792 (1948). Cf. Campbell, *Guaranties and the Suretyship Phases of Letters of Credit*, 85 U. PA. L. REV. 261, 291 (1937); See also FINKELSTEIN, *LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT* 5, n.7 (1930); WARD AND HARFIELD, *BANK CREDITS AND ACCEPTANCES* 146 et seq. (4th. ed. 1958).

¹⁸ See FINKELSTEIN, *op. cit. supra* note 17, at 6.

¹⁹ See FINKELSTEIN, *op. cit. supra* note 17, at 5. Campbell, *supra* note 17, at 291. The corporate powers of state banks are not expanded by the Federal Reserve Act.

issued in this state by persons or institutions other than banks. The greater part of the credits issued in Washington are issued by national banks. We have not, however, found any evidence that state banks seriously doubt their power to issue letters of credit.

Credits issued by Washington banks call for payment or acceptance of drafts. There has been no recent experience with or occasion to consider the significance of tax statutes which might dictate the use of a simple "demand for payment" rather than a draft. •

The documentary credits issued by Washington banks are typically labelled "Irrevocable Credit." Travelers' credits are typically labelled "Letter of Credit." The issuance of credits wholly or partially clean, in support of sales transactions, is so infrequent as to provide no basis for determining the existence of a practice regarding them.²⁰

Critique: The subsection excludes from the coverage of article 5 a clean credit issued by a bank if the credit is not "conspicuously so entitled," and a credit issued by a person other than a bank if the credit neither demands a title document nor is labelled "letter of credit." The reason for these distinctions is not explained in the Official Comment. It will be observed that non-conforming undertakings will be embroiled in the common law, including the criteria for determining whether an undertaking is a letter of credit. Such undertakings, particularly those of persons who do not ordinarily issue letters of credit, may well be held to be guaranties.

Since Washington banks adequately label travelers' credits, no change in the present practice with regard to such credits would be required by the subsection. Whether the present documentary credit forms meet the labelling requirement is not clear. The point may be critical if a documentary credit is modified to delete the requirement of documents or if a credit is partly clean and partly documentary. It would seem desirable to obviate all risk of difficulty with these variations by printing at the top of the forms the full phrase "Letter of

²⁰ The so-called "red-clause," a type of credit which is available in whole or in part against drafts drawn in connection with a sales transaction, it being expected that documents will later be forthcoming, appears not to be used in Washington at the present time. Neither is it the practice of Washington banks to delete by subsequent modification the requirement of documents in credits issued as documentary. Interesting examples of clean credits are to be found in *American Nat'l Bank & Trust Co. v. Banco Nacional*, 231 Ala. 614, 166 So. 8 (1936), same cases 238 Ala. 128, 189 So. 191 (1939); *French American Banking Corp. v. Isbrandtsen Co., Inc.*, 126 N.Y.S.2d 853 (1953), *aff'd*, 126 N.Y.2d 887 (1953), *aff'd*, 307 N.Y. 616, 120 N.E.2d 826 (1954). The use of a credit partly documentary and partly clean is illustrated in *Oelbermann v. National City Bank of New York*, 79 F.2d 534 (2d Cir. 1935), *modified*, 298 U.S. 638, (1936). The extraordinary risks taken by the person who procures a red-clause credit are well enough demonstrated in these decisions.

Credit." Similarly as to any forms devised for clean credits, other than travelers' credits.

It may well be that enactment of the *Uniform Commercial Code* will stimulate wider use of letters of credit in domestic trade, and encourage the issuance of credits by finance companies and other business organizations.²¹ The draftsman of their forms will of course be careful to meet the "conspicuously so entitled" requirement of the subsection.

The fact that letters of credit typically and traditionally call for payment or acceptance of that variety of negotiable instrument known as a "draft" creates a risk of controversy about the legal characteristics of a promise to pay on submission of a simple demand for payment. On the other hand, document taxes levied on drafts may make desirable the use of the simple demand. This subsection and § 5-103 perform a useful service in removing a possible source of trouble.

Although there is no reason to question seriously the implied power of a Washington state bank to issue letters of credit, it must be recognized that any corporate power which rests on inference is to a degree unsatisfactory. The enactment of article 5 would strengthen the argument that RCW 30.08.140 impliedly authorizes the issuance of credits, by opening the additional argument that the legislature would not regulate, with the particularity of article 5, an activity which it did not think was within the corporate powers of state banks.

(2) Unless the engagement meets the requirements of subsection

²¹ That there is a tremendous potential for the letter of credit in domestic transactions seems obvious. No other commercial arrangement so far devised serves as well the needs of a seller who requires protection from credit risks. With the letter of credit he can be sure of payment at the time and point of shipment. Collection at the point of delivery, by use of a draft accompanied by the bill of lading, poses serious problems in the protection and disposition of the goods if the buyer refuses performance. These problems are so serious in international trade as to have fostered general use of the letter of credit despite uncertainties as to the resulting legal relations. Enactment of article 5 and the resulting increase in assurance concerning the substantive law, plus wider familiarity with it on the part of lawyers and business men, should much expand use of letters of credit in domestic trade. This is not to suggest that there is now no appreciable use of the device in such trade. Although exact figures are not available, the aggregate dollar amount of domestic letters of credit must reach a very large figure. See Mentischikoff, *Letter of Credit: The Need for Uniform Legislation*, 23 U. CHI. L. REV. 571, 615 *et seq.* (1956). The successive-security arrangements which commence with a letter of credit and end with a trust receipt, well known in import transactions, are equally feasible in domestic trade. The transaction litigated in *Consolidated Sales Co., Inc. v. Bank of Hampton Road*, 193 Va. 307, 68 S.E.2d 652 (1952), involved household appliances, a type of merchandise which readily lends itself to financing by a bank or finance company after receipt of goods by the buyer and thus facilitates a secured-transaction package starting with a letter of credit. The transaction litigated in *Drinc-O-Matic v. Frank*, 141 F.2d 177 (2d Cir. 1944), involved soda dispensing machines. Machinery of all kinds would appear to be a type of merchandise well suited to successive security. For a discussion of the bank-charter problems encountered in domestic trade, see WARD AND HARFIELD, *BANK CREDITS AND ACCEPTANCES* 94 *et seq.* (4th ed. 1958).

(1), this Article does not apply to engagements to make advances or to honor drafts or demands for payment, to authorities to pay or purchase, to guarantees or to general agreements.

UCP—As was indicated in the discussion of subsection (1), *UCP* purports to deal with “documentary credits including authorities to pay, accept, negotiate or purchase. . . .” The evident ambiguity in this passage is clarified in the *Proposed Revision*. See the discussion of *UCC* § 5-103.

The present law—*In general and in Washington*: There is no “law” on the subject matter of this subsection.

Washington practice: It is not the practice in Washington to describe as “letter of credit” a transaction which falls within the exclusions stated in this subsection. There appears to be no commercial use in Washington of authorities to draw or of authorities to pay.

Critique: It is the view of some that letters of credit are a variety of suretyship, since performance by the issuer will discharge the customer's duty to the beneficiary. Such a classification is not desirable. It suggests serious charter-power problems for banks, whose power to enter into guaranties is limited.²² Equally fatal would be the saddling of letters of credit with the suretyship defense principles which give a special flavor to the contracts of sureties. It seems obviously preferable to classify the letter of credit as *sui generis*. Clearer recognition of this fact should be fostered by the subsection, which makes clear the non-application of article 5 to “guarantees” (a term which no doubt encompasses guaranties), and by the definition of “letter of credit” which appears in § 5-103(1). Just what is meant by the phrases “engagements to make advances” and “general agreements” is not clear.

Authorities to draw and authorities to pay do not add the credit of a third person to the basic buyer-seller or debtor-creditor relationship.

²² *Merchant's Bank v. Baird*, 160 Fed. 642 (8th Cir. 1908) (national bank guaranty held *ultra vires*). See also *Dunn v. McCoy*, 113 F.2d 587 (3rd Cir. 1940); *Pan-American Bank & Trust Co. v. National City Bank*, 6 F.2d 762 (2d Cir. 1925), *cert. denied*, 269 U.S. 554 (1925), particularly the dissent; *O'Connor v. Bankers Trust Co.*, 159 Misc. 920, 289 N.Y. Supp. 252 (1936), *aff'd*, 253 App.Div. 714, 1 N.Y.S.2d 641 (1937), *aff'd*, 278 N.Y. 649, 16 N.E.2d 302 (1938); *Trust Co. v. Jefferson Trust Co.*, 14 N.J. Misc. 656, 186 Atl. 732 (1936); *Commercial Trust Co. v. American Trust Co.*, 256 Mass. 58, 152 N.E. 104 (1926); *Nowell v. Equitable Trust Co.*, 249 Mass. 585, 144 N.E. 749 (1924). These decisions differ in approach and result, indicating the inherent difficulty in determining whether a particular transaction is at that time and place *ultra vires* the particular bank concerned.

Although in some discussions of letters of credit these authorities are lumped with transactions in which a bank or other third person does lend its credit,²³ there is in modern practice a clear-cut line of demarcation between the two types of transaction.²⁴ The regulatory system of article 5 is not appropriate to authorities to draw or to pay and their exclusion in this subsection is quite in order. That they are excluded is made clear by the definition of a credit which appears in § 5-103.

(3) This Article deals with some but not all of the rules and concepts of letters of credits as such rules or concepts have developed prior to this act or may hereafter develop. The fact that this Article states a rule does not by itself require, imply or negate application of the same or a converse rule to a situation not provided for or to a person not specified by this Article.

UCP—Although *UCP* does not expressly so indicate, the propositions therein stated do not purport to cover the whole range of letter of credit problems.

The present law—In general and in Washington: There is no “law” on the subject matter of this subsection.

Washington practice: There is no practice relevant to this subsection.

Critique: The Official Comment says of this subsection:

no statute can effectively or wisely codify all the possible law of letters of credit without stultifying further development of this useful financing device. The more important area not covered by this Article revolves around the question of when documents in fact and in law do not comply with the terms of the credit.²⁵ In addition such minor matters as the absence of expiration dates and the effect of extending shipment but not expiration dates are also left untouched for future adjudication. The rules embodied in the Article can be viewed as those expressing the fundamental theory underlying letters of credit. . . .

Another detail not covered by article 5 is the revocability of a credit which does not expressly indicate whether it is revocable or irrevocable.

²³ See the discussion in McCurdy, *COMMERCIAL LETTERS OF CREDIT*, 35 HARV. L. REV. 539, 549 *et seq.* (1922); WARD AND HARFIELD, *BANK CREDITS AND BANKING* 11-13 (4th ed. 1958).

²⁴ Although the oldest type of transaction to which the name “letter of credit” has been given involved only an understanding by the prospective debtor to pay or accept drafts drawn on him, it has been suggested that the term should now be reserved for credits issued by a third person. FINKELSTEIN, *op. cit. supra note 17*, at 18.

²⁵ See the discussion of § 5-114(1) below (to be published Winter, 1963).

able.²⁶ Still another area ignored in article 5 is the sales contract and the operation of its provision for a credit.²⁷

²⁶ It is the practice of Washington banks to clearly label documentary credits as revocable or irrevocable. The incidence of the former is very small. Foreign and domestic credits do not differ in this particular. Clean credits such as travelers credits are typically not so labelled. What the position of the Washington court would be were the issue of revocability to reach it under a credit, silent regarding revocation, cannot be determined. *UCP* provides in article 3: "All credits, unless clearly stipulated as irrevocable, are considered revocable even though an expiry date is specified." (The *Proposed Revision* omits this provision and reads: "Credits may be either (a) revocable, or (b) irrevocable. All credits, therefore, must clearly indicate whether they are revocable or irrevocable.") *UCP* is routinely incorporated in Washington bank-issued documentary credits by express reference. On this detail the incorporation is not meaningful. *UCP* relates only to documentary credits. Such credits, where issued by a Washington bank, expressly cover the matter of revocation. There appears to be no definitive American case authority on this problem. Opinions such as that in *Ernesto Foglino & Co., Inc. v. Webster*, 217 App. Div. 282, 216 N.Y. Supp. 225 (1926), in which a credit is characterized without discussion as "irrevocable" are neither authoritative nor helpful. Opinions such as that in *Moss v. Old Colony Trust Co.*, 246 Mass. 139, 140 N.E. 803 (1923), in which a letter of credit was, without careful scrutiny of the analytic problems, characterized as an "offer," can lead to the erroneous conclusion that it must be revocable. An offer for which a price has been paid is not revocable and if the credit be an offer it will often have been "purchased" by means of a promise or cash. It may seriously be doubted whether the offer idea, which had its inception during a period when credits were promises by a prospective buyer or borrower to pay or accept a draft drawn on him (see note 23 *supra*), has any relevancy now with regard to a credit issued by a bank or other third party. Such credits are promises made for a price (see the Introduction, note 15 *supra* and the discussion of § 5-114(2) below, to be published Winter 1963) and would appear to be obligatory when made, not mere offers looking to future obligation. Under this analysis, revocability is a simple interpretation problem. The preferable approach is that taken in *First Wisconsin Nat'l Bank v. Forsyth Leather Co.*, 189 Wis. 9, 206 N.W. 843 (1926), noted *MINN. L. REV.* 612 (1926), in which the issue of revocability was resolved by ascertaining the intent of the parties as disclosed by the usual canons of interpretation. (It should however be noticed that the cases cited after the statement: "Where letters are so issued without express designation, there is authority to the effect that they are revocable," and those cited for the contrary proposition, do not support the propositions attributed to them by the court.) See also *Federal Coal Co. v. Royal Bank of Canada*, 10 F.2d 679 (2d Cir. 1926), in which the court held that a credit expressly stating it was revocable would not, because it also stated a duration, support interpretation as irrevocable. A credit silent regarding revocability may be deemed unclear. If so, to it there may be applied one of two quite different approaches. The doubt may be resolved against the issuer, using a well-known interpretation standard (see *RESTATEMENT, CONTRACTS* § 236(d) (1932)). The doubt may be resolved by resort to trade usage, which supplies the missing term (see *RESTATEMENT, CONTRACTS* § 246(b)). Whether a relevant trade usage has developed even among American banks is not clear. It is unclear whether such a usage, if it does exist among banks, will appertain to a particular beneficiary. The usage-effect of *UCP* article 3 is also unclear (see discussion notes 8 and 9 *supra*). On the other hand, it can be argued with some force that the credit is not ambiguous. An issuer which promises to honor drafts has arguably made a contract promise and a contract promise cannot be terminated by an obligor who failed to expressly reserve the power to do so. Under this approach, revocation becomes an attempt to assert an express condition, *i.e.* non-termination. Courts are in general reluctant to find express conditions by inference. It follows that such a credit is probably irrevocable.

Another argumentative factor of uncertain weight is the declaration in § 2-325(3) of the *UNIFORM COMMERCIAL CODE*, that a sales contract clause calling for a credit requires an irrevocable credit save where the contrary is agreed. In ordinary course a seller will expect and get the buyer's promise to establish an irrevocable credit. This cannot directly affect the issuer's duty to the beneficiary, but it may well shed some light on the issuer's intent and the reasonableness of the beneficiary's interpretation where the credit is silent regarding revocation.

²⁷ One recurring problem is conformity of the credit actually established, to the

Section 5-103—Definitions

(1) In this Article unless the context otherwise requires

- (a) "Credit" or "letter of credit" means an engagement by a bank or other person made at the request of a customer and of a kind within the scope of this Article (Section 5-102) that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit. A credit may be either revocable or irrevocable. The engagement may be either an agreement to honor or a statement that the bank or other person is authorized to honor.
- (b) A "documentary draft" or a "documentary demand for payment" is one honor of which is conditioned upon the presentation of a document or documents. "Document" means any paper including document of title, security, invoice, certificate, notice of default and the like.
- (c) An "issuer" is a bank or other person issuing a credit.
- (d) A "beneficiary" of a credit is a person who is entitled under its terms to draw or demand payment.
- (e) An "advising bank" is a bank which gives notification of the issuance of a credit by another bank.

demands of a sale contract. Another is the liability of the buyer who established a conforming credit which has been defaulted by the issuer. On the latter point there is considerable case authority. Whether the buyer by establishing the credit discharges his duty to pay is to be determined by interpretation of the sales contract. Where it is silent on the point most of the cases have held that the buyer remains liable and can be held by the seller if the issuer fails to perform the credit. *Greenough v. Munroe*, 53 F.2d 362 (2d Cir. 1931), *cert. denied*, 284 U.S. 672 (1931) (and the cases discussed in the opinion); *Bank of United States v. Seltzer*, 251 N.Y. Supp. 637 (1931), noted *COLUM. L. REV.* 1358 (1931); *In re Canal Bank & Trust Co.'s Liquidation*, 178 La. 575, 152 So. 297 (1933). See also Note, *Recourse against the buyer in a letter of credit transaction*, 40 *HARV. L. REV.* 294 (1926). In *Dickerman v. Ohashi Importing Co.*, 62 Cal. App. 101, 218 Pac. 458 (1923), a buyer unsuccessfully argued that his duty to pay was by reason of trade usage impliedly conditioned on presentment of a draft by the seller within the period stipulated in the letter of credit; payment was refused by the issuer because the draft was presented after expiry of the credit. Interpretation can lead to a different result, as is indicated by *Ornstein v. Hickerson*, 40 F. Supp. 305 (E.D. La. 1941), where a contract provision calling for "payment" by acceptance of a time draft under a letter of credit was held to mean the buyer was discharged when such acceptance took place; the issuer failed after acceptance and the draft was not paid at maturity. This is certainly a detail which should be specifically and fully covered in the sales contract. The risk of controversy about it is acute if the issuer becomes insolvent after the credit is established. Other aspects of the matter do not so readily lend themselves to drafting. Having tendered to the bank, must the seller recover his documents and tender them to the buyer in order to mature a cause of action against him, and what of the time factor? Ordinarily performance by the seller will be a constructive condition to the buyer's duty to pay, and delay past performance date may well be fatal to an effective tender of performance.

- (f) A "confirming bank" is a bank which engages either that it will itself honor a credit already issued by another bank or that such a credit will be honored by the issuer or a third bank.
- (g) A "customer" is a buyer or other person who causes an issuer to issue a credit. The term also includes a bank which procures issuance or confirmation on behalf of that bank's customer.
- (2) Other definitions applying to this Article and the sections in which they appear are:
- | | |
|-----------------------|-------------------|
| "Notation of Credit". | Section 5-108. |
| "Presenter". | Section 5-112(3). |
- (3) Definitions in other Articles applying to this Article and the sections in which they appear are:
- | | |
|---------------------------|----------------|
| "Accept" or "Acceptance". | Section 3-410. |
| "Contract for sale". | Section 2-106. |
| "Draft". | Section 3-104. |
| "Holder in due course". | Section 3-302. |
| "Midnight deadline". | Section 4-104. |
| "Security". | Section 8-102. |
- (4) In addition, Article 1 contains general definitions and principles of construction and interpretation applicable throughout this Article.

UCP—Article 5 of *UCP* reads in part : "Irrevocable credits are definite undertakings by an issuing Bank and constitute the engagement of that Bank to the beneficiary or as the case may be, to the beneficiary and bona fide holders of drafts drawn thereunder that the provisions for payment, acceptance or negotiation contained in the credit, will be duly fulfilled . . ." This article goes on to say that confirmation of an irrevocable credit "implies a definite undertaking of the confirming Bank as from the date on which it gives confirmation," and that confirmation of a credit available by negotiation of drafts "implies only the undertaking of the confirming bank to negotiate drafts without recourse to drawer." Article 6 reads: "Irrevocable credits may be advised to the beneficiary through an advising Bank without responsibility on the latter's part." The *Proposed Revision*, General Provisions and Definitions, adds a definition of

“credit,” in language comparable to that of the *Uniform Commercial Code*, and goes on to include an arrangement which “authorizes such payments to be made, or such drafts to be made, accepted or negotiated by another Bank . . .”. General Provisions and Definitions.

The present law—In general: There are opinions in which a promise by a prospective buyer or debtor to honor drafts drawn on him is denominated “letter of credit.”²⁸ The decisions acknowledge the classification of credits as irrevocable or revocable.²⁹ No particular form of language for a letter of credit is demanded by American cases.³⁰ There is no consensus in the use of descriptive terms for the process by which the obligation is undertaken and for the parties to a letter of credit transaction. “Seller” and “Buyer” are often used to indicate the person who procures a credit and the obligee of it, while the obligor is often referred to only as “the bank.” Various special terms (which are mentioned in *Critique* below) appear in opinions.

Washington Law: The Washington court has referred to the person who procured a credit as the “customer” and has used the phrase “the letter of credit was issued.”³¹

Washington practice: Washington banks regard as a letter of credit only an undertaking by one other than a prospective buyer or debtor, acknowledge that credits can be revocable or irrevocable, and use indifferently in their documents the terms “we agree to honor,” “we engage that drafts will be honored” and “we authorize you to draw on us.” Washington banks also use the terms “issuer,” “beneficiary,” “confirming bank” and “advising bank” in ways not inconsistent with § 5-103. The term “customer” has not been used to describe a bank which at the request of its customer asks another bank to issue a letter of credit. No particular term has been used to describe the requesting bank. The person who purchases a credit is now often referred to as the “account party.”

Critique: The terminology of *UCP* as indicated in the parts quoted above is in general that of Washington banks. Section 5-103 does not conflict with this usage. The section states a precise word-usage which is a welcome relief from the variations in terminology encountered in opinions. There is no reason to think the definitions set out here point to legal results at variance with those otherwise expectable in Washing-

²⁸ See discussion note 10 *supra*.

²⁹ See discussion note 26 *supra*.

³⁰ See the discussion of § 5-104 below.

³¹ *National City Bank v. Seattle Nat'l Bank*, 121 Wash. 476, 209 Pac. 705 (1922).

ton. The section does not use, and hence should foster the obsolescence of various terms which on occasion have been used to designate refinements in letter of credit transactions.³²

Extension of the term "customer" to include a bank which requests another bank to issue a credit seems entirely sound. It is presently expected that the requesting bank will reimburse the issuing bank and otherwise have the burdens which characterize a "customer."³³ It may as well be so denominated.

The term "document" as used in this section differs from the usage of that word in article 9, where it means "document of title."³⁴ The broader use in article 5 is clearly set out here and conforms to the present letter of credit usage. It has long been recognized that a documentary credit can and typically will require not only a document of title but related papers such as an inspection certificate and an insurance policy.

Section 5-104. Formal Requirements; Signing

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

UCP—The *UCP* is silent regarding form and the need for a writing. The *Proposed Revision* defines a credit as "any arrangement, however named or described. . . ." (General Provisions and Definitions), and, in article 3, requires a confirmation to be in writing.

The present law—In General: American courts have refused to create standards which would force a letter of credit into a particular phrasing.³⁵ The cases divide on the applicability of the Statute of

³²Examples are: "negotiation credit," "straight credit," "acceptance credit," "cash credit," "circular credit," "open credit," "anticipatory credit," "revolving credit," "presentation credit," "special credit" and "sight credit."

³³Whether these expectations conform to the legal situation is another matter. See the discussion of § 5-114(3) below (to be published Winter, 1963).

³⁴§§ 1-201(15); 9-105(e).

³⁵*Border Nat'l Bank v. American Nat'l Bank*, 282 Fed. 73 (5th Cir. 1922), *cert. denied*, 260 U.S. 701 (1922) ("We guarantee irrevocably payment for account Joseph De Bona covering purchase 200 long tons . . ." was held to create a letter of credit and not a guaranty); *Second Nat'l Bank of Toledo v. M. Samuel & Sons*, 12 F.2d 963 (2d Cir. 1926), *cert. denied*, 273 U.S. 720 (1926) ("You are hereby authorized to draw on Irving National Bank . . . We hereby agree with the drawers, indorsers, and bona fide holders of the drafts . . . that the same will be duly honored . . ."); *Drink-O-Matic, Inc. v. Frank*, 141 F.2d 177 (2d Cir. 1944) (letter from bank to its customer expressing willingness to pay a draft drawn on the bank by a seller from

Frauds.³⁶ There appears to be no definitive authority regarding modifications. The *Uniform Negotiable Instrument Law* does not require that an extrinsic or virtual acceptance be written on the draft but does demand that the collateral undertaking of the drawee be in writing.³⁷ Although an expression in a credit of an unconditional purpose to accept will fall within this statute,³⁸ a documentary credit is by definition conditional.

Washington law: The Washington court has enforced an oral promise by A to B, to honor drafts drawn on A by C if B purchased

whom the customer was purchasing goods, held to be a letter of credit); Citizens Nat'l Trust & Savings Bank v. Londono, 204 F.2d 377 (9th Cir. 1953), *cert. denied*, 346 U.S. 866 (1953) ("We hereby authorize you to value on us . . ." said to be a letter of credit); Liberty Nat'l B. & T. Co. v. Bank of American Nat'l T. & S. Ass'n, 218 F.2d 831 (10th Cir. 1955) (the dispute grew out of a sale and re-sale; Liberty for the second buyer issued a credit requiring the presentation of documents; Bank of America was the beneficiary of Liberty's credit and the issuer of a credit requiring the presentation of documents, on behalf of the first buyer; of this credit a Swiss bank was the beneficiary; due to demands of the original seller, Liberty was induced to wire Bank of America authorizing, to quote the court "payment in Geneva on receipt of cable advice from Bank of Switzerland that it held the documents . . ."; Bank of America paid under its credit on receipt of such a cable; in this action against Liberty, Bank of America recovered; the court apparently treated Liberty's wire as a credit and Bank of America as the beneficiary of it); Moss v. Old Colony Trust Co., 246 Mass. 139, 140 N.E. 803 (1923) ("Advise Moss & Co. we open irrevocable credit . . . in their favor . . ." constituted a credit); John McClure Estate, Inc. v. Fidelity Trust Co., 243 Mass 403, 137 N.E. 701 (1923) (bank "notified" seller that it "would honor such draft for \$4,783.73"; this communication was held to create legal liability in the bank to honor the mentioned draft; the bank's message evidently operated as a letter of credit although the court did not so denominate it); Lamborn v. National Park Bank, 240 N.Y. 520, 148 N.E. 664 (1925) (letter reading: "We beg to advise you that we have received instructions . . . to open a confirmed credit in your favor with Bankers' Trust Co. . . . We advised the Bankers' Trust Company of this credit . . . but they have returned our advices, stating that credit should have been directly with you. . . . Kindly advise us in this connection," was held to create a letter of credit); First Wisconsin Nat'l Bank v. Forsyth Leather Co., 189 Wis. 9, 206 N.W. 843 (1926) ("We hereby authorize you to value on (us)" was not questioned as letter of credit language; the dispute was about revocability); Consolidated Sales Co. v. Bank of Hampton Roads, 193 Va. 307, 68 S.E. 2d 652 (1952) ("If you will draft on the Holland Radio Company at this bank . . . drafts will be honored. . ." was held to constitute a credit); Bridge v. Welda State Bank, 222 Mo. App. 586, 292 S.W. 1079 (K.C. Ct. App. 1927) ("The four Brecheisen brothers . . . are all shipping hay to you. Please honor any sight drafts they should draw on you. Should any of them overdraw, please draw sight draft back of them . . . and our bank will guarantee that the draft will be promptly paid," held to be a letter of credit). See also Annot., *What constitutes letter of credit*, 30 A.L.R. 1310, 1312 *et. seq.* (1924), and Second Nat'l Bank of Hoboken v. Columbia Trust Co., 288 Fed. 17 (1923). Granted that an issuer's undertaking can be in any language which expresses a promise to pay, no credit can exist where the alleged issuer made no promise. Bril v. Suomen Pankki Finlands Bank, 199 Misc. 11, 97 N.Y.S.2d 22 (Sup. Ct. 1950).

³⁶ See the discussion, FINKELSTEIN, *op. cit. supra* note 17, at 33. See also *id.* at 118 as to oral actual or virtual acceptances and the impact on them of the *Uniform Negotiable Instruments Law*.

³⁷ Sections 132, 134, 135. See BRITTON, *BILLS AND NOTES* § 172 *et seq.* (2d ed. 1961); Finkelstein, *Acceptances and Promises to Accept*, 26 COLUM. L. REV. 684 (1926).

³⁸ FINKELSTEIN, *op. cit. supra* note 17, at 117; See also Annot., *Rights and remedies of holder of draft issued under letter of credit which is dishonored*, 53 A.L.R. 57, 60 (1928) for citations of pre-Uniform Negotiable Instruments Law decisions.

such drafts.³⁹ An undertaking of this kind is the same as the promise of an issuer to a person who negotiates drafts drawn by the beneficiary, and is not distinguishable from a promise by A to B to honor drafts drawn on A by B, which is the stereotype of the modern commercial credit.

Washington practice: The language used by Washington banks in their letter of credit forms⁴⁰ amply demonstrates their assumption that a credit need not be couched in any particular words. There is apparently no commercial use of oral credits, modifications, or confirmations in Washington, and no likelihood that change in this pattern will occur in the future. There being no relevant practice, there is no basis for estimating the expectations of banks and their customers about oral credits, modifications or confirmations.

Critique: The first sentence of the subsection conforms to the present practice. Enactment of article 5 will not inhibit the development of variant phraseology if commercial expediency makes it desirable.

In requiring that a documentary credit, modification or confirmation be in writing and signed by the issuer the subsection exacts a formality not now necessary. Even in jurisdictions which apply to a credit the Statute of Frauds section relating to sureties the credit need not be written. A memorandum will suffice. The change would bring the law into harmony with long standing business practice. Documentary credits are demanded, purchased and issued by persons and institutions who understand the hazards of excessive informality in contractual relations and expect credits, modifications and confirmations to be written and signed. In requiring that a non-documentary credit, modification, or confirmation be in writing and signed by the issuer the subsection conforms both to the existing law and to the present practice. It will be noted that the subsection does not purport to say what the legal situation will be if what is otherwise a credit is expressed verbally. Courts will be free to attribute to such undertakings whatever legal attributes they deem properly derivable from the general law of contracts.

³⁹ *Kelley v. Greenough*, 9 Wash. 659, 38 Pac. 158 (1894). Cf. *Seattle Shoe Co. v. Packard*, 43 Wash. 527, 86 Pac. 845 (1906), in which § 132 of the UNIFORM NEGOTIABLE INSTRUMENTS LAW (which requires an acceptance to be in writing) was invoked to defeat an attempt to establish a virtual acceptance by evidence showing that the drawee had honored previous similar drafts.

⁴⁰ For example, "We engage that drafts . . . will meet with due honor"; "We hereby authorize you to value on us"; "We engage with you that drafts . . . will be duly honored"; "We hereby agree . . . that drafts shall be honored."

Enactment of the subsection will not necessitate any change in the forms now preferred by Washington banks. On the other hand, the subsection does not preclude the use of an ordinary business letter as a vehicle for expressing a credit, a modification of a credit, or a confirmation.

Since § 3-410 requires an acceptance to be written on the draft, enactment of the *Uniform Commercial Code* will clarify the position of persons who hold drafts issued pursuant to a credit. The present confusion as to whether such a person should sue on the draft or on the credit will be resolved. He can only sue on the credit.

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

UCP—Article 12, (article 10, *Proposed Revision*) reads in part: "Banks assume no liability or responsibility for the consequences arising out of . . . errors . . . in the transmission of cables, telegrams, or other mechanically transmitted messages. . . ." This indicates an expectation that credits will be communicated by telegraph but is otherwise not relevant concerning the problem to which the subsection is addressed.

The present law—In General: There appears to be no reason to doubt the sufficiency of a telegram as a memorandum, in jurisdictions which now apply the Statute of Frauds to letters of credit.⁴¹

Washington law: There appears to be no relevant decision in Washington.

Washington practice: The telegraph is customarily used in letter of credit transactions and Washington banks do not question the legal efficacy of such messages.

Critique: The subsection is made necessary by the requirement that a credit be in writing and signed. Use of the telegraph is often important in issuing, modifying or confirming a credit and it is desirable to leave no open question concerning the adequacy of a telegram either as to its being a "writing" or as to its being "signed." The provision for authentication by a code symbol recognizes the general use of such symbols in the transmission of cablegrams. The subsection

⁴¹ See 2 CORBIN, CONTRACTS § 508 (1950); 4 WILLISTON, CONTRACTS § 568 (3d ed. 1961).

conforms to the present practice and will require no change in forms or procedures.

Section 5-105. Consideration

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

UCP—There is no proposition about consideration to be found in *UCP*. The omission is not surprising. Consideration is a common law notion and unknown to the civil law. *UCP* does, in article 5 (article 3, *Proposed Revision*), define irrevocable credits as “definite undertakings by an issuing Bank and constitute the engagement of that Bank to the beneficiary . . . that the provisions for payment, acceptance or negotiation contained in the credit will be duly fulfilled provided that the documents . . . comply with the terms and conditions of the credit.” Under this provision the credit is a legal obligation when issued, and one which can be defeated only by showing non-compliance with “terms and conditions.” The common-law concepts of mutual assent, consideration and failure of consideration are not compatible with an obligation of this kind.

The present law—In general: There appear to be but a few cases in which consideration for an issuer’s promise was directly in issue. The decisions demonstrate no general inclination to abandon consideration as a criterion for the issuer’s legal liability.⁴² Failure of consideration cases are too infrequent to be meaningful.⁴³

⁴² *Carnegie v. Morrison*, 43 Mass (2 Met.) 381 (1841) is a good example. So are *Townsley v. Sumrall*, 27 U.S. 170 (1829) (X promised Y to accept a draft drawn on X by W; Y knew W did not then have any funds with X and that X expected to receive such funds before maturity of the draft; W became insolvent and X refused to accept; held that consideration was provided in Y’s acquisition of the drafts for a price); *Ouachita Valley Bank v. De Motte*, 173 Ark. 53, 291 S.W. 984 (1927) (beneficiary’s act of “shipping and delivering” the subject matter of its contract with the customer was consideration for issuer’s promise); *Evansville Nat’l Bank v. Kaufman*, 93 N.Y. 273 (1883) (a letter phrased “Any drafts that you may draw on Mr. A. Feigelstock, of our city, we guarantee to be paid at maturity.”; court referred to this as a “letter of credit” and regulated by “guaranty” principles including a requirement of consideration which the court found was not satisfied). See also *Russell Grader Mfg. Co. v. Farmers’ Exch. State Bank*, 49 N.D. 999, 194 N.W. 387 (1923) (the court inferred that absence of consideration would be a defense, had such been proved). *Contra*, *Bridge v. Welda State Bank*, 222 Mo. App. 586, 292 S.W. 1079 (1927) (The court said: “The fact that defendant (issuer) derived no benefit from its promise constitutes no defense to liability on a letter of credit,” 292 S.W. at 1083; this proposition was not elaborated). In *Maurice O’Meara Co. v. National Park Bank*, 239 N.Y. 386, 146 N.E. 636 (1925), it was held that an alleged modification of a credit failed for lack of consideration.

An interesting variation is provided by *Johannessen v. Munroe*, 158 N.Y. 641, 53 N.E. 535 (1899), in which the court held an issuer estopped from attacking the credit “for any cause.” The asserted defense was diversion of the credit from the contemplated use. The court’s approach has obvious promissory estoppel implications.

⁴³ *Oil Well Supply Co. v. MacMurphy*, 119 Minn. 500, 138 N.W. 784 (1912) (issuer

Washington law: There appears to be no relevant Washington decision.

Washington practice: Washington banks expect an issuer who undertakes an irrevocable credit to perform quite without regard to any technical details such as consideration and failure of consideration. Customers who procure and beneficiaries who demand credits entertain a like understanding. Washington banks do not regard revocable credits as legally obligatory, no matter what the customer may have paid or promised to pay for such a credit.

Critique: The infrequency with which issuers have invoked absence or failure of consideration principles in an effort to escape liability reflects much credit on the banking industry. It has, however, stultified the development of the appellate litigation which would clearly delineate judicial attitudes toward the irrevocable credit. Although there is not, so far as decided cases go, any reason to expect American courts in general to open consideration defenses for issuers, there is ample reason for uneasiness. There is an obvious gap between basic contract law and the irrevocable credit as understood by the business community. It is a gap which can be bridged satisfactorily only by legislation. Section 5-105 supplies the needed corrective.

defended on the ground that the customer was expected to put up collateral and had not done so; the court said: "We fail to see how the proffered proof could affect the plaintiff, which bought the draft on the strength of the telegrams," but did not discuss the technical failure of consideration problem); *American Steel Co. v. Irving Nat'l Bank* 266 Fed. 41 (2d Cir. 1920) (issuer tried to defend on the ground that the customer's plan to export the goods had become impossible of execution because of a change in government regulations. Presumably this affected the customer's ability to secure the bank, although the detail is not examined in the opinion. In denying the defense the court said: "The law is that a bank issuing a letter of credit . . . cannot justify its refusal to honor its obligations by reason of the contract relations between the bank and its depositor."); *Palmer v. Rice*, 36 Neb. 844, 55 N.W. 256 (1893) (issuer refused payment because customer's account showed a debit balance; court viewed this as an attempt to fasten a new condition on the credit and held for the beneficiary without discussing consideration or failure of consideration). These decisions demonstrate an inclination to hold the issuer despite the development of facts which might support a failure of consideration defense. They can hardly be deemed direct holdings on such a defense. A flat statement such as appears in FINKELSTEIN, *op. cit. supra* note 17, at 251, "It has therefore been held that the bank cannot refuse to pay its drafts to the seller on the ground that the . . . consideration from the buyer has failed. . . ." must be taken with much caution.

Still another analytic difficulty is illustrated by *Russell v. Timothy Wiggin*, 2 Story 213 (C.C. Mass. 1842). The court was invited to deny recovery by a beneficiary on the ground that he was not in privity with the issuer. The invitation was declined. The court held the beneficiary became a party and provided the consideration when it extended credit to the customer. It is apparent that this approach kills any concern for the issuer's reimbursement interest. In the *Russell* case the court informs us that the customer became insolvent and breached his promise to put the issuer in funds, but as an explanation for the issuer's refusal to honor drafts and not as a basis for a failure consideration discussion. If it be recognized that the issuer's consideration must be found in an act or promise of the customer, cases like this shed no light on the expectable results where the customer breaches his promise to the issuer.

For several hundred years the common law has been developing contract doctrine around the concept of bargain (with reliance as an alternative reason for enforcing a promise). The bargain idea postulates an exchange and hence consideration, which is something demanded and obtained by a promisor as the price for his promise. Equally vital is the concept of failure of consideration. Where the exchange received by a promisor is a counter-promise, subsequent events which make performance of the counter-promise impossible or unlikely should justify the promisor's refusal to render his performance. These propositions cannot be harmonized with the conception of a credit as an obligation on which the beneficiary can implicitly rely.

If the credit is analyzed as a simple offer to the beneficiary, it must be revocable even though it purports in its terms to be irrevocable.⁴⁴

⁴⁴In the usual offer the offeror in specifying what he wants from the offeree (promise, act or forbearance) indicates what the offeree must do to accept and also identifies the consideration the offeree is to provide. Despite recurring definitions of a letter of credit as a "request" to the beneficiary to sell goods or loan money to the customer, it is obvious that the modern documentary credit requests nothing of the beneficiary. The forms contain no language of request addressed to the beneficiary and none can be made out by implication. The basic contract between customer and beneficiary will have already been entered into and the beneficiary's duty to sell or loan will have been created by it. There are serious antecedent-duty problems if the beneficiary's performance of that duty is asserted as consideration for the issuer's promise. The issuer is not bargaining for an advantage to the customer. The issuer of a credit charges a fee which is the exchange it exacts. For this reason a traveler's credit which contains (as some do) language of request, cannot properly be analyzed as bargaining for the beneficiary's putting the customer in funds. Moreover such a credit is often addressed to banks in countries where the very idea of consideration is unknown. On similar reasoning the issuer's promise to honor, made to bona fide holders of drafts drawn by the beneficiary, is not a request that drafts be negotiated as the price contemplated by the issuer for his undertaking. There may of course be from time to time transactions in which a non-professional issuer undertakes a credit without charging a fee, actually bargaining for the benefit to the customer which will come from shipment of goods or other extension of credit. This possibility is not a valid basis for questioning the wisdom of § 5-105. Consideration is not compatible with the normal function of credits and the individual who strays into such a transaction cannot with propriety object to the invocation against him of the legal principles which normally appertain.

Cases such as *Moss v. Old Colony Trust Co.*, 246 Mass. 139, 140 N.E. 803 (1923), in which a letter of credit is defined as "an offer by a bank or other financial agency to be bound . . . when accepted and acted upon. . .", invoke not only the mutual assent principles which the court was apparently anxious to apply but also consideration principles, since the offeree's promise or act is the only rational source of consideration. The whole analytic structure of these decisions seems demonstrably at variance with the facts. Preferable in result, although typically unhelpful in explaining it, are cases such as *Doelger v. Battery Park Nat'l Bank*, 201 App. Div. 515, 194 N.Y.S. 582 (1922) (credit said to be a contract between issuer and beneficiary, from the time of issuance). For discussions of the impact on consideration and revocation issues of the absence of consensus as to the basic theory on which letters of credit rest, see Comment, *Banks and Banking: Letters of Credit*, 12 CALIF. L. REV. 500 (1924); WILLISTON, *CONTRACTS* § 1011D (rev. ed. 1936). With particular reference to revocability, see McCurdy, *The Right of the Beneficiary Under a Commercial Letter of Credit*, 37 HARV. L. REV. 323 (1924); Thayer, *Irrevocable Credits in International*

If the credit is analyzed as an option or as a contract promise to pay or accept, consideration being provided by the customer's promised payment of a commission and of reimbursement, the credit is irrevocable when issued but is vulnerable to failure of consideration defenses. Neither analysis is compatible with the business use of an irrevocable credit. There is no provision within the framework of contract doctrine as it now exists for the type of legal duty which a credit must create in order to perform its proper business function. It would perhaps be within the power of courts to carve out an exception applicable to credits. The possibility that in time and after much litigation American courts might come to hold an "irrevocable" credit to be irrevocable in fact and law is not a satisfactory foundation for credits as a commercial institution. This is peculiarly a situation in which legislation is the only satisfactory solution. A statute like § 5-105 is badly needed.

It will be observed that the section accomplishes its objective by removing a defense which an issuer might otherwise have, a defense which would in some transactions take all force from the affirmative declaration of the issuer's duties which is set out in §§ 5-106, 5-114 and 5-115.

Modification of an existing irrevocable credit creates problems no different from those present in the original credit, so far as revocability is concerned.⁴⁵ The section is therefore properly made broad enough to make modifications obligatory without regard to consideration.

Granted that the section is a necessary element in the future development of letter of credit use by business men, does it put on issuers an undesirable risk? If the customer fails, his promise to reimburse the issuer may be worthless. There is a simple answer to this inquiry. Banks now regard themselves as taking the risk of inability to obtain reimbursement from the customer, and approach the possibility as a straight bank-credit problem. If the documents are not sufficient collateral, additional collateral or a cash payment is demanded from the customer. It must also be recognized that the section does not destroy a defense which issuers now certainly have. Rather it terminates an uncertainty as to whether such a defense

Commerce: Their Legal Nature, 36 COLUM. L. REV. 1031, 1041 (1936); Thayer, *Irrevocable Credits in International Commerce: Their Legal Effects*, 37 COLUM. L. REV. 1326, 1330 *et seq.* (1937).

⁴⁵ Some knotty consideration problems are created by modification agreements in Washington, which make it especially desirable to free credits from consideration complications. See Shattuck, *Contracts in Washington, 1937-1957*, 34 WASH. L. REV. 24, 57 (1959).

might be available. The existence of a statute fixing an issuer's liability under an irrevocable credit will be beneficial for still another reason. It will strengthen the position of an issuer which is faced with a demand from the customer that the credit be revoked. Such a demand, if accompanied by a threat of refusal to reimburse, produces a very complicated problem. It is a repudiation by the customer which is in turn prospective failure of consideration where the consideration for the bank's promise is the customer's promise and this is arguably a defense to the issuer justifying his non-performance to the beneficiary. If the issuer performs anyway, its right to reimbursement is arguably prejudiced. Although there is apparently no case authority indicating that this argumentative chain will be persuasive to judges, the section does some good in enabling the issuer to stand flatly on a statute declaring his legal duty to the beneficiary to be irrevocable no matter what the customer threatens or demands.

Revocable credits present a quite different analytic problem. By definition such credits can be avoided by the issuer. On the other hand, in modern practice revocable credits may be issued by third persons to back up a transaction between customer and beneficiary, just as are documentary credits, and the customer will have paid for the service. Application of normal consideration principles to a revocable credit is unsatisfactory. The issuer's complete control over its performance makes its promise illusory. The customer's promise to the issuer is arguably unenforceable because the issuer's promise is illusory, hence is not consideration. The issuer cannot on this reasoning receive consideration in the customer's promise. If it is attempted to analyse the credit as an offer, intending to locate consideration in the beneficiary's acts, the attempt must arguably fail because the issuer has really made no promise. Revocable credits need a statutory base and freedom from the uncertainties which now appertain.

Sections 5-106. Time and Effect of Establishment of Credit

(1) Unless otherwise agreed a credit is established

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

The word "sent" used in this subsection is defined in § 1-201(38). A writing (which includes a telegram; see § 5-104(2)) is sent when it is deposited in the mail or delivered to a telegraph company for transmission, properly addressed and postage or transmission charges prepaid. A communication which does not satisfy the indicated conditions will nevertheless be effective if received within the time which would have been required for transmission had the conditions been met. The word "established" used here and in § 5-105 is not defined in the *Code* and is not otherwise a term of art. It evidently means "comes into existence as a legal obligation."

UCP—The *UCP* has no coverage of these details.

The present law—In general and in Washington: There appears to be no definitive case authority fixing the precise point in the transaction at which a credit becomes legally obligatory or indicating that differing points might appertain as to customer and beneficiary. There is considerable indirect and confusing information to be derived from decisions in which other points were in issue.⁴⁶ Presumably a court which purports to find in a credit an offer to the beneficiary can be expected to hold that a contract is created when the beneficiary accepts the acceptance being his extension of credit to the customer. Presumably a court which regards the credit as a legal obligation created by a combination of customer's consideration and issuer's promise is also prepared to find mutual assent in the negotiations between these parties. A contract will exist when the acceptance is made. In a jurisdiction which is not committed to a particular theory of credits, no prediction about the point at which a credit will become a legal obligation can be validly undertaken. It can safely be noted however that none of the theories which have so far been advanced permits of the flexibility in operation possible under § 5-106.

Washington practice: Washington banks deem themselves bound for some purposes when the credit is put in course of transmission, and believe they have a legal right to intercept and terminate a credit

⁴⁶ See the discussion of § 5-103(1) (a). See also *Bril v. Suomen Pankki Finlands Bank*, 199 Misc. 11, 97 N.Y.S.2d 22 (Sup. Ct. 1950), which contains a dictum indicating that a credit is a legal obligation only when "delivered" to the beneficiary; and *Pan-American Bank & Trust Co. v. National City Bank*, 6 F.2d 762 (2d Cir. 1925), *cert. denied*, 269 U.S. 554, (1925), in which the problem was raised but was disposed of by the court in these words: "We are of opinion that by express agreement it became irrevocable as soon as . . . communicated . . . to (beneficiary). . . ." The contest was between an issuer and a bank which requested issuance of the credit and tried to get it cancelled after the beneficiary had been informed by the issuer's agent that the credit was issued.

by a telegram which reaches the addressee before the credit. Save for travelers credits, delivery of a credit to the customer is so rare that no discernible practice has developed concerning the right of an issuer to take back a credit from a customer so long as the beneficiary has not been informed of it.

Critique: This subsection creates a system which conforms to the needs and expectations of the business community. The system is a complex of three elements. First: It is recognized that the customer buys an irrevocable credit *i.e.*, a legal obligation of which the beneficiary is the obligee, as he buys any merchandise or service. Having bought it he should have the advantage of it at the earliest practicable time. Part (a) fixes this time as the moment of sending, either to the customer or to the beneficiary. In so doing it provides as much certainty on this detail as can reasonably be expected. After the credit is sent the issuer cannot by its own motion vary or terminate the credit as a legal obligation.

Second: It is recognized that the customer may change his mind. After buying a credit he may find he does not want it. He should be able to re-sell it to the issuer. This the subsection makes possible. His right to undo the credit must however be subject to limitations which acknowledge the beneficiary's right to rely on a credit known to him. Hence the cut-off point indicated in part (b).

Third: It is recognized that the issuer will on occasion rely on the customer for both reimbursement and its fee. The customer's circumstances may change for the worse. If he fails the issuer should be able to terminate the credit provided it or advice of it has not yet reached the beneficiary. This the subsection makes possible, provided the customer's consent is obtained. There is no reason why the customer's consent cannot be given in his application for the credit and an appropriate provision will no doubt be incorporated in application forms. An obligation having the characteristics indicated above fits no category of legal relation now known to the common law. A statute is needed to achieve such flexibility.

The *Code* cannot and does not attempt to extricate issuers from the factual uncertainties which will be encountered in the operation of these subsections. The issuer is given a right to terminate an irrevocable credit not yet delivered to or advised to the beneficiary, either to protect the issuer's interest or that of the customer, but must accept the uncertainty of whether the terminating communication reaches

the beneficiary first. Issuers must and will develop techniques for handling this problem. The financial risks involved should be borne by the customer, whose application provides the obvious vehicle for anticipating and allocating such risks.

The issuer will not be able to deal safely with a customer who proposes to surrender a credit which was delivered to him and remains in his possession. The phrase in subsection (1) (a), "or an authorized written advice of its issuance is sent to the beneficiary," appears to cover a written advice sent by the customer (although an application-form clause to this effect will be useful) and the issuer cannot be certain that the beneficiary has not been so advised. This too presents issuers with a problem for which appropriate operating procedures will have to be developed.

In the final analysis, it will be seen that the *Code* at this juncture represents a desirable improvement in the assurance it affords concerning the legal situation. The accompanying uncertainties are of a factual nature and will be resolvable in practice without undue difficulty.

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

UCP—Article 5 (article 3, *Proposed Revision*) reads in part: "Such undertakings can neither be modified nor cancelled without the agreement of all concerned." The "undertakings" referred to are irrevocable credits and confirmations thereof.

The present law—In general: An unjustified repudiation of a credit is actionable by the beneficiary.⁴⁷ An attempted modification by the issuer, not consented to by the beneficiary, is inoperative.⁴⁸ There are several decisions illustrating modifications which were evidently consented to by all concerned and not contested.⁴⁹ An issuer need not

⁴⁷ *Ernesto Foglino & Co. v. Webster*, 217 App. Div. 282, 216 N.Y.S. 225 (1926), *mod. as to damages*, 244 N.Y. 516, 155 N.E. 878 (1926). See also the discussion of § 5-115(2) below (to be published Winter, 1963).

⁴⁸ *Dulien Steel Products, Inc. v. Bankers Trust Co.*, 189 F. Supp. 922 (S.D. N.Y. 1960), *aff'd*, 298 F.2d 836 (2d Cir. 1962); *Lambourn v. National Park Bank*, 240 N.Y. 520, 148 N.E. 664 (1925).

⁴⁹ *Dulien Steel Products, Inc. v. Bankers Trust Co.*, *supra* note 48; *American Nat'l Bank & Trust Co. v. Banco Nacional*, 238 Ala. 128, 189 So. 191 (1939); *G. Jaris & Co. v. Banque D'Athenes*, 246 Mass. 546, 141 N.E. 576 (1923); *Ernesto Foglino & Co.*

accede to a demand by the customer for modification of a credit after the beneficiary has been notified, and cannot modify a credit by agreement with the beneficiary alone.⁵⁰ A credit is not established by a communication from the alleged issuer to an advising bank, of which neither the alleged issuer nor the advising bank informed the beneficiary. A later communication from the alleged issuer to the beneficiary, indicating that no credit will be forthcoming, is accordingly without legal significance.⁵¹ A by-product of the offer theory of credits appears in *Moss v. Old Colony Trust Co.*⁵² Insistence by the beneficiary on a different term was said to be a "rejection" which destroyed the original credit and made valid what was otherwise a wrongful modification by the issuer. Whether the consent of both customer and beneficiary must be obtained to a modification or revocation of a credit is a question on which there appears to be no authority.

Holders of drafts drawn under an irrevocable credit have direct, rather than derivative, rights against the issuer, if the credit is a virtual acceptance⁵³ or a statement of an express or implied promise to the holder which will be enforced as such.⁵⁴ Although no case squarely in point has been found, it would appear that a holder if for value, takes free of any change not known to him, which has been agreed upon by issuer and beneficiary.

Washington law: There appears to be no decision on these details.

Washington practice: See the discussion under subsection (1) above. Washington banks expect a holder of a draft, drawn under an irrevocable credit, to have a direct right against the issuer which is immune

v. Webster, 217 App. Div. 282, 216 N.Y.S. 225 (1926), *mod. as to damages*, 244 N.Y. 516, 155 N.E. 878 (1926); National City Bank v. Seattle Nat'l Bank, 121 Wash. 476, 209 Pac. 705 (1922).

⁵⁰ *Distribuidora Del Pacifico v. Gonzalez*, 88 F. Supp. 538 (S.D. Calif. 1950), (customer's request); *Williams Ice Cream Co. v. Chase Nat'l Bank*, 210 App. Div. 179, 205 N.Y.S. 446 (1924), (beneficiary's request). See also the discussion of § 5-116 below (to be published Winter, 1963).

⁵¹ *Bril v. Suomen Pankki Finlands Bank*, 199 Misc. 11, 97 N.Y.S.2d 22 (Sup. Ct. 1950).

⁵² 246 Mass. 139, 140 N.E. 803 (1923).

⁵³ The UNIFORM NEGOTIABLE INSTRUMENTS LAW § 135 makes an unconditional written promise to accept operate as an acceptance in favor of one who takes the bill for value. Although the irrevocable credit is rarely unconditional it can be. See the discussion, McCurdy, *Commercial Letters of Credit*, 35 HARV. L. REV. 715, 721 (1922).

⁵⁴ FINKELSTEIN, *op. cit. supra* note 17, at 99; Annot. *Rights and remedies of holder of draft issued under letter of credit which is dishonored*, 53 A.L.R. 57, 62 (1928). As decisions cited in this Annot. at 64 indicate, an issuer's promise can run to the beneficiary alone, in which case there is no contract formed between the issuer and a person who negotiates a draft. See also the analysis of the position of a holder, in *Courteen Seed Co. v. Hong King & S.B. Corp.*, 216 App. Div. 495, 215 N.Y.S. 525 (Sup. Ct. 1926), *aff'd*, 245 N.Y. 377, 157 N.E. 272 (1927).

from changes in the credit which are unknown to him, provided (1) that the credit has been exhibited to him, and (2) that the credit contains a promise to pay holders. Correlatively, they expect a holder who does not meet these conditions to take his chances that the credit then exists in the form in which it was represented to him by the beneficiary, and that it will continue to so exist.

Critique: See the discussion under subsection (1) above. See also the discussion of § 5-105. In declaring the irrevocability of an irrevocable credit and the circumstances under which such a credit can be modified or revoked, this subsection accomplishes relationships which conform to the prevailing practice so far as customer, beneficiary and issuer are concerned. It would be difficult indeed for a court to explain all of these relationships in terms of existing common-law principles.

The position of a holder of a draft drawn by the beneficiary is not so readily summarized. No express statement about his position appears in the subsection. Virtual acceptances are not possible under the *Code*,⁵⁵ so that analysis is barred. Subsection (4) of this section states a proposition protecting holders of drafts drawn under a revocable credit, which suggests that the omission in subsection (2) was designed. In stating a right of modification or revocation "only with" the indicated consents, the subsection infers that no other consents are necessary.⁵⁶ On the other hand, the phrase "unless otherwise agreed" supports an argument that a credit which contains, as most irrevocable credits now do, a promise to honor drafts directed to "bona fide holders of drafts drawn hereunder" makes a conforming holder a party who has a right to be paid (unless he consents otherwise) according to the credit as exhibited to him. Although the subsection is not entirely clear on this detail, there appears to be no particular reason why the suggested argument should not prevail. If the credit contains no promise to pay holders, a holder will presumably take no direct rights against the issuer and must stand on his derivative position as a successor of the drawer.⁵⁷

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

⁵⁵ Section 3-410(1) requires that an acceptance be written on the draft.

⁵⁶ Section 5-103(1) (d) defines a beneficiary as "a person who is entitled . . . to draw or demand payment." A holder cannot meet this test.

⁵⁷ See the discussion of § 5-116(3) (to be published Winter, 1963).

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

UCP—Article 4 (article 2, *Proposed Revision*) of *UCP* reads:

“Revocable credits are not legally binding undertakings between Banks and beneficiaries. Such credits may be modified or cancelled at any moment without notice to the beneficiary. When a credit of this nature has been transmitted to a branch or to another Bank, its modification or cancellation can take effect only upon receipt of notice thereof by such branch or other bank, [prior to payment or negotiation, or the acceptance of drawings thereunder by such branch or other Bank.]” (The bracketed phrase does not appear in the *Proposed Revision*.)

The present law—*In general*: A credit which is in terms revocable is also subject to modification since “the greater includes the less.”⁵⁸ The theory appertaining to revocable credits, the point at which the credit becomes a legal obligation which the issuer cannot vary, and the question whether intent to revoke must be communicated to the beneficiary to be legally operative, are matters on which there are differences of opinion.⁵⁹ There appears to be no definitive case authority on the issuer’s recourse against the customer where the issuer is obliged to honor a draft despite revocation of the credit.

Washington law: There appears to be no relevant Washington authority.

Washington practice: Washington banks regard *UCP* article 4 as an accurate statement of the legal situation. Use of revocable credits in Washington is limited. If used, the credit will, if documentary, incorporate *UCP* by reference. No practice has developed with regard to the customer’s liability to the issuer where the issuer must honor a draft despite revocation, although it may be assumed that banks will expect reimbursement from the customer should the problem arise.

Critique: These subsections conform to the existing practice which is in turn based on *UCP* article 4. Here is another of the several points

⁵⁸ United States Steel Products Co. v. Irving Bank-Columbia Trust Co., 9 F.2d 230, 232 (2d Cir. 1925).

⁵⁹ See FINKELSTEIN, *op. cit. supra* note 17, at 150; WARD AND HARFIELD, BANK CREDITS AND ACCEPTANCES 14, 15 (1958); McCurdy, *Commercial Letters of Credit*, 35 HARV. L. REV. 539, 568 (1922).

in the use of credits at which normal contract principles are ill-suited to accomplishment of the precise relationships contemplated by the parties. Offer principles demand communication of revocation. Protection of a negotiating party cannot be readily harmonized with the idea that the beneficiary has no legal rights under the credit. The expectations of banks about the operation of revocable credits may not be borne out in future decisions.⁶⁰

On the other hand, the revocable credit as envisaged by those in the business of using and issuing credits is but a set of ground rules governing a transaction in which the issuer undertakes no legal duty at all to the beneficiary. The commercial utility of such an arrangement in ordinary sales transactions is small indeed.

Under the subsection the issuer need obtain no one's consent to revocation save where it is "otherwise agreed after a revocable credit is issued." The kinds of agreement which are contemplated by the proviso is not clear. Presumably what is at the outset a revocable credit can be made irrevocable by a later appropriate expression of purpose by the issuer, but to whom this purpose shall be expressed and other relevant details are obscure.

The subsection is understandably silent concerning the right of the customer to require the issuer to exercise its right to revoke. This is a detail properly left to the area of customer-issuer legal relations, and regulated strictly by the contract between them. Put in another way, whether refusal of the issuer to revoke creates liability to the customer is to be ascertained from its agreement with the customer and not from the credit or § 5-106. That the only one having the power to revoke a credit is the issuer seems clear enough under the subsection.

Whether the section goes too far in making unnecessary any notice to the beneficiary of revocation can be debated. In support of the section is the fact that a requirement of notice would introduce an element of uncertainty, particularly acute in international transactions,

⁶⁰ It has been suggested that the risks put on the beneficiary by *UCP* articles 3 and 4 are so unfair that courts probably will not enforce these articles even though they be incorporated (purportedly) in the credit. Menschikoff, *Letters of Credit: The Need for Uniform Legislation*, 23 U. CHI. L. REV. 571 (1956). This observation is also in effect a criticism of § 5-106(3). The criticism seems unjustified. A beneficiary who acts on a credit which he knows or should know to be revocable has only himself to blame if the consequences are not to his liking. The subsection is concerned only with a revocable credit. It is left to the common law to determine whether a credit is revocable. Presumably courts can be relied on to develop principles which will adequately protect beneficiaries, including perhaps a principle which denies complete effect to a purported incorporation of *UCP*. See the discussion notes 9, *supra*, and 63, *infra*.

which would make a revocable credit impracticable from the issuer's point of view.

Revocable credits are not, in practice, confirmed. They are on occasion advised. An advising bank would normally be authorized to negotiate drafts and would be a probable negotiator. If revocable credits ever again achieve any general commercial use it would appear desirable to so handle them that notice of revocation will go in routine to an advising bank and to the beneficiary's bank-of-deposit if known. Travelers credits may be so worded as to restrict the beneficiary negotiation of drafts at designated banks. The issuer should advise these banks at once if the credit is revoked or modified.

Having honored a draft presented by a holder who must be paid pursuant to § 5-106(3) even though the beneficiary then has no legal right against the issuer, has the issuer any recourse against the beneficiary? There are two possible situations. The beneficiary may have negotiated the draft with knowledge of the revocation, or without such knowledge. It is difficult to see any theory on which the issuer can proceed in either situation, if the documents are genuine and the goods (where a sale is involved) conform to the underlying contract. As a drawee the issuer has no right against the drawer on the instrument. Whether courts may be persuaded that there is a duty of some other kind running from beneficiary to issuer is conjectural. Insolvency of a customer might very well raise the problem.

Section 5-107. Advice of credit; confirmation; error in statement of terms.

(1) Unless otherwise specified an advising bank by advising a credit issued by another bank does not assume any obligation to honor drafts drawn or demands for payment made under the credit but it does assume obligation for the accuracy of its own statement.

UCP—Article 6 of *UCP* reads: "Irrevocable credits may be advised to the beneficiary through an advising Bank without responsibility on the latter's part." (Article 3 of the *Proposed Revision* is to the same effect.)

The present law: In general: There appears to be no definitive case authority concerning the existence of a contract duty running from advising bank to beneficiary. There appears to be no definitive case authority concerning the tort liability of an advising bank which negli-

gently misstates the terms of credit. The problem was discussed in a New York case, and the court suggested as dictum that liability in the advising bank is doubtful.⁶¹ Whether the advising bank is liable to the customer for misstating the credit to the beneficiary is not determinable. In a comparable situation the customer has been denied recovery.⁶²

Whether a reference to *UCP* in a letter of advice will successfully incorporate article 6 of *UCP* is not clear.⁶³ Whether inclusion in such a letter of an express disclaimer of liability for negligence will be legally operative is not entirely free from doubt. The preponderance of modern authority supports the legality of the disclaimer.⁶⁴

Washington law: There appears to be no definitive case authority on any phase of this subsection. There are conflicting Washington decisions concerning the legality of a disclaimer of liability for negligence,⁶⁵ and (apparently) no cases on the other details.

Washington practice: Although Washington banks feel that article 6 of *UCP* is an accurate statement of their legal position on the credit, as to both revocable and irrevocable credits, they include express disclaimer clauses in the forms used for the advising of credits (*e.g.* "This advice conveys no engagement on our part"). It is not clear whether this is an expression of doubt about the effectiveness of an incorporation of *UCP* by reference in the letter of advice, or is an acknowledgment of the ambiguity of the word "responsibility" as used in article 6. Washington banks expect to be responsible if, through their negligence, a credit is incorrectly advised.

Advising is done by Washington banks and their domestic correspondents without charge and as an inter-bank service. For advising a

⁶¹ Scanlon v. First Nat'l Bank, 249 N.Y. 9, 162 N.E. 567 (1928).

⁶² Courteen Seed Co. v. Hong Kong & Shanghai Banking Corp., 245 N.Y. 377, 157 N.E. 272 (1927).

⁶³ The distaste of courts for broad-gauged exculpatory clauses suggests that an attempt to incorporate such a clause by reference may not work, unless the beneficiary can be shown to have actual knowledge of the provisions of *UCP*. See the discussion in Mentschikoff, 23 U. CHI. L. REV. 571 (1956).

⁶⁴ RESTATEMENT, CONTRACTS § 574 (1932); 6 CORBIN, CONTRACTS § 1472 (1950); 6 WILLISTON, CONTRACTS §§ 1751B, 1751C (rev. ed. 1936); Annot. *Validity of contractual provision by one other than carrier or employer for exemption from liability, or indemnification, for consequences of own negligence*, 175 A.L.R. 8 (1948).

⁶⁵ Cf. Broderson v. Rainier Nat'l Park Co., 187 Wash. 399, 60 P.2d 234 (1936), and Ramsden v. Grimshaw, 23 Wn.2d 864, 162 P.2d 901 (1945). See the discussion, Shattuck, *Contracts in Washington, 1937-1957: Part III*, 34 WASH. L. REV. 467 (1959). Since the Broderson case seems the better reasoned, the odds appear to favor the court following it in the future. The disclaimer is of simple negligence, not of wilful misdoing. Use of express disclaimer clauses in letters advising of credits would appear desirable and likely to prove successful.

modification in a credit a small charge is made. The fact that a bank is asked to advise a credit is taken as demonstrating an implied request to negotiate drafts drawn under the credit.

Critique: The subsection conforms to the existing practice insofar as it disclaims any duty by an advising bank to honor drafts. The absence of any statement about a duty to negotiate drafts is proper. Protection in this subsection is not needed, since a credit has no undertaking by anyone which can reasonably be argued to be a promise to negotiate drafts. An advising bank can enter into an agreement with the beneficiary to negotiate, but evidence of such agreement is hardly to be found in a letter of advice.

Neither here nor elsewhere does article 5 attempt to determine the legal relations between a negotiating bank and the customer. The omission seems entirely justified. Whether there are or should be any legal relations between these parties is an inquiry quite foreign to the relationships created by the credit or directly germane to it.⁶⁶

The subsection clearly enough limits the scope of the obligation to mistakes of the advising bank. Mistakes of the issuer, or of the telegraph company either in transmitting the issuer's message to the advising bank or in transmitting the advice, are not included.⁶⁷

The subsection does not specify to whom the duty to advise accurately shall run. The beneficiary is an obvious obligee but the customer's position is obscure.

What is intended by the phrase "unless otherwise specified" is unclear. If a correspondent bank undertakes to honor drafts it will not be an advising bank. Perhaps this phrase is declaratory of legal effect for a clause, disclaiming liability for negligence, used in an advising letter.

(2) A confirming bank by confirming a credit becomes directly obli-

⁶⁶ The very limited case coverage of controversies between them suggests that there is no legal duty running from the negotiating bank to the customer. *Oelbermann v. National City Bank of New York*, 79 F.2d 534 (2d Cir. 1935); *Courteen Seed Co. v. Hong Kong & Shanghai Banking Corp.*, 245 N.Y. 377, 157 N.E. 272 (1927); *Samuel Kronman & Co. v. Public Nat'l Bank*, 218 App. Div. 624, 218 N.Y.S. 616 (App. Div. 1926).

⁶⁷ Neither here nor elsewhere does article 5 attempt to cover a very knotty problem, *i.e.*, can the recipient of a telegram hold the sender to the message as received, where the message as received differs from the message handed to the telegraph company by the sender? General use of cablegrams in the handling of credits makes the question of some importance in such transactions. It arose indirectly in a letter of credit context, in *Murray Oil Products Co. v. Poons Co.*, 190 Misc. 110, 74 N.Y.S.2d 814 (New York City Ct. 1947), and the court allied itself with the jurisdictions which regard the telegraph company as an independent contractor. The problem is discussed in 1 CORBIN, CONTRACTS § 105 (1950); 1 WILLISTON, CONTRACTS § 94 (3rd ed. 1957).

gated on the credit to the extent of its confirmation as though it were its issuer and acquires the rights of an issuer.

UCP—Article 5 of *UCP* reads in part:

“When the issuing Bank instructs another Bank to confirm its irrevocable credit and when the latter does so, the confirmation implies a definite undertaking of the confirming Bank as from the date on which it gives confirmation. In case of credits available by negotiation of drafts, the confirmation implies only the undertaking of the confirming Bank to negotiate drafts without recourse to drawer.”

Article 3 of the *Proposed Revision* is to the same effect, plus a requirement that confirmation be in writing.

The present law—In general and in Washington: There appears to be no definitive case authority concerning the obligations of a confirming bank. The dearth of decisions evidently reflects a general assumption that a confirming bank is legally liable on its undertaking.⁶⁸ Just what rights a confirming bank has under the present law is not clear.⁶⁹

Washington practice: Washington banks assume that confirmation creates a legal duty to the beneficiary co-extensive with that of the issuer. The requests for confirmation received by Washington banks typically incorporate instructions about reimbursement, *i.e.*, to charge the requester's account or to draw on the requester. If a request comes in which does not conform to this practice, confirmation may be refused. If confirmation is made, an implied duty to reimburse is assumed to exist.

Critique: The subsection commits a confirming bank to the undertaking recited in the credit, save as limitations are stated in the confirmation. This conforms to the present practice and provides a useful positive statement of law. The subsection does not purport to cover all of the possible legal relations attending the confirmation process and

⁶⁸ *E. g.*, FINKELSTEIN, *op. cit. supra* note 17, at 154 (flat statement that beneficiary has rights against a confirming bank similar to those he has against the issuer; no cases cited); *Dulien Steel Products, Inc. of Wash. v. Bankers Trust Co.*, 298 F.2d 836 (2d Cir. 1962), (action by customer against confirming bank; that the bank was liable to the beneficiary when conditions were met was stated by the court as a base point); *North Woods Paper Mills v. National City Bank*, 121 N.Y.S.2d 543 (Sup. Ct. 1953), *aff'd*, 283 App. Div. 731, 127 N.Y.S.2d 663 (1954) (“It is a general rule that a bank which confirms or issues an irrevocable letter of credit thereby assumes an obligation to honor all drafts . . .”), 121 N.Y.S.2d at 546.

⁶⁹ See the discussion of § 5-114(3). (To be published in the winter, 1963 issue) *Pan-American Bank & Trust Co. v. National City Bank*, 6 F.2d 762 (2d Cir. 1925), *cert. denied*, 269 U.S. 554 (1925), demonstrates that it may be difficult to determine whether a bank requesting another to participate in a letter of credit transaction is an issuer requesting confirmation or a correspondent bank requesting issue of a credit. Until this detail is resolved a discussion of “rights” is bootless.

the omissions seem sound. Section 5-109 is the more appropriate context in which to consider the confirming bank's duty (if any) to the customer and § 5-114(3) is the better place to consider its right to reimbursement and security. Less understandable is the absence of a statement to the effect that a confirmation is also an advice of the basic credit. There seems no reasonable doubt, however, that the phrase "authorized written advice of its issuance" as used in § 5-106(1)(a) will encompass the combination of a request to the correspondent bank for confirmation and communication of the confirmation by such bank to the beneficiary. The confirmation forms used by Washington banks clearly state the terms of the basic credit and identify the issuer of it. The beneficiary has two obligors⁷⁰ and is not restricted by this subsection or any other provision of article 5 in his recourse against either or both of them. It must be expected of course that he can get satisfaction but one. The confirming bank will ordinarily be the closer and hence the easier to sue.

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

UCP—The *UCP* has no comparable provision.

The present law—*In general and in Washington*: There appears to be no relevant case authority.

Washington practice: Washington banks assume that the terms of their obligation will not vary from those stated to the advising bank, which is in part a reflection of their assumption that they are not responsible to anyone for mistakes of the advising bank.⁷¹ There appears to have been no occasion to consider whether a beneficiary who met the terms of the credit as communicated to the advising bank has a right to performance even though the credit as advised to him had other terms. In the nature of things such a beneficiary will be rare indeed.

⁷⁰ The Official Comment to § 5-107 reads in part: "The most important aspect of this rule is that a beneficiary who has received a confirmed credit has the independent engagements of both the issuer and the confirming bank. A confirming bank may of course be an advising bank so far as the issuer's engagement is concerned but this is rarely of importance because its own engagement if the terms be improperly advised will be to honor in accordance with those terms."

⁷¹ *UCP* article 14 reads in part: "Banks utilising the services of another Bank assume no liability or responsibility (unless they themselves are at fault) should the instructions they transmit not be carried out exactly, even if they have themselves taken the initiative in the choice of their correspondent." Article 12 of the *Proposed Revision* is to the same effect. Comparable clauses appear in the application forms used by Washington banks.

Critique: The negative inference of the subsection, that an issuer is not bound to the terms of an incorrectly advised credit, coincides with the existing practice. Liability on the original credit is apparently a matter on which there is as yet neither case authority nor practice. Basic agency principles might support a denial of the issuer's liability for the credit as advised, but cannot support liability on a credit stated to the advising bank by the issuer and not advised. Incorrect advice means the correct credit is not advised. If the credit is a contract which exists without regard to communication between issuer and beneficiary, there would be liability on it although the advising bank advised a different credit. Section 5-106(1)(b) states however that a credit is established as to the beneficiary when he receives authorized written advice of its issuance. Arguably this means correct advice. Were it not for § 5-107(3) it might be difficult to work out a plausible theory on which to hold the issuer to the terms of the credit it intended to issue, and the subsection therefor removes another source of possible conflict. Why an issuer should choose to or be entitled to resist the beneficiary's attempt to enforce this credit is unclear. The subsection seems entirely sound.

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

UCP—Article 12 (article 10, *Proposed Revision*) of *UCP* reads:

“Banks assume no liability or responsibility for the consequences arising out of delay and/or loss in transit of any messages, letters and/or documents, or for delay, mutilation or other errors in the transmission of cables, telegrams, or other mechanically transmitted messages, or for errors in translation or interpretation of technical terms, and Banks reserve the right to transmit credit terms without translating them.”

The present law—In general and in Washington: There appears to be no relevant case authority.

Washington practice: The following is quoted from the application form which a Washington bank receives from its customers, and is typical: “Neither you nor your correspondents shall be responsible . . . for errors, omissions, interruptions or delays in transmission or delivery of any messages, by mail, cable, telegraph, wireless or otherwise,

whether or not they be in cipher. . . ." As to errors in translation made by a correspondent bank the issuer will be protected by a general application-form waiver covering all acts of correspondents. As to errors in translation made by the issuer the application forms used by Washington banks contain no direct waiver. The forms do contain broadly stated clauses purporting to approve all good-faith acts of the issuer taken in connection with the credit, which might include acts taken pursuant to a mistaken translation.⁷² *UCP* is not incorporated in applications for credits, nor in travelers credits. It is routinely made a part of documentary credits by incorporation. Washington banks in advising or confirming a credit received via cable indicate to the customer that it has been so received and is subject to correction on receipt of the pertinent mail communication.

Critique: The subsection conforms to the existing practice so far as responsibility for the transmission of messages is concerned and provides a desirable legal basis for the practice. In relieving the issuer from liability for reasonable but erroneous (and possibly negligent) translation or interpretation the subsection states a more limited waiver than does *UCP*, which purports to relieve the issuer without regard to the reasonableness of his conduct or its negligent character. On the other hand, there is real doubt whether a disclaimer of liability for negligence is lawful in Washington. The subsection clarifies the law on this detail, and should produce sound results.

Subsection (4) is directed at customers. Errors in the transmission of a credit can induce disputes between issuer and beneficiary. For such disputes article 5 provides no solution.⁷³

Section 5-108. "Notation Credit"; Exhaustion of Credit

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

⁷² Whether an application-form clause by which the customer waives its claim for injury suffered by reason of the issuer's negligence would be lawful in Washington is not clear. The problem is discussed in another context in note 65 *supra*.

⁷³ This is a detail on which there are cases in other areas, divided in result. The schism is produced by divergent views about the relationships between telegraph carriers and the persons who use their services. See the discussion at note 67 *supra*. This is an area of conflict which is collateral to the function of article 5 and is wisely omitted from it. Whether incorporation of *UCP* in a credit, by reference, will produce a result different from that which the court would otherwise reach is unclear.

(2) Under a notation credit

- (a) a person paying the beneficiary or purchasing a draft or demand for payment from him acquires a right to honor only if the appropriate notation is made and by transferring or forwarding for honor the documents under the credit such a person warrants to the issuer that the notation has been made; and
- (b) unless the credit or a signed statement that an appropriate notation has been made accompanies the draft or demand for payment the issuer may delay honor until evidence of notation has been procured which is satisfactory to it but its obligation and that of its customer continue for a reasonable time not exceeding thirty days to obtain such evidence.

UCP—The *UCP* has no coverage of these details.

The present law—*In general and in Washington*: There appear to be no relevant decisions.

Washington practice: Travelers credits issued by Washington banks typically call for notation. Commercial credits typically do not. Some notation credits recite a warranty by a negotiating bank, that the notation has been made, and others simply say that the negotiating bank must make the notation. Issuers expect to have a legal excuse for not honoring a draft which has not been noted, and a right over against a negotiating bank which fails to note. Drafts presented under notation credits are honored without requiring proof of notation, save where the issuer has reason to believe the draft in question has not been noted. There is no practice with regard to modes of proof or grace periods. It is the practice of Washington banks when negotiating drafts under a non-notation credit to note the draft on the credit as a safeguard to itself and other negotiating banks.

The application forms taken from customers typically exonerate the issuer from responsibility for the failure of any person to make proper notation on the credit.

Critique: Here again article 5 supplies a statutory statement of basic legal relations which are expected but which are in fact now uncertain. The forms currently in use in Washington for notation credits appear to adequately specify that notation must be made. Under subsection (2) such a specification produces both a condition to the issuer's duty

and a warranty to the issuer by a person who negotiates, which is the desired result but one difficult to reach by the application of normal contract analysis.⁷⁴

Because notation is a condition operative even though the draft is presented by a remote transferee, the issuer is entitled to proof. The details are regulated by subsection (2) (b) in a sensible way. The stated grace period will extend an expiry date set in the credit. It may be surmised that in practical operations the indicated "signed statement" will become a routine adjunct to the documents submitted to the issuer, the grace period serving only as a safety valve for the occasional aberrant transaction. The provision for a "reasonable" grace period, not exceeding thirty days, has an obvious potential for uncertainty in operation. The drawbacks in this type of standard seem offset here by the need for flexibility in meeting the various problems which can arise. There will no doubt be instances in which the issuer prefers to waive the condition and pay even though the draft was not noted. The subsection does not preclude such a waiver. The application form can be so framed (and those in current use seem adequate) as to continue the customer's duty to reimburse, either where there is a waiver or where the issuer is led by a non-notation, of which it is unaware, to exceed the stated amount-limit of the credit.

What are the legal relations between the issuer and a person who negotiates a draft which, with earlier drafts, makes the total of the draws against the credit exceed the authorized total? Although subsection (2) does not expressly so indicate, an issuer which pays a draft it was not under a legal duty to pay cannot very well assert this fact as an excuse for not paying a draft which would not be an over-draw had the non-complying draft not been paid.⁷⁵ Under this analysis, an issuer which chooses to waive notation as to a particular draft will not be able

⁷⁴ The typical credit avoids the direct language: "We will pay only on condition that each draft be noted on the credit," and thus presents the ambiguity implicit in a promisor's statement that something "shall be done" by the other party. Whether this kind of statement demands a counter-promise or expresses a condition qualifying the promisor's undertaking is a common problem. On litigation a condition will probably be found, but the issue is an interpretation one which may in an individual transaction go either way. See RESTATEMENT, CONTRACTS § 260, 261 (1932). Cf. Campbell, *Guaranties and the Suretyship Phases of Letters of Credit*, 85 U. P.A. L. REV. 174, 197 (1936). That a statement like this can both exact a counter-promise, impliedly made by negotiating a draft drawn by the beneficiary, and also condition the issuer's undertaking, is a novel concept.

⁷⁵ An analogous problem was litigated in *Bank of Seneca v. First Nat'l Bank*, 105 Mo. App. 722, 78 S.W. 1092 (1904) (bank held unable to reduce credit by the amount of checks drawn by the beneficiary and negotiated to a holder which took and presented them without knowledge of the credit).

to charge that draft to the credit as against a person later presenting a conforming draft. On similar reasoning an issuer which pays a nonconforming draft cannot charge it to the credit even though the issuer does not know that the notation condition has not been met. The "signed statement" mentioned in subsection (2)(b) does not satisfy the notation condition. Subsection (2)(a) clearly makes "the appropriate notation" the condition and the arguable inference in subsection (2)(b) that the issuer must pay on presentation of a "signed statement" seems unsupported. Whether this means issuers will always demand other proof remains to be seen. They probably will not, simply because delays in honoring drafts would destroy the utility of credits, whereas the signed statement will usually provide assurance enough that the notation was made, the statement having been made by a bank.

In imposing both a duty to note and a warranty of notation on a "person paying the beneficiary or purchasing a draft from him" subsection (2) achieves results which are currently in particular doubt.⁷⁶ The warranty runs to the issuer, leaving for the law of negotiable instruments a controversy between transferor and transferee of a draft.

In the final analysis these subsections create a system which should enable the beneficiary to negotiate his drafts with a minimum of difficulty. The penalty for non-notation is sure enough to make the absence of notation on the credit satisfactory evidence that un-noted drafts have not been issued. Meanwhile issuers are amply protected. The incidence of un-noted drafts should be very small. The issuer's recourse will ordinarily be against a bank, and often against a correspondent bank. The system provides a sound and workable basis from a banking point of view, for credits which permit of multiple draws.

The customer appears to be the forgotten man in subsection (2)(b). There is much difference between a travelers credit and a documentary credit at this point. Under the latter the customer may be materially prejudiced by delay for even a reasonable time. In these days of telegraphic communication and wide-spread networks of correspondent banks, any appreciable delay at this stage of a documentary credit seems unjustifiable. Whether this is a detail which can be fixed by appropriate language in the credit is not clear. On principle it would seem that it can, and that credits can effectively restrict the time within which proof of notation can be furnished. The point is to a

⁷⁶ See Mentschikoff, *Letters of Credit: The Need for Uniform Legislation*, 23 U. CHI. L. REV. 571, 599 (1956).

considerable degree moot. Commercial documentary credits issued by Washington banks are now typically non-notation and there is no reason to expect a change in this practice.

(3) If the credit is not a notation credit

- (a) the issuer may honor complying drafts or demands for payment presented to it in the order in which they are presented and is discharged pro tanto by honor of any such draft or demand;
- (b) as between competing good faith purchasers of complying drafts or demands the person first purchasing has priority over a subsequent purchaser even though the later purchased draft or demand has been first honored.

UCP—The *UCP* has no coverage of these details.

The present law—In general and in Washington: There appear to be no relevant decisions.

Washington practice: Washington banks issue many non-notation credits, (in fact, almost all commercial documentary credits issued here are non-notation) and expect to be discharged pro tanto by each draft honored under such a credit. Although little occasion has arisen to consider the problem, it is probably expected that the priorities of persons who negotiate drafts from the beneficiary are regulated by the time order of the negotiations.

Critique: The subsection states legal relations which conform to the present practice. It also conforms to § 3-801 (Drafts in a Set), which in turn conforms to *Uniform Negotiable Instruments Law* §§ 178, 179, and 183.⁷⁷ Implicit in the recited priorities is a legal right in a holder whose draft was first negotiated to recover from a person who subsequently negotiated a draft which exhausted the credit and on which honor was obtained.

[This discussion will be continued in the Winter, 1963 issue.]

⁷⁷ RCW 62.01.178, 62.01.179, 62.01.183.