Washington Law Review

Volume 37 | Number 4

12-1-1962

Letters of Credit—A Comparison of Article 5 of the Uniform Commercial Code and the Washington Practice [Part 2]

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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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(Continued from 37 Washington Law Review 325)

Section 5-109. Issuer's Obligation to Its Customer

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

(a) for performance of the underlying contract for sale or other transaction between the customer and the beneficiary; or

(b) for any act or omission of any person other than itself or its own branch or for loss or destruction of a draft, demand or document in transit or in the possession of others; or

(c) based on knowledge or lack of knowledge of any usage of any particular trade.

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

Section. 1-102(3)

The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

UCP—Article 1 provides that "commercial documentary credits are essentially distinct transactions from sales contracts, on which they may

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be based, with which Banks are not concerned." The *Proposed Revision,* General Provisions and Definitions, contains a similar provision.

Article 9 provides that "banks must examine all documents and papers with care so as to ascertain that on their face they appear to be in order." Article 7, *Proposed Revision,* requires "reasonable" care, and adds the additional requirement, "also in accordance with the terms and conditions of the credit."

Under Article 10,

> If the documents, on their face, are not as stipulated by the terms and conditions of the credit, the issuing Bank must, upon receipt of the documents, determine, on the basis of the documents alone, whether or not to claim that payment, negotiation or acceptance was not made in accordance with the terms and conditions of the credit.

This article deals with interbank relations and is only indirectly significant in an analysis of the relations between issuer and customer. Article 8, *Proposed Revision,* is to the same effect.

Article 11 provides that,

> Banks assume no liability or responsibility for the form, sufficiency, correctness, genuineness, falsification or legal effect of any document or papers, or for the description, quantity, weight, quality, condition, packing, delivery or value of goods represented thereby, or for the general and/or particular conditions stipulated in the documents, or for the good faith or acts of the consigner or any person whomsoever, or for the solvency, standing, etc., of the carriers or insurers of the goods.

Article 9, *Proposed Revision,* is to the same effect.

Article 14 provides that "banks utilising [*sic*] 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, *Proposed Revision,* omits the phrase "unless they themselves are at fault," and is otherwise identical.

The present law—In general: There is but little relevant case authority. An issuer which receives nonconforming documents is liable to the customer for the ensuing loss.[78] If the documents conform on

[78] Overseas Trading Corp. v. Irving Trust Co., 82 N.Y.S.2d 72 (Sup. Ct. 1948). See also Citizens Nat'l Trust & Savings Bank v. Londono, 204 F.2d 377 (9th Cir. 1953), *cert. denied,* 346 U.S. 866 (1953) (court indicated the customer's theory should be failure of consideration; in this action, based on a theory of wrongful disbursement of trust funds, the customer lost). In Pacific Financial Corp. v. Central Bank & Trust Co.,

their face but are not genuine, the issuer who in good faith pays the presenter is not liable to the customer.[79] Nor is the issuer under any legal duty to ascertain whether the goods conform to the sales contract.[80] If the agreement between customer and issuer contains a particular undertaking by the issuer with regard to its handling of the transaction, nonperformance of this undertaking will result in liability.[81] Bank issuers are not to be charged with imputed knowledge of the usages of the businesses followed by their customers.[82]

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

Washington practice: The duties of an issuer to its customer, as seen by Washington banks, include the exercise of good faith and observance of general bank usages. The forms in general use do not purport to remove these burdens from issuers. Not included among the issuer's duties, however, are responsibility for performance by the beneficiary of the underlying contract between customer and beneficiary, responsibility for the faults of correspondents or communication media, or adherence to non-bank trade usages.

General bank usages include the scrutiny of documents with reasonable care and the honoring of drafts accompanied by conforming documents which appear on their face to be genuine.

Application forms taken from customers typically include clauses such as this: "The users of the Credit shall be deemed our agents and we assume all risks for their acts or omissions. Neither you nor your correspondents shall be responsible: for the . . . genuineness of docu-

296 F.2d 68 (5th Cir. 1961), a customer tried without success to recover the money paid for a credit, on the ground that a non-conforming document was taken by the issuer. The customer lost on the facts.

[79] W. A. Havemeyer & Co. v. Exchange Nat'l Bank, 293 Fed. 311 (8th Cir. 1923); Camp v. Corn Exchange Nat'l Bank, 285 Pa. 337, 132 A. 189 (1926).

[80] Distribuidora del Pacifico v. Gonzales, 88 F. Supp. 538 (S.D. Cal. 1950); Hibernia Bank & Trust Co. v. J. Aron & Co., 134 Misc. 18, 233 N.Y. Supp. 486 (Sup. Ct. 1928); Tocco v. Rinaudo, 249 Mass. 267, 143 N.E. 905 (1924). See also Maurice O'Meara Co. v. National Park Bank, 239 N.Y. 386, 146 N.E. 636, 639 (1925), in which the court said an issuer has neither the right nor the obligation "to see that the description of the merchandise contained in the documents presented is correct." The contest was between issuer and beneficiary. See also notes 107, 108 *infra*. "The rule in New York seems well established that a bank issuing or confirming a letter of credit is not concerned with the underlying contract between the buyer and seller in the absence of appropriate provisions in the letter of credit." Dulien Steel Products, Inc. v. Bankers Trust Co., 298 F.2d 836, 841 (2d Cir. 1953).

[81] Gidden v. Chase Nat'l Bank, 82 N.Y.S.2d 341 (1948); Caloric Stove Corp. v. Chemical Bank & Trust Co., 205 F.2d 492 (2d Cir. 1953).

[82] Bank of New York & Trust Co. v. Atterbury Bros., 226 App. Div. 117, 234 N.Y. Supp. (Sup. Ct. 1929), *aff'd*, 253 N.Y. 569, 171 N.E. 786 (1930). See also Old Colony Trust Co. v. Lawyers' Title & Trust Co., 297 Fed. 152 (1924) *cert. denied*, 265 U.S. 585 (1924).

ments, even if such documents should in fact prove to be in any or all respects invalid, insufficient, fraudulent or forged . . . ." Washington banks expect such exculpatory clauses to be legally operative, an expectation which appears to be justified.[83]

Critique: These subsections conform to the existing practice and to such case law as now exists. In a jurisdiction which, as Washington, has no helpful decisions, they provide a very desirable legal foundation for the existing practice. Section 5-109(1)(c) may on first encounter seem odd. It exempts the issuer from liability or responsibility alleged to flow from a non-bank trade usage which is known to the issuer. This is, however, a necessary precaution and one which coincides with the understanding of Washington banks. The detail can be of moment in a contest between an issuer and a customer who insists that the bank's decision to honor or to dishonor was improperly made in light of the known trade usage. The subsection enables the bank to reach its decision safely on a comparison of credit and documents in light of bank usages.

The very awkward problems encountered when the issuer is aware of deviations between the sales contract and the beneficiary's actual performance are covered by § 5-114(2). It can be noted here, however, that the issuer's duty to the customer, as indicated in the subsequent subsection, does not encompass dishonor of drafts accompanied by conforming documents.

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

The *UCP* has no coverage.

The present law—In general and in Washington: There appears to

[83] If the issuer's conduct is not negligence, there is no reason to question the effectiveness of clauses like this, although decisions directly in point are scarce. Such a clause was assumed, without discussion, to be operative in Bank of New York & Trust Co. v. Atterbury Bros., *supra* note 82. See also Chairmasters, Inc. v. Public Nat'l Bank & Trust Co., 283 App. Div. 704, 127 N.Y.S.2d 806 (Sup. Ct. 1954), and Kingdom of Sweden v. New York Trust Co., 197 Misc. 431, 96 N.Y.S.2d 779 (Sup. Ct. 1949). In Camp v. Corn Exchange Nat'l Bank, 285 Pa. 337, 132 A. 189, 193 (1926) the court suggested that an application-form clause authorizing the issuer to accept drafts if the "documents appear to be correct on their face or unimpeachable in their discretion, even if the documents should in fact prove to be incorrect, defective, or forged" might give the issuer wider latitude than would their legal duty, but would give the issuer no discretion to accept documents which on their face showed nonconformity. The discussion of exculpatory clauses at notes 63, 64 and 65 *supra* indicates that the enforcement of such clauses is by no means certain if the issuer is negligent. One important by-product of the bank usage in this area will be the arguments about standards of care and negligence opened by the usage. Payment against conforming documents which appear on their face to be genuine is arguably not negligence.

be no letter of credit decision in point. There is ample authority, however, for the general proposition that a contract obligor is not bound by a usage of which he has neither actual nor imputed knowledge.[84]

Washington practice: There is no discernible practice relevant to this detail.

Critique: In relieving non-bank issuers from the customs of banks the subsection states an obvious but desirable precaution. So long as banks issue the bulk of credits, bank usage will continue to develop and to dominate the area. Perhaps other types of issuers should not be bound by bank usages which are not known to them. This is debatable. The reasonable expectations of the customer and the beneficiary may merit consideration. Whether such issuers should be bound to bank usages which are known to them is another matter. The subsection supports an inference that they are so bound. Since bank usages are arguably also "trade usages" as to the customers who buy credits, it would appear sound enough to charge non-bank issuers with bank usages which are known to the them and which are not expressly disclaimed.

Section 5-110. Availability of Credit in Portions; Presenters Reservation of Lien or Claim

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

UCP—Art. 36 of *UCP* reads: "Unless otherwise expressly stipulated, Banks may pay, accept or negotiate for partial shipments, even though the credit mentions the name of a vessel and when partial shipment is made by that vessel." Article 33, *Proposed Revision,* is different. It reads: "Partial shipments are not allowed unless authorized in the credit: expressions such as 'shipment in one or more consignments' or 'shipment in lots' or similar expressions shall be deemed to allow partial shipments."

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

Washington practice: The practice of Washington banks is in accord with this subsection. As *UCP* article 36 is interpreted, it is the bene-

[84] See the discussion, Shattuck, *Contracts in Washington, 1937-1957: Part II,* 34 WASH. L. REV. 345, 385-387 (1959).

ficiary rather than the issuer which has the right to decide whether a credit which is not specific in this particular shall be used in portions. *UCP* is routinely incorporated in all documentary credits. Traveler's credits typically contain language clearly permitting multiple draws.

Critique: Subsection (1) produces results now expected by Washington banks and would as to documentary credits provide a needed legal basis for those results. No explanation has been seen of the change in *UCP* indicated in the *Proposed Revision.*

It should be pointed out with regard to credits issued in connection with sales contracts that partial shipments are not always in the best interest of the buyer. This, however, is a detail which must be handled in the sale contract, and by specific instructions to the issuer where a single draw is desired. The practice has developed as it has because partial disbursements under credits are normally expected. A customer who is involved in a transaction which falls outside this pattern must take the appropriate precautions.

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

UCP—The *UCP* has no coverage.

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

Washington practice: Washington banks expect to receive the documents free of any reserved claim of the beneficiary.

Critique: The subsection states an obvious proposition, which coinsides with the present practice. It is most unlikely that a beneficiary could persuade an American court of his compliance with the credit, on a proffer of documents with the proviso that he shall have an interest in them after honor by the issuer. Although the usual credit does not expressly state that documents are to be tendered with no strings attached, it does not fairly permit of any other interpretation.[85] What

[85] Relevant to the interpretation issue is the general trade usage, which must be widely known to persons who require, use and buy credits, that issuers commonly rely on the documents as security for reimbursement claims. See the discussion of § 5-114(3) below. This aspect was stressed in Wells Fargo Nevada Nat'l Bank v. Corn Exchange Nat'l Bank, 23 F.2d 1 (7th Cir. 1928), where the beneficiary submitted invoices showing a total price in excess of the maximum amount of the credit, together with a separate

function the phrase "Unless otherwise specified" will serve in this context is obscure. There is no commercial use in Washington of credits which authorize the proffer of documents in which the beneficiary retains an ownership or lien interest.

Section 5-111. Warranties on Transfer and Presentment

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

UCP—The *UCP* has no coverage.

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

Washington practice: As to a warranty obligation of the beneficiary to a customer there is no discernible Washington practice. Washington banks expect an issuer to have a legal right to recover a payment made under a credit from a beneficiary who knowingly presented a forged document. They would, however, distinguish between such and one who innocently presented a forged insurance policy, consular invoice or inspection certificate. As to conformity in fact, apart from forgery, the issuer must decide for itself and will, as between it and the beneficiary, be bound by its determination.

Critique: In stating a warranty obligation the subsection both extends the beneficiary's obligation beyond that which Washington banks now expect and provides a sound legal basis for the belief that there is an obligation. The existence, scope and theory of the beneficiary's legal responsibility in this context is now obscure.

It is doubtful that there is a tort remedy of any interest, other than that for deceit. Deceit is of no value against a beneficiary whose proffer of objectionable documents resulted from his simple negligence or from the misdoing of a third person for whose conduct he is not legally liable. Under the best of circumstances, establishing a deceit cause of action is a difficult operation. Restitution might provide a satisfactory remedy where the beneficiary himself presented the draft, but this is rarely the case. Getting at the beneficiary where the draft has gone

draft for the excess, drawn on the customer. Although the beneficiary did not attempt to reserve any interest for itself, it evidently expected the customer to have some sort of interest in the documents coextensive with the amount of the separate draft. The documents were held to be nonconforming.

through the hands of negotiating banks requires much straining of the basic fabric of restitution. That the beneficiary should be directly liable to the issuer, and to the customer and negotiating banks too, seems obvious enough. A statute is needed to declare this obligation.

The subsection evidently means to impose only a warranty that the demands of the credit have been met, and not a warranty that the beneficiary's duties under the beneficiary-customer contract have been met. The dividing line between these two areas is not, however, always clearly discernible.[86] Particularly difficult to analyse is the kind of fraud which consists of loading shipping containers with trash instead of merchandise, and procuring a bill of lading which conforms to the credit in describing receipt by the carrier of so many containers of merchandise. Documents which are fraudulent in fact, whether by design or accident, ought not be deemed in law to be conforming documents. The problems will be examined further in the discussion of § 5-114(2). Section 5-111(1) does not resolve this detail with the completeness which would be ideal.

A warranty is a type of obligation which is traditionally vulnerable to disclaimer and there is no reason to think the warranty stated in this subsection is any exception. The phrase "Unless otherwise agreed" is an express recognition of this possibility. There is also no reason to believe that banks will issue credits under which documents plus a disclaimer will satisfy the stated conditions.

The warranties of Articles 3, 4, 7 and 8 are not apt to prove of substantial value as between issuer and beneficiary.[87]

[86] See Camp v. Corn Exchange Nat'l Bank, 285 Pa. 337, 132 A. 189 (1926) and Imbrie v. D. Nagase & Co., 196 App. Div. 380, 187 N.Y. Supp. 692 (Sup. Ct. 1921), which in denying the issuer a right against the beneficiary for defects in the goods serve also to demonstrate the weakness in the issuer's position vis a vis the beneficiary where the documents (and the goods they represent) are to be collateral in the issuer's hands.

[87] The drafts are not ordinarily defective and the warranties of § 3-417 will therefore not ordinarily be breached. For the same reason the warranties of § 4-207, between customer and collecting bank, will not ordinarily be breached in the transaction between beneficiary and negotiating bank. The warranties of § 7-507 will be of interest as between beneficiary and negotiating bank, but *quaere* whether proffer to the issuer by the beneficiary is a "transfer." The process by which draft and documents are proferred to the issuer is described in § 5-112(3) in a way which suggests that "presentment" rather than "transfer" is the terminology of the *Code*. In § 4-207 "transfer" is distinguished from presentment for payment or acceptance. The bill of lading will ordinarily be the key document and the one which a dishonest beneficiary will forge or tamper with. The usual credit will demand a bill of lading naming the issuer as consignee. If it be argued that the draft is "presented" and the bill of lading "transferred" by the beneficiary, it is equally arguable that the form of the bill of lading precludes analysis of this phase of the transaction as involving a "transfer." The incidence of letter of credit transactions in which article 8 becomes significant must be very small. If it does become of moment, it is difficult to see how the issuer will be able to proceed under § 8-306 unless he is a transferee, as to which there is room for disagreement.

(2) Unless otherwise agreed a negotiating, advising, confirming, collecting or issuing bank presenting or transferring a draft or demand for payment under a credit warrants only the matters warranted by a collecting bank under Article 4 and any such bank transferring a document warrants only the matters warranted by an intermediary under Articles 7 and 8.

UCP—The *UCP* has no coverage.

The present law—In general: A collecting bank which tenders a draft and collateral documents does not warrant the genuineness of the documents.[88]

Washington law: There appears to be no relevant decision.

Washington practice: Washington banks do not expect a collecting or negotiating bank to impliedly warrant the genuineness of documents or the conformity of documents to the credit. Situations do develop in which express warranties are demanded and given, *e.g.*, where a negotiating bank asks the issuer to pay while the documents are in transit or are otherwise not immediately available for presentation.

Critique: Insofar as the subsection states a rule of nonliability for collecting banks it coincides with the current expectations of banks and probably with the law applicable to credits.[89] The warranties of a collecting bank under articles 4, 7 and 8 are of relatively narrow compass.[90] In restricting to these warranties the obligation of a negotiating, advising or confirming bank the subsection clarifies an area in which the law is now obscure, and in a way which coincides with the expectations of Washington banks. The end result is to force resort by issuers to the warranty created in subsection (1) even though the beneficiary may not be so easily reached as might a negotiating bank. What propositions the common law might in time develop for this area it is difficult to predict. Banks in the negotiating, advising and confirming categories

[88] Bishop & Co. v. Midland Bank, 84 F.2d 585 (9th Cir. 1936), *cert. denied*, 299 U.S. 587 (1936); Archibald & Lewis Co. v. Banque Int'l De Commerce, 214 N.Y. Supp. 366 (Sup. Ct. 1926); Jacobs v. Banque Pour Le Commerce, 131 Misc. 162, 225 N.Y. Supp. 410 (Sup. Ct. 1926); Springs v. Hanover Nat'l Bank, 209 N.Y. 224, 103 N.E. 156 (1913); Goetz v. Bank of Kansas City, 119 U.S. 551 (1887).

A disclaimer of warranties by a collecting bank has been sustained. Kingdom of Sweden v. New York Trust Co., 197 Misc. 431, 96 N.Y.S.2d 779 (Sup. Ct. 1949).

[89] For an argument that a negotiating bank should warrant the documents, see Thayer, *Irrevocable Credits in International Commerce: Their Legal Effects*, 37 COLUM. L. REV. 1326, 1342 (1937).

[90] Section 4-207 imposes on a collecting bank warranties of authority to collect, nonalteration and ignorance of certain types of defect. Under § 7-508 and § 8-306 a collecting bank warrants only its good faith and authority. The incidence of letter of credit transactions in which one of these obligations will be breached will probably be very small.

will not usually be just collecting banks. They may be purchasers. Often they will be obligees under the credit. A purchaser or an obligee is arguably to be distinguished from a collecting bank, and liable to the issuer on exactly the same reasoning as is the beneficiary.

The basic concept of the subsection conforms to that of section 5-114(2) (a). The subsection refers only to banks and the reason for this restricted coverage is not clear. Granted that persons other than banks rarely participate in the movement of drafts and allied papers from beneficiary to issuer, so narrow a formulation of the subsection is hardly justified. Presumably, comparable obligations would be imposed by a court on a non-bank participant, but this must remain conjectural pending the appearance of decisions.

There will no doubt be continued need for express warranties in unusual transactions and this the subsection covers in its "Unless otherwise agreed" provision. An issuer could, by an appropriate recital in the credit, state a broad warranty which any presenter aware of the recital would be deemed to make. There is no reason to expect such a practice to develop.

Section 5-112. Time allowed for Honor or Rejection; Withholding Honor or Rejection by Consent; "Presenter."

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

(a) defer until the close of the third banking day following receipt of the documents; and

(b) further defer honor if the presenter has expressly or impliedly consented thereto.

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

UCP—Article 10, (Article 8, *Proposed Revision*) reads in part: "The issuing Bank shall have a reasonable time to examine the documents." This sentence is in a section concerned with inter-bank relations, and probably was not intended to appertain where presentment is by the beneficiary or his agent rather than by an advising or confirming bank which is itself an obligee under the credit. The con-

sequences of excessive delay are not specified. The term "documents" as used in this context appears to cover allied papers, not drafts.

The present law—In general: The *Uniform Negotiable Instruments Law,* § 136 reads in part: "The drawee is allowed twenty-four hours after presentment, in which to decide whether or not he will accept the bill. . . ." Section 137 reads: "Where a drawee to whom a bill is delivered for acceptance destroys the same, or refuses within twenty-four hours after such delivery, or within such other period as the holder may allow, to return the bill accepted or non-accepted to the holder, he will be deemed to have accepted the same [sic]." Section 150 reads: "Where a bill is duly presented for acceptance and is not accepted within the prescribed time, the person presenting it must treat the bill as dishonored by non-acceptance or he loses the right of recourse against the drawer and indorsers."

These sections are incomplete and inconclusive. Do they cover sight drafts? The cases are divided.[91] Does inaction result in dishonor or acceptance? The cases are divided.[92] Do these sections apply to drafts drawn under a documentary credit? Such credits will ordinarily incorporate *UCP*, which arguably extends the time within which action on the drafts must be taken, to a "reasonable time," in the situations covered by *UCP* article 10. This article suggests that the issuer has a "reasonable time" if the presenter is a "Bank authorized to" take up the documents, and 24 hours if the presenter is someone else. Inspection of the documents is known by all concerned to be a function of the issuer, a fact which suggests the existence in the credit of an implied term authorizing delay of decision to honor or dishonor the draft pending such inspection. On this detail there appears to be no definitive case authority.[93] Presumably drafts drawn under a non-documentary credit fall within the twenty-four hour rule, whatever it may be in the jurisdiction.

As to a "demand for payment" there appears to be no relevant statutory or case law.

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[91] BRITTON, BILLS AND NOTES § 179 (1943); BRANNAN'S NEGOTIABLE INSTRUMENTS LAW 1092, 1093 (6th ed. 1938).

[92] BRITTON *op. cit. supra* note 90, at § 179.

[93] In Liberty Nat'l Bank & Trust Co. v. Bank of America Nat'l Trust & Savings Ass'n, 218 F.2d 831, 838-839 (10th Cir. 1955) the beneficiary sought to rely on the "well established law in Oklahoma that a bank which neglects, fails or refuses to return a draft drawn upon it within twenty-four hours after the delivery of such draft to it, or within the further period of time allowed by the holder to the drawee, is deemed to have accepted the draft and its liability is measured accordingly." The court, however, found as a fact that the beneficiary had extended the time and that the issuer met the extended deadline.

Washington law: The cited *Uniform Negotiable Instruments Law* sections are RCW 62.01.136, 62.01.137 and 62.01.150. There appears to be no relevant Washington case.

Washington practice: The experience of Washington banks has for the most part been with sight drafts and documentary credits. In such transactions they expect to have a reasonable time within which to inspect the documents and act on the draft, without regard to the identity of the presenter. They further expect that excessive delay would be tantamount to dishonor of the draft and breach of the credit. The development of a like practice with regard to time drafts and documentary credits seems expectable. It is assumed that drafts drawn under non-documentary credits are regulated, as to dishonor, by the *Uniform Negotiable Instruments Law.*

Critique: UCP is ambiguous and incomplete. The present law is obscure. Statutory coverage is highly desirable. Whether the statute should provide for a reasonable time, with the resulting flexibility and its attendant uncertainty, or for a fixed period, is debatable. There is much to be said for the solution of the subsection. In providing that excessive delay is dishonor of the draft the subsection states a workable and sound proposition which coincides with the expectations of Washington banks. The constructive acceptance which some courts have found by interpretation of § 137 of the *Uniform Negotiable Instruments Law* makes a minimum of sense.

Inclusion in the subsection of demands for payment is obviously desirable.

The coverage of article 3 is not fully harmonized with § 5-112(1). Section 3-506(2) excepts documentary drafts from the requirement of payment "before the close of business on the day of presentment" but § 3-506(1) does not expressly except such drafts from the demand for acceptance before "the close of the next business day following presentment." That the exception is present in the latter section, by implication, seems inescapable.

The term "documentary draft" is defined in § 5-103.

Dishonor of a draft will be a breach of the credit only if the presenter has met its conditions. Section 5-115(1) indicates that wrongful dishonor of a draft or demand for payment drawn under a credit is a breach of the credit.

This subsection applies only to documentary credits, leaving for

article 3 the answers to questions about the dishonor of drafts drawn under clean credits. The fate of a "demand for payment" presented under a clean credit is undeterminable. The concept of "dishonor" has developed around negotiable paper. The extension of this concept to demands for payment, in § 5-115(1), makes it just as necessary to know how long an issuer has to act on such a demand as it is to know how long he has to act on a draft. Article 3 cannot supply the answers. The failure of article 5 to cover the point is regrettable.

The subsection does not purport to state any test for determining what evidence will establish consent of the presenter to delay past the third banking day. The potential for trouble in the idea of implied consent is so evident as to suggest that an issuer will be well advised to act within the three day period unless it is prepared to produce written evidence of actual consent. It should be emphasized that consent must come from the presenter, not from the customer. Nothing in the present practice suggests that sales contracts may in time come to stipulate not only the details of the credit which the buyer must provide, but also the period within which the issuer must act when drafts are presented. There is no reason why the beneficiary's consent cannot be obtained in this way, but his consent would not bind a bank authorized by the credit to negotiate drafts. On the other hand the customer may be much prejudiced by delays. Presumably a customer can, in his application, instruct the issuer to act within indicated periods. Perhaps the sales contract can be made the vehicle for a declaration by the buyer that credits issued at his instance must stipulate for no extensions of the statutory periods without his consent. For counsel who represent customers these are details which merit serious attention.

Although subsection (1) states flatly, "Failure to honor within the time here specified constitutes dishonor," this must be read with § 5-108(2) (b). Under the latter section, the presentment which starts time running for the purposes of § 5-112(1) occurs when the indicated evidence of notation reaches the issuer. On similar reasoning, delay in providing such evidence may mean that the presenter fails to meet the expiration-date deadline stated in the credit.

The phrase "close of the third banking day," used in § 5-112(1)(2), indicates clearly enough that Saturdays, Sundays and holidays are not (in Washington) to be included in computing the time within which the issuer can act.

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

UCP—The *UCP* has no coverage.

The present law—In general and in Washington: The legal effect of failure to return the draft is part of the uncertainty indicated in the discussion of the preceding subsection.

Washington practice: Washington banks customarily inform the presenter of dishonor and hold the draft and documents pending receipt of his instructions.

Critique: "Dishonor," as the word is used here, means failure to pay or accept within the allotted time.[94] Inactivity by the drawee cannot be an acceptance. Yet § 4-302 makes a drawee liable for the amount of the draft on failure to return it, an idea which has obvious drawbacks in the case of a documentary credit. Ordinarily the documents will relate to and govern goods which are in transit at the time of presentment. The goods cannot readily be intercepted and will in due course reach their destination. Unless the documents are there, the necessary custodial and liquidation steps cannot be taken. The presenter's interests require the subsection, which conforms to and provides a needed legal sanction for the present bank practice.

The subsection does not specify when the advice shall be given to the presenter, nor the consequences of failure to advise that draft and documents are being held subject to his disposal. Presumably the issuer must act promptly, on pain of liability for conversion.

Although *UCP* has no coverage of this detail, it does address itself in article 10 (art. 8, *Proposed Revision*) to the reimbursement position of a bank authorized to negotiate, pay or accept. An issuer which decides to deny that its authorization was properly exercised must act. "Notice to that effect, stating the reasons therefore, must be given by cable or other expeditious means to the Bank demanding reimbursement, and such notice must state the documents are being held at the disposal of such Bank or are being returned thereto." Subsection 5-112(2) conforms to this provision. Presentment by an authorized bank is none the less presentment because the objective is "reimbursement."

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[94] Section 3-507(1)(a).

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

UPC—The *UCP* has no coverage. Article 10 (Art. 8, *Proposed Revision*) contains a comparable provision, in its requirement of notice or return by an issuer, where an authorized bank submits the papers for reimbursement.

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

Washington practice: The term "presenter" has no general use in Washington. The idea that a confirming bank has the same rights in the draft and documents as would the beneficiary and is entitled to the same treatment on dishonor, is in accord with the thinking of Washington banks.

Critique: A confirming bank occupies a dual status. By reason of the request for confirmation, it has a direct right against the issuer for reimbursement. By reason of its possession of the draft and the documents, it should have the rights of any holder. Although there appears to be no reason to anticipate difficulty in establishing these propositions in litigation, the subsection does no harm in declaring the confirming bank's right to return of the papers or notice. It is also useful to have a clear statement that each presenter, whether an obligee of the credit or an agent of the beneficiary, whether owner or non-owner, is to be accorded identical treatment at this point.

Section 5-113. Indemnities

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

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

(a) unless otherwise explicitly agreed applies to defects in the documents but not in the goods; and

(b) unless a longer time is explicitly agreed expires at the end of ten business days following receipt of the documents by the ultimate customer unless notice of objection is sent before such expiration date. The ultimate customer may

send notice of objection to the person from whom he received the document and any bank receiving such notice is under a duty to send notice to its transferor before its midnight deadline.

UCP—The *UCP* has no coverage.

The present law—In general and in Washington: There appears to be no decision testing the power of a bank to execute an indemnity of the type contemplated by the subsection. There are limitations on the power of a bank to enter into guaranty contracts[95] which must be considered, as well as the distinctions between guaranties and credits, and between guaranties and indemnity contracts. The power of national banks to issue credits is now assured[96] and state banks in general will probably have implied if not express power to issue credits.[97] The indemnity under consideration has become a common step in the consummation of letter of credit transactions, and is an indemnity contract rather than a technical guaranty although the term "guaranty" is often erroneously attached to them.[98] For these reasons it is to be expected that a bank which can issue a credit can issue this type of indemnity. There are some states in which the existence of power to issue credits is uncertain. It is accordingly appropriate that article 5 contains, as it does here and in § 5-103(1), provisions which remove all doubt about this detail. The subsection cannot of course appertain to national banks, which no doubt now have the power and do not require additional statutory authorization.

The second Circuit Court of Appeals has held that an issuer's duty was matured by the tender of nonconforming documents plus a bank indemnity.[99] The decision turned on a finding that custom and usage

[95] See Shattuck & Guernsey, *Letters Of Credit—A Comparison Of Article 5 Of The Uniform Commercial Code And The Washington Practice,* 37 WASH. L. REV. 325, 335 n.21 (1962).

[96] Shattuck & Guernsey, *supra* note 95, at 331 n.17.

[97] Shattuck & Guernsey, *supra* note 95, at 331, nn. 18 & 19.

[98] The function of a guaranty is to back up another person's obligation, and the duty of the usual guarantor is to perform if the principal defaults. The indemnity contract is to protect the obligee against loss from a contemplated course of action and the duty of the indemnitor is to perform if indicated conditions are met. As an adjunct to a letter of credit transaction, the indemnitor promises to pay such loss as the issuer may sustain if the issuer honors a draft accompanied by nonconforming documents.

[99] Dixon, Irmaos & Cia v. Chase Nat'l Bank, 144 F.2d 759 (2d Cir. 1944) *cert. denied,* 324 U.S. 850 (1945). The decision has received considerable attention in legal journals. See Note, *Commercial Letters of Credit—Strict Compliance with Terms Necessary—Banking Custom Impliedly Incorporated into Letter of Credit,* 31 VA. L. REV. 689 (1945); Backus and Harfield, *Custom and Letters of Credit: The Dixon, Irmaos Case,* 52 COLUM. L. REV. 589 (1952); Honnold, *Letters of Credit, Custom, Missing Documents and the Dixon Case: A Reply to Backus and Harfield,* 53 COLUM.

required such an interpretation of the credit. This appears to be the only relevant American case.

Washington practice: Washington banks execute and receive indemnities in lieu of full performance of conditions, where the discrepancies are minor, and do not question their power to enter into contracts of this kind. It is not the practice of Washington banks to include in application forms a clause authorizing them to take indemnity where documents do not conform. These forms typically contain an authorization to honor drafts even though the required documents are missing, which is arguably broad enough to cover the taking of indemnity. There appears to have been no occasion to consider whether it does, probably because it is the practice to consult the customer and to take or refuse indemnity in accordance with his stated preference. It is assumed that if he consents, his duty to reimburse will not be impaired by the taking of defective documents.

Washington banks expect indemnity to cover only defects in documents. There is no determinable practice relevant to the details covered by subsection (2)(b).

Critique: As the discussion of § 5-114(1) will demonstrate, a beneficiary acquires a right qualified by express conditions which he must meet before he acquires a legal right to immediate performance by the issuer. It is a characteristic of express conditions that they must be exactly and fully met.[100] It can be argued with some force that the conditions in a letter of credit should not operate so rigidly. So far the practice has been in the direction of limited leeway. A contract obligor who has exacted an express condition can waive it. An issuer has the legal power to waive conditions in a credit, but if it does so it will find a non-consenting customer no longer obliged to make reimbursement.[101]

L. REV. 504 (1953). The case has also received incidental treatment. See Harfield, *The National Bank Act and Foreign Trade Practices*, 61 HARV. L. REV. 782, 786 (1948); Comment, *Letters of Credit under the Proposed Uniform Commercial Code: An Opportunity Missed*, 62 YALE L.J. 227, 247 (1953).

[100] There is an exception of limited scope. A contract promisee may succeed in escaping the operation of an express condition where enforcement of it would induce extreme forfeiture. RESTATEMENT, CONTRACTS § 302 (1932). Beneficiaries of credits will not ordinarily be able to invoke this principle.

[101] Concerning the reimbursement problem, see the discussion of § 5-114(3) below. Concerning waivers, see: Maurice O'Meara Co. v. National Park Bank 239 N.Y. 386, 146 N.E. 636 (1925), (defect in dock delivery order held waived by issuer which refused honor for the stated reason that the goods did not conform to the sales contract); Lamborn v. Cleveland Trust Co., 29 F.2d 46 (2d Cir. 1928) (an issuer which refused proffered documents on the ground that honor was barred by a restraining order obtained by the customer, was held to be "estopped" from thereafter asserting deviations in the documents which could have been corrected in due time had the initial proffer been refused because of such defects); Bank of Taiwan v. Union Nat'l Bank

Banks have sought a partial solution in the application forms taken from customers by taking the authorization mentioned in the Washington-practice discussion above. This method is not calculated to preserve customer good will, if arbitrarily used. Hence the practice of ascertaining and following the customer's wish as to a waiver. The application form clause makes it possible for the issuer to accept an informal clearance from the customer, and is also helpful where the fact of compliance with conditions is disputed and the issuer exercises its good faith judgment in favor of compliance. The waiver technique will permit the issuer to honor the credit despite departures from literal compliance with conditions, where the customer, by reason of market or other changes, does not want to find a legal excuse for refusing honor. The indemnity practice is simply a variation on this theme, the waiver being made on the proffer of indemnity. The beneficiary has no legal right to force a waiver.[102] Subsection (1) makes but one contribution—it removes from the indemnity practice the ultra vires risk as to an indemnity issued by a state bank.

Subsection (2), in restricting the indemnity to defects in the documents, coincides with the present practice and will protect an indemnitor whose undertaking is informally stated from a claim of liability if the goods do not comply with the sales contract. It will nevertheless be desirable to frame indemnity agreements with precision. Genuineness of documents, for example, may not be a risk contemplated by the indemnitor. The ten-day limitation and its allied details, stated in the subsection, have no counterpart in the present practice. These are matters of practical importance and the method of their disposition

1 F.2d 65 (3rd Cir. 1924); Bank of America v. Whitney-Central Nat'l Bank, 291 Fed. 929 (5th Cir. 1923). *Cf.* Old Colony Trust Co. v. Lawyers' Title & Trust Co., 297 Fed. 152 (2d Cir. 1924) *cert. denied,* 265 U.S. 585 (1924) (where issuer, when documents were proffered, stated one ground for refusal and later asserted another, held no waiver because "estoppel presupposes either knowledge or information of a sufficient character or the means of obtaining such knowledge or information by reasonable inquiry...."; the court also indicated that there can be no waiver of a defect which the presenter could not cure); Moss v. Old Colony Trust Co., 246 Mass. 139, 140 N.E. 803 (1923) (an issuer's refusal of honor for the stated general reason that the documents are not conforming is not a waiver of any specific ground, nor is the specification of one ground a basis for an estoppel against showing others, absent any intent to mislead); Consolidated Sales Co. v. Bank of Hampton Roads, 193 Va. 307, 68 S.E.2d 652 (1952) (submission of a draft, as a condition, was held waived by conduct in honoring simple invoices indicating the amounts due).

[102] The absence from § 5-113 of any provision which would give the beneficiary such a right is entirely understandable. Responsibility for the form and content of documents is entirely on the obligee and if there is to be any relief from that burden it must come from the issuer as a matter of grace. Only if the credit itself, by express provision or by implication drawn from trade usage, conditions the issuer's duty on the presentation of documents plus indemnity, can the beneficiary as a matter of right assert that this combination matures the issuer's duty to honor.

here seems sound. The subsection should induce a desirable uniformity in the practice as to these details. A striking characteristic of indemnities as now used is the absence of any uniformity in phrasing.

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

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

UCP—"Commercial documentary credits are essentially distinct transactions from sales contracts, on which they may be based, with which Banks are not concerned." Article 1, *Proposed Revision,* General Provisions and Definitions, contains a similar provision.

"In documentary credit operations, all parties concerned deal in documents and not in goods." Article 10 (in part). Article 8, *Proposed Revision,* contains an idential provision:

> If the documents, on their face, are not as stipulated by the terms and conditions of the credit, the issuing Bank must, upon receipt of the documents, determine, on the basis of the documents alone, whether or not to claim that payment, negotiation or acceptance was not made in accordance with the terms and conditions of the credit.

Article 10 (in part; this paragraph is concerned with the legal relations between the issuer and a negotiating bank "authorized to do so.") Article 8, *Proposed Revision,* is to the same effect.

Articles 15 through 34 set out standards for ascertaining the conformity of various types of documents, and articles 35 through 48 deal with other details which may become of moment in determining whether an issuer is under a duty to honor.[103] These matters are covered in the *Proposed Revision* by articles 13 *et seq.*

The present law—In general: A credit is by definition a promise to perform on compliance with stated conditions. It differs in its business use from other promises to pay on condition. In practice, the

[103] Several of these articles are discussed in Note, *Revised International Rules for Documentary Credits,* 65 HARV. L. REV. 1420 (1952).

credit will recite a promise to pay or honor drafts submitted within an indicated time and up to an indicated amount. The documentary credit will further state as a term the production of indicated documents. Although words of express condition are rarely used, there is abundant case authority interpreting statements by issuers concerning time,[104] quantities, dollar limits and other details,[105] or documents,[106] as creating express conditions.

[104] First Nat'l Bank v. Bensley, 2 Fed. 609 (C.C.N.D. Ill. 1880) (where the credit does not otherwise specify, the beneficiary must draw his draft within a reasonable time); Lamborn v. National Bank of Commerce, 276 U.S. 469 (1928) (dictum; time of shipping goods, stated in credit, is a condition); Liberty Nat'l Bank & Trust Co. v. Bank of America Nat'l Trust & Savings Ass'n, 218 F.2d 831 (10th Cir. 1955) (the stated time for negotiation of drafts was held to be a condition); Commercial Union of America v. Anglo-South American Bank, 16 F.2d 979 (2d Cir. 1927) (the credit specified "steamer... sailing during first half of November, 1920"; actual departure of the vessel before Nov. 16th was a condition); North Woods Paper Mills v. National City Bank, *infra.* n. 105; Asbury Park & Ocean Grove Bank v. National City Bank, 35 N.Y.S.2d 985 (Sup. Ct. 1942) (where credit demanded shipping tickets but did not specify when in relation to the time of shipment such tickets should be submitted, a condition of prompt submission will not be inferred); Lamborn v. National Park Bank, 240 N.Y. 520, 148 N.E. 664 (1925) (where credit does not specify the time within which drafts are to be submitted, the expiry date will be a "reasonable time" after issue); G. Jaris & Co. v. Banque D'Athenes, 246 Mass. 546, 141 N.E. 576 (1923) ("Where a date is fixed as the time for the expiration of a letter of credit, that becomes an important and essential condition. There must be strict compliance with it....")

See Annot., *Rights and remedies of holder of draft issued under letter of credit which is dishonored,* 53 A.L.R. 57, 67 *et seq.* (1928).

[105] Germania Nat'l Bank v. Taaks, 101 N.Y. 442, 5 N.E. 76 (1886) (drafts against "particularly described shipments"); Lamborn v. National Bank of Commerce 276 U.S. 469 (1928) (dictum; amount and quality of the goods, place of shipment and ultimate destination, stated in the credit, are condition; in issue was the phrase "steamer to Philadelphia"; of this the court said it related to the manner of shipment and "was confessedly a condition"); First Nat'l Bank v. Home Savings Bank, 88 U.S. (21 Wall.) 294 (1874) (guaranty of drafts "on shipment of cattle"; the quoted phrase was held to state a condition); Wells Fargo Nevada Nat'l Bank v. Corn Exchange Nat'l Bank, 23 F.2d 1 (7th Cir. 1928) (specification of maximum amount of credit was held to state a condition affecting the invoices, which must indicate a sale price not exceeding such maximum); Richard v. Royal Bank of Canada, 23 F.2d 430 (2d Cir. 1928) (credit contained the usual language, undertaking that drafts would be honored; the beneficiary submitted and the issuer honored documents which were merely receipts; the court held that the drawing of drafts was not made a condition by the indicated credit-language); Banco Nacional Ultramarino v. First Nat'l Bank, 289 Fed. 169 (D. Mass. 1923) (where credit covered "Brazil white crystal sugar" the "documents, or some one or more of them" should conform); International Banking Corp. v. Irving Nat'l Bank, 283 Fed. 103 (2d Cir. 1922) (where credit said of the cloth for which the drafts were to pay, "total width of stripes not more than 50% of the material width," the beneficiary was obliged to furnish proof that the cloth conformed); Banco Nacional de Credito Ejidal S.A. v. Bank of America, 118 F. Supp. 308 (N.D. Cal. 1954) (requirement that the issuer be notified of clearance of the goods by the U.S. Pure Food & Drug Administration stated a condition); Portuguese-American Bank v. Atlantic Nat'l Bank, 200 App. Div. 575, 193 N.Y. Supp. 423 (App. Div. 1922) ("guaranty" of $7,440 draft for 400 cases of eggs, California white Petaluma extras to be shipped by express; held the draft must show it was drawn for the indicated purpose and the express receipt must describe eggs of the indicated grade); Moss v. Old Colony Trust Co., 246 Mass. 139, 140 N.E. 803 (1923) (United States Chamber of Commerce inspection certificate and government export license); Camp v. Corn Exchange Nat'l Bank, 285 Pa. 337, 132 Atl. 189 (1926) (requirement of a bill of lading held not to demand an on-board bill; a specification of "shipped" creates a condition, met here by documents other than the bill of lading); Consolidated Sales Co. v.

A credit is always used as a means of assuring a payment, the occasion for which must be found in some other transaction. Put in another way, the credit is invariably collateral to some other relationship. Beneficiaries have sometimes sought to escape the conditions stated in a credit by showing that they have matured a right, against the customer, in the other transaction.[107] Issuers have sometimes sought to avoid paying a beneficiary who has met the conditions of the credit, by showing that he was in default in the other transaction.[108] Neither

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Bank of Hampton Roads, 193 Va. 307, 68 S.E.2d 652 (1952) (credit which indicated it was issued pursuant to a line of flooring financing of major appliances, did not as a matter of interpretation excuse the issuer from paying against vacuum cleaners which it declined to floor under a trust receipt; appliances of this type had previously been financed under the credit and this course of conduct provided evidence of practical construction; the reference to flooring did not state a condition; the submission of invoices was however a condition; the credit demanded drafts but this condition became, by waiver, a requirement of invoices); Bridge v. Welda State Bank, 222 Mo. App. 586, 292 S.W. 1079 (1927) (the phrase "itemized statement" as contained in a credit was ambiguous in its context; whether it stated a condition was for the jury); Palmer v. Rice, 36 Neb. 844, 55 N.W. 256 (1893) (where a credit indicated it was to pay for livestock and against bills of lading, submission of a bill of lading and of a document indicating the draft was to cover the cost of livestock are conditions; the issuer did not, however, establish as a condition the existence of a credit balance on his books in favor of the customer).

See Annot., *Right and remedies of holder of draft issued under letter of credit which is dishonored,* 53 A.L.R. 57, 69 *et seq.* (1928).

[106] Liberty Nat'l Bank & Trust Co. v. Bank of America Nat'l Trust & Savings Ass'n, 218 F.2d 831 (10th Cir. 1955); 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); Dixon, Irmaos & Cia v. Chase Nat'l Bank, 144 F.2d 759 (2d Cir. 1944) *cert. denied,* 324 U.S. 850 (1945); Anglo-South American Trust Co. v. Uhe, 261 N.Y. 150, 184 N.E. 741 (1933); Crocker First Nat'l Bank v. De Sousa, 27 F.2d 462 (9th Cir. 1928) *cert. denied,* 278 U.S. 650 (1928); Richard v. Royal Bank of Canada, 23 F.2d 430 (2d Cir. 1928); Bank of Italy v. Merchants' Nat'l Bank, 236 N.Y. 106, 140 N.E. 211 (1923) *cert. denied,* 264 U.S. 581 (1924); Bank of Taiwan v. Union Nat'l Bank, 1 F.2d 65 (3rd Cir. 1924); Arctic Ice & Coal Co. v. Southgate, 287 Fed. 48 (4th Cir. 1923); Bank of America v. Whitney-Central Nat'l Bank, 291 Fed. 929 (5th Cir. 1923).

[107] Banco National de Credito Ejidal S.A. v. Bank of America, 118 F. Supp. 308 (N.D. Cal. 1954); North Woods Paper Mills v. National City Bank, 121 N.Y.S.2d 543 (Sup. St. 1953), *aff'd,* 283 App. Div. 731, 127 N.Y.S.2d 663 (1954); Continental Nat'l Bank v. National City Bank, 69 F.2d 312 (9th Cir. 1934) (dictum); Crocker First Nat'l Bank v. De Sousa, 27 F.2d 462 (9th Cir. 1928) *cert. denied,* 278 U.S. 650 (1928).

See Annot., *Rights and remedies of holder of draft issued under letter of credit which is dishonored,* 53 A.L.R. 57, 70 *et seq.* (1928).

[108] Continental Nat'l Bank v. National City Bank, 69 F.2d 312 (9th Cir. 1934) (dictum); Bank of Taiwan v. Union Nat'l Bank, 1 F.2d 65 (3rd Cir. 1924) (held error to admit the sales contract in evidence, where its terms differed from those of the credit, even though the beneficiary did not perform the sales contract); Second Nat'l Bank v. Columbia Trust Co., 288 Fed. 17 (3rd Cir. 1923) (evidence of breach by the seller, of the underlying sale contract, is not admissible in an action on a credit; the issuer attempted unsuccessfully to show that its undertaking was really a guaranty); Bank of Plant City v. Canal-Commercial Trust & Savings Bank, 270 Fed. 477 (5th Cir. 1921) (breach of warranty in the sale is not a defense to the issuer); Maurice O'Meara Co. v. National Park Bank, 239 N.Y. 386, 146 N.E. 636 (1925) (failure of goods to meet the sales contract is no defense to an issuer sued by the beneficiary).

Also of interest at this point are Bank of Taiwan v. Gorgas-Pierie Mfg. Co., 273 Fed. 660 (3rd Cir. 1921) (customer, because of a breach of the sale contract by the beneficiary, sought to enjoin issuer from paying a negotiating bank which was presenting the draft; the presenter appeared; the trial court on motion of the issuer re-

endeavor has succeeded. The credit is a contract the scope of which must be ascertained strictly by ascertaining what the issuer promised and on what conditions. Transactions in which forged or fraudulent documents were submitted put the most severe strain on this analysis. The cases, which are not entirely harmonious, are considered in the discussion of § 5-114(2).

As will be observed in the discussion of § 5-116, beneficiaries often utilize the facilities of the banking system, the presentment of drafts in person by beneficiaries being relatively rare. The draft may be put

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quired the presenter and the customer to interplead; held error); American Steel Co. v. Irving Nat'l Bank, 266 Fed. 41 (2d Cir. 1920) *aff'd*, 277 Fed. 1016 (2d Cir. 1921) *cert. denied*, 258 U.S. 617 (1922) (issuer unsuccessfully tried to justify dishonor of the drafts by alleging that the customer's duty to the beneficiary was discharged by frustration); and Dulien Steel Products, Inc. v. Bankers Trust Co., 298 F.2d 836 (2d Cir. 1962) (customer sued confirming bank, alleging wrongful honor, and lost on the facts). Also significant are: French American Banking Corp. v. Isbrandtsen Co., Inc., 126 N.Y.S.2d 853 (Sup. Ct. 1953), *aff'd*, 126 N.Y.S.2d 887 (1953), *aff'd*, 307 N.Y. 616, 120 N.E.2d 826 (1954) (in what appears to have been a reimbursement action by issuer against customer, the plaintiff was held entitled to recover although an embargo frustrated the underlying transaction); Asbury Park & Ocean Grove Bank v. National City Bank, 35 N.Y.S.2d 985 (Sup. Ct. 1942), *aff'd*, 268 App.Div. 984, 52 N.Y.S.2d 583 (1944) (customer which pledged collateral with issuer to secure reimbursement cannot recover the value of the collateral on a theory of wrongful disposition, where the issuer paid on receipt of conforming documents but after notice by the customer, which was a bank acting for a customer of its own, that its customer was colluding with the beneficiary to defraud it); Hibernia Bank & Trust Co. v. J. Aron & Co., 134 Misc. 18, 233 N.Y. Supp. 486 (Sup. Ct. 1928) and Imbrie v. D. Nagase & Co., 196 App. Div. 380, 187 N.Y. Supp. 692 (App. Div. 1921) (issuer cannot recover from beneficiary sums paid against conforming documents, where the goods failed to meet sale contract warranties); Williams Ice Cream Co. v. Chase Nat'l Bank, 210 App. Div. 179, 205 N.Y. Supp. 446 (App. Div. 1924) and Frey & Sons v. E. R. Sherburne Co., 193 App. Div. 849, 184 N.Y. Supp. 661 (App. Div. 1920) (customer cannot enjoin honor, where goods do not conform to the sales contract); Benecke v. Haebler, 38 App. Div. 344, 58 N.Y. Supp. 16 (App. Div. 1899), *aff'd*, 166 N.Y. 631, 60 N.E. 1107 (1901) (customer cannot defeat issuer's claim to reimbursement, by showing the goods did not conform to the sale contract); Camp. v. Corn Exchange Nat'l Bank, 285 Pa. 337, 132 Atl. 189 (1926) (bills of lading were held to be conforming although they bore marginal notations, it being found as a fact that these did not vary the effect of the text).

The evident concern of the issuer with the security value of the goods may suggest that credits should be so phrased as to make certain the issuer will get not only documents but also goods which conform to the sales contract. Credits are not generally so written, and for a good reason. Such a credit would complicate the financing to the point at which the usefulness of credits would be diminished. An example of a type of credit which most sellers would probably be unwilling to accept is to be found in International Banking Corp. v. Irving Nat'l Bank, 283 Fed. 103 (2d Cir. 1922) (credit covered shipment of silk cloth and contained the phrase: "as per sample . . . to be made as per our designs and total width of stripe not more than 50% of the material width....") Providing suitable documentation for demands like these is awkward and the opportunities for controversy are excessive. The hazards of excessive detail are recognized in *UCP*, which states: ". . . instructions embodied in commercial documentary credits (must) be complete and precise . . . ; any attempt to include technical terms or cumbersome details should be discouraged. . . ." General Provisions. *Proposed Revision* contains a similar provision, phrased in terms of "excessive detail." General Provisions and Definitions.

See Annot., *Rights and remedies of holder of draft issued under letter of credit which is dishonored*, 53 A.L.R. 57, 70 *et. seq.* (1928).

in the hands of a bank for collection, it may be discounted, it may be drawn on a bank other than the issuer, it may be honored by a bank authorized to do so by the credit, or it may be negotiated to a bank under a credit which provides broadly that the issuer will honor the draft on presentment by any bona fide holder. The presenter may accordingly be a bank which is an agent of the beneficiary, an owner, an agent of the issuer, or an obligee of the credit. These differing relationships have one point in common, *i.e.*, unless the conditions stated in the credit are satisfied or waived, the presenter will have no legal right under the credit against the issuer.[109]

Granted that the terms stated by an issuer are express conditions, the key question remains to be answered—How do these conditions work? Thanks to the looseness with which the typical credit states terms, and the desire of the typical customer to escape when an adverse market shift occurs, there are a number of pertinent appellate decisions. A preponderance of them were decided by courts sitting in New York. Although these cases turn on their facts, the disposition of them is of some interest and many are cited here.[110] It would be useful to know

[109] Annot., *Rights and remedies of holder of draft issued under letter of credit which is dishonored*, 53 A.L.R. 57, 65 *et seq.* (1928). In most of the cases cited in notes 104, 105, and 106 *supra* and in notes 110 and 111 *infra*, the presenter was a negotiating or collecting bank.

[110] First Nat'l Bank v. Bensley, 2 Fed. 609 (C.C.N.D. Ill. 1880) (beneficiary failed to meet time condition and requirement of the credit as to the form of the bill of lading); Lamborn v. National Bank of Commerce, 276 U.S. 469 (1928) (in issue was a credit term, "shipment by Steamer or Steamers to Philadelphia"; the goods were shipped by a vessel which left Java destined for "Port Said option New York" and was diverted en route; the voyage from Java to Philadelphia was continuous; held that the questioned phrase did not, as a matter of interpretation, require shipment via a vessel continuously destined for Philadelphia; four justices dissented; the Circuit Court of Appeals had held for the issuer); First Nat'l Bank v. Home Savings Bank, 88 U.S. (21 Wall) 294 (1874) (guaranty conditioned on drafts drawn for "shipment of cattle"; the word "cattle" was held to include hogs); Liberty Nat'l Bank & Trust Co. v. Bank of America Nat'l Trust & Savings Ass'n, 218 F.2d 831 (10th Cir. 1955) (condition was "full set of clean on board ocean bills of lading"; held not satisfied by a bill of lading bearing the notations "ship not responsible for kind and condition of goods" and "ship not responsible for rust"; the court said that to conform the bill of lading must not indicate "by deletion, addition, or otherwise that the merchandise or commodity being shipped is not in apparent good condition."); Dixon, Irmaos & Cia v. Chase Nat'l Bank of City, 144 F.2d 759 (2d Cir. 1944) ("Full set bills of lading" was a condition; held satisfied by incomplete set plus indemnity, this interpretation being reached in light of trade usage); Crocker First Nat'l Bank v. De Sousa, 27 F.2d 462 (9th Cir. 1928) *cert. denied*, 278 U.S. 650 (1928) (credit specified part "white Java refined granulated sugar, 97/98 degrees polarization" and part "white Java refined fine granulated sugar, 97/98 degrees polarization"; issuer argued that all documents must so describe the goods; this the court refused, holding that only the "essential documents," *i.e.*, consular invoices, certificates of quality and certificates of polarization, must meet the condition; the court went on to hold that documents describing the goods as "white Java granulated sugar No. 24" and "white Java fine sugar No. 24" did not conform); Commercial Union of American v. Anglo-South American Bank, 16 F.2d 979 (2d Cir. 1927) (where "sailing" before a set date was the condition, satisfaction was not shown by the fact the vessel was scheduled or

whether a trend can be discerned, toward strict and literal enforcement of conditions, or toward a more liberal and flexible enforcement of them. The traditional attitude of American judges toward express conditions favors strict enforcement, and it appears that this attitude

expected to sail before that date); Bank of Taiwan v. Union Nat'l Bank, 1 F.2d 65 (3rd Cir. 1924) (where credit required a bill of lading "dated during September or October, 1920, in an Oriental port," for shipment to Philadelphia, held the condition was met by a bill of lading so dated, although the vessel did not clear port until after the end of October); Bank of America v. Whitney-Central Nat'l Bank, 291 Fed. 929 (5th Cir. 1923) (various deviations between credit and documents were urged, without success); Banco Nacional Ultramarino v. First Nat'l Bank, 289 Fed. 169 (D. Mass. 1923) (documents showing "sugar," "sugar crystal" and "superior crystal sugar" were held not to satisfy the condition of a credit which called for "Brazil white crystal sugar"); Maurice O'Meara Co. v. National Park Bank, 239 N.Y. 386, 146 N.E. 636 (1925) (the phrase "to test 11-12, 32 #" creates a condition requiring presentation of documents reciting conformity to the test, but not a condition giving the issuer discretion as to the proof of test it will require, nor justifying dishonor on proof the goods did not meet the test); the case is noted 38 HARV. L. REV. 1117 (1925), 9 MINN. L. REV. 657 (1925), 34 YALE L.J. 775 (1925); Bank of Italy v. Merchants' Nat'l Bank, 236 N.Y. 106, 140 N.E. 211 (1923) *cert. denied,* 264 U.S. 581 (1924) (where credit required a bill of lading covering "dried grapes," the issuer need not pay on presentation of a bill of lading covering "raisins"); Samuel Kronman & Co. v. Public Nat'l Bank, 218 App. Div. 624, 218 N.Y. Supp. 616 (App. Div. 1926) (documents in "the exact form required" were said by the court to be necessary); Portuguese-American Bank v. Atlantic Bank, 200 App. Div. 575, 193 N.Y. Supp. 423 (App. Div. 1922) (express receipt describing the shipment as "eggs" does not satisfy a condition which requires description as "California whites Petaluma extras"); Lamborn v. Lake Shore Banking & Trust Co., 196 App. Div. 504, 188 N.Y. Supp. 162 (App. Div. 1921), *aff'd,* 231 N.Y. 616, 132 N.E. 911 (1932) (where credit required bills of lading for "Java white granulated sugar" made to the order of the issuer, a bill of lading for "Java white sugar" made to the order of the beneficiary and indorsed by it, are not conforming); Moss v. Old Colony Trust Co., 246 Mass. 139, 140 N.E. 803 (1923) (where certification of sugar as equal "to fine American standard granulated sugar" was a condition, the issuer is not liable save on a certificate which establishes the sugar as within the limits permitted by the divergent practices of American refineries; in particular, a conforming chemical analysis is not enough, there being other standards in terms of friability, uniformity of grain size and so forth).

The question of issuer's right to reimbursement or its liability to the customer may turn on whether its duty to honor was matured by a proffer of conforming documents. Contests between these parties therefore provide some information about the operation of conditions in credits. These cases must be evaluated with caution, however. It appears that courts may take a less literal view of conditions where the issuer has honored in good faith and is in litigation with the customer, particularly where the documents conform to the customer's direction to the issuer. As to this see a dictum in Lamborn v. Lake Shore Banking & Trust Co., *supra.* See also: the discussion in Continental Nat'l Bank v. National City Bank, 69 F.2d 312 (9th Cir. 1934) *cert. denied,* 293 U.S. 557 (1934); Richard v. Royal Bank of Canada, 23 F.2d 430 (2d Cir. 1928) (an argument that the credit should be interpreted to require the bill of lading to show the cost of the goods, the cost of transportation and the charges for handling and commission was rejected, on the ground that these details do not ordinarily appear in a bill of lading and that the requested interpretation was obviously unreasonable; the court also said that the omission on the bills of lading of the phrase "freight collect" was not fatal where the bills of lading clearly showed the consignee was to pay freight; the court also held that a condition requiring weight certificates approved by indicated persons was satisfied by the invoices, which stated the weights and were approved by the indicated persons); Pan-American Bank & Trust Co. v. National City Bank, 6 F.2d 762 (2d Cir. 1925) *cert. denied,* 269 U.S. 554 (1925) (issuer was obliged to honor on proffer of an insurance policy payable in Brazilian currency, and of documents which were "bills of lading" under Brazilian law, where the credit authorized negotiation of the drafts in Brazil); W. A. Havemeyer & Co. v. Exchange Nat'l Bank, 293 Fed. 311 (8th Cir. 1923) (exchange bills of lading were held to satisfy

has carried over into the cases involving credits.[111] On the other hand, courts do not strain to find express conditions and are apt to interpret adversely to language which does not clearly state a condition. This attitude has not in general carried over into the cases involving credits.[112] A considerable literature has developed around these problems.[113]

a credit which required "bills of lading"); Brandt v. Day, 208 Fed. 495 (S.D.N.Y. 1913) (issuer is not liable to customer for honoring drafts accompanied by conforming documents which falsely stated a critical date, even though the customer had demanded dishonor because it suspected the fraud); Anglo-South American Trust Co. v. Uhe, 261 N.Y. 150, 184 N.E. 741 (1933) (customer's duty to reimburse is conditioned on tender to him by the issuer of the documents called for in the credit); Laudisi v. American Exch. Nat'l Bank, 239 N.Y. 234, 146 N.E. 347 (1924) (where the credit called for invoice and bill of lading, and drafts to be drawn in payment for Alicante Bouchez grapes, the issuer is not liable to the customer on honoring a draft accompanied by an invoice showing Alicante Bouchez grapes and a bill of lading for "grapes." The case is noted 38 HARV. L. REV. 1117 (1925)); Bank of Montreal v. Recknagel, 109 N.Y. 482, 17 N.E. 217 (1888) (where the credit called for "documents, Manila hemp," the word "documents" included a bill of lading and the words "Manila hemp" mean the bill of lading must so describe the goods; the issuer was denied reimbursement, having paid on a nonconforming bill of lading); Bank of New York & Trust Co. v. Atterbury Bros., 226 App. Div. 117, 234 N.Y. Supp. 442 (App. Div. 1929) (where credit called for drafts drawn by "Arthur James Brown" for "casein," two copies of shipping documents to be sent to issuer, the conditions were met by drafts drawn by A. James Brown, for "unground casein," all copies of the documents, including forged bills of lading, being attached to the draft, which reached the issuer before the vessel arrived); Philippine Nat'l Bank v. Bowring & Co., 123 Misc. 89, 204 N.Y. Supp. 327 (Sup. Ct. 1924) (red clause credit authorized part payment on presentation of the beneficiary's receipt stating that the merchandise would be shipped pursuant to the credit; the issuer was held justified in paying against a document reading "In conformity with this credit I hereby bind myself to deliver documents covering 3,000 bales of hemp within the time stipulated [sic]....")

[111] Dixon, Irmaos & Cia v. Chase Nat'l Bank, 144 F.2d 759 (2d Cir. 1944) *cert. denied*, 324 U.S. 850 (1945) ("It is true, as the defendant argues, that the law requires strict compliance with the terms of a letter of credit.") This proposition is supported by many cases. See, for examples, the cases cited in notes 104, 105, 106, and 110, *supra*.

An occasional decision has deviated from the norm, giving a presenter the benefit of a less-than-literal enforcement of a condition. Second Nat'l Bank v. M. Samuel & Sons, 12 F.2d 963 (2d Cir. 1926), *cert. denied*, 273 U.S. 720 (1926), *aff'd*, 35 F.2d 1021 (2d Cir. 1929), *cert. denied*, 281 U.S. 732 (1930) (issuer was said to be obligated to honor a draft submitted a day later than the terminal date specified in the credit, because the delay occurred in the course of transmission by mail; the opinion is quite unpersuasive); Bank of America v. Whitney-Central Nat'l Bank, 291 Fed. 929 (5th Cir. 1923). See also the cases cited in n. 110 *supra*, involving reimbursement controversies.

[112] See the discussion and cited cases, notes 104 and 105 *supra*. A change in judicial attitude has occurred however where the questioned language has concerned the quality of the goods. Because the usual practice is to pay against documents, a credit clause of this kind will be interpreted as calling for a document certifying the indicated quality and if such a document is proffered the issuer must pay. An explicit statement making conformity to quality standards a condition is necessary before the issuer can defend on the ground that the goods do not meet the quality standards indicated in the credit. Continental Nat'l Bank v. National City Bank, 69 F.2d 312 (9th Cir. 1934), *cert. denied*, 293 U.S. 557 (1934), noted 29 ILL. L. REV. 806 (1935); Maurice O'Meara Co. v. National Park Bank, 239 N.Y. 386, 146 N.E. 636 (1925).

In any individual transaction the direct evidence of intent concerning a condition may be strong enough to carry the interpretation issue. See, for example, Bank of Plant City v. Canal-Commercial Trust & Savings Bank, 270 Fed. 477 (5th Cir. 1921).

Where the problem is interpretation of a condition, the exact scope of which is not clearly indicated by the issuer's language, the full range of interpretation canons

There appears to be no relevant case authority concerning the operation of satisfaction as a condition to an issuer's duty.

Washington law: Where the credit called for documents evidencing the shipment of "standard white granulated sugar" and the documents submitted described "granulated white sugar, Java No. 24, direct polarization 98.5 per cent," the presenter acquired no right to honor.[114] The court refused to require the issuer to ascertain whether the words used in the documents meant the same as those used in the credit, and refused to concern itself with the beneficiary's performance or nonperformance of the sale contract.

In *Bank of East Asia v. Pang*[115] the disassociation of the credit and the sales contract was carried to the point of refusing recourse by the issuer against a beneficiary who submitted documents which conformed to the credit but represented a shipment which did not conform to the sale contract. Said the court:

A bank, when it issues a letter of credit, has the right to write into it

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appears properly applicable. Various examples are to be found in the cases cited in n. 110 *supra.*

[113] See: Comment, *Liability of Bank Issuing Letter of Credit When Goods Fail to Comply with Documentary Description,* 9 WASH. L. REV. 159 (1934); Finkelstein, *Performance of Conditions Under a Letter of Credit,* 25 COLUM. L. REV. 724 (1925); Thayer, *Irrevocable Credits in International Commerce: Their Legal Effects,* 37 COLUM. L. REV. 1326 (1937); Draper, *What is a "Clean" Bill of Lading?—A Problem in Financing International Trade,* 37 CORNELL L. Q. 56 (1951); McCurdy, *Commercial Letters of Credit,* 35 HARV. L. REV. 715, 724 *et seq.* (1922); Brown, *Documentary Conditions of Payment in Commercial Letters of Credit,* 13 TUL. L. REV. 495 (1939); Campbell, *Guaranties and the Suretyship Phases of Letters of Credit,* 85 U. PA. L. REV. 261, 273 *et. seq.* (1937); Comment, *Descriptions in Documents Tendered Under Letters of Credit,* 33 YALE L.J. 651 (1924); Comment, *Letters of Credit Under the Proposed Uniform Commercial Code: An Opportunity Missed,* 62 YALE L.J. 227, 243 *et seq.* (1953).

See also: Annot., *Variance between description of goods in letter of credit and documents accompanying draft as affecting duty to accept draft,* 30 A.L.R. 353 (1924); Annot., *Liability of bank on letter of credit as affected by quality or condition of goods for purchase price of which it is issued,* 39 A.L.R. 755 (1925); Annot., *Rights and remedies of holder of draft issued under letter of credit which is dishonored,* 53 A.L.R. 57, 65 *et seq.* (1928); WILLISTON, CONTRACTS § 1011D (rev. ed. 1936); WILLISTON, SALES § 469f(rev. ed. 1948); WARD AND HARFIELD, BANK CREDITS AND ACCEPTANCES 36 *et seq.* (4th ed. 1958); FINKELSTEIN, LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT 174 *et seq.*, 223 *et seq.* (1930).

[114] National City Bank v. Seattle Nat'l Bank, 121 Wash. 476, 209 Pac. 705 (1922). The credit in question is a good example of the kind of loose wording which causes disputes. It read in part: "for invoice cost of One Hundred Fifty-five tons standard white granulated sugar." What does this mean, in terms of the documents? The court accepted the issuer's argument that somewhere in the documents this description of the sugar must appear. A contrary interpretation would have been equally expectable. Although the defendant is referred to here as the "issuer," and was discussed in the opinion as though it had issued or confirmed the credit, it was in fact simply authorized to advise the credit and negotiate drafts. The issuer was a Chicago bank. Why the Seattle bank was sued and why it chose to defend on the condition rather than on the absence of any promise by it are not indicated in the opinion.

[115] 140 Wash. 603, 249 Pac. 1060 (1926), noted 2 WASH. L. REV. 130 (1927).

> such requirements and conditions as it sees fit. If it does not do so, and, as in this case, simply issues the letter of credit obligating itself to pay when certain documents are presented, then the terms of the contract are satisfied when documents conforming to the requirements of the credit are presented.

Washington practice: Washington banks expect to pay when the conditions of the credit are met, without regard to performance of the sales contract, and rely on the *UCP* standards for help in resolving questions about the satisfaction of conditions.

There is no commercial use in Washington of credits in which the issuer's "satisfaction" is a stated condition. Washington banks do not regard *UCP* article 43, (Article 40, *Proposed Revision*), which reads: "Paying, negotiating or accepting Banks may refuse documents if in their judgment they are presented to them with undue delay," as involving any element of "satisfaction." The preceding sentence of article 43 reads: "Documents must be presented within a reasonable time after issuance." Someone must decide whether a reasonable time has passed, and the *UCP* makes the issuer's determination final. Article 43 will be applicable to a documentary credit which incorporates *UCP* by reference.

Critique: In stating an issuer's duty to pay on compliance with conditions, and in denying the relevance of the underlying beneficiary-customer contract, the subsection conforms to the existing law and practice. It makes no attempt to provide a basis on which to resolve disputes about compliance with conditions where the bone of contention is interpretation of the credit or conformity in fact of documents to the credit. The answer to these problems must be found in trade usage or in the nuances of word-meanings. This is not an area which lends itself to statutory control. The decision of the draftsmen to refrain from trying to help with these disputes, which occasion so much of the appellate litigation about credits, was a wise one.

The sentence dealing with satisfaction is obscure in purpose and language. There is no current use in Washington of satisfaction as a condition and no reason to think beneficiaries will in the future be any more apt to prescribe or accept credits containing such an obvious risk of controversy. The prohibition of a general condition seems to be pointless, in light of the authorization of satisfaction with individual documents as conditions.

If the issuer knows that documents which conform in language are

in fact false, there are difficult problems. They are discussed with the following subsection.

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

(a) the issuer must honor the draft or demand for payment if honor is demanded by a negotiating bank or other holder of the draft or demand which has taken the draft or demand under the credit and under circumstances which would make it a holder in due course (Section 3-302) and in an appropriate case would make it a person to whom a document of title has been duly negotiated (Section 7-502) or a bona fide purchaser of a security (Section 8-302); and

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

Section 7-507 specifies several warranties: that the document is genuine; that there is no knowledge of any fact which impairs its validity or worth; and that the negotiation or transfer is rightful and fully effective respecting title to the document and to the goods it represents. Section 8-306 specifies analogous warranties: that the transfer is effective and rightful; that the security is genuine and has not been materially altered; and that there is no knowledge of a fact which might impair the validity of the security.

UCP—The *UCP* has no coverage.

The present law—In general: Decisions are few and inconclusive. The cases concerned with an attempt by a customer to obtain an injunction against honor by the issuer are divided.[116] There is some

[116] Sustaining the customer's petition for an injunction are: Sztejn v. J. Henry Schroder Banking Corp., 177 Misc. 719, 31 N.Y.S.2d 631 (Sup. Ct. 1941) (presenter was beneficiary's agent; the credit called for bristles; the beneficiary shipped rubbish; the court indicated that a contrary result will be reached where the presenter is a

support for the view that a negotiating bank cannot prevail where it proffers documents which are regular on their face but which are in fact false.[117] The opposed view has more adherents.[118] Periodical and text discussions outnumber the modern cases and demonstrate no consensus. There is support for and against an analysis of credits which would force an issuer to pay a holder in due course of the draft where the documents conform, even though the documents are forged or fraudulent. There is also disagreement about the position of other presenters and about the propriety of injunctive relief for the customer.[119]

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holder in due course of the draft); Nadler v. Mei Loong Corp. of China, 177 Misc. 263, 30 N.Y.S.2d 323 (Sup. Ct. 1941) (temporary restraining order issued, on the customer's contention that the goods had not in fact been shipped, or if shipped had been later removed from the vessel; the shipment was from China and the court stressed the uncertainties of the times and the difficulty in obtaining recourse from the beneficiary; the presenter appears to have been an agent of the beneficiary); Higgins v. Steinhardter, 106 Misc. 168, 175 N.Y. Supp. 279 (Sup. Ct. 1919) (injunction issued on a showing that the bill of lading falsely stated the shipment date; the court did not identify the presenter, but indicated that the order would issue even though the drafts were in the hands of third persons).

Denying the petition for an injunction are: Grob v. Manufacturer's Trust Co., 177 Misc. 45, 29 N.Y.S.2d 916 (Sup. Ct. 1941) (an allegation that the bills of lading may have been issued by Japanese ships which will not perform them was held to be an insufficient basis for the order; the risk of non-delivery was assumed by the customer; the presenter was not identified by the court); Frey & Son v. E. R. Sherburne Co., 193 App. Div. 849, 184 N.Y. Supp. 661 (App. Div. 1920) (customer held not entitled to enjoin honor of drafts presented either by the beneficiary or by holders, on a showing that the beneficiary had breached the sale contract in shipping late; the court emphasized the absence of any showing that either the issuer or the beneficiary was in financial difficulties).

[117] Old Colony Trust Co. v. Lawyers' Title & Trust Co., 297 Fed. 152 (2d Cir. 1924) *cert. denied*, 265 U.S. 585 (1924) (said the court: "Obviously, when the issuer of a letter of credit knows that a document, although correct in form is, in point of fact, false or illegal, he cannot be called upon to recognize such a document as complying with the terms of a letter of credit"; this comment was elicited by a warehouse receipt issued where no goods had been received, and by invoices stating net landed weights when the goods were not yet landed; the presenter was a holder of the draft); Maurice O'Meara Co. v. National Park Bank, 239 N.Y. 386, 146 N.E. 636 (1925) (the credit called for paper of a certain test; an affidavit certifying conformity of the paper was among the documents presented; the affidavit was false; the majority saw in the deviation merely a breach of the sales contract; two judges dissented; they were prepared to hold generally that falsity in the documents, as to a material element in the transaction, would be a defense to the issuer).

[118] Goetz v. Bank of Kansas City, 119 U.S. 551 (1886) (negotiating bank recovered of issuer; the bill of lading presented was forged); Bank of Taiwan v. Union Nat'l Bank, 1 F.2d 65 (3rd Cir. 1924) (the fact the bill of lading recited a false date held no defense to the issuer, where the presenter is not shown to have been aware of the defect); Brandt v. Day, 208 Fed. 495 (S.D.N.Y. 1913) (held that the issuer must honor if the documents conform, although the customer has notified the issuer that a document carried a false date; the action was by the customer against the issuer, by a counterclaim, to recover for an allegedly wrongful honor); Asbury Park & Ocean Grove Bank v. National City Bank, 35 N.Y.S.2d 985 (Sup. Ct. 1942), *aff'd*, 268 App. Div. 984, 52 N.Y.S.2d 583 (1944) (issuer's duty to honor was held not varied by notice from the customer that the beneficiary was defrauding it); Brown v. Rosenstein Co., 120 Misc. 787, 200 N.Y. Supp. 491 (Sup. Ct. 1923) (held that the issuer, having accepted a time draft, was bound to pay the holder of it even though the bill of lading was forged; the action was by the issuer against the customer for reimbursement).

[119] See Comment, *Liability of Bank Issuing Letter of Credit When Goods Fail to*

Washington law: There appears to be no relevant decision.

Washington practice: Washington banks do not distinguish between holders in due course and other presenters. They anticipate no legal obligation to pay anyone where documents are forged. They expect to pay any presenter if genuine conforming documents are presented, despite known fraud, in the absence of a restraining order.

The application forms taken from customers by Washington banks contain broadly phrased authorizations to honor without regard to the genuineness of documents or the existence of fraud.

Critique: The subsection is in accord with the Washington practice, in preserving a right to receive reimbursement from the customer where the issuer has in good faith honored a draft, and in denying any duty of the issuer to the beneficiary or a collecting bank where documents are forged. It departs from the Washington practice in denying (inferentially) any duty of the issuer to the beneficiary or a collecting bank where documents are fraudulent, and in stating a duty to a holder in due course which is broader than that running to the beneficiary. These variations make commercial sense and should occasion no serious dislocations in practice. It seems particularly desirable to create a principle which gives the issuer a weapon against known fraud by the beneficiary, yet preserves the reimbursement position of an issuer who acts in good faith. In this detail the subsection is aligned with the view that the separation of sales contract and the credit is carried to

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Comply with Documentary Description, 9 WASH. L. REV. 159, 164 *et seq.* (1934); Thayer, *Irrevocable Credits in International Commerce: Their Legal Effects,* 37 COLUM. L. REV. 1326, 1335 *et seq.* (1937); Note, *Sales—Letters of Credit—Buyer May Enjoin Payment of Seller's Drafts on Ground of Fraud,* 42 COLUM. L. REV. 149 (1942) (discusses Sztejn v. J. Henry Schroder Banking Corp., 177 Misc. 719, 31 N.Y.S.2d 631 (Sup. Ct. 1941), and similar cases); McCurdy, *Commercial Letters of Credit,* 35 HARV. L. REV. 715, 735 (1922); Note, *Letters of Credit—Bank Issuing Letter Enjoined from Honoring Drafts with Allegedly Fraudulent Bills of Lading Though Presented by Holders for Value,* 55 HARV. L. REV. 878 (1942) (discussing Nadler v. Mei Loong Corp., 177 Misc. 263, 30 N.Y.S.2d 323 (Sup. Ct. 1941), and similar cases); Comment, *Revised International Rules for Documentary Credits,* 65 HARV. L. REV. 1420, 1427 (1952); McGowan, *Assignability of Documentary Credits,* 13 LAW & CONTEMP. PROB. 666, 668 n.8 (1948) (makes the interesting argument that the beneficiary should be enjoined from using the credit, rather than the issuer enjoined from honoring its promise to pay or accept); Mentschikoff, *Letters of Credit: The Need for Uniform Legislation,* 23 U. CHI. L. REV. 571 *et seq.* (1956); Campbell, *Guaranties and the Suretyship Phases of Letters of Credit,* 85 U. PA. L. REV. 261, 271 (1937) (particularly interesting in its argument against liability of the issuer to a bona fide holder of the draft who presents forged or fraudulent documents); Comment, *Letters of Credit Under the Proposed Uniform Commercial Code: An Opportunity Missed,* 62 YALE L.J. 227, 252 *et seq.* (1953); Comment, *Adverse Claims Under the Uniform Commercial Code: A Survey and Proposals,* 65 YALE L.J. 807 (1956).

See also: WILLISTON, CONTRACTS § 1011E (rev. ed. 1936); FINKELSTEIN, LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT 236 *et seq.* (1930); WARD AND HARFIELD, BANK CREDITS AND ACCEPTANCES 55 (4th ed. 1958).

an absurd length if a beneficiary who has shipped rubbish or falsified critical document-dates can force an issuer to pay. Concededly the rule of the subsection will subject beneficiaries to the risks of factual disputes about the existence of fraud or forgery. To this extent the credit becomes a less-than-perfect source of compensation. This is not apt to be a serious impediment to the use of credits by honest sellers. These are matters with a complexion quite different from the disputes about conformity of goods to sales contracts, against which the beneficiary is protected by the preceding subsection.

The subsection will in practice permit an issuer to safely honor, where it does so in good faith, despite contrary instructions by a customer who alleges forgery or fraud. This seems entirely proper. The promise at stake is that of the issuer. Dishonor is a breach by the issuer unless legally justified. The issuer's commercial reputation is in question and it should not be put in the embarrassing position of having to resolve factual disputes of a type which cannot really be resolved short of litigation. The subsection achieves a fair balance between the conflicting interests of issuer and customer, since the latter is always free to seek injunctive relief. If he succeeds, the onus is removed from the issuer.

No attempt is made in the subsection to spell out the elements of "fraud." Particularly troublesome is the dividing line between "fraud" and non-fraudulent breach of warranty or contract. Also difficult is the proper classification of deviations between the actual facts and the recitals in documents. The statement of standards by which disputes of these kinds are to be resolved is not however a function of the *Uniform Commercial Code*. Such details are wisely left to be worked out by courts in the normal processes of litigation.

The subsection does not grapple with the problems of jurisdiction encountered in injunction actions involving a presenter who is in another state or country, nor with the propriety of enjoining the issuer in a proceeding to which the beneficiary is not a party. Vital as these problems are to the proponent of an injunction, the answers must be sought in general principles.

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

UCP—The *UCP* has no coverage. Article 10 (Art. 8, *Proposed Revision*) provides in part: "Payment, negotiation or acceptance against documents in accordance with the terms and conditions of a credit by a Bank authorized to do so binds the party giving the authorization to take up the documents and reimburse the Bank making the payment, negotiation or acceptance." The context of this passage suggests, however, that it relates only to inter-bank relations.

The present law—In general: There appears to be no decision establishing the time at which reimbursement must be made by the customer. In several cases the issuer recovered from the customer on an express promise to reimburse.[120] The customer's request for issuance of a credit will no doubt evidence an implied promise to reimburse the issuer, although there is little case authority directly in point.[121] In *Anglo-South American Trust Co. v. Uhe*[122] the issuer failed in its attempt to get reimbursement because it accepted nonconforming documents and could not prove a waiver of the defects by the customer. The court stressed the issuer's failure to perform the credit. More logically, the reimbursement right of an issuer depends on performance by it of the contract evidenced by the customer's offer (application

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[120] Richard v. Royal Bank of Canada, 23 F.2d 430 (2d Cir. 1928); Bank of New York & Trust Co. v. Atterbury Bros., 226 App. Div. 117, 234 N.Y. Supp. 442 (App. Div. 1929); Philippine Nat'l Bank v. Bowring & Co., 123 Misc. 89, 204 N.Y. Supp. 327 (Sup. Ct. 1924); Brown v. C. Rosenstein Co., 120 Misc. 787, 200 N.Y. Supp. 491 (Sup. Ct. 1923). The customer's typical defense is that the issuer should have refused to pay or accept the beneficiary's draft. See n. 109 above. See also: Thayer, *Irrevocable Credits in International Commerce: Their Legal Effects*, 37 COLUM. L. REV. 1326, 1344 *et seq.* (1937); FINKELSTEIN: LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT 149 (1930).

[121] In Liberty Nat'l Bank & Trust Co. v. Bank of America Nat'l Trust & Savings Ass'n, 218 F.2d 831 (10th Cir. 1955), an implied promise was found in a transaction which appears to have been in effect a credit. In an occasional opinion the court does not clearly indicate whether the customer did expressly promise when he applied for the credit. See *e.g.*, French American Banking Corp. v. Isbrandsen Co. Inc., 126 N.Y.S.2d 853 (Sup. Ct. 1953) *aff'd*, 126 N.Y.S.2d 887 (1953), *aff'd*, 120 N.E.2d 826 (1954) and Benecke v. Haebler, 38 App. Div. 344, 58 N.Y. Supp. 16 (App. Ct. 1899). (The asserted defense was the failure of the goods to conform to the sales contract). That the request should sufficiently evidence an implied promise would seem clear enough. There is a long history of comparable transactions in suretyship which supports the argument. The *Benecke* case also put in issue an interesting anticipatory breach point. The customer repudiated before maturity of time drafts accepted by the issuer. This the court held did not mature a cause of action in the issuer, who therefore could not then have realized on the collateral.

[122] 261 N.Y. 150, 184 N.E. 741 (1933). The waiver argument will on occasion be successful. A customer who consents to payment or acceptance by the issuer despite defects in the documents, or who demonstrates his approval of such wrongful honor by thereafter accepting the documents, will probably find that his duty to reimburse continues unimpaired. Supporting this analysis is Williams Ice Cream Co. v. Chase Nat'l Bank, 210 App. Div. 179, 205 N.Y. Supp. 446 (App. Div. 1924), in which the customer sought without success to enjoin honor by the issuer, because of defects in the documents, which the customer accepted before trial.

for the credit) and the issuer's acceptance. There is some support for this analysis.[123]

The dearth of appellate decisions in this area is probably explained by the widespread use of forms which embody both an express promise to reimburse, and also an exculpatory clause so broadly phrased as to discourage litigation by the customer.[124]

The subsection does not identify the person from whom the issuer is entitled to have reimbursement or indemnity. Presumably that person will be the "customer" as defined in § 5-103. The term includes a bank which requests another bank to issue a credit on behalf of a customer of the requesting bank. So construed, § 5-114(3) clarifies an area now obscure.[125] That the customer of the requesting bank is intended also to be a "customer" of the issuer is indicated by paragraph 4 of the Official Comment to § 5-103. Section 5-114(3) contains nothing which derogates from the idea that both the requesting bank and its customer owe a duty to the issuer, although this is a detail which might better have been explicitly stated.

The legal relations between an issuer and a confirming bank are

[123] Bank of Montreal v. Recknagel, 109 N.Y. 482, 17 N.E. 217 (1888). See also: Greenough v. Munroe, 53 F.2d 362 (2d Cir. 1931) and Bank of United States v. Seltzer, 233 App. Div. 225, 251 N.Y. Supp. 637 (App. Div. 1931), in which an insolvent issuer's failure to honor was held to be a defense in its action against the customer. The suggested analysis is also supported by decisions discussing the issuer's liability to the customer. See *e.g.*, Citizens Nat'l Trust & Savings Bank v. Londono, 204 F.2d 377 (9th Cir. 1953); C. Lievense, Ltd. v. Credit Suisse, 285 App. Div. 1046, 140 N.Y.S.2d 3 (App. Div. 1955); Gidden v. Chase Nat'l Bank, 82 N.Y.S.2d 341 (Sup. Ct. 1948); Tocco v. Rinaudo, 249 Mass. 267, 143 N.E. 905 (1924); Camp v. Corn Exchange Nat'l Bank, 285 Pa. 337, 132 Atl. 189 (1926).

[124] Concerning the legal operation of such clauses, see n. 82 *supra*.

[125] Whether the requesting bank is a "customer," or an "issuer" requesting confirmation, or a "guarantor" undertaking (with possible ultra vires consequences) to back up its customer's duty to reimburse the issuing bank, or a principal asking the issuer to act as its agent, or just an agent for its customer, undertaking no kind of liability, are questions for which definite answers are not now possible. In practice the requesting bank is often asked to make an express indemnity promise, which disposes of some problems but not of the ultra vires difficulty. See 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. In the transaction litigated in Asbury Park & Ocean Grove Bank v. National City Bank, 35 N.Y.S.2d 985 (Sup. Ct. 1942) *aff'd*, 268 App. Div. 984, 52 N.Y.S.2d 583 (App. Div. 1944) the metropolitan bank required the requesting bank to put up collateral. The relations between the two banks were described by the court as a "contract," but the reasoning which led to this conclusion was not stated. The ultra vires problem is discussed: Campbell, *Guaranties and the Suretyship Phases of Letters of Credit*, 85 U. PA. L. REV. 261, 294-295 (1937); FINKELSTEIN: LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT 39, 40 (1930); WARD AND HARFIELD, BANK CREDITS AND ACCEPTANCES 209 (4th ed. 1958). Thayer, *Irrevocable Credits in International Commerce: Their Legal Effects*, 37 COLUM. L. REV. 1326, 1346 n. 86, says of the requesting bank that it is in "the same position as the buyer," citing several English decisions and Kunglig Jarnvagsstyrelsen v. National City Bank, 20 F.2d 307 (2d Cir. 1927) *cert. denied*, 275 U.S. 497 (1927). The opinion in the latter case contains some helpful language, although the contested point was the liability of the issuer to a sub-vendee of the requesting bank's customer.

not mentioned in this subsection, but do receive some attention in § 5-103(g). It is indicated there that the term "customer" includes a bank which procures confirmation on behalf of a customer of the requesting bank. This helps in the analysis of the relations between the confirming and issuing banks, and supports the implication of a promise by the latter to reimburse. It seems clear enough that such a promise will be found, although there is a dearth of supporting case authority. Less clear is the relation between the confirming bank and the issuing bank's customer. Whether the customer is under a duty to reimburse, and if so, whether such duty is secondary to that of the issuer, are details on which there appears to be no definitive decision. In practice the confirming bank is typically a correspondent and collects by charging the account maintained with it by the issuer, or by drawing a draft on another correspondent with which the issuer maintains an account.

There is only limited authority concerning the legal relation in which the issuer holds the documents and the goods they represent. It would appear reasonably certain that the issuer has, as against the customer, a security interest, but its exact nature is obscure.[126]

Washington law: There appears to be no relevant case authority concerning the customer's duty to reimburse the issuer. The court has recognized that a bank which discounts a draft accompanied by a bill of lading acquires a security interest in the property,[127] and would no doubt reach a similar analysis in the instance of an issuer which honors a draft accompanied by title documents.

Washington practice: Washington banks routinely require customers to execute an application form which recites a promise to put the issuer in funds before the time for disbursement by it arrives, or in the alternative and at the issuer's election to reimburse the issuer. These forms also confer authority on the issuer to honor drafts and pay accepted drafts regardless of the conditions stated in the credit, so long as the issuer acts in good faith. Although the latter provision seems aimed

[126] No more than an occasional glimpse of the secured-transactions aspect of a letter of credit transaction is to be had in the decisions. See *e.g.*, Centola v. Italian Discount & Trust Co., 135 Misc. 697, 238 N.Y. Supp. 245 (N.Y. City Ct. 1929); Benecke v. Haebler, 38 App. Div. 344, 58 N.Y. Supp. 16 (App. Ct. 1899). See also McCurdy, *Commercial Letters of Credit*, 35 HARV. L. REV. 715, 736 (1922). Concerning the relation of a discounting bank to the property covered by an accompanying bill of lading, see nn. 126 & 128 *infra*.

[127] Chase Nat'l Bank v. Spokane County, 125 Wash. 1, 215 Pac. 374 (1923). This case reached the usual result. Note, *The Tripartite Ownership Resulting from the Transfer of a Bill of Lading to Seller's Order to a Discounting Bank*, 26 COLUM. L. REV. 63 (1926).

more at the issuer's liability to the customer than at reimbursement, it should suffice to establish the scope of the issuer's authority for all purposes.

The forms used by Washington banks purport to create in the issuer an "ownership" interest in the documents and property, for security, with power to liquidate the collateral on default by the customer.

Critique: An issuer which has "duly honored" a draft or demand for payment is said by the subsection to be entitled to reimbursement. This phrase is explained in the Official Comment as including not only honor where the issuer was legally obligated to honor, but also honor pursuant to § 5-114(2)(b) and pursuant to § 5-106(4). This coverage is not adequate. It does not acknowledge the tendency of courts to protect an issuer who acted reasonably and in good faith. It permits the customer to second guess the issuer and test, by litigation, the fact of conformity of documents to the credit, whereas the decision of the issuer that the documents conform, or that a draft should be honored despite minor defects in the documents, ought to be final if reasonable and bona fide. This defect in the subsection is, however, curable by drafting. The phrase "Unless otherwise agreed," with which the subsection begins, authorizes drafting which will achieve the necessary protection for the issuer. The application forms now in use in Washington may be adequate to establish the needed authority in the issuer. It would nevertheless be desirable to consider redrafting them in light of this subsection.

In declaring a statutory duty to reimburse, the subsection will remove any risk of controversy about the existence of the duty in those infrequent transactions in which the issuer neglects to take an express promise.

Neither here nor in § 5-109 is there provision for the problem created by an issuer's failure to follow the customer's instructions in preparing the credit. Presumably the draftsmen intended that this problem should be resolved by the common law of contracts. Any expectation that the answers will be readily found there seems overly sanguine. There is a distressing shortage of decisions analysing the basic customer-issuer transaction. The usual customer application looks like an offer for a unilateral contract, the issuance of the requested credit being the acceptance. If this approach be taken, a deviating credit is simply no acceptance. It may be doubted that this is a sound interpretation. The customer will usually expect and think he is getting a promise from

the issuer. Both wrongful honor and the issuance of a credit which varies from the application should be legal wrongs. Support for this view is given by several cases in which the customer sued the issuer for alleged wrongful honor and the existence of some kind of duty in the issuer seems to have been assumed.[128] The only plausible source of such a duty, when those cases were in litigation, was a promise, made in acceptance of the customer's offer. The customer-issuer transaction appears to be a bilateral contract, accompanied by the usual constructive conditions. That the application form contains no express promise by the issuer complicates but does not necessarily defeat this analysis. The issuer's promise can be oral or implied.

Whether the statutory duty of customer to issuer declared by the subsection is contingent on the existence of a contract between issuer and customer, or on the absence of a material breach of such a contract by the issuer, is a key question. It cannot be answered with assurance. One may surmise that courts will not impose liability on the customer where the credit materially deviates from the customer's request, but it is unfortunate that a detail of this importance is left by the subsection in the realm of speculation.

If the customer's duty to reimburse is conditioned on compliance with his instructions the doctrine of waiver or a modifying contract will often provide an answer to practical problems. Despite the use of application forms which give the issuer much discretion in the acceptance of documents, it is the practice of Washington banks to consult with the customer where there is doubt about the conformity of documents, or where the defects in them are relatively minor. This is a salutary custom. It would be even more beneficial if written clearances were always taken from a customer who approves honor. Having acquiesced before the event, the customer will certainly be unable to resist a claim for reimbursement, despite deviations between the credit and the documents or between the credit and the original instructions. Acquiescence after the event should also sufficiently prove a waiver. The subsection does not purport to codify a rule for these situations. The omission seems sound. Waiver is a pervasive concept which does not require codification. Nor is a statute needed to support a change of instructions by a customer. It would seem that on occasion the cus-

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[128] Laudisi v. American Exch. Nat'l Bank, 239 N.Y. 234, 146 N.E. 347 (1924); W. A. Havemeyer & Co. v. Exchange Nat'l Bank, 293 Fed. 311 (8th Cir. 1923); Brandt v. Day, 208 Fed. 495 (S.D.N.Y. 1913).

tomer's approval of deviations from the original application can be analysed as evidencing a modifying contract.

The subsection is silent regarding the issuer's relation to the documents and to the property represented by a document such as a bill of lading or a warehouse receipt. Washington banks believe that these are held in pledge. Although better pledge-creation language could be formulated than is now customary in application forms,[129] there is no reason to doubt the legal sufficiency of these arrangements as pledges. Under the *Uniform Commercial Code* all security in documents and personal property is regulated by article 9, the details of which will be of interest to issuers who expect a bill of lading or goods to be security. It would appear, however, that the security aspect of the documents is not their only legal significance. In a real sense the documents are the exchange the customer expects to receive from the issuer. A proffer of them to him is probably a condition to the customer's duty to reimburse. Viewed from this perspective, the issuer's receipt of nonconforming documents will make it impossible to mature the customer's reimbursement duty by a tender of documents. In specifying immediate reimbursement for an issuer which has disbursed, the subsection conforms to the current practice where the letter of credit transaction is not followed by a period of secured or unsecured commercial credit. The subsection does not provide, as is the Washington practice, for the issuer to be put in funds before the presentment of a sight draft, if the issuer so demands. This additional right is conferred by the application forms now used, and can continue to be so created. In providing that the customer shall put the issuer in funds not later than a day before the maturity of an accepted time draft, the subsection conforms to the Washington practice where the transaction has not shifted into a commercial loan.

[129] An attempt to describe a security transfer of chattels in terms of "ownership" is manifestly hazardous where a pledge is expected, since a chattel mortgage is normally the method by which a proprietary security is taken in such property. Despite some judicial discussion of the issuer's security interest as ownership, it should be recognized that this is unsound as to chattels and is misleading even as to documents of title. See *e.g.*, Centola v. Italian Discount & Trust Co., 135 Misc. 697, 238 N.Y. Supp. 245 (N.Y. City Ct. 1929) (beneficiary required a credit for part only of the price; he collected this part from the issuer and surrendered shipping documents; on refusal of the customer to pay the balance he sought to recover the documents on tender of the sum the issuer had disbursed; the effort was unsuccessful; the seller was held to have surrendered its lien and to have parted with title; the issuer was said to have "ownership"; the issuer's position was further strengthened by a general pledge agreement with the customer, and the existence of other claims against him.) Cases like this, where the rights of creditors or liquidators are not involved and filing statutes are not in issue, provide no real assurance that the practice illustrated is a sound one.

The subsection does not preclude the continued use of arrangements by which the customer defers repaying the issuer. It is not unknown in import transactions, and is fairly common in domestic ones, for the customer to execute to the issuer a demand or time note and to acquire the goods from the issuer on trust receipt. This secondary stage may be handled by the commercial department of the issuing bank.

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

(a) any payment made on receipt of such notice is conditional; and

(b) the issuer may reject documents which do not comply with the credit if it does so within three banking days following its receipt of the documents; and

(c) in the event of such rejection, the issuer is entitled by charge back or otherwise to return of the payment made.

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

UCP—The *UCP* has no coverage.

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

Washington practice: Washington banks have developed no practice with regard to these details.

Critique: The Official Comment explains the inclusion of these subsections, as "for the purpose of clarifying a situation which has arisen under the currency restrictions of a few nations and in which payment is required to be made under the credit before opportunity exists to examine the documents." Apart from currency restrictions, there occasionally developes a transaction in which the seller or his agent will insist on honor by the issuer before the documents reach it.[130] The subsections will have an occasional field for operation and seem to provide sensible solutions for the problems covered.

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[130] See *e.g.*, Liberty Nat'l Bank & Trust Co. v. Bank of America Nat'l Trust & Savings Ass'n, 218 F.2d 831 (10th Cir. 1955).

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

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

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

Section 2-707 gives a "person in the position of a seller" the rights of a seller under § 2-705 to stop or withhold delivery, under § 2-706 to resell, recovering as damages the difference between the contract price and the sum realized on resale and under § 2-710 to recover incidental damages such as expenses incurred in effecting stoppage and in preserving the goods pending resale.

Section 2-610 permits the seller, on anticipatory repudiation by the buyer, to wait a reasonable time for performance, or to pursue remedies under § 2-703 even though he has urged retraction, and in either case to suspend his own performance or proceed to identify goods to the contract under § 2-704 or salvage unfinished goods.

Section 2-703 permits the seller to withhold delivery, to stop delivery by a bailee under § 2-705, to resell and recover damages under § 2-706, to recover damages for nonacceptance under § 2-708 or, in a proper case, to recover the price under § 2-709. He is also permitted to cancel.

Under § 2-704 the seller can identify to the contract conforming goods then in his possession and not already identified to it, and treat as the subject of resale the goods which were demonstrably intended

for that contract even though unfinished at the time of the repudiation. He is also permitted, "in the exercise of reasonable commercial judgment for the purposes of avoiding loss and of effective realization," to either complete and identify goods or stop work and resell the unfinished goods for scrap or salvage.

Under § 2-708 the seller recovers the difference between contract price and market value plus incidental expenses; or if this is inadequate, the profit he would have made on performance, plus incidental expenses.

Under § 2-709 the seller recovers the price of identified goods provided he cannot with reasonable effort resell them at a reasonable price, holding unsold goods for the buyer, and crediting the net proceeds of sale to the buyer.

The detailed operation of these subsections and their relation to the present Washington law are discussed in a recent Washington Law Review article.[131]

Under § 5-112(1), dishonor of one draft is dishonor of a credit which contemplates a series of drafts.

The term "wrongfully" as used in this section merely indicates the absence of legal justification for refusing to honor or for repudiating. Whether there is legal justification turns on the application of principles discussed under § 5-106(2) and § 5-114(1) and (2) above.

UCP—The *UCP* has no coverage.

The present law—In general: The matter of remedies for the beneficiary or other presenter under a modern commercial letter of credit, as against the issuer, is the subject of some illuminating text and periodical discussion,[132] but has not often reached American courts. The decisions are diverse in approach and result.

The issuer has been held to the difference between the market price and the contract price of the goods.[133] Damages have been measured

[131] Cosway, *Sales—A Comparison of the Law in Washington and the Uniform Commercial Code*, 36 WASH. L. REV. 50, 84; 440, 443 (1961).

[132] Comment, *Damages for Breach of Irrevocable Commercial Letters of Credit: The Common Law and The Uniform Commercial Code*, 25 U. CHI. L. REV. 667 (1958); Finkelstein, *Acceptances and Promises to Accept*, 26 COLUM. L. REV. 684, 719 (1926); FINKELSTEIN, LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT, 262 *et seq.*, 271 (1930).

[133] Doelger v. Battery Park Nat'l Bank, 201 App. Div. 515, 194 N.Y. Supp. 582 (App. Div. 1922) (issuer dishonored a draft drawn for part of the credit and repudiated, as the court interpreted its language, the remainder, for the stated reason that the customer had so requested; this, said the court was virtually a repudiation of the sale contract; the court also held that tender of documents for the remainder of the credit was excused by the repudiation); Foglino & Co. v. Webster, 244 N.Y. 516, 155 N.E. 878 (1926) (on repudiation the issuer was held liable for the difference between market and contract prices; the beneficiary still had the goods).

by the amount of the draft less the proceeds of sale of the goods.[134] Recovery of incidental expenses has been permitted.[135] The usual burden of mitigation has been said to rest on the beneficiary.[136] Anticipatory repudiation[137] has been held to mature a cause of action against the issuer.

Washington law: There appears to be no significant Washington case.

Washington practice: Washington banks expect an issuer which wrongfully dishonors or repudiates a credit to be liable for the amount of the credit less the value of the documents (and of any goods controlled by the documents). Refinements and ramifications of this basic proposition have not developed.

Critique: The uncertainties concerning the basic theory of the irrevocable letter of credit, which were discussed with § 5-103 and § 5-105, greatly complicate an attempt to arrive at a logically consistent common-law pattern of remedies for a presenter. The issuer has promised to pay money, not to buy goods or documents. Is this promise a virtual acceptance or other type of unilateral contract, a bilateral contract, an option, or an offer for a bilateral contract? If it is a unilateral contract the promise, having been paid for, logically would support an action for the full amount promised. How to handle the fact, where it exists, that there are goods still in the presenter's control, would then become a problem. If the issuer's promise is a unilateral contract, there is also serious theoretic difficulty in applying the anticipatory breach doctrine. If the credit is only an offer, repudiation would be only a revocation. If the credit is an option, is a proffer of documents an acceptance and what is the appropriate remedy for repudiation? If the credit is a bilateral contract between issuer and beneficiary, damages would be much affected by the contemplated exchange and whether the beneficiary had or had not performed when the issuer's

[134] Second Nat'l Bank v. Columbia Trust Co. 288 Fed. 17 (3rd Cir. 1923) (in issue was the inclusion of interest; this the court approved because the demand was for an amount ascertainable by simple computation); Maurice O'Meara Co. v. National Park Bank, 239 N.Y. 386, 146 N.E. 636 (1925).

[135] De Sousa v. Crocker First Nat'l Bank, 23 F.2d 118 (N.D. Cal. 1927) (reversed on another ground in 27 F.2d 462 (9th Cir. 1928)). In Border Nat'l Bank v. American Nat'l Bank, 282 Fed. 73 (5th Cir. 1922), *cert. denied,* 260 U.S. 701 (1922) storage and reselling expenses were allowed below and not contested on appeal.

[136] Maurice O'Meara Co. v. National Park Bank, 239 N.Y. 386, 146 N.E. 636 (1925).

[137] Foglino & Co. v. Webster, 244 N.Y. 516, 155 N.E. 878 (1926). In Mendelson v. Wechsler, 203 N.Y. Supp. 197 (Sup. Ct. 1924), concerning what the court describes as a transaction analogous to a letter of credit, the obligor argued that the anticipatory breach doctrine was inapplicable because the contract was unilateral; this the court met by the flat statement, "the contract . . . was bilateral."

breach occurred. In short, the various ideas which from time to time have been advanced to explain the nature of an irrevocable credit produce chaos when translated into terms of remedies.

Were it agreed that the credit is a contract, the issuer's promise being at once obligatory because based on mutual assent running between customer and issuer and supported by the customer's promise as consideration, the damages problems would not vanish. Irrevocable credits may be clean or documentary. If documentary, the documents may or may not have value. In the typical transaction the documents will actually represent the goods which were to be paid for by the issuer's performance. Yet the documents are but conditions to the issuer's duty to pay. Should the damages formula always be that applied to debts, the documents (if any) being deemed security, or should the damages formula be that applicable in a sale contract, where the underlying transaction is a sale? The former would be more logical. The latter would often be more practicable. The unique characteristics of the credit are again apparent here. So far as other jurisdictions are concerned, nothing has really been settled by the few cases which have so far been decided. Assurance about the range of damages-liability incurred by an issuer can come in a jurisdiction like Washington only from cases, which might not appear for years, or by a statute. The enactment of this subsection would be a desirable solvent for the present uncertainties about remedies.

On the merits, the section seems sound. In case of dishonor the presenter is given an election between proceeding on the draft with the documents as collateral to be surrendered when the judgment is satisfied, or recovery of the difference between the amount of the credit and the worth or net resale value of the goods. Neither the money-debt analysis nor the sale-contract analysis is adopted completely. The resulting flexibility will probably enhance the commercial utility of credits, without creating any undue risks for issuers. The extreme variety of the transactions in which credits are now used must produce an extreme range of problems for beneficiaries and other presenters when the issuer wrongfully dishonors. The very fact that the presenter will in one transaction be the beneficiary or his agent and in the next one be a negotiating bank suggests that a rigid damages formula would be unwise.

In case of repudiation the section with seeming inconsistency demands adherence to the sale-contract theory (including mitigation

through resale of the goods) if the beneficiary is informed of the repudiation in time to avoid procuring the documents. Reflection suggests that this limited application of the mitigation principle is quite justifiable. Procuring the documents will ordinarily involve expense which will be an economic waste in light of the repudiation. This circumstance justifies the more restricted damages formula. Once the documents have been procured the balance shifts, and the issuer may properly be required to undertake the trouble of liquidating the documents or goods if the presenter so elects.

In permitting immediate suit on an anticipatory breach the section coincides with the position of most American courts, including the Washington court.[138]

The section does not expressly refer to a confirming bank. Since § 5-107(2) provides that a confirming bank, as to the credit, "becomes directly obligated . . . as though it were its issuer," the word "issuer" as used in § 5-115 evidently encompasses a confirming bank.

Section 5-116. Transfer and Assignment

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

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

(a) the assignment is ineffective until the letter of credit or advice of credit is delivered to the assignee, which delivery constitutes perfection of the security interest under Article 9; and

(b) the issuer may honor drafts or demands for payment drawn under the credit until it receives a notification of the assignment signed by the beneficiary which reasonably identifies the credit involved in the assignment and contains a request to pay the assignee; and

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[138] See Shattuck, *Contracts in Washington, 1937-1957; Part III*, 34 WASH. L. REV. 467, 483 *et seq.* (1959).

(c) after what reasonably appears to be such a notification has been received the issuer may without dishonor refuse to accept or pay even to a person otherwise entitled to honor until the letter of credit or advice of credit is exhibited to the issuer.

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

UCP—Article 49 provides as follows: "A transferable or assignable credit is a credit in which the paying or negotiating Bank is entitled to pay in whole or in part to a third party or parties on instructions given by the first beneficiary.

"A credit can be transferred only on the express authority of the opening Bank and provided that it is expressly designated as 'transferable' or 'assignable'. In such case the credit can be transferred once only (that is to say that the third party or parties designated by the first beneficiary are not entitled to retransfer it), and on the terms and conditions specified in the original credit, with the exception of the amount of the credit, of any unit price stated therein, and of the time of validity or of shipping, any or all of which may be reduced or curtailed. In the event of any reduction in amount or unit price, a transferor may be permitted to substitute his own invoices for those of the transferee, for amounts or unit prices greater than those set forth in the transferee's invoices, but not in excess of the original sum stipulated in the credit, and upon such substitution of invoices, the transferor may draw under the credit for the difference between his invoices and the transferee's invoices.

"Fractions of a transferable or assignable credit (not exceeding in the aggregate the amounts of the entire credit) may be transferred separately provided partial shipments are not excluded, and the aggregate of such transfers will be considered as constituting only one transfer of the entire credit.

"Authority to transfer a credit includes authority to transfer it to a beneficiary in another place whether in the same country or not, unless otherwise specified. (In the United States, when credits are transferred to a beneficiary in another place whether in the same country or not, the credits may be changed from one requiring payment on or before a certain date to one requiring negotiation on or before that date, and

during the validity of the credit as transferred, payment or negotiation may be made at the place to which the credit has been transferred.)

"Bank charges entailed by transfers are payable by the first beneficiary unless otherwise specified.

"No transfer shall be binding upon the Bank which is to act thereunder except to the extent and in the manner expressly consented to by such Bank, and until such Bank's charges for transfer are paid."

Article 46, *Proposed Revision,* covers the same ground, with some changes in language.

Article 49 is ambiguous and there is no means now available for finding certain answers to the obvious questions which arise concerning its meaning. *Eriksson v. Refiners Export Co.,* which is discussed in note 139 *infra,* appears to be the only American case in which the article was in issue. The phrase "transfer a credit," which is the keystone of the article, is unclear. The beneficiary can transfer only a contract right, not a "credit." Does the article purport to forbid assignment of the right to the honor of drafts even though the beneficiary himself satisfies all conditions, or does it forbid only an assignment under which the assignee is expected to meet some or all of the conditions? The phraseology of the article poses the same problem as does the general phrase "assign a contract," which often leaves delegation of the duties of the "assignor" in dispute.

The first paragraph of the article, in the words "entitled to pay" and "instructions," is foreign to the thinking of American lawyers about the assignment process. Does the article really mean the issuer can but is not under a duty to pay the assignee? Is the assignment "instruction" enough or must the assignee produce something additional?

The second paragraph is obscure. It appears to demand both a recital, in the credit, of assignability, and a supplementary "authority" as well. Such a combination does not square with the American concept of "consent to assignment." (The *Proposed Revision* omits the "express authority" requirement).

The present law—In general: Cases in which assignment of rights under a credit was in issue are few in number, unsatisfactory in analysis, and diverse in result.[139] In a majority of states, a contract

[139] In support of assignment is Old Colony Trust Co. v. Continental Bank, 288 Fed. 979 (S.D.N.Y. 1921) (complaint alleging issuance of credit, its assignment to the plaintiff, acquisition by plaintiff of drafts drawn by the beneficiary, and "that the conditions of the letter of credit were carried out and performed by the plaintiff," was

held not demurrable; the court said the credit was in effect a promise to accept a draft and that such a contract is not personal; no attention was paid to the conditions, and the issue of personality involved in meeting them).

Also of interest in this connection is Kingdom of Sweden v. New York Trust Co., 197 Misc. 431, 96 N.Y.S.2d 779 (Sup. Ct. 1949), in which the court in discussing the duties of a confirming bank to the customer, indicated approval of the commercial practice known as "back to back" credits. This is an arrangement whereby a confirming bank or other bank in the seller's vicinity issues a second credit naming the seller's supplier as beneficiary, the original credit being taken as collateral. The original credit can become collateral only on the basis of an assignment. The court in the *Kingdom of Sweden* case gave no emphasis to the fact that the beneficiary had assigned and that the confirming bank had disbursed part of the credit-proceeds to the assignee. The case, in approach and reasoning, seems in conflict with Eriksson v. Refiners Export Co., *infra*, insofar as the opinion there discusses the legal situation apart from article 49 of *UCP*.

Also interesting is Pintel v. K.N.H. Mohamed & Bros., 107 Cal. App. 2d 328, 237 P.2d 315 (Dist. Ct. App. 1951), in which title to a draft drawn by the beneficiary was held to have passed to a negotiating bank. Although the law of Ceylon, so holding, was held to apply, the court also said that no different result would be reached under the law of California. The court mentioned the fact that the credit contained a promise to holders of drafts, although the relevance of this detail is not manifest. Eriksson v. Refiners Export Co., *infra*, was distinguished on the stated ground that the credit there in litigation prohibited transfer. The occasion for examining the *Ericksson* case in this context is obscure. It would seem that ownership of the draft raises issues quite foreign to the problem of the issuer's duty.

Transactions in which the issuer's promise runs to a negotiating bank do not, so far as the promisee is concerned, involve any assignment issues. See *e.g.*, Belton Nat'l Bank v. Armour & Co., 11 F.2d 929 (5th Cir. 1926) (the point in controversy was interpretation of the credit, to ascertain whether the plaintiff, a negotiating bank, was a promisee).

Opposed to assignment are: Eriksson v. Refiners Export Co., 264 App. Div. 525, 35 N.Y.S.2d 829 (App. Div. 1942) (assignee of draft drawn against a credit which incorporated *UCP* by reference sought to defeat an attachment levied on the proceeds of the credit in the issuer's hands by a creditor of the beneficiary; the draft was drawn by the beneficiary and the conditions were evidently met by it; the credit did not mention holders of drafts; the court said a letter of credit is not assignable and cannot be transferred by assignment of a draft; *UCP* article 49 was referred to with approval as a further reason for the result but received no detailed discussion; in concluding that it forbade an assignment under which the beneficiary drew the draft and met all conditions, the court assumed an interpretation of *UCP* article 49 which it may or may not merit); cited in the *Eriksson* case opinion was Evansville Nat'l Bank v. Kaufmann, 93 N.Y. 273 (Ct. App. 1883) ("guaranty" by defendant that drafts drawn by *B* on *C* would be paid was held not to create an enforceable right in plaintiff, which discounted a draft drawn by *B* on *C*; one reason given for the result was the fact the guaranty was addressed to *B*, rather than to the world at large; this explanation seems obviously unsupportable, since plaintiff held a conforming draft drawn by *B* and should have prevailed as *B's* successor if *B* could have prevailed; it should not be necessary for a holder of such a draft to make itself out to be either an offeree or a contract obligee; *cf.* Pintel v. K.N.H. Mohamed & Bros., *supra*.). Also of interest is a dictum in State Nat'l Bank v. Young, 14 Fed. 889 (C.C.D. Neb. 1883) (a promise to honor drafts drawn by Dawson & Young would not, said the court, require honor of a draft drawn by Dawson alone). Different are transactions in which a prospective buyer of goods promises *X* to honor drafts drawn on the buyer by his seller, and *Y*, having negotiated conforming drafts, asserts rights under the promise. See *e.g.*, Lyon v. Van Raden, 126 Mich. 259, 85 N.W. 727 (1901) and Fletcher Guano Co. v. Burnside, 142 Ga. 803, 83 S.E. 935 (1914). These cases deny the promisor's liability to *Y* and seem properly decided. The analogy here is much closer to an ordinary offer of suretyship than to a modern commercial letter of credit. An extension of credit to the drawer-seller is contemplated and requested, and the result may be explained by reference to the basic proposition that only the offeree can accept a simple offer. On similar reasoning Bank of Buchanan County v. Continental Nat'l Bank, 277 Fed. 385 (8th Cir. 1921) is understandable. There a bank promised another bank to honor drafts drawn by seller on buyer, and it was held that a third bank, having negotiated the seller's draft, acquired no rights against the promisor.

clause prohibiting assignment of a right created by the contract will be enforced.[140]

Washington law: There appears to be no letter of credit case involving assignments. A prohibition of assignment will be valid.[141]

Washington practice: Washington banks expect *UCP* article 49 to regulate transfers of the right to draw under documentary credits and appear to be unaware of the ambiguities implicit in it. As interpreted by them, the article means that only drafts drawn by the named beneficiary must be honored. It will be recalled that *UCP* is incorporated in documentary credits by reference.

Since a documentary credit as used by a Washington bank will ordinarily include a promise running to holders of drafts, it is expected that a holder will be entitled to honor without regard to the fact that he acquired the draft by negotiation. Nothing approaching a "practice" has developed in connection with a documentary credit which does not contain a promise running to holders of drafts. Documentary credits containing an express assignment-authorization are rarely used. Absent an express authorization of assignment, Washington banks do not expect to honor where documents are procured by an assignee. On the other hand, they do not object to an assignment by the beneficiary of the proceeds, provided a written assignment signed by the beneficiary is in the hands of the bank.

Washington banks do not contemplate legal liability under a clean credit such as a traveler's bill to anyone save the named beneficiary and a bank to whom he has negotiated a draft. There has been insufficient experience with an attempt by the beneficiary of a clean credit to "assign" rights, to have produced any "practice" with regard to such departures from the norm.

Critique: Despite considerable help by writers[142] the legal area

[140] 4 CORBIN, CONTRACTS §872 *et seq.* (1951); 3 WILLISTON, CONTRACTS § 422 (3rd ed. 1960).

[141] Levinson v. Linderman, 51 Wn.2d 855, 322 P.2d 863 (1958); Indemnity Insurance Co. v. Nelson, 173 Wash. 294, 22 P.2d 984 (1933); Boyd v. Bondy, 113 Wash. 384, 194 Pac. 393 (1920); Lockerby v. Amon, 64 Wash. 24, 116 Pac. 463 (1911); Bonds-Foster Lumber Co. v. Northern Pac. Ry. Co., 53 Wash. 302, 101 Pac. 877 (1909); Behrens v. Cloudy, 50 Wash. 400, 97 Pac. 450 (1908).

[142] McGowan, *Assignability of Documentary Credits,* 13 LAW & CONTEMP. PROB. 666 (1948); Harfield, *Secondary Uses of Commercial Credits,* 44 COLUM. L. REV. 899 (1944); Note, *Revised International Rules for Documentary Credits,* 65 HARV. L. REV. 1420, 1430 (1952); Mentschikoff, *Letters of Credit: The Need for Uniform Legislation,* 23 U. CHI. L. REV. 571 (1956); Ufford, *Transfer and Assignment of Letters of Credit Under the Uniform Commercial Code,* 7 WAYNE L. REV. 263 (1960); FINKELSTEIN: LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT, 142 (1930); WARD AND HARFIELD, BANK CREDITS AND ACCEPTANCE 156 (4th ed. 1958).

covered by this section remains extraordinarily obscure. The need for statutory clarification is correspondingly great.

Part of the difficulty stems from the absence of consensus concerning the proper analysis of the credit. Differing transfer principles appertain to offers, options, contract rights to receive money, and contract rights qualified by conditions the satisfaction of which involves a substantial quantum of personal effort or supervision.

So long as the present analytic uncertainties exist as to credits, the development of any consistent body of case law about assignments is not to be expected.

Even though a credit is analysed as a contract promise, as it presumably should be, there remain serious questions about assignability. The issuer's promise is to honor drafts. The beneficiary is a promisee. Often the issuer's promise runs also to any bona fide holder of a draft drawn under the credit. Despite artificial language obscuring this detail, the typical credit can readily be interpreted as a promise to honor drafts drawn by the beneficiary. The presentation of drafts drawn by the beneficiary would accordingly appear to be a condition. Documentary credits will also contain references to various documents, the presentation of which are conditions. The credit will not in so many words say who is to procure the documents but it seems fairly evident that in general the beneficiary is expected to do so, either personally or by an agent under his supervision. It is apparent that the typical credit must be interpreted before any progress can be made toward answers to assignment problems, and that there is room for disagreement in individual transactions as to who is to draw the drafts and procure the documents.

If the credit receives the suggested interpretation, can the beneficiary assign his "right?" Technically, the only right he has to assign is a right to have the issuer's performance, which is, in turn, payment or acceptance of a draft or drafts. Since the basic assignment principle to which most American courts will routinely adhere is that nonpersonal contract rights can be assigned, save where the contract forbids assignment, it would seem that the beneficiary can certainly assign unless his right is "personal" or prohibited by the contract. Since the issuer's performance will neither be varied nor made more burdensome if rendered to an assignee, it is difficult to see any valid "personal-right" basis for invalidating an assignment. A transferee who presents a conforming draft drawn by the beneficiary and conforming documents

procured by the beneficiary should always prevail, in the absence of a prohibition of assignment.

Attempts by the beneficiary to invest his transferee with the power to meet the conditions are in essence attempts to delegate. Although "delegation" is more commonly encountered in a duty context, it being the endeavor of an obligor to discharge his duty by a performance rendered by another person, the same personal element can inhere in the conduct requisite to satisfying a condition.[143] Whether there is such a personal element in letter of credit conditions is the key question. So far as documents are concerned, the answer would seem to be in the affirmative. Honest documents are the heart of a documentary credit. The character, standing and reputation of the beneficiary are the only assurance the customer and issuer have that bills of lading are not forged, that shipping containers bear goods which conform to the sale contract, that insurance policies are genuine, that documents bear true dates, and so forth. If the beneficiary procures the documents it probably makes little difference who draws the drafts and the personal element involved in meeting this condition in a documentary credit is arguable. If the credit is a clean one, another factor becomes significant. Here the principal risk of embarrassment for the issuer will be in the failure of negotiating banks to comply with the notation requirement and in the drawing of successive drafts which exceed in amount the limit of the credit. To a considerable degree the character of the beneficiary determines the seriousness of this risk. It follows that the issuer ought not be bound to honor drafts drawn by a successor of the beneficiary.

In any type of credit, express authorization of delegation will no doubt be legally effective. Express authorizations phrased this way seem to be rare. More common is an express authorization of "assignment" by the beneficiary. Such an authorization may or may not be intended by the issuer to include delegation as well as assignment.

If the credit incorporates *UCP* article 49 or otherwise purports to forbid "assignment," the critical language must first be interpreted. It may, in its context, be found to forbid delegation, not assignment. If assignment is forbidden, the legality of the prohibition must be considered. It is a restraint on alienation and should fail unless it meets the usual "reasonableness" standard. A majority of American juris-

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[143] 4 CORBIN, CONTRACTS § 865 at 443, n.14 (1951); 3 WILLISTON, CONTRACTS § 411 at n.20 (3rd ed. 1960).

dictions have, however, sustained prohibitions of assignment without helpful discussion of the reasonableness of the prohibition. The wisdom of so doing is far from certain where the obligation is a simple duty to pay money or honor a draft. It may be doubted that the obligor can actually meet a reasonableness test. Presumably a credit-clause forbidding assignment will receive the treatment accorded such restraints in other types of contract in the jurisdiction.

The language of § 5-116 is not at all points ideal. The phrase "right to draw" used in subsection (1) is unclear. Whether a beneficiary has any such right is arguable. The issuer's promise is to honor drafts, not that the beneficiary can draw drafts, and the promisee's right would appear to be measured by the promise. The critical question is whether the subsection gives a transferee the delegated power to satisfy all conditions, and this question is not directly answered. Since the subsection otherwise has no effect it probably means "the beneficiary can transfer his right to have the issuer honor drafts, and can delegate to such transferee the power both to draw drafts and to satisfy all conditions having to do with documents, provided the credit contains an express recital of assignability." This reading is supported by the Official Comment. It produces a result in harmony with *UCP* article 49, with the existing practice, and with the theoretic analysis suggested above. It does not, however, answer questions about partial or successive assignments. If a credit states that it is assignable, does this permit several assignments of parts so that a sum which would otherwise be encompassed by one draft is now sought to be split up and handled by several drafts? Does it permit an assignee to re-assign? Neither detail is resolved in the section.

The omission of any express reference to these problems in the subsection may mean that they are left for resolution under the common law. If so, partial assignments sought to be enforced with appropriate procedural safeguards protecting the obligor's interest will be operative,[144] and a contract term forbidding partial assignments will no doubt be effective. There is no common law principle forbidding re-assignment. A contract term purporting to prohibit re-assignment would be effective or not, depending on the court's handling of the legality issue presented in this kind of restraint on alienation.

It will be recalled that *UCP* article 49 forbids re-assignment and

[144] 4 CORBIN CONTRACTS § 889 (1951); 3 WILLISTON, CONTRACTS § 441-443 (3rd ed. (1960).

approves partial assignments. If a credit authorizes "assignment" and also incorporates the *UCP* article, a conflict would result for which there is no obvious solution.

The phrase "right to proceeds" used in subsection (2) is unclear. Before conditions are met the beneficiary has no immediate right to the issuer's performance. He therefore has no right to receive money or to have drafts accepted, and the word "proceeds" is troublesome. Apparently the subsection is intended to permit an assignee to acquire from the beneficiary a right against the issuer to have drafts drawn by the beneficiary honored if the beneficiary satisfies all other conditions, even though the credit purports to forbid such an assignment. This interpretation is supported by the Official Comment. So read, the subsection conforms to the theoretic analysis suggested above, but departs from the existing law in most jurisdictions, including Washington, and from the existing practice, in invalidating a restraint on this type of assignment. It also departs from the law in a few states in permitting an assignment where the beneficiary is to draw drafts and meet conditions. These departures from the present law and practice appear to be entirely sound. There is no legitimate purpose to be served in prohibiting the type of assignment permitted by the subsection, as every reasonable objective of both customer and issuer are protected. Not only must all conditions be met, but they must be met by the beneficiary. On the other hand, the subsection makes legally sound the practice of issuing credits back-to-back, an operation which is now unsafe in many states unless the issuer expressly authorizes the assignment. A secondary credit makes the original credit more useful to the beneficiary without in any material way diminishing the safeguards needed by the issuer. The fate of a useful commercial transaction of this kind ought not to be left to the whim of the issuer of the original credit.

Whether a beneficiary can make partial assignments despite a recital of nonassignability in the credit is unclear. A statutory right to assign the proceeds does not necessarily encompass a right to carve the contract interest into parts. See the following paragraph also, as to partial assignments. Whether an assignee of "proceeds" can re-assign in the face of a credit-clause forbidding assignment is debatable. The words "the beneficiary . . . may . . . assign" arguably excludes assignment by an assignee. The purpose of the subsection may well be achieved even though the assignee is denied a right to re-assign. It will be noted that

the re-assignment prohibition set out in *UCP* article 49 is a limitation on an express authorization. Whether it would create an operative agreed-on limitation of a statutory right to assign created by § 5-116(2) is obscure.

The special provisions of subparts (a) through (c) of subsection (2) appertain only to assignments in which the assignee is ultimately to get the money whereas the beneficiary is to meet conditions. This conforms to the scheme of *UCC* article 9, which covers security and financing assignments only.[145] In their details these provisions are generally clear enough. The requirements that the credit be delivered to the assignee and exhibited to the issuer, however, have obvious possibilities for trouble where the credit contemplates multiple and successive drafts. Just how the credit in practice can make the geographic moves exacted by the subsection is far from clear. These requirements would appear to discourage partial assignments. The way in which the subsection handles the familiar successive-assignment problem, created by an obligee's fraudulent attempt to sell his right to more than one person, is both interesting and sensible.

Subsection (3) infers the obvious proposition that a beneficiary cannot rightfully negotiate drafts, after an assignment, to one other than the assignee. It states, perhaps unnecessarily, the right of a beneficiary to negotiate drafts. Since the draft will be drawn by the beneficiary, negotiation falls within subsection (2) even though it be seen as a kind of proceeds-assignment.

Section 5-116 deals with problems of considerable practical importance which are singularly difficult to resolve in the present state of the law. Despite the unfortunate obscurities in language which were discussed above, enactment of the section would clarify and improve the law. The section cannot and does not attempt to do more than create a legal environment in which assignments can be taken with assurance. The business problems will continue to be acute. Unless the assignee can control the development of the transaction in such a way as to insure the satisfaction of all conditions to the obligor's duty, a conditional right is a hazardous kind of collateral. Banks which issue back-to-back credits are well aware of this fact, and can often exercise the requisite degree of control.

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

[145] Section 9-104 (f).

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

(a) to the extent of any funds or collateral turned over after or before the insolvency as indemnity against or specifically for the purpose of payment of drafts or demands for payment drawn under the designated credit, the drafts or demands are entitled to payment in preference over depositors or other general creditors of the issuer or bank; and

(b) on expiration of the credit or surrender of the beneficiary's rights under it unused any person who has given such funds or collateral is similarly entitled to return thereof; and

(c) a charge to a general or current account with a bank if specifically consented to for the purpose of indemnity against or payment of drafts or demands for payment drawn under the designated credit falls under the same rules as if the funds had been drawn out in cash and then turned over with specific instructions.

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

UCP—The *UCP* has no coverage.

The present law—In general: This is, again, an area in which there are but few cases, not all harmonious in approach and result. It has been held that the receiver of a failed issuer can be required to accept the customer's payment and hold it in trust for the holders of accepted drafts.[146] An issuer which failed after accepting a draft and debiting

[146] Greenough v. Munroe, 53 F.2d 362 (2d Cir. 1931) *cert. denied*, 284 U.S. 672 (1931) (the receiver tried without success to persuade the court that the seller was paid under the sale contract when he received the credit; the court also stressed the impropriety of permitting the receiver both to default the drafts and collect from the customer). A similar decision is In re Canal Bank & Trust Co.'s Liquidation, 178 La. 575,

the customer's checking account, at the same time crediting "Prepaid Acceptances," has been held to be a "bailee or trustee" of a fund equal to the amount so debited and credited. The beneficiary or bailor was the holder of the draft.[147] An issuer which failed and dishonored a draft has been denied recourse against the customer, who paid the draft "for honor supra protest."[148] The essence of these decisions is segregation of the letter of credit transaction from the checking-account and general-lending parts of the issuer's business. The issuer's insolvency has not been permitted to inflict loss on either customer or beneficiary to the gain of the issuer's general creditors. There are, on the other hand, two cases which took a different approach in refusing to permit the customer to recover a deposit made to indemnify the issuer, which thereafter failed.[149]

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

Washington practice: It is the custom of Washington banks to segregate cash collateral in a special letter of credit reserve account. Where such collateral is provided by means of a debit against the customer's general checking account, the charge is actually made against the account, rather than by merely placing a hold on it. Property collateral is of course always segregated. Washington banks which negotiate time drafts drawn under credits expect to be more than general creditors if the issuer fails. Beyond these details, there does not appear to be any relevant "practice."

Critique: The language of the section could be more clear. Inclusion of advising banks is puzzling, since such a bank assumes, under § 5-107(1), no obligation save responsibility for the accuracy of its advice. The phrases "allocation of funds or collateral," "funds or collateral turned over," and "any person who has given such funds or

152 So. 297 (1933). See also Annot., *Rights and remedies of parties to letter of credit or draft issued thereunder upon insolvency of bank issuing letter before payment of the draft*, 80 A.L.R. 803 (1932).

[147] Shawmut Corporation v. William H. Bobrick Sales Corp., 260 N.Y. 499, 184 N.E. 68 (1933). By way of dictum, the court said that the holder of the draft would be but a general creditor of the issuer if the customer had not paid.

[148] Bank of United States v. Seltzer, 233 App. Div. 225, 251 N.Y. Supp. 637 (App. Div. 1931) (failure of consideration for the customer's promise to reimburse the issuer was the stated ground, citing Leslie v. Bassett, 129 N.Y. 523, 29 N.E. 834 (1892) and Bassett v. Leslie, 123 N.Y. 396, 25 N.E. 386 (1890). The *Bank of United States* case is noted in 31 COLUM. L. REV. 1358 (1931).

[149] Taussig v. Carnegie Trust Co., 156 App. Div. 519, 141 N.Y. Supp. 347 (App. Div. 1913) (a traveler's credit was involved; the court cited Kuehne v. Union Trust Co., 133 Mich. 602, 95 N.W. 715 (1903)). Whether the *Taussig* case would be similarly decided now is made speculative by Bank of United States v. Seltzer, 233 App. Div. 225, 251 N.Y. Supp. 637 (App. Div. 1931).

collateral" are not models of precision. Read against current practices the section evidently contemplates that an issuer which receives either cash collateral, a cash deposit to cover an expected draft or draft maturity, or property collateral cannot both retain the collateral or deposit, and dishonor drafts. This general purpose accords with the later and better reasoned decisions. The section gives the presenter a prior claim to the extent of such collateral or deposit, but accords him no preferential treatment where no such collateral or deposit has been made. Subsection (1)(b) is consistent with this approach, in recognizing the customer's prior claim. Subsection (1)(c) is a needed counter to a technical trust fund argument which might deny "collateral" classification to a transfer of funds made by a book entry debiting the customer's checking account. Similar provision is made for a confirming bank and a bank which procures another bank to issue a credit, which seems sound. In either situation the bank will occupy, as to beneficiary and ultimate customer, a position which justifies segregation of the letter of credit transaction.

The section does not purport to deal with the right of an insolvent issuer against the customer for reimbursement. The strength of the arguments supporting the customer who resists a reimbursement claim made by an issuer which has defaulted on the credit is such that the result reached in the cases cited at note 146 above seems generally expectable.

Despite the use of the phrase "the insolvent bank" in subsection (2), it seems certain that the section covers nonbank issuers. In state court receiverships of such issuers, the section will apply. But priorities in bankruptcy liquidations are governed by the federal *Bankruptcy Act*. Applicability of the section in the event of this type of liquidation is doubtful, depending on interpretation of it as creating substantive property rights rather than priorities. There is a similar difficulty in the case of national bank liquidations, which will not be affected by state legislation purporting to govern priorities.[150] Conforming amendments of the pertinent federal legislation would accordingly be a desirable supplement to state enactment of the *Uniform Commercial Code*.

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[150] Excellent discussions are to be found in Neidle and Bishop, *Commercial Letters of Credit: Effect of Suspension of Issuing Bank*, 32 COLUM. L. REV. 1 (1932); Campbell, *Guaranties and the Suretyship Phases of Letters of Credit*, 85 U. PA. L. REV. 261, 262 (1937). See also Note, *Recourse against the Buyer in a Letter of Credit Transaction*, 40 HARV. L. REV. 294 (1926); WARD AND HARFIELD, BANK CREDITS AND ACCEPTANCE 236 *et seq.* (4th ed. 1958). *Cf.* FINKELSTEIN, LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT, 150 n.13, 159 n.36 (1930).

Although the section falls short of perfection it will serve a useful purpose in Washington. The theoretic difficulties encountered in analysing the positions of the interested parties when the issuer becomes insolvent are formidable,[151] and prediction of the outcome of litigation in a jurisdiction which has no case law is most difficult. The section will bring some order into the area.

CONCLUSION

Any assumption that *UCP* provides a reasonably coherent and comprehensive regulatory system would appear to be ill-founded. *UCP* provides no coverage of clean credits, is in various particulars incomplete, and is in others ambiguous. Moreover, there is no assurance that upon incorporation by reference in a credit it will always be legally effective.[152] Despite its deficiencies and the fact that it alone is a totally inadequate basis for letters of credit, *UCP* can be a useful supplement to Article 5. Particularly helpful are the *UCP* provisions concerning the standards by which the conformity of documents is to be determined. Nothing in Article 5 forbids the incorporation of *UCP* into documentary credits. Article 5 at several points uses the phrase "unless otherwise agreed," while § 1-102(3) states broadly that the *Act* "may be varied by agreement" save for the obligations of "good faith, diligence, reasonableness and care." At the few points of actual conflict between them, *UCP* will control if incorporated into a credit, with one possible exception. § 5-116(2) forbids a restraint on transfer by a beneficiary of his right to proceeds and this prohibition cannot be varied by drafting. If *UCP,* which is unclear on this detail, purports to forbid an assignment of proceeds it would yield to *UCC.* Improvements of *UCP* will no doubt be promulgated from time to time and these too can be effectively incorporated into credits so long as *UCP* does not attempt to relieve issuers of the duties of good faith and care which are stated in § 5-109.

Most of the legal problems which can grow out of a modern commercial letter of credit transaction have not reached the Washington court nor the courts of most of the states. Even in New York the number of firm, square holdings is surprisingly small, save on the one fundamental point that the demands of a credit are conditions. There

[151] Jennings v. United States Fidelity & Guaranty Co., 294 U.S. 216 (1935).

[152] See Shattuck & Guernsey, *Letters of Credit. A Comparison of Articles of the Uniform Commercial Code and the Washington Practice* 37 WASH. L. REV. 325, 326 n.7, 357 n.63 (1962).

are more than enough cases testing the conformity of a particular set of proffered documents. These cases have limited value as precedents, insofar as they turn on fact issues.

Washington issuers and users of credits and their counsel must now steer their way through the legal phases of letter of credit transactions by a combination of guesswork, hope, and, possibly, prayer. That this must be said of so important a commercial device is indeed astonishing. Fees are modest, averaging ⅛ of 1%. There are impressive opportunities for development, particularly in the area of domestic trade.[153]

The elimination of legal uncertainties will help maintain the present fee schedule, encourage banks and their customers to find broader uses for credits, and provide the drafting and planning base which counsel must have if credits are to go through future periods of sharply breaking prices and general economic upheaval without inducing burdensome controversies and litigation between issuers and customers or issuers and presenters. Article 5 of the *Uniform Commercial Code* provides a good many of the needed legal guide posts. This is not a perfect statute. It is a workable one, and a great improvement over the existing Washington situation.

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[153] See Mentschikoff, *Letters of Credit: The Need for Uniform Legislation*, 23 U. CHI. L. REV. 1, 571 (1956); Comment, *Recent Extensions in the Use of Commercial Letters of Credit*, 66 YALE L.J. 902 (1957).