Why not Uniform Commercial Code Article 5 ? : Some Aspects of Fundamental Principles of Letter of Credit

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1933年に誕生し1951年に一部改訂された ICC の「商業荷為替信用状に関する統一規則」は，最近の国際貿易の著しい発展にともない再び改訂の必要に迫られ，既に改訂案も公表されて1963年4月開催の ICC メキシコ総会において採択される予定となっている。そして今回は EEC への加盟問題をもかかえる英国が，自国の判例や慣習に固執する態度をやめて改訂統一規則を採択する用意があるとの画期的な態度をうちだしているため，この統一規則の権威性がさらに高められるであろうことは疑いない。しかしながらこの統一規則は法的拘束力を有しないこともあって，米国では統一商法典の第五章に信用状に関する法規を含ましめようとの努力がなされてきたが，これに対し，特にニューヨーク所在銀行は信用状制度の flexibility が破壊されることをその主たる理由として強硬に反対の立場をとった。その結果は米国の重要な商業州において統一商法典がほぼそのままの形で州法に採択されたにもかかわらず，ニューヨーク州のみは実質上信用状に関する第五章を骨抜きのものとすることになっている(本文脚註7参照)。何故にニューヨーク州は第五章をそのように扱ったのか。はたして第五章は flexibility を喪失させるものであるのか。これが本稿において解明しようとする点である。そして本稿の後半では統一商法典第五章中問題となりそうな重要な規定を個々的に取上げて，米法上もその妥当なことを証明することに主力を注いだ。

Yale Law School に昨年フルブライト留学生として籍をおいた期間私は Gilmore 教授の御指導を得る機会を得たが，丁度その頃恩師である伊沢孝平先生の還暦記念論集の発刊の予定をきき，先生の学位論文が「商業信用状論」であることもあってこれこそ先生にお捧げするに好適のテーマと考え準備したのが本稿である。最初本稿は邦文で発表する予定であったが，同じく信用状に深い関心を抱かれる州立ワシントン大学の Shattuck 教授と伊沢教授との日米商業信用状取引に関する共同研究に丁度私もお手伝いさせて頂く光栄を受けることになったので，それへの一つのステップともなると考えて今回はあえて英文で発表させて頂くことにした。共同研究に関する最終の報告は，日米の実際と統一商法典第五章及び新統一規則案との関連を綜合的に取扱い，ワシントン大学ロー・レヴィユー五月号に英文で，また本学法学論集第十三巻一号以下に邦文で各々発表の予定である。恩師伊沢孝平先生が益々御壮健で法学の進化・発展のために寄与されていかれることを心からお祈りしたい。

Merit of the Codification

The function of commercial letter of credit is to finance the movement of goods and assure the seller that he will be paid. The commercial letter of credit is one of the most efficient and inexpensive methods that has yet been devised for facilitating the exchange of goods. Most foreign import and export business is financed by this convenient method. This is accomplished by substituting the acceptable credit standing of a bank for the unknown or doubtful credit standing of the buyer.

A commercial letter of credit is a bank's promise to accept drafts or pay money, provided, in most cases, there is a presentment to it of certain documents described in the letter. In almost all cases it is written by a bank at the request of buyer of merchandise. It is directed to the seller, and it assures him that he can rely on the credit of the bank in addition to the credit of the buyer. In banking business sense the buyer is the "customer", the bank promising to honor drafts is the "issuer" and the seller is the "beneficiary". The issuer will sometimes notify the beneficiary directly that a credit has been opened, but normally it will call upon a branch or correspondent bank in the beneficiary's country to notify him.[1] The notification form is the "letter of credit", and where the notice is given by a correspondent bank it is called the "notifying" or "advising" bank. Frequently the correspondent bank will be asked to "confirm" the credit. When a credit is confirmed, the correspondent bank is called the "confirming bank" and its confirmation renders it liable to honor drafts drawn by the beneficiary. Under a confirmed letter of credit, the beneficiary has rights against both the issuer and the confirming bank. The confirming bank, of course, has a right of reimbursement against the issuing bank.

The advantages of letter of credit financing are considerable to both buyer and seller. The buyer benefits from the fact that the device is inexpensive[2] and efficient and from the fact that he is dealing with a local (issuing) bank which knows and trusts him. Normally after the issuing bank has paid the drafts drawn by the beneficiary and has received the documents which control the goods, the goods are turned

1. Sometimes the customer will be authorized to notify the beneficiary, but this is rare. See, Note, *Letters of Credit Under the Proposed Commercial Code: An Opportunity Missed*, 62 Yale L.J. 227, 229, ftn. 10 (1953).

over to the buyer on trust receipts. In such a case the buyer's working capital is not encumbered and he can pay his obligation to the issuer out of the proceeds derived from the sale of the goods. Moreover, the fact that the seller must deliver specified documents befor he is entitled to payment, reduces greatly the risk that buyer is "purchasing a lawsuit", for the documents assure the buyer that the goods have been shipped and apparently conform to the contract. The seller likewise benefits from the use of the letter of credit. Firstly, it greatly reduces his risk of non-payment, for he has the promise of a bank or banks that he will be paid, rather than merely the promise of the buyer. Secondly, a draft backed by a letter of credit is readily discountable, and this means that the seller easily is able to obtain payment immediately upon shipment of the goods. Finally, methods have been developed which permit the beneficiary to transfer the benefits of a letter of credit, and this enables the seller to use the device to finance the production of the goods. "Thus the seller, in effect, often uses the buyer's line of credit to finance a transaction from which both will benefit." [3]

Two legal and economic facts dominate letter of credit financing. The first is that the banks which issue, advise or confirm letters of credit are financial institutions and not merchants. They deal in documents and not in merchandise. The bank's liability to the beneficiary is a direct liability, and the bank is not an agent for the customer in any regard. The matter can be summed up by stating that the letter of credit is a contract independent of the sales contract between the buyer and seller. If the terms of the letter of credit are satisfied, the issuing bank is liable to the beneficiary, notwithstanding the fact that the latter may

2. The Yale Law Journal survey indicates that letters of credit may cost as little as one-tenth of one percent of the face amount of the draft, and for confirming a letter of credit as little as one-twentieth of one percent. The survey found that "The cost will depend, among other factors, on (1) the credit standing of the buyer; (2) the nature of the bank's duties—whether typical or requiring additional functions; (3) the nature of the trade; (4) distances and countries involved; (5) the duration of the credit; and (6) the amount of credit." Yale L.J. *op. cit.*, 233, ftn. 28; See also, Harfield, *Trade Without Tears, or Around Letters of Credit in 17 sections*, 1952 Wis. L. Rev. 298, 299 *et seq.* (1952) ("…the documentary credit is cheap. The issuing bank may, and frequently does, engage its credit for a year for a commission of one-eighth of one percent.").

3. Yale L.J. *op. cit.*, 233.

have breached the underlying sales contract by shipping defective goods. Conversely, non-performance by the buyer, caused by insolvency or otherwise, does not excuse the issuer or confirming bank from performing the letter of credit contract. Because banks are isolated from the underlying sales contract for the very convincing reason that their function is only to finance the sale and not to otherwise participate in it, letters of credit can be written cheaply.[4] This is the second fundamental fact of letter of credit financing. The inexpensiveness of the letter of credit is due largely to the fact that banks are not called upon to assume any risks with respect to the performance of the sales contract. This divorcement has permitted them to do letter of credit business in a standardized, streamlined manner, for their undertaking requires only the receipt, examination and payment against documents.

The efficiency of the work of the banks with respect to letters of credit would not be possible without rules of law and practice which are internationally understood and accepted. A leading New York bank lawyer, Mr. Harfield, puts it this way:

> It is apparent that the business (letter of credit) can only be done if the letter of credit device is standardized, and streamlined and made as mechanical as possible. The letter of credit, as presently conceived and used, is not substitute for the sales contract, nor for an insurance policy, nor for the precautions which a prudent and experienced merchant ought to take. It is plain cheap food, and not a miracle drug. In concept, it could be made to be a luxury article, but in practice it is a mass production article, and unless it is to be priced out of existence, it must be a mass produced article. Mass production articles need simple, standard parts with very few trimmings. So the vital and vigorous commercial letter of credit business requires simple, standard, easily applicable rules which are internationally understood and accepted.[5]

Such rules do exist, but not as rules of law. Most of the commercial nations of the world have accepted a tabulation of customs and practices in the letter of credit field which has been compiled by the International Chamber of Commerce. This comprehensive tabulation is called the "*Uniform Customs and Practice for Commercial Documentary Credits*".

4. Yale L.J. *op. cit.*, 233; Izawa, Commercial Letters of Credit, rev. ed. (1958) 370.

5. Harfield, *op. cit.*, 300; See generally, Ward and Harfield, Bank Credits and Acceptances, 4th ed. (1958), 169 *et seq.*

American bankers adopted these rules in 1938. In 1951 the rules were revised at the Thirteenth Congress of the International Chamber of Commerce, and adherence to the revised rules was given by American banks in 1952.[6] The "*Uniform Customs and Practices for Commercial Documentary Credits*" does not have the force of law. It has not been adopted by treaty or by local legislation. Nevertheless, this tabulation does represent a fairly successful effort by bankers to govern themselves and the international field by means of consensual regulation.

Other rules, comprising the substantial basis of the law of letters of credit in the United States rest in the decisional law of contracts derived in part from the law merchant but absorbed into the common law. The number of dcisions in this field, however, is small in relation to the number and variety of transactions involved and their economic and financial importance.

Article 5 of the *Unifom Commercial Code* prepared and submitted by the American Law Institute and the National Conference of Commissioners on Uniform State Laws is an attempt to establish uniform rules for letters of credit.[7] Article 5 is not intended to be a comprehensive statute. Instead it attempts to state basic principles, leaving to custom, agreement and decisional law many details, and especially the tests for determining conformity of documents to the letter of credit prescribing them. Most of Article 5 is proposed as a statute declaratory of present law. Other provisions appear to be intended to resolve doubts, to settle conflicts of authority or of opinion, or write into "law" what are now mere contractual rules embodied in the *Uniform Customs and Practice* and subject in most cases to adoption or rejection by the parties.

6. The *Uniform Customs and Practice for Commercial Documentary Credits* were codified in 1933 by the Seventh Congress of the International Chamber of Commerce (Brochure No. 82) and received formal acceptance by many countries. During the intervening years, however, there have been many new developments, and some practices, either new or variations of the old have appeared. The International Chamber of Commerce has therefore prepared a revised text (Brochure No. 151). The purpose of this revision of the *Uniform Customs and Practice* is to codify the customs and practice as they now exist. The International Chamber of Commerce submited this revised text for adoption to the Banking Associations in the various countries and recommended that it should as far as possible be put into force by the banks uniformly on the 1st of January 1952. Brochure No. 151 of International Chamber of Commerce (38, *Cours Albert-1er; Paris-8e*).

It has been urged, however, that Article 5 should be eliminated from the Code. The reasons advanced for the elimination of Article may be briefly summarized as follows: (1) there is no real demand or need for Article 5; the letter of credit business is operating smoothly under the set of rules set forth in the statement of *Uniform Customs and Practice*;[8] (2) the enactment of Article 5 will have the effect of placing a strait jacket on a credit device whose nature requires that it be flexible;[9] and, (3) particularly in international transactions, its enactment may cause confusion because Article 5 will not be in effect in the countries of some of the parties who are parties to the letter of credit transaction (conflict of laws problem).

The principle criticism of Article 5 has been made by the New York Law Revision Commission:

> The Commission doubts whether any codification of the law of documentary letters of credit is needed. The great usefulness of the letter of credit device stems largely from its flexibiliy. Most letter of credit transactions, moreover, take place in international trade. The desirable objective of uniformity, both

7. Since the *Uniform Commercial Code* has been enacted in eighteen states, Alaska, Arkansas, Connecticut, Georgia, Kentucky, Illinois, Massachusetts, Michigan, New Hampshire, New Jersy, New Mexico, New York, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, and Wyoming, it is in actuality the "present law" in those jurisdictions. In New York (1962) which occupy the most important position in letters of credit business not only in the United States but in the world, however, Section 5-102 (1) was enacted with a deviation from the text as promulgated by the sponsors of the *Uniform Commercial Code;* that Article 5 of the Code will not apply to a credit which "is by its terms or by agreement or by custom subject in whole or in part to the *Uniform Customs and Practice for Commercial Documentary Credits* fixed by the Thirteenth or by any subsequent Congress of the Internation Chamber of Commerce……" This remarkable deviation would be allowed to presume that the contention for the elimination of Article 5 from the Code had finally succeeded to pursuade the legislature to reach the same effect. See the forthcoming discussion.

8. Same line of the opinion: Bankers' Association for Foreign Trade, Stenographic Report of Hearing on Art. 5 of the *Uniform Commercial Code*, April 20, 1954, State of New York Leg. Doc. (1954) No. 65(D) 20; Special Committee on the *Uniform Commercial Code* of the Commerce and Industry Association of New York, Inc., New York Leg. Doc. *op. cit.*, 8.

9. Same line of the opinion: New York State Bar Association on the *Uniform Commercial Code*, State of New York Law Revision Commission Legislative Document (1954) No. 65(J) 47, 155; Mr. G. Russell Clark (Manager, New York Clearing House), State of New York Leg. Doc. *op. cit.*, 21.

> nationally and internationally, is now obtained to a high degree by decisional law and commercial usage. Legislation in such a field even if it purports to be declaratory of existing law, should not be adopted unilaterally by American jurisdictions unless the need for it in the enacting jurisdictions is so great as to override considerations of flexibility and of present and future international uniformity. As the present New York law on the subject is on the whole satisfactory, the Commission does not believe that such need has been shown.[10]

Mr. O'Halloran, Vice President, Manafacturers Trust Company, member of subcommittee of the New York Clearing House Association, also puts the criticism in this way, representing the subcommittee:

> It would seem impracticable, if not impossibie, to provide for the disposition of such varied and complex problems by means of statute. The letter of credit is a delicate instrumentality. Such large sums are involved and transactions are conducted in such great degree by cable or business letter that any factor which would serve to disrupt or make difficult the common understanding and reliance which is so essential to this field would seriously imprair the usefulness of the device and the world-wide acceptability of New York letters of credit. We feel strongly that legislation here would be a disruptive factor in that it would bind New York banks and parties to rules not necessarily accepted or understood abroad or, if understood and accepted abroad today, might not be accepted abroad as trade practices and customs develop. We see no need for legislation in this field which although it involves billions of dollars annually touches only a limited area of the population, primarily banks, exporters and importers, factors and brokers, who are thoroughly familiar with the device and with customs and usages here and abroad. Since letters of credit involve, in the main, international and interstate transactions, involving a number of parties, and institutions, we believe that the opportunities for conflicts of laws, and for misunderstandings and controversies between parties, would be greatly augmented by attempted legislation in this field by one or more states in this country, and that the ability of banking institutions in such states to furnish this important service to world-wide trade and business would be seriously impaired.[11]

It might be true that the existing letter of credit practice, as embodied in the *Uniform Customs and Practice* and similar documents, is satisfac-

10. State of New York, Legislative Document (1956) No. 65(A) 36 *et seq.*
11. State of New York, Leg. Doc. *op. cit.* in ftn. 8, 74.

tory and is reasonably responsive. However, how we make those rules really applicable in the event of dispute, by what contract, by what acceptance by the parties to the dispute, lies in the field of considerable obscurity. Of course, perhaps due to the meagerness of the law in this area in the United States, the *Uniform Customs and Practice* has been of great importance. At the same time, these rules not only present strong evidence of the customs and practice in this field, but in a great number of cases, they are incorporated in whole or part into the letter of credit agreement. Still they are not and do not purport to be laws. They have the equivalent effect only if and to the extent that they are incorporated as contractual terms into the transactions of the parties.[12] It must be noted here clearly that a good deal of the law in this field is what the bankers consider the law to be, not that the bankers necessarily have any case law to guide them or any statute to guide them, but since it is a very restricted field, and since they are the ones that operate in it, they therefore assume that what they do is the law. A rather unusual field of the law exists here, whereby a businessman considers this to be law and it becomes law.[13] I will take Mr. Chadsey's words:

> The absence of that litigation, I think - to the commercial community, comprising merchants and bankers, in any event - is a situation devoutly to be desired but I do not think that it springs from the sweet reasonableness of bankers or of their customers, but I think it arises, rather, from the existence of a self-imposed set of rules which fortunately have worked very well.[14]

The advocates for the elimination of Article 5 from the Code states that where such practical uniformity exists, there seems no need for an independent legislative statement of the rules. However, when we peep into details, these rules are rather curious instruments in themselves. They represent an attempt to find a common ground between somewhat

12. But according to Prof. Schlesinger's statement at the hearing, there are quite a lot of banks which do not manifestly insert in their letters of credit the reference clause to the *Uniform Customs and Practice*. See, State of N.Y. Leg. Doc. *op. cit.* in ftn. 8, 71 *et seq.* Under such a situation, whether by implication the *Uniform Customs and Practice* would be applied to such letters of credit is completely an important problem.

13. Daniel Gersen, Leg. Doc. *op. cit.* in ftn. 8, 73.

14. Leg. Doc. *op. cit.* in ftn. 8, 56.

conflicting national practices, and between confusing phrases which were peculiar to different languages, and the translation had a tendency not to lend themselves to a clear interpretation. They are combination of statements of principles, assertions of intent, definition of terms, a rather curious conglomeration which, in their entirety, make up a working manual by chance.[15] There has been left to the *Uniform Customs and Practice* those aspects of practice which seem to be in the shape of a working manual. But to state the basic philosophy or principles of the letter of credit, which would not affect at all to the flexibility of the device, is rather important to build up the basis concrete on which daily transactions be done safely.

In the areas where the Code does touch it, the business is done now on a basis of common understanding and common usage, which develops by freedom of contract between the parties as trade practices and trade customs develop. I think that an attempt to stipulate rights, to stipulate which bank can do something and which bank cannot, that an attempt to say what a letter of credit can say and what it cannot say, all has a hampering effect on what trade practices and customs as they develop may require.[16] And only those basic principles have been codified which it seemed worth while making available to the commercial community in a readily ascertainable form, that community being the merchant, the banker and the lawyer. Mr. Chadsey, Vice President, First National Bank of Boston, states at the hearing, as his own belief, that out of the customs, the essence of the legal philosophy, the hard core of the legal principle that is applicable to letters of credit, has been distilled and restated in the *Uniform Commercial Code.* Flexibility is preserved and it makes these basic principles available to the whole community in a form which is easily ascertainable and easily understandable.[17] I agree that there has been no insistent clamor for such legislation, but the well established principles deserve to be made available in statutory form, ascertainable and understandable to the commercial community generally, as contrasted with the surprisingly limited segment of that community to which these matters are now familiar. Mr. Chadsey also puts this in this way:

15. Chadsey, Leg. Doc. *op. cit.* in ftn. 8, 58.
16. Haberkern, Leg. Doc. *op. cit.* in ftn. 8, 76.
17. Chadsey, Leg. Doc. *op. cit.* in ftn. 8, 56 *et seq.*

> Out of some 14,000 commercial banks in the United States, only about 100 have any letter of credit business of consequence, and of this 100 probably 25 account for three-fourths of the volume. Any step toward expanding the availability of authoritative standards in this field would not seem to run counter to the public interest.[18]

Subsection 5-102(3) of the Code addresses itself to the basic question of whether or not codification of the law of letters of credit desirable. It answers the question affirmatively, but with a caveat: Codification is desirable to the extent and only to the extent that it does not stultify the development of this important financial device. The subsection is aimed at preventing stultification by specifically providing that Article 5 does not cover the whole field of letters of credit and that there is room for growth in the areas not specifically regulated by the article. Thus Article 5, as official comment 2 makes clear, expresses "only the fundamental theories underlying letters of credit."[19] Other sections of Article 5 also allow and encourage growth of letter of credit law by

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18. Leg. Doc. *op. cit.* in ftn. 8, 9; also see the Report of Public Hearing, Stat of New York Leg. Doc. (1954) No. 65 I 14 *et seq.*, McLaughlin, *The Letter of Credit Provisions of the Proposed Uniform Commercial Code*, 63 Harv. L. Rev. 1373 (1950).

The Special Commission to Investigate and Study The *Uniform Commercial Code* of the State of Massachusetts believed the Article 5 will accomplish the following intended purposes which are desirable: (1) that it will enlarge the utility of the letter of credit mechanism, particularly for domestic financing;(2) it will serve to prevent litigation which might develop in the absence of statute; and (3) it will tend to prevent development of case law along inconsistent lines. See, Report of the Special Commission to Investigate and Study the *Uniform Commercial Code* of the State of Massachusetts, January, 1954 House No. 2400, 19 Majority Opinion.

J.P. Beal said in his article, though it relates primarily to the standardization of forms, "Checks, drafts and notes have been standardized on uniform lines—why not letters of credit? The uniform bills of lading adopted by the railroads of the country have materially assisted both the shippers and the carriers in a more thorough understanding of the conditions and protection afforded to each." See, Beal, *Utility of Letters of Credit in the Export Trade-A Plea for Standard Forms*, The Bankers Magazine, Aug. 1917, cited from Ward and Harfield, *op. cit.* in ftn. 5, 170.

19. The existing and developing case law and banking practice is intended to supply detailed provision. See, 1956 Recommendations of the Editorial Board of the *Uniform Commercial Code*, Sec. 5-102.

20. See, Sections 5-103, 106, 107, 110, 111, 113, 114, and 116.

permitting variation by agreement.[20] Because of this flexibility Mr. Harfield has stated:

> The letter of credit instrumentality and its usefulness depends upon in large measure upon its flexibility and adaptability to many kinds of transactions and developing trade practices in this country and abroad. I hope, and in large measure I believe, that Article 5 is so broad in its statements of law and so confined in its scope to fundamental principles that, if enacted, it would not operate to restrict the development of the letter of credit business.[21]

Not even the most ardent proponents of Article 5 of the Code claim that every one of its sections is perfect. Rather, it is claimed that the article is as perfect as its draftsmen have been able to make it. They point to the obvious advantage of having all the basic rules of letters of credit stated in one place as rules of law. And, they claim that the article is workable and sound.[22]

> The practical effect of the Code's Letter of Credit Article on members of the commercial community—bankers, merchants and their counsel-is this; If heretofore they have been conducting their operations in accordance with widely accepted American practice, they may continue to do so in the future with the assurance

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21. Letter of Mr. Henry Harfield to the N.Y. Law Revision Commission dated May 24, 1954, Leg. Doc. *op. cit.* in ftn. 8, 32.

On this point of flexibility, the following part at the hearing would be interesting :

Mr. Bartels: Mr. Haberkern, suppose we simply adopted the *Uniform Customs and Practice* of the International Chamber of Commerce, as they now are, and made that Article 5. What would you think ?

Mr. Haberkern : We would be very much opposed to it. As Mr. Chadsey has said, the *Uniform Customs* deal with very meticulous operating details of the letter of credit business, for the most part, and those do change. We are up now to the 13th Congress revision, and I would suppose that one can look forward to revisions every three or four years, as time goes on.

Mr. Bartels: You say it shouldn't be frozen at any point ?

Mr. Haberkern: That is right, sir.

See, Leg. Doc. *op. cit.* in ftn. 8, 78 *et seq.*

Possibly the subsection 5-102 (3) is intended to mean that custom may be used in the interpretation of provisions of the Code but not to vary their terms and that custom is to be applied where the Code is silent. There is no reason the application of Section 1-205 (usage of trade) of the Code should be omitted.

22. See, generally, K. N. Llewellyn, *Brief Statement on Article 5*, dated August 16, 1954, Leg. Doc. *op. cit.* in ftn. 8, 5.

> of some statutory support. The situation is as simple as that because the article makes no attempt to revolutionize established letter of credit practice as it exists in the United States, but simply codifies it.[23]

To the extent that one can evaluate the past and predict the future, not only by the American bankers but by the foreign bankers who are dealing with the American bankers, it would appear that Article 5 is sound, workable and therefor desirable.[24] Almost all of the fundamental essence of the principles which are shown in Article 5 are in accordance with the understanding in Japan and in European countries, especially in Germany and in France.[25] I can hardly stand for Mr. O'Halloran's criticism against Article 5 that by the attempted legislation the ability of banking institutions in the United States and the world-wide acceptability of New York letter of credits would be seriously impaired by the conflict of laws problem. So far as I could judge from various documents appeared to the public, the reluctant attitude of New York bankers toward the codification of the fundamental rules of letter of credit seems to me that they just do not want to lose their face, that they just desire to maintain their dignity that they are the ones who have been controling and policing this useful device, but nothing else. To state those principles in a form of a statute on the American side would surely help to avoid unnecessary confusion on our side. There is much to gain and little to lose by incorporation into the provisions relating to letters of credit.[26]

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23. Chadsey, *Practical Effect of the Uniform Commercial Code on Documentary Letter of Credit Transactions*, 102 U. of Pa. L. Rev. 618 (1954).

24. See, Harfield, *op. cit.* in ftn. 2, 303; Grant Gilmore, *The Uniform Commercial Code : A Reply to Prof. Beutel*, 61 Yale L. J. 364 *et seq.* (1952) ; Statement at the hearing by Mr. Leslie Jacobson (Member of the International Business Relations, Committee of the American Arbitration Association and of the Committee on International Commercial Arbitration of the International Chamber of Commerce), Leg. Doc. *op. cit.* in ftn. 9, 113.

25. See generally, Izawa, *op. cit.* in ftn. 4.

Mr. Harfield takes it warranted that the existing practice relating to letters of credit is substantially uniform among the 48 states. See, Leg. Doc. *op. cit.* in ftn. 8, 33.

26. See, Chester B. McLaughlin, *The Letter of Credit Provisions of the Uniform Commercial Code*, 63 Harv. L. Rev. 1173 *et seq.* (1950).

Particular Provisions of Article 5

The following study will be aimed to prove the soundness of some of the most important provisions in this article. The study will be chiefly concerned with a comparison of the Code and the existing law and practice in the United States. The provisions of Article 5 are shown at the last part of this paper for convenience.

a. *Time of Establishment of Credit* (5-106)

Article 5 of the *Uniform Customs and Practice* provides that "Irrevocable Credits are definite undertakings by an issuing bank and constitute the engagement of that bank to the beneficiary or as the case may be, to the beneficiary and bona fide holders of drafts drawn thereunder that the provisions for payment, acceptance or negotiation contained in the credit, will be duly fulfilled provided that the documents or as the case may be, the documents and the drafts drawn thereunder comply with the terms and conditions of the credit... Such undertakings can neither be modified nor cancelled without the agreement of all concerned." The Code's prohibition against modification or cancellation without agreement is more specific, since it has reference not to "all concerned" but to all parties as to which it has been established. Subsection (1) of this section makes it clear that the credit may become established with reference to the beneficiary at a different time from its establishment with relation to the customer. Thus, under this Code, it is possible for the customer to cancel or modify a credit without procuring consent of the beneficiary if such attempted modification takes place after the credit has been established in favor of the customer but before it has been established in favor of the beneficiary.[27]

Subsections 5-106(1)(a) and (b), however, are not precisely in accord with general bank practice. Bankers consider that their credits or confirmations become binding at the time the documents are mailed or the confirmations are cabled.[28] The only case on the question holds that

27. *Penna. Annotations to the Proposed Uniform Commercial Code*, A Report of the Subcommittee on the Proposed *Uniform Commercial Code* of the Joint State Government Commission of the Genral Assembly of the Commonwealth of Penna., Sept. 1952.

28. Statement of Mr. O'Halloran, Leg. Doc. *op. cit.* in ftn. 8, 46 *et* 55; Letter of Mr. Harfield, *id.* 22 *et seq.*

mailing rather than receipt is the determinative moment for establishing the credit.[29] The *Uniform Customs and Practice* is silent on the point, but it has been contended that the practice of treating the credit as established at the time of mailing is "substantially universal."[30]

Although banks treat credits as being established at the time of transmission to, and not at the time of receipt by, the beneficiary, they frequently countermand the credit by intercepting it before it reaches the beneficiary. On this matter and on the reasons behind the changes made by the Code, the opinion of Mr. Chadsey seems most instructive:

> In the ordinary case no question of cancellation or modification of a credit does arise until long after the credit has been both mailed or cabled and received, so that there is usually no alternative to obtaining the beneficiary's consent before any change can be made in the terms of an irrevocable credit as issued. It could happen, however, that within a few hours after mailing or cabling, the bank's customer, or the issuing bank itself, might desire to change some term. Then it would become a question of whether the advice to the beneficiary could be intercepted. Several possibilties are present : (a) If the issuer had dispatched its cable to a correspondent bank (the ordinary practice) - a second cable might arrive in time to forestall

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

30. See, statement of Mr. Roy Haberkern, Leg. Doc. *op. cit.* in ftn. 8, 55; but see, Izawa, *op. cit.* in ftn. 4, 254: Credits are established at the time of receipt by the beneficiary; same in Germany.

Prof. Schlesinger made the question whether the underlying assumption that the mailing establishes the letter of credit, is really borne out to be reliable authority, and the hearing is as follows, Leg. Doc. *op. cit.* in ftn. 8, 55:

Mr. Haberkern: I know nothing today to the contrary.

Prof. Schlesinger :* * * I have tentatively come to the conclusion that under existing law a mailing does establish the credit. In other words, the conclusion to which Mr. O'Halloran seems to come. But I am troubled by the fact that authority on the point is exceedingly thin.

Mr. Haberkern: The practice is substantially universal, I believe, which is a powerful weapon in this field.

Prof. Schlesinger : In other words, you would say, then that the practice supports the legal argument that mailing establishes the credit.

Mr. Haberkern: I think that the practice is so well established is one reason probably why there has been no question or so few questions about it legally.

It would be very interesting to know from the hearing banker's strong confidence toward their way of practice. This might be one of the causes which made New York bankers object against the codification.

notification of the first cable's terms to the beneficiary ; (b) If the credit had been mailed by the issuing bank to a correspondent for delivery to the beneficiary — a cable could easily anticipate its arrival and prevent its delivery ; (c) If the credit had been cabled or mailed by the issuing bank directly to the beneficiary—then no means would probably exist of preventing its receipt by the beneficiary, and in such a case dispatch of the cable or letter would appear to have become constructive receipt for purposes of irrevocability. In this situation, however, a neat question would arise should it later develop that the letter had never arrived or that the cable company had failed to deliver the message. It would appear, therefore, that the emphasis in the Code upon abtual receipt by the beneficiary is of real significance.[31]

Under the rules of subsections 5-106 (1) (a) and (b), however, it might be difficult for an issuing bank to know if its credit has been engaged in a situation in which it has attempted to intercept or countermand a letter of credit which had been sent previously to the beneficiary. It may be difficult to show whether the letter of credit or the cancellation reached the beneficiary first ; thus it will not know whether it can be cancelled or modified without the beneficiary's consent. The New York Law Revision Commission, therefore, found that the Code had put the issuing bank in an " unenviable position " and hinted that letter of credit business could not be carried on in an atmosphere of so much uncertainty.[32]

But this would seem to overstate the case against the subsections. It must be remembered that the credit is established as against the

31. Leg. Doc. *op. cit.* in ftn. 8., 11 *et seq.*

Mr. Henry Harfield thinks it a better rule to provide that a credit is established with respect to all parties concerned when the instrument or authorized written advice of it is dispatched. On the other hand, however, he cocognizes the virtues in having the obligations bite down only when the creditor authorized advice is received by the beneficiary. Even though he thinks his discomfort about this section is greatly alleviated by the fact that it permits variations by agreement it seems to me there exists some contradictions in his discussion on this point. See, Leg. Doc. *op. cit.* in ftn. 8, 22 *et seq.*

The Official Supplement No. 1 (1955) to the *Uniform Commercial Code*, 152, says: The time of receipt rather than the time of sending as establishing credit was deliberately chosen after consideration of the same arguments as are made in support of the suggested change.

32. New York Law Revision Commission Report on the *Uniform Commercial Code* (1955), 54 *et seq.*

customer as soon as "an authorized written advice . . . is sent to the beneficiary." At this point of time the bank should consider its credit engaged. If the customer or bank wishes to countermand an irrevocable credit, this may be done under the subsections until the beneficiary "receives" the letter of credit. The burden of proving that a credit is countermanded should be placed on the person who contends that a countermand has been effected. Under this view of the Code the bank is not in an "unenviable position". Where the customer wishes to countermand a credit, the bank may be under a duty to carry out the instructions.[33] But this is not an onerous duty, and the bank is fully protected. It should be able to treat the credit as engaged until the customer proves that the countermand was effective. Until this proof is forthcoming, the bank should be under no obligation to release any collateral which it holds as security for the customer's duty to reimburse and it should be able to honor drafts drawn in accordance with the credit. The weakness of the subsections, if any, would seem to be their failure to spell-out explicitly the rules governing burden of proof and the like which must be read into them to make their provisions fully just and efficacious. But it is not defect at all.

There is also an inquiry as to the "purpose of establishing the credit as to the customer." Mr. O'Halloran states:

> In the ordinary course, a credit is not delivered to the customer and it is difficult to see the purpose of establishing the credit as to the customer.[34]

A very fine reason in response to it seems to me quite apparent. It prevents the issuing bank from revoking.[35] Mr. Chadsey's reasoning on this point seems completely sound:

> (a) It is quite possible, and in fact by no means uncommon, for the issuing bank to turn the original letter of credit over to the customer in order that he may himself forward it to the beneficiary.
>
> (b) Even when the dispatching of the credit is undertaken by the issuing bank, some copy of the instrument or advice of its issuance or some other evidence of the issuer's having complied with the customer's request to issue a credit and of the consequent effectiveness of the customer's corresponding obligation to the issuing bank must, it would seem, certainly be

33. See, Sec. 5-109 of the Code.
34. Leg. Doc. *op. cit.* in ftn. 8, 46.

delivered to the customer.

Once wither of these actions had been taken, the customer's consent would be required before any withdrawal or concellation of an irrevocable credit could be effected. The issuing bank might in fact repent of having issued the credit within a few hours of such issuance and it might be capable of intercepting the advice to the beneficiary by the mechanism earlier discussed. But at that point a question would arise as to the right of the customer in the situation and it would become essential to determin at what stage the issuing bank ceased to be a free agent so far as this customer was concerned.[36]

b. *Issuer's Obligation to Its Customer; Issuer's Duty and Privilege to Honor; Right to Reimbursement* (5-109, 5-114)

Subsection 5-109(1)(a) states a basic principle of letter of credit financing, namely that the issuer is not responsible for the performance of the underlying sales contract. Bankers are not engaged to assure that the customer will perform his duty but accepting its independent duty towards the beneficiaries.[37] The other subsections of 5-109 also state

35. Another reason for the purpose of establishing the credit as to the customer would be to prevent the customer from cancelling. This is why 1958 *Uniform Commercial Code* provides that a credit is established as regards the customer as soon as letter of credit is sent to him or the letter of credit or an authorized written advice of its issuance is sent to the beneficiary, 5-106 (1) (a). The 1955 drafts provided that a credit is established as regards the customer when it is received by the customer. And there had been a criticism that it might be desirable to amplify Section 5-106 by providing that the credit is established with respect to the customer, "as soon as the letter of credit or a copy or other advice of establishment thereof is delivered to him." See, Leg. Doc. *op. cit.* in ftn. 8, 23. Official Comment of the *Uniform Commercial Code* (1958) puts the explanation in this way: "The primary purpose of determining the time of establishment of an irrevocable credit is to determine the point at which the issuer is no longer free to take unilateral action with respect to the cancellation of the credit or modification of its terms. So far as the customer is concerned this point of time is reached when the issuer 'sends' the credit or when its authorized agent, the advising bank, sends the advice of the credit to the beneficiary. Since the sending is pursuant to an agreement between the issuer and the customer, it is the issuer's performance of the first stage of the contract and under Section 5-107(4) the risk of transmission is on the customer." See, *Uniform Commercial Code* Section 5-106, Official Comment, Purposes 1.

36. This problem would be quite apart from that which would exist, were a request for a change in the credit terms to come from the beneficiary a request which of course the issuing bank could not grant without obtaining the customer's consent. Chadsey, Leg. Doc. *op. cit.* in ftn. 8, 12.

the usual understanding with respect to the bank's duty of good faith and care. The primary obligation of an issuer is to examine documents with normal banking care to determine whether or not on their face they appear to comply with the terms of the credit.[38] If the documents appear to be regular, the issuing bank may honor the complying draft and be entitled to reimbursement from its customer, even if the documents have been forged.[39] Article 12 of the *Unifom Customs and Practice* is in accord with subsection 5-109(1)(b).

The requirement that the issuer must honor drafts meeting the terms of the credit codifies present commercial understanding with respect to the outstanding feature of the letter of credit. One of the fundamental principles of letter of credit financing is that the letter of credit contract is independent of the sales contract and "in documentary credit operations, all parties concerned deal in documents and not in goods." Therefore, the first sentece of subsection 5-114(1) states a fundamental rule.[40] The practice is to require the bank to examine the documents to see whether they conform to the credit, but not to examine the goods or to inform itself as to performance of the underlying contract.[41]

37. See, *e.g., American Steel Co. v. Irving National Bank*, 266 Fed. 41, 43 (2d Cir. 1920), *cert.* denied, 258 U.S. 617 (1922); *Jones & Co. v. Bend*, 191 Cal. 551, 217, 725 (1923); *Old Colony Trust Co. v. Moss*, Mass. 139, 140 N.E. 803 (1923); Yale L.J. *op. cit.* in ftn. 1, 250, ftn. 115. See also, Art. 1 of the *Uniform Customs and Practice. Sussman & Sons v. National Union Bank of America*, 62 N.J.L.J. 117 (1940).

38. See, Art. 9 of the *Uniform Customs and Practice.*

39. See *Havemeyer & Co. v. Exchange National Bank*, 293 Fed. 311 (8th *Cir.* 1923). Yale L.J., *op. cit.* in ftn. 1, 252, ftn. 122. Izawa, *op. cit.* in ftn. 4, 310. Art. 11 of the *Uniform Customs and Practide.*

40. See, Art. 1 of the *Uniform Customs and Practice; Old Colony Trust Co. v. Moss, op. cit.* in ftn. 37, 805. *Kingdom of Sweden v. New York Trust Co.* (1949), 96 N.Y. S. (2d) 779; "Unless express conditions are contained in the letter of credit, the performance of the sales contract is not a condition percedent of the credit or of the buyers' agreement to reimburse. The letter of credit is a wholly independent contract." Also see, *Overseas Trading Corp. v. Irving Trust Co.* (1948), 82 N.Y.S. (2d) 72.

41. See Art. 9 of the *Uniform Customs and Practice; Bank of Italy v. Merchants' National Bank*, 236 N.Y. 106, 140 N.E. 211 (1923) (Issuer not required to honor draft under credit for "dried grapes" where bill of lading for "raisins" presented with draft; implication that bank need not make inspection of goods to determine whether these items are same); *Laudisi v. American Exchange National Bank*, 239 N.Y. 234, 146 N.E. 347 (1924) (Bank paying draft

Subsection 5-114(1) only states one of the fundamental rules and does not solve the difficult problem as to what documents meet terms of the credit, whether invoice description conforming to terms of letter is sufficient or whether bill of lading, in general terms, need only be

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accompanied by documents complying with language of credit not liable to customer who notified bank that goods did not conform to underlying sales contract); *Second National Bank of Hoboken v. Columbia Trust Co.*, 288 Fed. 17 (C.C.A. 3rd 1923).

In *O'Meara Co. v. National Park Bank of New York* (1925), 239 N.Y. 386; 146 N.E. 636. (See a note hereon in 34 (1925) Yale L.J., 775), the defendant bank issued an irrevocable letter of credit in which it agreed to pay sight drafts "covering a shipment of 1322 2/3 tons of newsping paper in 72 ½ in. and 36 ½ in. rolls to test 11 - 12, 321 b.," on presentation of certain specified documents. When the drafts for the goods shipped were presented with the documents required by the letter of credit, the bank refused to pay on the ground that neither the beneficiary under the letter of credit, nor the plaintiff (his assignee), had presented evidence "reasonably satisfactory" that the paper referred to in the documents accompanying the drafts was of the tensile strength specified in the letter of credit. The Court (Cardozo and Crane, JJ., dissenting) (Cardozo, J.'s judgment is set out in Finkelstein, Legal Aspects of Commercial Letters of Credit (1930) 229) held that the defendant had no right to insist that a test of the tensile strength of the paper should be made before paying the drafts, nor did it even have the right to inspect the paper before payment to determine whether it in fact corresponded to the description contained in the documents. All that the letter of credit provided was that documents should be presented which described the paper shipped as of a certain size, weight, and tensile strength. This was done, and the defendants were therefore under an obligation to pay the drafts.

In *O'Meara Co. Case* there was merely a lack of evidence that the paper referred to in the documents was of the quality specified in the letter of credit, but the same conclusion was reached in a latter case — *Continental National Bank v. National City Bank of New York*, (1934), 69 F. (2d) 312, when the bank knew that the goods were below standard. The facts were as follows : the Continental National Bank issued a letter of credit covering a cargo of cement. The letter of credit called for the usual shipping and consular documents and contained a provision which read : "Cement to be of sound merchantable quality and standard of same shall meet with the requirements of the American Society for Testing Materials." The documents which came forward in due course corresponded to those specified in the letters of credit and included in addition a document entitled "Certificate of Quality." The bank refused to honour the draft accompanying these documents, which had been purchased by the plaintiff bank, on the ground of lack of conformity of the goods to those specified. The plaintiff contended that, as the issuer of a letter of credit is bound to accept drafts drawn under that letter when the documents presented

consistent with terms of the credit.[42]

The second sentence of subsection 5-114 (1) is novel. It provides that if a documentary draft complies with the terms of an irrevocable credit honor is not excused by reason of an additional general term that all documents must be satisfactory ; however, the last clause permits a requirement that specified documents must be satisfactory. The provision was criticized by Mr. O'Halloran in his testimony before the New York Law Revision Commission :

> The latter provision (last clause of the second sentence of subsection 5-114 (1)) seems to make meanigless the prohibition against a requirement that all documents must be satisfactory to the issuer. If the issuer can determine in its sole discretion whether or not one document is unsatisfactory, it woule hardly make any difference that it had no such power with respect to other documents.[43]

It is true that an additional general term requiring all documents must be satisfactory to the issuer is essentially repugnant to an irrevocable letter of credit. However, that is not quite the same thing as permitting an issuing bank to stipulate that with respect to some particular document, it may be essential that approval be reserved until the document can be examined. The subsection distinguishes between a general clause making all documents subject to satisfaction and a clause specifying a particular document or documents. The general provision

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conform to its terms, the question of actual conformity of the goods to the description on the documents was not material. This contention was upheld and damages were awarded against the bank. The Court said : "The defendant contends that the language of the letter before us, properly interpreted, makes shipment of cement that in fact complied with the requirements of the American Society for Testing Materials, a condition of the defendant's obligation. To accept this contention would practically undermine the general principle that the bank must honour the draft if the documents comply with the terms of the letter of credit, for any description of the goods in such a letter might quite as readily be interpreted to create such a condition. Admitting that the issuer of a letter of credit may impose such a condition if it so wishes, it should be required at least to make such an intention perfectly clear. While the clause here is slightly different from the mere description of the goods usually found in letter of credit, it is no more a condition than the specification of tensile strength in the *O'Meara Case.*" cited from, Davis, The Law Relating to Commercial Letters of Credit (2d ed. 1954), 74 *et seq.*

42. See, Yale L.J. *op. cit.* in ftn. 1, 227.

43. Leg. Doc. *op. cit.* in ftn. 8, 42 *et* 46.

tends to make the engagement to honor illusory, the specific permits use of satisfaction test what it is really required by the business needs of the situation.[44] It is possible, for example, that a certification of inspection is desird. And since the point at which inspection will take place is too remote or too small, the creditor might want to stipulate in the credit that certificate of inspection must be in a form or by an inspector satisfactory to it, an internationally well known inspector. There are plenty of cases of that sort that may arise the recognition of which will give the flexible aspect of the letter of credit transactions. It is not only the buyer who faces the risk of dishonesty or sharp practice on the part of the seller. For, in many instances, the banker looks to the goods for reimbursement of the whole or part of the amount he pays under the letter of credit. It is equally to his interests to ensure that such documents are called for by the letter of credit as will result in goods of the contract description being ultimately delivered. The buyer is not compelled to enter into the sales contract nor is the banker compelled to issue the letter of credit. If either of these contracts is entered into then it is for the buyer and the banker respectively to safeguard themselves by the terms of the contract. Otherwise they must be prepared to bear any ensuing loss.[45] It is perfectly reasonable, therefore, to allow an issuer to demand that specified documents must be satisfactory to it, because only after it has seen the instrument can it exercise reasonable judgment with respect to it. Mr. Chadsey's statement seems very constructive :

> The Code appears simple to be striving for a workable compromise between a legitimate need to examine and approve perhaps unusual documents and an effective negation of irrevocability by reason of making fulfillment subject to the issuer's discretion. At least such a requirement with respect to a specified document should come more conspicuously to a beneficiary's attention than might a general condition. The beneficiary is in the best position to determine whether the requirement that a specified document be satisfactory to the issuer is in all the circumstances reasonable. If he does not consider it reasonable then he ought not to accept the letter of credit. . . No beneficiary has ever had to accept a letter of credit that had

44. See, The Official Supplement No. 1 (1955) to the *Uniform Commercial Code*, 153.

45. See, Davis, *op. cit.* in ftn. 41, 76.

provisions in it that he did not like. Acceptance of the letter of credit is purely voluntary on his part. If he gets one that has stipulations in it that seem unfair, not capable of compliance, not in accord for that matter with his underlying contract, all he has to do is to say, "I don't like it ; I won't take it, and I won't function under it."[46]

Subsection 5-114(2)(a) resolves a division of legal and scholarly opinion.[47] Most cases seem to hold that an issuer has an option to set up its defense of fraud or forgery against any presenter except a holder in due course. Legal scholars, however, are in disagreement on the question.[48] In *Sztejn v. Schroder Banking Corp.*, 177 Misc. 719, 721, 31 N.Y.S. 2d 631, 635 (1941),

The plaintiff sued to restrain the payment or presentment for payment of drafts under a letter of credit, alleging that the document accompanying the drafts were fraudulent in that they did not represent actual merchandise. The Chartered Bank, which had taken the draft for collection, moved to dismiss on the ground that the documents on their face conformed to the requirements of the credit. The court, emphasizing the fact that the presenter was a collecting bank, which stood in the same position as the seller, refused to dismiss the supplemental complaint, but said :

If it had appeared from the face of the complaint that the bank presenting the draft for payment was a holder in due course, its claim against the bank issuing the letter of credit would not be defeated even though the primary transaction was tainted with fraud.[49]

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46. Leg. Doc. *op. cit.* in ftn. 8, 13 *et* 64. Also see, *Continental National Bank v. National City Bank of New York, op. cit.* in ftn. 41.

47. Since this problem was not treated clearly under the 1952 Draft of the Code, there was an opinion at the hearing held at the New York Law Revision Commission (1954) that; "I wish there were some clear provision which would put the financer in the position of a bona fide holder under the *Sztejn Case.* That situation presents a headache under present law and would present the same kind of a headache under Article 5", Leg. Doc. *op. cit.* in ftn. 8, 25.

48. Compare, McCurdy, *Commercial Letters of Credit*, 35 Harv. L. Rev. 539, 715, 735 (1922) (Bank must pay innocent purchaser) ; Thayer, *Irrevocable letters of Credit in International Commerce : Their Legal Effects*, 37 Colum. 1. Rev. 1326, 1335, 1342 (1937) (Bank has option not to pay even a holder in due course) ; Finkelstein, Legal Aspects of Commercial Letters of Credit (1930); 248; (At any rate, the legal principle is clear. Where the bank can show that the seller has acted fraudulently, it is under no duty to pay the seller. The bona fide purchaser, however, is entitled to be paid.)

Subsection 5-114(2)(b) is consistent with present-day law.[50] The provision with respect to injunction of payment, codifies the result of *Sztejn v. Schroder Banking Corp., Supra.*

Subsection 5-114(3) states the general understanding with respect to reimbursement.[51] The preface "unless otherwise agreed" leaves the parties free to arrange, by contract, that discharge of the customer's obligation shall take place at an earlier time than would be expected in view of the normal practice.

c. *Warranties on Transfer and Presentment* (5-111)

Subsection 5-111(1) seems in accord with existing law with respect to the obligation of the beneficiary to interested parties to see to it that there is compliance with the terms of the credit. Existing law, however, has developed mainly around a fact situation in which the beneficiary has received payment by tendering spurious documents. Under such facts, the courts have had little difficulty in finding the beneficiary liable for repayment.[52] Becuase that the beneficiary and his guilty cohorts are liable to make restitution to the issuer who honored a documentary draft and later discovers fraud or forgery in the documents, follows

49. Cited from Harfield, Wisconsin L. Rev. vol. 1952, 308. Also see, *Asbury Park & Ocean Grove Bank v. National Bank*, 35 N.Y.S. 2d 985 (Sup. Ct. 1942); *Old Colony Trust Co. v. Lawyers' Title and Trust Co.*, 297 Fed. 152 (2d Cir. 1924); *Doelger v. Battery Park National Bank* (1922), 201 App. Div. 515, 194 N.Y. S. 582, (The defence that the bank had been instructed by the buyer not to pay because it was alleged that documents were out of time was rejected.); Yale L.J. *op. cit.* in ftn. 1, 253, ftn. 124.

50. See, *Brandt v. Day*, 208 Fed. 495 (S.D.N.Y. 1913); *Frey v. Sherburne & National City Bank of New York* (1910), 193 App. Div. 849, 184 N.Y. S. 661; Yale L.J. op. cit. in ftn. 1, 253, (But the issuer is in no case denied reimbursement when it does pay in the absence of an injunction secured by the customer.) Also see, *Brown v. Rosenstein Co.*, 120 Misc. 787, 200 N.Y. S.491(1923), aff'd w.o. op., 208 App. Div. 799,203 N.Y. S. 922 (1924) (In suit by drawee against customer for reimbursement of amount paid on draft accompanied by forged bill of lading and insurance policy, defense by customer that documents were forged held irrelevant or insufficient, but note that draft had been accepted by drawee before notice received and that payment made to holder in due course); Finkelstein, *op. cit.* in ftn. 48, 244.

51. See, Article 10 of the *Uniform Customs and Practice;* Izawa, *op. cit.* in ftn. 4, 321.

52. See, 3 New York Law Revision Commission Report on the *Uniform Commercial Code*, 107 (1955).

from elementary principles of torts and quas-icontracts. The subsection extends this rule and makes it apply to an innocent beneficiary who through inadvertence or mistake has failed to satisfy the necessary conditions of the credit. The theory of liability is changed from quasi-contract and tort to warranty.

Subsection 5-111 (2) codifies existing law in its rule that the handling of documents in a commercial credit transaction does not involve any warranty or representation by the various banks. Each one passes the document on the next one and it is up to the party receiving the documents to examine them and be satisfied in its own mind.[53]

d. *Time Allowed for Honor or Rejection: Withholding Honor or Rejection by Consent* (5-112)

Under the *Uniform Negotiable Instruments Law* section 137, "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." This curious law, termed the "constructive acceptance", is substantially modified by section 5-112. The modification has bee praised as a "reluctant recognition of reality."[54] Other experts, however, have criticised the rule of the section. Mr. Harfield, for example, writes:

> I am not enthusiastic about the three-day rule in section 5-112. I am in accord with the subcommittee's view (of the New York Clearing House Association) that anything which tends to rigidify the time for inspection of documents is disadvantageous, and not just to the banks but to the merchants they serve. Nevertheless, 5-112 seems to me about as flexible as a rule could be and still be a rule. The bank can withhold honor indefinitely if the presentor 'expressly or impliedly' consents thereto. There is thus plenty of scope practical necessities.[55]

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53. See, *Springs v. Hanover National Bank*, 209 N.Y. 224, 103 N.E. 156 (1913) (Drawee of draft not entitled to recover from bona fide purchaser who presents with forged documents attached); 3 New York Law Revision Commission Report on the *Uniform Commercial Code*, 105 (1955); Letter of Mr. Harfield, Leg. Doc. *op. cit.* in ftn. 8, 24. That the rule of the subsection is particularly applicable to the collecting bank acting only as agent for the owner of a draft, see, *Archibald & Lewis Co. v. Banque Internationale de Commerce*, 216 App. Div. 322, 214 N.Y. S. 366 (1926).

54. See, Chadsey, *The Effect of the Uniform Commercial Code on Documentary Letter of Credit Transactions*, 102 U. of Penna. L. Rev. 618, 624 (1954).

The most harsh criticism has been submitted by Mr. O'Halloran. He argues :

> This is a particularly objectionable and dangerous provision since there are many circumstances which may render it impracticable to make this decision within the arbitrary time limit. Since letters of credit frequently involve international dealings, it is often necessary for a bank to communicate with its customer or with a beneficiary or negotiating bank abroad as to its action and the eventual honor or dishonor of the draft may depend upon communications between the customer, the beneficiary or negotiating bank and the issuing or confirming bank expending over a greater period than three banking days. The provision also seems to be in conflict with Article 10 of the *Uniform Customs and Practice* which provides, in part : 'The issuing bank shall have a reasonable time to examine the documents.'
>
> The provision destroys the flexibility which is essential to international letter of credit transactions and may work hardship on all parties concerned. Where documents are questionable, banks may be forced by the Code to dishonor since the time allowed may not permit communication with its customer or the issuing bank... In any event as a matter of established practice banks do not handle documentary drafts under letters of credit within the time permitted for clean drafts.
>
> We believe that under the rule proposed banks in this state (New York) would suffer by reason of the irritation and resentment which would be felt by parties abroad if the banks were required to adhere to a specified deadline and were not permitted a reasonable time within which to act. Moreover, and very importantly, the provision makes no allowance for extraordinary conditions which may exist during time of war, strikes, freezing regulations, etc., or even holiday periods here at home or in the country of the correspondent or beneficiary. Very recently a bank strike in one foreign country delayed communications beyond the three banking day period permitted by this provision.[56]

It should be noted clearly, however, that what is needed is time to examine and to determine conformity and not the time to communicate with parties at interest. Such determination on conformity is the matter of the bank itself and does not relate, in any means, to others. The assertion, stressing the necessity of consulting with parties at interest

55. Leg. Doc. *op. cit.* in ftn. 8, 25.

56. *Id.*, 48 *et sqe.*

who may be at a distance, perhaps overseas, betrays confused thinking.[57] Such consultation is in no way necessary if the documents do conform to the credit. In that case the draft must be honored anyway and no consultation with any one necessary. Three days are allowed, simply because at times great congestion can arise for such examination in letter of credit departments.[58]

The section should be compared with Section 3-506 of the Code. The latter provision sets the time allowed for acceptance of drafts "until the close of the next business day following presentment." "Documentary draftr" drawn under a letter of credit are excepted from this provision.[59] Since Article 5 of the Code permits "clean" credits as well as documentary credits, it is clear that the terminology of Section 3-506 (2) and 5-112(1) means that only documentary drafts are subject to the three-day rule. Drafts drawn under "clean" credits must be processed by the "close of the next business day following presentment." This seems sensible. A bank obligated to honor drafts drawn against documents must be given time to examine the documents. A bank not paying against documents should be expected to act more quickly.

Except for drastically modifyiny the rule of "constructive acceptance", Section 5-112 seems to restate present letter of credit practice. It seems to me that no actual conflict will occure between the section and Article 10 of the *Uniform Customs and Practice.*[60]

There is a contention that even where the beneficiary and the issuer

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57. Mr. Harfield stated at the hearing that there had been an alarming tendency on the part of many foreign banks, when one of the documents was defective in some particular which might or might not be indicative of a serious defect in the merchandise, to wait for the arrival of the merchandise, allow the buyer to examine it and then (usually when the market was falling) throw back the draft and documents to the presenting bank with a statement, which was quite accurate, that the documents did not comform to the terms of the credit.

From such a historical background, he made the distinction between Section 5-112 and Article 10 of the *Uniform Customs and Practice;* putting this way: "Section 5-112 sets a prior time limit for honor or dishonor; Article 10 of the *Uniform Customs and Practice* is a short statute of limitations." Leg. Doc. *op. cit.* in ftn. 8, 26 *et* 27. But the conclusion to separate them in this way is quite doubtful.

58. Chadsey, Leg. Doc. *op. cit.* in ftn. 8, 15 *et* 16.

59. See, Section 3-506(2) of the Code.

have agreed that they are going to take their own sweet time about it the customer is completely bound by that.[61] But this problem, whether the issuer, by delaying for extremely long days, with the consent of the beneficiary, or the agent, might not lose his right of indemity, seems to me untouched in this section. It will be easy to predict that be judged from the standpoint of 'due honor'[62] and under the general principles.

e. *Indemnities* (5-113)

To enable the commercial transaction which the credit was inteneded to facilitate, to go ahead, rather than to obstract it by rejection of documents for technical inadequacies, and to enable that to be accomplished by reason of such an indemnity, is to foster the objective at which credit was aimed without violating the fundamentally protective provisions for which the credit was created. Such a practice actually does exist, right or wrong. That is the way it is done, and this is a recognition of an actuality. It is comforting to have logic bulwarked by legislation. Besides the recognition of actuality subsection (2) makes it clear some of the legal aspects of an indemnity agreement.[63] The propriety of issuing indemnities was inferentially noted in *Dixon, Irmaos & Cia. v. Chase National Bank*, 144 F. 1d 759 (2nd Cir. 1944), *cert.* denied 324 U.S. 850, 65 S. Ct. 687 (1945).[64]

Earlier drafts of present section 5-113 enacted the rule of the *Dixon Case*.[65] In that case a bank issued a letter of credit callng for a "full" set of ocean bills of lading. The holding of the court is that, at the time of litigation, there was a custom, "established beyond dispute", among bankers in New York whereby an issuer was obliged to accept the indemnity of a prime bank in lieu of a missing counter part of a bill of lading. This case aroused a storm of protest among letters of credit bankers, representing the banking point of view for its holding

60. *Cf.*, Prof. Schlesinger states that whether additional time ought to be available even in the absence of consent is the policy issue. Leg. Doc. *op. cit.* in ftn. 8, 61, but see, The Official Supplement No. 1 (1955) to the *Uniform Commercial Code*, 156.

61. Harfield, Leg. Doc. *op. cit.* in ftn. 8, 70.

62 See, Section 5-114(3) of the Code.

63. See, Chadsey, Leg. Doc. *op. cit.* in ftn. 8, 60.

64. See generally, Harfield, *The National Bank Act and Foreign Trade Practices*, 61 Harv. L. Rev. 782 (1948).

65. See, 1950 Draft, Section 5-118(3)(a); 1949 Draft, Section 4-114(3).

that custom can prevail over the unambiguously expressed terms of a contract, particularly a banking contract. Most of them felt that the court erred in its findings of fact as to the nature of the custom involved.[66] The present (1958) version of the Code neither accepts nor rejects the *Dixon Case*. The question whether a particular custom requires honor of documentary drafts accompanied by indemnities in lieu of missing or defective documents is now a matter to be determined by construing the terms of the credit.[67] Custom is one factor to be considered in this process of construction.[68] The decision in the *Dixon Case* is thus confined to its juridical isolation ward, neither executed by express statutory reversal, nor by statutory approval encouraged to resume its career. The *Uniform Customs and Practice* does not cover the issue, either.[69]

f. *Remedy for Improper Dishonor or Anticipatory Repudiation* (5-115)

This seems to codify general American case law which holds that the beneficiary's measure of damages for wrongful dishonor is the same as a seller's damages upon a buyer's breach of contract.[70] Section 135 of the *Negotiable Instruments Law* gives the right of recovery, as on an acceptance, on a promise to accept a bill before it is drawn, only to the person "who upon the faith thereof, receives the bill for value." No such restriction is contained in subsection (1) of this section of the Code, which gives the right to receive the face amount of the draft to the holder without qualification. In *O'meara Co. v. National Park Bank*, 239 N.Y. 386, it has been said that the plaintiff's damages were, primarily, the face amount of the drafts. Although Section 135 of the *Negotiable Instrument Law* makes an actual acceptance out of a promise to accept, letters of credit do not fall within its scope because of the *Negotiable Instrument Law* requirement that the promise be "unconditional." The

66. See, *e.g.*, Backus and Harfield, *Custom and Letters of Credit: The Dixon Irmaos Case*, 52 Colum. L. Rev. 589 (1952). Also see, Honnold, *Letters of Credit Custom, Missing Documents and the Dixon Case: A Reply to Backus and Harfield*, 53 Colum. L. Rev. 504 (1953).

67. See, Official Comment 4 to the section.

68. See, Section 1-205 of the Code.

69. See, Harfield, Wis. L. Rev. vol. 1952, 310.

70. See, *Riggs v. Lidsay*, 11 U.S. (7 Cranch) 500 (U.S. 1813); *De Sousa v. Crocker First National Bank*, 23 F. 2d 118, 122 (N.D. Cal. 1927): *cf. Carnegie v. Morrison*, 2 Metc. 381 (Mass. 1841).

inference from the *Negotiable Instrument Law* is that recovery will be limited, on a promise to accept the bill, to the face amount of the bill.[71] Previously the Code had provided that "in no event shall recovery exceed the amount of the credit or the draft as the case may be."[72] A "contract" recovery on the conditional promise on the letter of credit, however, should allow recovery not only of the face amount of the draft but also of the reasonably foreseeable damages resulting from breach.[73] That seems to have caused the deletion of the previous provision restricting recovery to the face amount.

There is some question at common law whether or not an aggrieved party under a letter of credit must mitigate damages.[74] The English courts have held that there is no duty to mitigate.[75] So far as the State of New York concerns, however, there seems no conflict on this point. The authority is quite clear that the duty to mitigate exists. In the *O'Meara Case, supra,* the court said :

> The plaintff's damages were, primarily, the face amount of the drafts. Plaintiff, of course, was bound to minimize such damages so far as it reasonably could... There was absolutely no statement in defendent's affidavits to the effect that the plaintiff did not act in the utmost good faith or with reasonable care and diligence in making the resale... The only requirement is that the resale must be a fair one.

In *Dustan v. McAndrew,* 44 N.Y. 72, the court had also stated :

> He should act with reasonable care and diligence, and in good faith. He should make the sale without unnecessary delay, but he must be the judge as to the time and place of sale, provided he act in good faith and with reasonable care and diligence.[76]

Under the circumstances detailed 5-115 (1) it would appear that the

71. See, Finkelstein, *Acceptances and Promises to Accept,* (1926) 26 Colum. L. Rev. 684, 719 *et seq.*

72. See, 1952 Draft, Sec. 5-516(3).

73. See, Izawa, *op. cit.* in ftn. 4, 420.

74. Compare, *O'Meara v. National Park Bank,* 239 N.Y. 386, 400; 146 N.E. 636, 640 (1925) (duty to mitigate) and *Huber & Co. v. Lalley Light Corp.,* 242 Mich. 171, 218 N.W. 793 (1928) (no duty to mitigate).

75. See, *Stein v. Hambro's Bank,* 91 L1. L. Rep. 507 (1921); Izawa, *op. cit.* in ftn. 4, 421 *et seq.*; Yale L.J. *op. cit.* in ftn. 1, 257, ftns. 150, 151, 152.

76. Also see, *Pollen v. LeRoy,* 30 N.Y. 549; *Smith v. Pettee,* 70 N.Y. 13; *General Electric Co. v. National Contracting Co.,* 178 N.Y. 369; *Jardine, Matheson & Co. v. Huguet Silk Co.,*203 N.Y. 273; *Second National Bank v. Columbia Trust Co.,* 288 Fed. Rep. 17, 26.

Code imposes no duty to mitigate. Under subsection 5-115 (2), however, there seems to be a duty to mitigate, since the subsection incorporates by reference Section 2-610, a section under which mitigation is required.[77]

g. *Transfer and Assignment* (5-116)

The issuing bank deals only in documents and not in goods. A dishonest seller (beneficiary) can obtain payment in full under a letter of credit by tendering complying documents, even though he has breached the underlying sales contract. The buyer, of course, is given considerable protection by the fact that documents must comply with the credit, but it is nevertheless undoubtedly true that letter of credit finacing assumes and is largely based on the buyer's confidence in the honesty of the seller.[78] Therefore, when the buyer causes a bank to issue a credit in favor of a named beneficiary, he contemplates performance by that beneficiary alone. He may know and trust the beneficiary. He may be in a position to effect an offset against him in case of default. If the beneficiary were permitted to assign the benefits of the creidt, these expectations of the buyer would be defeated. It is not fair to him that the seller should transfer the fulfillment of the contract to someone else, unknown to the buyer, and possibly project him into a situation which would be unhappy, by reason of inadequate deliveries, insufficient deliveries, and various other failures to perform.[79] The courts, therefore, have held that a letter of credit is not assignable, unless it specifically states that it is assignable.[80] Subsecion 5-116 (1) is in accord with this law. The subsection has recognized it by saying that such a transfer of the right to draw, the right to perform, is

77. Even though the duty of mitigation (the duty to mitigate damages) exists, the bank is liable, at least, to the extent of the full amount of the draft under all conceivable circumstances regardless of the amount of damages suffered by the holder under Section 5-115.

78. See, *Laudisi v. American Exchange National Bank*, 239 N.Y. 234, 146 N.E. 347 (1924); Harfield, *Secondary Uses of Commercial Credits*, 44 Colum. L. Rev. 899, 900 (1944).

79. Since the right of the beneficiary on the letter of credit is independent of the underlying contract, the explanation given above might not sound theoretical. But such a conclusion must be admitted from the stand-point of need and fairness which support the letters of credit transactions go forward. *Cf.* Izawa, *op. cit.* in ftn. 4, 653 *et* 778.

80. See, *e.g.*, *Eriksson v. Refiners Export Co.*, 264 App. Div. 515, 35 N.Y.S. 2d 829 (1924).

possible only if it is satisfactory to the bank which has issued the credit and that in turn means only if it is satisfactory to the buyer who has come to the bank to ask that the credit be issued.[81] Subsection 5-116(1) is not inconsistent with the philosophy of Section 2-210 of the Code which broadly validates delegation of performance and assignment of rights under normal sales contract. The subsection deals with an abnormal situation, and the normal rules set out in 2-210 do not apply.

Where the letter of credit permits assignment, a question may arise as to how many times it may be assigned. It would seem in such a case that the buyer has placed exclusive reliance on the documents for protection and that he would not object to multiple assignments. Article 49 of the *Uniform Customs and Practice*, however, provides that the assignable credit "can be transferred once only on the express authority of the opening bank and provided that it is expressly designated 'transferable' or 'assignable' (that is to say that the third party or parties designated by the first deneficiary are not entitled to retransfer it)," even when it is designated as transferable. This view represents prevailing bank notions.[82] Subsection 5-116 (1) is silent on the matter.

An assignment of the proceeds of a letter of credit must be sharply distinguished from an assignment of the credit itself.[83] Where proceeds alone are assigned, the buyer's protection arising out of the beneficiary's duty to perform is not defeated; it matters not to him who receives the funds from the bank. At the same time, once the beneficiaries of the letter of credit have such an instrument in their hands, once they have such assurance of ability to collect the proceeds of the sale which they have made, they ought to be able to take advantage of its bankability. It ought to have some value to them as a source of raising funds with which to acquire or fabricate the merchandise which they have sold, and which they must now deliver. That seems not unreasonable either, and so it is contemplated in the Code that if the beneficiary wants to assign his rights to what he will get out of the performance, he may.[84]

81. Chadsey, Leg. Doc. *op. cit.* in ftn. 8, 61.

82. See, Leg. Doc. *op. cit.* in ftn. 8, 40 *et* 67.

83. Article 5 of the Code does not deal with the element of assignment which is inherent in the negotiation of drafts drawn by the named beneficiary under a negotiation credit.

84. Chadsey, Leg. Doc. *op. cit.* in ftn. 8, 62.

In the *Eriksson Case*, however, it was held that not only the performance under the credit was not assignable, but that the proceeds were not assignable. *Eriksson v. Refiners Export Co., Inc.*, 264 App. Div. 525, 35 N.Y.S. 2d 829 (lst Dep't 1942), involved a claim by Cities Service Oil Company that it was the owner of the proceeds of a credit as assignee of the letter of credit and of the draft drawn against the credit. Although the court stated that Cities Service Oil Company was an assignee of the letter of credit, it appears from the facts that it was an assignee of proceeds since the opinion expressly mentions that the draft was drawn by the original beneficiary and was endorsed to Cities Service Oil Company. The letter of credit issued in the transaction was a special confirmed irrevocable credit which in that case made express reference to the *Uniform Customs and Practice.* Article 49 of the *Uniform Customs and Practice* as in effect at that time also provided that a credit could only be transferred on the express authority of the principal. The court held that the letter of credit itself not being subject to assignment, the credit could not be transferred by any assignment of a draft against it. The court stated :

> It seems clear, however, that the purpose of Article 49 is to prevent a special letter of credit from becoming general merely by some form of transfer. We are constrained to hold, therefore, that Cities Service Oil Company acted at its peril in attempting to become assignee of the letter of credit"[85]

Because of the existence of this authority there arouse a severe criticism on the subsection(2). Mr. O'Halorran stated :

> Section 5-116 would reverse this rule because it purports to make a distinction between the right to draw under a credit, which under Subsection (1) can be assigned only on express authority of the issuer, thus following the pattern of Article 49 of the Uniform Customs and Practice, on the one hand, and the right to assign the proceeds of a credit, which under Subsection (2) are expressly made assignable, on the other hand. In view of the international character of letters of credit, this change would inevitably result in confusion and uncertainty since parties abroad or in non-Code states cannot be expected to take cognizance of this important change."[86]

However, since the possibility of chain assignements relates only to

85. Cited from The Official Supplement No.1 (1955) to the Uniform Commercial Code, 157 *et seq.*

86. Leg. Doc. *op. cit.* in ftn. 8, 50 *et seq.*

proceeds, and since Article 49 of the *Uniform Customs and Practice* is not really concerned with proceeds but with performance, no international cmplications may be expected here.[87]

In case of an ordinary contract, there is compartively little hardship in requiring one party to make payment according to the terms of the contract to the assignee of the other party. But the situation is quite different in respect of letters of credit. The very small commissions[88] which are exacted by banks in the letter of credit business are possible to work out only on the basis of handling a volume of business and handling it in as expeditious and as little troublesome a way as possible. To become involved in notices of assignment, to have to put red flags on letter of credit, and to give them a treatment which varies from that which is ordinary and traditional, is to incur additional expense.

> It appeared in the course of the drafting sessions that banks would be quite likely to avoid altogether letter of credit transactions which were likely to project them into that sort of situation, rather than to take them on for the small remuneration which they got.[89]

The section represents a fair compromise among the interests of the beneficiary who may need to assign proceeds to finance the deal, the negotiating bank or other third party dealing with a draft drawn by the beneficiary and the paying bank which may have an administrative problem in the handling of notices of assignment.[90]

It should be noted here parenthetically, however, that the assignment of proceeds of a letter of credit, though a useful device, does not give maximum protection to the assignee. The assignee is usually a manufacturer or supplier whose performance enables the prime beneficiary (subseller) under the letter of credit to complete his performance. This

87. See, Chadsey, Leg. Doc. *op. cit.* in ftn. 8, 17. Of course, in the State of New York, the *Uniform Customs and Practice* has to be read the way they have been read by the courts, *i.e.*, here, the *Eriksson Case*. It is doubtful, however, whether *Eriksson Case* would bind as an authority the latter cases which might occur in future, since the reasoning of it is apparently so vague and crude. Mr. Chadsey states that he is not so sure that it is evident from the *Uniform Customs and Practice* that the proceeds cannot be assigned. See, *id.*, 68.

88. See, ftn. 2.

89. Chadsey, Leg. Doc. *op. cit.* in ftn. 8, 62.

90. See, The Official Supplement No.1 (1955) to the *Uniform Commercial Code*, 160.

supplier wants assurance that the prime beneficiary under the letter of credit will pay him, and a crude method of obtaining this assurance is to take an assignment of the proceeds of the credit. The method is crude because it does not afford the assignee maximum security. He must promptly notify the issuing bank of the assignment, his right to the money depends on the assignor's performance, and he has no guarantee that the assignor has not made a prior assignment.

The back-to-back letter of credit is much more satisfactory to the supplier than taking an assignment of the proceeds of the letter of credit. The back-to-back credit works in this way.[91] X bank issues a letter of credit to S and this credit is confirmed by Y Bank. S needs the performance of M to fill the contract. M needs assurance that S will pay him. S gets Y Bank to issue a letter of credit with M named beneficiary. The documents required of M are the same documents which S is reqired to furnish under the prime letter of credit. When these documents are presented to Y, it can safely pay M, knowing that it will be reimbursed by X Bank under the prime letter of credit. The additional credit risk to the correspondent bank is negligible where the documents under each credit are literally identical except for price term and invoice.[92] Since back-to-back credits are safe and cheap and give the assignee maximum protection, it is to be expected that they will completely replace the less satisfactory assignment of proceeds device. Subsection 5-116 (2) safeguards the back-to-back credit, as well as the practice of assigning proceeds, by providing that these devices cannot be prohibted in advance of performance.[93]

(November 1962)

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91. See generally, Ward and Harfield, *op. cit.* in ftn. 5, 165 *et seq.*

92. See, Harfield, *Secondary Uses of Commercial Credits*, 44 Colum. L. Rev. 899, 908 (1944).

93. See, the Official Comment to the section. In *Kingdom of Sweden v. New York Trust Co.*, 197 Misc. 431, 96 N.Y.S. 2d 779 (1949), the court held that the issuance of a secondary or "back-to-back" credit was not in conflict with accepted practice of New York bankers and banks throughout the country (it had been argued that such a credit violated Article 49 of the *Uniform Customs and Practice*). Also see, *Meb Export v. National City Bank*, 131 N. Y. L. J. (June 30, 1954, 4), cited from Ward and Harfield, *op. cit.* in ftn. 5, 165.

UNIFORM COMMERCIAL CODE ARTICLE 5
LETTERS OF CREDIT

1958 Official Text
The American Law Institute
National Conference of
Commissioners on Uniform State Laws

Section 5-101. Short Title.

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

Section 5-102. Scope.

(1) This Article applies

(a) to a credit issued by a bank if the credit requires a documentary draft or a documentary demand for payment; and

(b) to a credit issued by a person other than a bank if the credit requires that the draft or demand for payment be accompanied by a document of title; and

(c) to a credit issued by a bank or other person if the credit is not within subparagraphs (a) or (b) but conspicuously states that it is a letter of credit or is conspicuously so entitled.

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

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

Section 5-103. Definitions.

(1) In this Article unless the context otherwise requires

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

(b) A "documentary draft" or a "documentary demand for payment" is one honor of which is conditioned upon the presentation of a document or documents. "Document" means any paper including document of title, security, invoice, certificate, notice of default and the like.

(c) An "issuer" is a bank or other person issuing a credit.

(d) A "beneficiary" of a credit is a person who is entitled under its terms to draw or demand payment.

(e) An "advising bank" is a bank which gives notification of the issuance of a credit by another bank.

(f) A "confirming bank" is a bank which engages either that it will itself honor a credit already issued by another bank or that such a credit will be honored by the issuer or a third bank.

(g) A "customer" is a buyer or other person who causes an issuer to issue a credit. The term also includes a bank which procures issuance or confirmation on behalf of that bank's customer.

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

"Notation of Credit".	Section 5-108.
"Presenter".	Section 5-112(3).

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

"Accept" or "Acceptance".	Section 3-410.
"Contract for Sale".	Section 2-106.
"Draft".	Section 3-104.
"Holder in due course".	Section 3-302.
"Midnight deadline".	Section 4-104.
"Security".	Section 8-102.

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

Section 5-104. Formal Requirements; Signing.

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

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

Section 5-105. Consideration.

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

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

(1) Unless otherwise agreed a credit is established

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

(b) as regards the beneficiary when he receives a letter of credit or an authorized written advice of its issuance.

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

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

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

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

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

(2) A confirming bank by confirming a credit becomes directly obligated on the credit to the extent of its confirmation as though it were its issuer and acquires the rights of an issuer.

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

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

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

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

(2) Under a notation credit

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

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

(3) If the credit is not a notation credit

(a) the issuer may honor complying drafts or demands for payment presented to it in the order in which they are presented and is discharged pro tanto by honor of any such draft or demand;

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

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

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

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

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

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

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

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

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

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

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

Section 5-111. Warranties on Transfer and Presentment.

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

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

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

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

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

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

Failure to honor within the time here specified constitutes dishonor of the draft or

demand and of the credit [except as otherwise provided in subsection (4) of Section 5-114 on conditional payment].

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

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

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

Section 5-113. Indemnities.

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

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

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

(b) unless a longer time is explicitly agreed expires at the end of ten business days following receipt of the documents by the ultimate customer unless notice of objection is sent before such expiration date. The ultimate customer may send notice of objection to the person from whom he received the documents and any bank receiving such notice is under a duty to send notice to its transferor before its midnight deadline.

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

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

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

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

(b) in all other cases as against its customer, an issuer acting in good faith may honor the draft or demand for payment despite notification from the

customer of fraud, forgery or other defect not apparent on the face of the documents but a court of appropriate jurisdiction may enjoin such honor.

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

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

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

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

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

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

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

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

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

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

Section 5-116. Transfer and Assignment.

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

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

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

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

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

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

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

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

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

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

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

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