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## The Effect of Section 1-102(3) and 1-103 on Commercial Agreements Involving UCC Transactions: Should They Be Revised?

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The Effect of Section 1-102(3) and 1-103 on Commercial  
Agreements Involving UCC Transactions: Should They Be Revised?

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THE EFFECT OF SECTION 1-102(3) AND 1-103 ON COMMERCIAL  
AGREEMENTS INVOLVING UCC TRANSACTIONS:  
SHOULD THEY BE REVISED?

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**Article 5**

Power to Modify Article 5 Obligations Under 1-102(3) and 1-203. See Sections 5-103(c) and 5-116(c) of Revised Article 5.

Persons speaking for issuing banks argued strongly in the Article 5 revision process that complete freedom of contract should prevail and that no provision should be made invariable. They argued successfully for the removal in current Section 5-109 of references to due care and they argued successfully against the inclusion of any similar obligation elsewhere in Article 5. Consequently Section 1-102(3) has no place to get a grip in Article 5--because no obligations of due care are expressed in the statute.

There are some restrictions on modifications of the provisions of Article 5. For example, 5-103(c) provides: "A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this article." The Comment elaborates as follows:

2. Like all of the provisions of the Uniform Commercial Code, Article 5 is supplemented by Section 1-103 and, through it, by many rules of statutory and common law. Because this article is quite short and has no rules on many issues that will affect liability with respect to a letter of credit transaction, law beyond Article 5 will often determine rights and liabilities in letter of credit transactions. Even within letter of credit law, the article is far from comprehensive; it deals only with "certain" rights of the parties. Particularly with respect to the standards of performance that are set out in Section 5-108, it is appropriate for the parties and the courts to turn to customs and practice such as the Uniform Customs and Practice

for Documentary Credits, currently published by the International Chamber of Commerce as I.C.C. Pub. No. 500 (hereafter UCP). Many letters of credit specifically adopt the UCP as applicable to the particular transaction. Where the UCP is adopted but conflicts with Article 5 and except where variation is prohibited, the UCP terms are permissible contractual modifications under Sections 1-102(3) and 5-103(c). See Section 5-116(c). Normally Article 5 should not be considered to conflict with practice except when a rule explicitly stated in the UCP or other practice is different from a rule explicitly stated in Article 5.

Except by choosing the law of a jurisdiction that has not adopted the Uniform Commercial Code, it is not possible entirely to escape the Uniform Commercial Code. Since incorporation of the UCP avoids only "conflicting" Article 5 rules, parties who do not wish to be governed by the nonconflicting provisions of Article 5 must normally either adopt the law of a jurisdiction other than a state of the United States or make explicit reference to the rule in Article 5 that is not to govern.

Neither the obligation of an issuer under Section 5-108 nor that of an adviser under Section 5-107 is an obligation of reasonable care of the kind that is invariable under Section 1-102(3). Section 5-103(c) and Comment 1 to 5-108 make it clear that the applicant and the issuer may agree to almost any provision establishing the obligations of the issuer to the applicant. The last sentence of subsection (c) limits the power of the issuer to achieve that result by a nonnegotiated disclaimer or limitation of remedy. What the issuer could achieve by a negotiated agreement with its applicant or by a conspicuous term, it cannot accomplish by a boilerplate disclaimer buried in the reimbursement agreement. The restriction on disclaimers in the last sentence of subsection (c) is based more on procedural than on substantive unfairness. Where the reimbursement agreement provides in bold letters that the issuer need not examine any

documents, the applicant understands the risk it has undertaken. Where the boilerplate merely states that the issuer will not be liable unless it has acted in "bad faith" or committed "gross negligence," the applicant may not understand and the courts should look upon such disclaimers with a jaundiced eye. On the other hand, courts should enforce narrower terms such as terms that entitle an issuer to reimbursement when it honors a "substantially" though not "strictly" complying presentation.

An issuer's incorporation of any rules that vary an issuer's agreement with its applicant concerning the form of a letter of credit or the performance to be rendered under such a letter of credit would not override the term in the contract between the applicant and the issuer to the contrary.

To test how these rules might be applied in practice consider several hypothetical cases:

1. Assume that the reimbursement agreement between the Applicant and the Issuer states that the Issuer shall have no liability for wrongful honor except in cases in which it has exercised gross negligence or bad faith. In the face of such an agreement, the issuer honors a presentation that does not include a required inspection certificate. It defends on the ground that it was required to examine the documents in a short period of time, that one of its important document checkers was ill on the day of the presentation, and while it might have been negligent, it was not grossly so. What outcome?

2. Assume alternatively that Issuer honors or dishonors a presentation the complies with the UCP but does not comply with the UCC or the American case law.

a. In the case of honor, may the Applicant recover from the Issuer if the reimbursement agreement requires that "the UCC applies," but the letter of credit incorporated the UCP?

b. In the case of dishonor, may the Issuer defend its dishonor under UCC rules and practice despite the fact that the letter was "subject to the UCP"? That

is, is the reference in the letter of credit enough to make the letter of credit, the reimbursement agreement, and other responsibilities under the letter of credit subject to the rules of the UCP? (For example, what about the responsibilities of advisers that differ somewhat in the UCC and the UCP?)

3. Assume that UCP 600 is adopted in 2005 and states that all parties to letters of credit governed by the UCP must submit all letter of credit disputes to arbitration and that none may go to court. Assume a letter states it is "subject to the UCP" and the beneficiary sues issuer in an American court for wrongful dishonor. Would that incorporation of the UCP be sufficient to deprive American courts of jurisdiction under the provisions of the UCP and the rules in 5-116?

4. Assume that Issuer and Applicant agree that with respect to the presentations of certain suppliers, issuer will simply pay and will not inspect the documents. Assume that this agreement is between a large commercial bank, such as NBD, and a large American corporation such as General Motors. If one of the parties later wishes to challenge that agreement, can they do so under Article 5 or under UCC 1-102(3)? What of the argument that the strict liability set up under 5-108 itself includes a floor responsibility (not to act negligently) and thus, under 1-102(3), cannot be reduced below some minimum level that would constitute ordinary care? This argument should be rejected, not so?