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## Article 5: Highlights of the Proposed Revision

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The Emerged and Emerging New Uniform Commercial Code

**\*149** ARTICLE 5: HIGHLIGHTS OF THE PROPOSED REVISION

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- I. The Current Status of Article 5: Drafting, Approval and Promulgation--The Most Significant Changes or Clarifications
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  - B. Section 5-108, Preclusion for Failure to Notify of Discrepancies.
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- III. More Subtle Questions About Revised Article 5
  - A. Scope of UCC's coverage when the UCP is incorporated, 5-116(c). When does the UCC conflict with the UCP? Could the warranties in the UCC be said to conflict with the UCP **\*152** that has no warranties?
  - B. When do nondocumentary conditions render an undertaking not a letter of credit? Compare 5-104, 5-102(a)(10), 5-108(g).
    - 1. Assume three letters of credit that provide the issuing bank must pay, respectively, (a) upon default of contractor or (b) default of contractor and certification by the architect that default has occurred, or (c) on certification by architect that default has occurred. Do any of these make the undertaking not a letter of credit?
    - 2. Assume that the letter of credit provides that the bank should pay on certification by "duly appointed and qualified arbitrator that an amount up to \$5 million is due from one party to another." Applicant maintains that the arbitrator was not duly appointed and qualified because the terms of its agreement with the beneficiary required a retired federal judge as the arbitrator and the person who became the arbitrator was a practicing lawyer who had never been a judge. How does the issuer deal with that claim?
  - C. Under what circumstances may one submit electronic documents? See 5-102(a)(6), 5-102(a)(14); compare 5-104.
    - 1. Assume the beneficiary on a conventional letter of credit fails to send a particular document to New York with its packet of documents for presentation. On the day of the expiration, the beneficiary faxes a copy of the omitted document directly to the bank. Has it made a proper presentation?
    - 2. Assume a fax to its agent bank across the street who carries the fax by hand to the issuer. Is the presentation **\*153** proper?

D. Beware of the one-year statute of limitations, 5-115.

If Applicant sues Issuer for breach of the reimbursement agreement one year and one day after expiration of the letter, can it recover?

E. Consider how one will take a security interest in the proceeds of a letter of credit. Compare 5-114 with the proposed revisions in Article 9. Note that Article 5 governs the issuer's responsibility and may free it from liability that it might otherwise have against an assignee under Article 9.

1. Assume that a letter of credit is transmitted electronically to an adviser of the beneficiary. The adviser prints out the letter and gives it to the beneficiary (with or without stamping it "original letter of credit"). Wishing to borrow against the letter of credit, the beneficiary transfers the document given it by the adviser to its own bank, executes a security agreement, and borrows \$2 million against the letter of credit proceeds. The beneficiary goes into bankruptcy and the trustee in bankruptcy claims that the security interest is unperfected because the bank did not take possession of the "letter of credit" but only of a copy of an electronic letter of credit. Who wins?

2. Assume alternatively that the secured creditor bank in 1. presents proper documents to the issuing bank and is met with various responses but no money. Among the possible responses are following:

\*154 (a) the letter of credit was cancelled, and under 5-106(b) you are not protected and therefore it is cancelled against you even though neither you nor the beneficiary knew of the cancellation.

(b) I (Issuer) did not consent to the assignment and so am not paying, 5-114(c). (The applicant has gone bankrupt and the issuing bank chooses not to pay because it will probably not get reimbursed by the applicant.)

(c) Somebody who looked a lot like the beneficiary was already here with complying documents and I paid him, therefore I need not pay you. See 5-108(i)(5).

#### \*155 UCC Article 5

September 29, 1994 DRAFT

**SECTION 5-101. SHORT TITLE.** This article may be cited as Uniform Commercial Code--Letters of Credit.

#### COMMENT

The Official Comment to the original Section 5-101 was a remarkably brief inaugural address. Noting that letters of credit had not been the subject of statutory enactment and that the law concerning them had been developed in the cases, the Comment stated that Article 5 was intended "within its limited scope" to set an independent theoretical frame for the further development of letters of credit. That statement addressed accurately conditions as they existed when the statement was made, nearly half a century ago. Since Article 5 was originally drafted, the use of letters of credit has expanded and developed, and the case law concerning these developments is, in some respects, discordant.

Revision of Article 5 therefore has required reappraisal both of the statutory goals and of the extent to which particular statutory provisions further or adversely affect achievement of those goals.

The statutory goal of Article 5 was originally stated to be: (1) to set a substantive theoretical frame that describes the function and legal nature of letters of credit; and (2) to preserve procedural flexibility in order to accommodate further development of the efficient use of letters of credit. A letter of credit is an idiosyncratic form of undertaking that supports performance of an obligation incurred in a separate financial, mercantile, or other transaction or arrangement. The objectives of the original and revised Article 5 are best achieved (1) by defining the peculiar characteristics of a letter of credit that distinguish it and the legal consequences of its use from other forms of assurance such as secondary guarantees, performance bonds, and insurance policies, and from ordinary contracts, fiduciary engagements, and \*156 escrow arrangements; and (2) by preserving flexibility through variation by agreement in order to respond to and accommodate developments in custom and usage that are not inconsistent with the essential definitions and substantive mandates of the statute. No statute can, however, prescribe the manner in which such substantive rights and duties are to be enforced or imposed without risking stultification of wholesome developments in the letter-of-credit mechanism. Letter-of-credit law should remain responsive to commercial reality and in particular to the

customs and expectations of the international banking and mercantile community. Courts should read the terms of this article in a manner consistent with these customs and expectations.

**SECTION 5-102. DEFINITIONS.**

(a) In this article:

(1) “Adviser” means a person who, at the request of the issuer, confirmer, or other adviser, notifies or requests another adviser to notify the beneficiary that a letter of credit has been issued, confirmed, or amended.

(2) “Applicant” means a person at whose request or for whose account a letter of credit is issued. The term includes a person who requests an issuer to issue a letter of credit on behalf of another if the person making the request undertakes an obligation to reimburse the issuer.

(3) “Beneficiary” means a person who under the terms of a letter of credit is entitled to have its complying presentation honored and includes a person to whom drawing rights have been transferred under a transferable letter of credit.

(4) “Confirmer” means a nominated person who undertakes, at the request or with the consent of the issuer, to honor a presentation under a letter of credit issued by another.

(5) “Dishonor” of a letter of credit means failure timely (i) to honor, or (ii) to take an interim action, such as acceptance of a draft, that may be **\*157** required by the letter of credit.

(6) “Document” means a draft or other demand, document of title, investment security, certificate, invoice, or other record, statement, or representation of fact, law, right, or opinion that (i) is presented in a written or other medium permitted by the letter of credit or, unless prohibited by the letter of credit, by the standard practice referred to in Section 5-108(e) and (ii) is capable of being examined for compliance with the terms and conditions of the letter of credit. A document may not be oral.

(7) “Good faith” means honesty in fact in the conduct or transaction concerned.

(8) “Honor” of a letter of credit means performance of the issuer's undertaking in the letter of credit to pay or deliver an item of value. Unless the letter of credit otherwise provides, “honor” occurs (i) upon payment, (ii) if the letter of credit provides for acceptance, [upon] acceptance of a draft and, at maturity, its payment, or (iii) if the letter of credit provides for incurring a deferred obligation, upon incurring the obligation and, at maturity, its performance.

(9) “Issuer” means a bank or other person that issues a letter of credit, but does not include an individual who makes an engagement for personal, family, or household purposes.

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

(11) “Nominated person” means a person the issuer (i) designates or authorizes to pay, accept, negotiate, or otherwise give value under a letter of credit and (ii) undertakes by agreement or custom and practice to reimburse.

**\*158** (12) “Presenter” means a person making a presentation as or on behalf of a beneficiary or nominated person.

(13) “Presentation” means delivery of a document to an issuer or nominated person for honor or giving of value under a letter of credit.

(14) “Record” means a durable representation of information which is in, or is capable of being retrieved or reproduced in, perceivable form. A record may be in writing or in any electronic or other media.

(15) “Successor of the beneficiary” means a person who succeeds to substantially all of the rights of a beneficiary by operation of law, including a corporation with or into which the beneficiary has been merged or consolidated, an administrator, executor, personal representative, trustee in bankruptcy, debtor in possession, liquidator, and receiver.

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

‘Accept’ or ‘Acceptance’ Section 3-409

‘Value’ Sections 3-303, 4-211

(c) Article 1 contains certain additional general definitions and principles of construction and interpretation applicable throughout this article.

## COMMENTS

1. Since no one can be a confirmer unless that person is a nominated person as defined in Section 5-102(a)(11), those who agree to “confirm” without the designation or authorization of the issuer are not confirmers under Article 5. Nonetheless, the undertakings to the beneficiary of such persons may be enforceable by the beneficiary as letters of credit issued by the “confirmer” on its own account or as guarantees or contracts outside of Article 5.

2. The definition of document contemplates and facilitates the growing recognition of electronic and other nonpaper media as “documents,” however, for the **\*159** time being, data in those media constitute documents only in certain circumstances. For example, a facsimile received by an issuer would be a document only if the letter of credit explicitly permitted it, if the standard practice authorized it, and the letter did not prohibit it or the agreement of the issuer and beneficiary permitted it. The fact that data transmitted in a nonpaper (unwritten) medium can be recorded on paper by a computer printer, facsimile machine, or the like does not normally render the data so transmitted a “document.” A facsimile or S.W.I.F.T. message received directly by the issuer is in an electronic medium when it crosses the boundary of the issuer's place of business. One wishing to make a presentation by facsimile (an electronic medium) will have to procure the explicit agreement of the issuer (assuming that the standard practice does not authorize it). Failing that, the beneficiary may transmit the documents electronically to its own agent who may then be able to present written documents manually.

3. Payment and acceptance are familiar modes of honor. A third mode of honor, incurring an unconditional obligation, has legal effects similar to an acceptance of a time draft but does not technically constitute an acceptance. The practice of making letters of credit available by “deferred payment undertaking” as now provided in UCP 500 has grown up in other countries and spread to the United States. The definition of “honor” will accommodate that practice.

4. The prohibition of consumers from being issuers (engagements of individuals in connection with family or household purposes) is to keep creditors from using a letter of credit in consumer transactions in which the consumer might be made the issuer and the creditor would be the beneficiary. If that transaction were recognized under Article 5, the effect would be to leave the consumer without defenses against the creditor. That outcome would violate the policy behind the Federal Trade Commission Rule in 16 CFR Part 433. In a consumer transaction, an individual cannot be an issuer where it would otherwise be either the principal debtor or a guarantor.

**\*160** 5. When a document labelled a letter of credit requires the issuer to pay not upon the presentation of documents, but upon the determination of an extrinsic fact such as applicant's failure to perform a construction contract, and where that condition appears on its face to be fundamental and would, if ignored, leave no obligation to the issuer under the document labelled letter of credit, the issuer's undertaking is not a letter of credit. It is probably some form of suretyship or other contractual arrangement (such as a secondary guarantee) and may be enforceable as such. See Sections 5-102(a)(10) and 5-103(d). Therefore, engagements whose fundamental term requires an issuer to look beyond documents and beyond conventional reference to the clock, calendar, and practices concerning the form of various documents are not governed by Article 5. Although Section 5-108(g) recognizes that certain nondocumentary conditions can be included in a letter of credit without denying the document the status of letter of credit, that section does not reach cases where the nondocumentary condition is fundamental to the issuer's obligation. The rules in Sections 5-102(a)(10), 5-103(d), and 5-108(g) approve the conclusion in *Wichita Eagle & Beacon Publishing Co. v. Pacific Nat. Bank*, 493 F.2d 1285 (9th Cir. 1974).

The adjective “definite” is taken from the UCP. It approves cases that deny letter of credit status to documents that are unduly vague or incomplete. See, e.g., *Transparent Products Corp. v. Paysaver Credit Union*, 864 F.2d 60 (7th Cir. 1988). Note, however, that no particular phrase or label is necessary to establish a letter of credit. It is sufficient if the undertaking of the issuer shows that it is intended to be a letter of credit. In most cases the parties' intention will be indicated by a label on the document itself indicating that it is a “letter of credit,” but no such language is necessary.

A financial institution may be both the issuer and the applicant or the issuer and the beneficiary. Such letters are sometimes issued by the bank in support of the bank's own lease obligations or on behalf of one of its divisions as an applicant or to one of its divisions as beneficiary, such as the trust **\*161** department. Because wide use of letters of credit in which the issuer and

the applicant or the issuer and the beneficiary are the same would endanger the unique status of letters of credit, only financial institutions are authorized to issue them.

In almost all cases the ultimate performance of the issuer under a letter of credit is the payment of money. In rare cases the issuer's obligation is to deliver stock certificates or the like. The definition of letter of credit in Section 5-102(a)(10) contemplates those cases.

6. Any bank is a nominated person under a letter of credit that permits "free negotiation." Such a letter might provide: "We hereby engage with the drawer, indorsers, and bona fide holders of drafts drawn under and in compliance with the terms of this credit that the same will be duly honored on due presentation" or "available with any bank by negotiation." A restricted negotiation credit might be "available with x bank by negotiation."

Several legal consequences may attach to the status, nominated person. First, when the issuer nominates a person, it is authorizing that person to pay or give value and is authorizing the beneficiary to make presentation to that person. Unless the letter of credit provides otherwise, the beneficiary need not present the documents to the issuer before the letter of credit expires; it need only present those documents to the nominated person who takes them up. If the nominated person (other than a confirmer) refuses to take up the documents, there has been no presentation and it is the responsibility of the beneficiary to make presentation to the issuer or another nominated person who takes them up. It is sufficient to meet the expiration date that a nominated person takes up the documents even if it does so with recourse or merely as a forwarding agent. Secondly, a nominated person that gives value in good faith has a right to payment from the issuer despite fraud. Section 5-109(a)(1).

7. Absent a specific agreement to the contrary, documents of a beneficiary delivered to an issuer or nominated person are considered to be presented under \*162 the letter of credit to which they refer and any payment or value given for them is considered to be made under that letter of credit. As the court held in *Alaska Textile Co. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 820 (2d Cir. 1992), it takes a "significant showing" to make the presentation of beneficiary's documents for "collection only" or otherwise outside letter of credit law and practice.

8. Although a successor of the beneficiary is one who succeeds "by operation of law," some of the successions contemplated by Section 5-102(a)(15) will have resulted from voluntary action of the beneficiary such as merger of a corporation. Any merger makes the successor corporation the "successor of the beneficiary" even though the transfer occurs partly by operation of law and partly by the voluntary action of the parties. The definition excludes certain transfers, where no part of the transfer is thought to be "by operation of law"--such as the sale of assets by one company to another.

9. "Draft" in Article 5 does not have the same meaning it has in Article 3. For example, a document may be a draft under Article 5 even though it would not be a negotiable instrument, and therefore would not qualify as a draft under Section 3-104(e).

#### **SECTION 5-103. SCOPE.**

(a) This article applies to letters of credit, as specifically defined in Section 5-102(a)(10), and to certain rights and obligations arising out of transactions involving letters of credit.

(b) The statement of a rule in this article does not by itself require, imply, or negate application of the same or a different rule to a situation not provided for, or to a person not specified, in this article.

(c) With the exception of this subsection, subsections (a) and (d), Sections 5-102(a)(9) and (10), 5-106(d), and 5-114(d), and except to the extent prohibited in Sections 1-102(3) and 5-117(d), the effect of this article may be varied by agreement or by \*163 a provision stated or incorporated by reference in an undertaking. A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this article.

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

#### **COMMENTS**

1. Sections 5-102(a)(10) and 5-103 are the principal limits on the scope of Article 5. Many undertakings in commerce and contract are similar, but not identical to the letter of credit. Principal among those are secondary guarantees. Although the word

“guarantee” is sometimes used in European practice to describe a primary obligation like that of the issuer of a letter of credit, in the United States the word “guarantee” is usually used to describe a suretyship transaction in which the “guarantor” is only secondarily liable and has the right to assert the underlying debtor's defenses. This article does not apply to secondary guarantees and it is important to recognize the distinction between letters of credit and those guarantees. It is often a defense to a secondary guarantor's liability that the underlying debt has been discharged or that the debtor has other defenses to the underlying liability. In letter of credit law, on the other hand, the independence principle recognized throughout Article 5 states that the issuer's liability is independent of the underlying obligation. That the beneficiary may have breached the underlying contract and thus have given a good defense on that contract to the applicant against the beneficiary is no defense for the issuer's refusal to honor. Only staunch recognition of this principle by the issuers and the courts will give letters of credit the continuing vitality that arises from the certainty and speed of \*164 payment under letters of credit. To that end, it is important that the law not carry into letter of credit transactions rules that properly apply only to secondary guarantees or to other forms of engagement.

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 \*165 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.

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

\*166 4. Section 5-102(2) and (3) of Article 5 as it existed prior to 199\_\_ are omitted as unneeded; the omission does not change the law.

**SECTION 5-104. FORMAL REQUIREMENTS.** A letter of credit, confirmation, advice, transfer, amendment, or cancellation may be issued in any form that is a record and is authenticated (i) by a signature or (ii) in accordance with the agreement of the parties or the standard practice referred to in Section 5-108(e).

### COMMENTS

1. Neither Section 5-104 nor the definition of letter of credit in Section 5-102(a)(10) requires that a document contain all the terms that are normally contained in a letter of credit in order for that document to be recognized as a letter of credit under Article 5. For example, a letter of credit should specify the amount available, the expiration date, the place where presentation should be made, and the documents that must be presented to entitle a person to honor. Engagements that have the formalities required by 5-104 and meet the conditions specified in 5-102(a)(10) will be recognized as letters of credit even though they omit one or more of the items usually contained in a letter of credit.

2. The authentication specified in this section is authentication only of the identity of the issuer, confirmer, or adviser. Many authentications will not only identify a particular person to be bound by the letter, confirmation, or advice, but also confirm the accuracy of the information transferred. Authentication of the accuracy of the information transferred is not required under this section but may be required by agreement or applicable practice. The encryption and verification procedures used by S.W.I.F.T., for example, are considered by those in the banking industry to be commercially sufficient to prevent tampering with the transmission and reproduction of documents. The invitation to authenticate by any means that is authorized by agreement or usage would permit the use of existing encryption techniques, the use of third party antirepudiation services, and authentication by other \*167 means not now clearly perceived.

An authentication agreement may be by system rule, standard practice, or by direct agreement between the parties. The reference to practice is intended to incorporate future developments in the UCP as well as those that may arise spontaneously in commercial practice.

3. A “record” must be a “durable representation” that is in or capable of being converted to a perceivable form. For example, an electronic message recorded in a computer memory that could be printed from that memory could constitute a record. Similarly a tape recording of an oral conversation would be a record.

Many banking transactions, including the issuance of many letters of credit, are now conducted mostly by electronic means. For example, S.W.I.F.T. is currently used to transmit letters of credit from issuing to advising banks. The letters of credit so transmitted are printed at the advising bank, stamped “original” and provided to the beneficiary in that form. The printed document may then be used as a way of controlling and recording payments and of recording and authorizing assignments of proceeds or transfers of rights under the letter of credit. Nothing in this section should be construed to conflict with that practice.

By declining to specify any particular medium in which the letter of credit must be established or communicated, Section 5-104 leaves room for future developments.

**SECTION 5-105. CONSIDERATION.** Consideration is not required to issue, amend, transfer, or cancel a letter of credit, advice, or confirmation.

### COMMENT

It is not to be expected that any issuer will engage its letter of credit without some form of remuneration. But it is not expected that the beneficiary will know what the issuer's remuneration \*168 was or whether in fact there was any identifiable remuneration in a given case. And it would be extraordinarily difficult for the beneficiary to prove the issuer's remuneration. This section dispenses with this proof and validates the position of Lord Mansfield in *Pillans v. Van Mierop*, 97 Eng.Rep. 1035 (K.B. 1765).

### **SECTION 5-106. ISSUANCE, AMENDMENT, CANCELLATION, AND DURATION.**

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



(b) After a letter of credit is issued, rights and obligations of a beneficiary, applicant, confirmer, and issuer are not affected by an amendment or cancellation to which that person has not consented except to the extent the letter of credit provides that it is revocable or that the issuer may amend or cancel the letter of credit without that consent.

(c) If there is no stated expiration date or other provision that determines its duration, a letter of credit expires one year after its stated date of issuance or, if none is stated, after the date on which it is issued.

(d) A letter of credit that states that it is perpetual expires five years after its stated date of issuance, or if none is stated, after the date on which it is issued.

### COMMENTS

1. This section adopts the position taken by several courts, namely that letters of credit that are silent as to revocability are irrevocable. *See, e.g.,* *Weyerhaeuser Co. v. First Nat. Bank*, 27 UCC Rep. Serv. 777 (S.D. Iowa 1979); *West Va. Hous. Dev. Fund v. Sroka*, 415 F. Supp. 1107 (W.D. Pa. 1976). This is the position of the current UCP (500). Given the usual commercial understanding and purpose of letters of credit, revocable letters of credit offer unhappy \*169 possibilities for misleading the parties who deal with them.

2. A person can agree to an amendment by implication. For example, a beneficiary that tenders documents for honor that conform to an amended letter of credit but not to the original letter of credit has probably agreed to the amendment. By the same token an applicant that has procured the issuance of a transferable letter of credit has consented to its transfer and to performance under the letter of credit by a person to whom the beneficiary's rights are duly transferred. If some, but not all of the persons involved in a letter of credit transaction agree (by waiver or modification) to performance that does not strictly conform to the original letter of credit, those persons assume the risk that other persons may insist on strict compliance with the original letter of credit. Under subsection (b) those not consenting are not bound. For example, an issuer might agree to amend its letter of credit or take documents presented after the expiration date in the belief that the applicant will consent to the amendment or waive presentation after the original expiration date. If that belief is mistaken, the issuer is bound by the terms of the letter of credit as amended or waived, even though it may be unable to recover from the applicant.

If the issuer and applicant agree to amend a letter of credit and the confirmer, having honored under the original letter of credit, seeks reimbursement, the issuer must reimburse the confirmer. If the issuer had to pay the confirmer more than it would have been obliged to pay if it had given timely notice of the modification to the confirmer, the issuer and not the applicant should bear any loss arising from that failure. In that circumstance the issuer would have to pay the confirmer, but it might have no right of reimbursement against the applicant. Where a nominated person has made an irrevocable commitment to honor before notice of cancellation or modification, it has the same rights as though it had honored before notice.

In general, the rights of a transferee from the beneficiary cannot be altered without the transferee's \*170 consent, but the same is not true of the rights of assignees of proceeds from the beneficiary. When the beneficiary makes a complete transfer of its interest that is effective under the terms for transfer established by the issuer, adviser, or other party controlling transfers, the beneficiary no longer has an interest in the letter of credit, and the transferee steps into the shoes of the beneficiary as the one with rights under the letter of credit. Section 5-102(a)(3). When there is a partial transfer, both the original beneficiary and the transferee beneficiary have an interest in performance of the letter of credit and each expects that its rights will not be altered by modification or amendment unless it consents.

The assignee of proceeds under a letter of credit from the beneficiary enjoys no such expectation. Notwithstanding an assignee's notice to the issuer of the assignment of proceeds, the assignee is not a person protected by subsection (b). An assignee of proceeds should understand that its rights can be changed or completely extinguished by amendment or cancellation of the letter of credit. An assignee's claim is precarious, for it depends entirely upon the continued existence of the letter of credit and upon the beneficiary's preparation and presentation of documents that would entitle the beneficiary to honor under Section 5-108.

6. Although all letters of credit should specify the date on which the issuer's engagement expires, the failure to specify an expiration date does not invalidate the letter of credit, or diminish or relieve the obligation of any party with respect to the

letter of credit. A letter of credit that may be revoked or terminated at the discretion of the issuer by notice to the beneficiary is not “perpetual.”

**SECTION 5-107. CONFIRMER, NOMINATED PERSON, AND ADVISER.**

(a) A confirmer is directly obligated on a letter of credit and has the rights and obligations of an issuer to the extent of its confirmation. The confirmer also has rights against and obligations to the issuer as if the issuer were an applicant and the confirmer \*171 had issued the letter of credit at the request and for the account of the issuer.

(b) A nominated person that is not a confirmer is not obligated to honor or otherwise give value for a presentation.

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

(d) A person that notifies the terms of a letter of credit, confirmation, amendment, or advice to a transferee beneficiary has the rights and obligations of an adviser under subsection (c), but the terms notified to the transferee beneficiary may differ from the terms notified to the transferor beneficiary to the extent permitted by the letter of credit, confirmation, amendment, or advice received by that person.

**COMMENTS**

1. A confirmer has the rights and obligations identified in Section 5-108. Accordingly, unless the context otherwise requires, the terms “confirmer” and “confirmation” should be read into this article wherever the terms “issuer” and “letter of credit” appear.

A confirmer that has paid in accordance with the terms and conditions of the letter of credit is entitled to reimbursement by the issuer even if the beneficiary committed fraud (see Section 5-109(a)(1)(ii)) and, in that sense, has greater rights against the issuer than the beneficiary has. To be entitled to reimbursement from the issuer under the typical confirmed letter of credit, the confirmer must submit conforming documents, but the confirmer's \*172 presentation to the issuer need not be made before the expiration date of the letter of credit.

A letter of credit confirmation has been analogized to a guarantee of issuer performance, to a parallel letter of credit issued by the confirmer for the account of the issuer or the letter of credit applicant or both, and to a back-to-back letter of credit in which the confirmer is a kind of beneficiary of the original issuer's letter of credit. Like letter of credit undertakings, confirmations are both unique and flexible, so that no one of these analogies is perfect, but unless otherwise indicated in the letter of credit or confirmation, a confirmer should be viewed by the letter of credit issuer and the beneficiary as an issuer of a parallel letter of credit for the account of the original letter of credit issuer.

2. No one has a duty to advise until that person agrees to be an adviser or undertakes to act in accordance with the instructions of the issuer. Except in circumstances where there is a prior agreement to serve or where the circumstances would cause the silence of the adviser to be an acceptance of an offer to contract, a person's failure to respond to a request to advise a letter of credit does not in and of itself create any liability, nor does it establish a relationship of issuer and adviser between the two. Since there is no duty to advise a letter of credit in the absence of a prior agreement, there can be no duty to advise it timely or at any particular time. When the adviser manifests its agreement to advise by actually doing so (as is normally the case), the adviser cannot have violated any duty to advise in a timely way. This analysis is consistent with the result of *Sound of Market Street v. Continental Bank International*, 819 F.2d 384 (3d Cir. 1987) which held that there is no such duty. This section takes no position on the reasoning of that case, but does not overrule the result. By advising or agreeing to advise a letter of credit, the adviser assumes a duty to the issuer and to the beneficiary accurately to report what it has received from the issuer, but, beyond determining the apparent authenticity of the letter, an adviser has no duty to investigate the accuracy of the message it has received from the issuer. The duty to \*173 “check” the apparent authenticity of the request to advise means only that the prospective adviser must attempt to authenticate its message and if it is unable to authenticate the message must report that fact to the beneficiary. By proper agreement, an adviser may disclaim its obligation under this section.

3. An issuer may issue a letter of credit which the adviser may advise with different terms. In such circumstances the issuer will believe that it has undertaken a certain engagement, yet the paper document in the hands of the beneficiary will contain different terms, and the beneficiary would not be entitled to honor if the documents it submitted did not comply with the terms of the letter of credit as originally issued. On the other hand, if the adviser also confirmed the letter of credit, it will be independently liable on the letter of credit as advised and confirmed. In such a situation, if the beneficiary's ultimate presentation entitled it to honor under the terms of the written document but not under those in the electronic document, the confirmer would have to honor but might not be entitled to reimbursement from the issuer.

4. When the issuer nominates another person to “pay,” “negotiate,” or otherwise to take up the documents and give value, there can be confusion about the legal status of the nominated person. In some cases the person might actually be an agent of the issuer and its act might be the act of the issuer itself. In most cases the nominated person is not an agent of the issuer and has no authority to act on the issuer's behalf. Its “nomination” allows the beneficiary to present to it and earns it certain rights to payment under Section 5-109 that others do not enjoy. For example, when an issuer issues a “freely negotiable credit,” it contemplates that banks or others might take up documents under that credit and advance value against them, and it is agreeing to pay those persons but only if the presentation to the issuer made by the nominated person complies with the credit. Usually there will be no agreement to pay, negotiate, or to serve in any other capacity by the nominated person, therefore the nominated person will have the right to decline to take the documents. It may return them or agree merely to act as a forwarding \*174 agent for the documents but without giving value against them or taking any responsibility for their conformity to the letter of credit.

**SECTION 5-108. ISSUER'S RIGHTS AND OBLIGATIONS.**

(a) Except as otherwise provided in Section 5-109, an issuer shall honor a presentation that, as determined by the standard practice referred to in subsection (e), appears on its face strictly to comply with the terms and conditions of the letter of credit. Except as otherwise provided in Section 5-113 and unless otherwise agreed with the applicant, an issuer shall dishonor a presentation that does not appear so to comply.

(b) An issuer has a reasonable time after presentation, but not beyond the end of the seventh business day of the issuer after the day of its receipt of documents (i) to honor, (ii) if the letter of credit provides for honor to be completed more than seven business days after presentation, to accept a draft or incur a deferred obligation, or (iii) to give notice to the presenter of discrepancies in the presentation.

(c) Except as otherwise provided in subsection (d), an issuer is precluded from asserting as a basis for dishonor any discrepancy if timely notice is not given, or any discrepancy not stated in the notice if timely notice is given.

(d) Failure to give the notice specified in subsection (b) or to mention fraud, forgery, or expiration in the notice does not preclude the issuer from asserting as a basis for dishonor fraud or forgery as described in Section 5-109(a) or expiration of the letter of credit before presentation.

(e) An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer's observance of that standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of that standard practice.

(f) An issuer is not responsible for (i) the \*175 performance or nonperformance of the underlying contract, arrangement, or transaction, (ii) an act or omission of others, or (iii) observance or knowledge of the usage of a particular trade other than the standard practice referred to in subsection (e).

(g) If an undertaking constituting a letter of credit under Section 5-102(a)(10) contains nondocumentary conditions, an issuer shall disregard the nondocumentary conditions and treat them as if they were not stated.

(h) An issuer that has dishonored a presentation shall return the documents or hold them at the disposal of, and send advice to that effect to, the presenter.

(i) An issuer that has honored a presentation as permitted or required by this article:

(1) is entitled to be reimbursed by the applicant in immediately available funds not later than the date of its payment of funds;

(2) takes the documents free of claims of the beneficiary or presenter;

(3) is precluded from asserting a right of recourse on a draft under Sections 3-414 and 3-415;

(4) except as otherwise provided in Section 5-110 and 5-117, is precluded from restitution of money paid or other value given by mistake to the extent the mistake concerns discrepancies in the documents or tender which are apparent on the face of the presentation; and

(5) is discharged to the extent of its performance under the letter of credit unless the issuer honored a presentation in which a required signature of a beneficiary was forged.

### COMMENTS

1. This section combines some of the duties previously included in Sections 5-114 and 5-109. Because a confirmer has the rights and duties of an \*176 issuer, this section applies equally to a confirmer and an issuer, see Section 5-107(a).

The standard of strict compliance governs the issuer's obligation to the beneficiary and to the applicant. By requiring that a "presentation" appear strictly to comply, the section requires not only that the documents themselves appear on their face strictly to comply, but also that the other terms of the letter of credit such as those dealing with the time and place of presentation are strictly complied with. Typically, a letter of credit will provide that presentation is timely if made to the issuer, confirmer, or any other nominated person prior to expiration of the letter of credit. Accordingly, a nominated person that has honored a demand or otherwise given value before expiration will have a right to reimbursement from the issuer even though presentation to the issuer is made after the expiration of the letter of credit. Conversely, where the beneficiary negotiates documents to one who is not a nominated person, the beneficiary or that person acting on behalf of the beneficiary must make presentation to a nominated person, confirmer, or issuer prior to the expiration date.

Although this section does not impose a bifurcated standard under which the beneficiary's right to honor is more limited than the issuer's right to reimbursement from the applicant, many issuers substantially restrict their liability to the applicant. Where that is done, the beneficiary will have to meet a more stringent standard of compliance as to the issuer than the issuer will have to meet as to the applicant.

Strict compliance does not mean slavish conformity to the terms of the letter of credit. By adopting commercial banking standards and practice as a way of measuring strict compliance, this article indorses the conclusion of the court in *New Braunfels Nat. Bank v. Odiorne*, 780 S.W.2d 313 (Tex. Ct. App. 1989) (beneficiary could collect when draft requested payment on 'Letter of Credit No. 86-122-5' and letter of credit specified 'Letter of Credit No. 86-122-S' holding strict compliance does not demand oppressive perfectionism). The section also indorses the result \*177 in *Tosco Corp. v. Federal Deposit Insurance Corp.*, 723 F.2d 1242 (6th Cir. 1983). The letter of credit in that case called for "drafts Drawn under Bank of Clarksville Letter of Credit Number 105". The draft presented stated "drawn under Bank of Clarksville, Clarksville, Tennessee letter of Credit No. 105." The court correctly found that despite the change of upper case "L" to a lower case "l" and the use of the word "No." instead of "Number," and despite the addition of the words "Clarksville, Tennessee," the presentation conformed. Similarly a document addressed by a foreign person to General Motors as "Jeneral Motors" would strictly conform in the absence of other defects. Where the context of the document does not make the identity of the person named unmistakable, an apparently minor discrepancy in a name could render a document noncomplying. Thus, the court in *Beyene v. Irving Trust Co.*, 762 F.2d 4 (2d Cir. 1985), held a document nonconforming where the name of the party to be notified on the bill of lading was listed as Mohammed Soran rather than Mohammed Sofan.

The section rejects the standard that commentators have called "substantial compliance," the standard arguably applied in *Banco Espanol de Credito v. State Street Bank and Trust Company*, 385 F.2d 230 (1st Cir. 1967) and *Flagship Cruises Ltd. v. New England Merchants Nat. Bank*, 569 F.2d 699 (1st Cir. 1978). The discrepancies in Banco and Flagship were significant, unlike those in the New Braunfels and Tosco cases.

Identifying and determining compliance with standard practice are matters of interpretation for the court, not for the jury. As with similar rules in Sections 4A-202(c) and 2-302, it is hoped that there will be more consistency in the outcomes and speedier resolution of disputes if the responsibility for determining the nature and scope of standard practice is granted to the court, not to a jury. Granting the court authority to make these decisions will also encourage the salutary practice of courts' granting summary judgment in circumstances where there are no significant factual disputes. The statute encourages outcomes such as *American Coleman Co. v. Intrawest Bank*, 887 F.2d 1382 (10th Cir. 1989), where summary \*178 judgment was granted.

In some circumstances standards may be established between the issuer and the applicant by agreement or by custom that would free the issuer from liability that it might otherwise have. For example, an applicant might agree that issuer would have no duty whatsoever to examine documents on certain presentations (e.g., those below a certain dollar amount). Where the transaction depended upon the issuer's payment in a very short time period (e.g., on the same day or within a few hours of presentation), the issuer and the applicant might agree to reduce the issuer's responsibility for failure to discover discrepancies. By the same token, an agreement between the applicant and the issuer might permit the issuer to examine documents exclusively by electronic or electro-optical means. Neither those agreements nor others like them knowingly made by issuers and applicants violate the terms of Section 5-108(a) or (b) or Section 5-103(c).

2. Section 5-108(a) balances the need of the issuer for time to examine the documents (and, when it chooses, to procure waiver) against the possibility that the examiner (at the urging of the applicant or for fear that it will not be reimbursed) will take excessive time to search for defects. Because a large share of all presentations are technically defective, yet the applicant wishes payment to be made, this section allows the issuer a reasonable opportunity to examine documents and procure a waiver from the applicant.

Under both the UCC and the UCP the issuer has a reasonable time to honor or give notice. The outside limit of that time is measured in business days under the UCC and in banking days under the UCP, a difference that will rarely be significant. Neither business nor banking days are defined in Article 5, but a court may find useful analogies in Regulation CC, 12 CFR 229.2, in state law outside of the Uniform Commercial Code, and in Article 4.

Examiners must note that the seven-day period is not a safe harbor. The time within which the issuer **\*179** must give notice is the lesser of a reasonable time or seven business days. Where there are few documents (as, for example, with the mine run standby letter of credit) and no request for a waiver from the applicant, the reasonable time would be far less than seven days. The reasonable time period grows only to accommodate the time required for examination of documents or to seek waivers of discrepancies. If more than a reasonable time is consumed in examination, no timely notice is possible. What is a "reasonable time" is to be determined by examining the behavior of those in the business of examining documents, mostly banks. Absent prior agreement of the issuer, one could not expect a bank issuer to examine documents while the beneficiary waited in the lobby if the normal practice was to give the documents to a person who had the opportunity to examine those together with many others in an orderly process. That the applicant has not yet paid the issuer or that the applicant's account with the issuer is insufficient to cover the amount of the draft is not a basis for extension of the time period.

This section does not preclude the issuer from contacting the applicant during its examination; however, the decision to honor rests with the issuer, and it has no duty to seek a waiver from the applicant or to notify the applicant of receipt of the documents. If the issuer dishonors a conforming presentation, the beneficiary will be entitled to the remedies under Section 5-111 irrespective of the applicant's views.

Even though the person to whom presentation is made cannot conduct a reasonable examination of documents within the time after presentation and before the expiration date, presentation establishes the parties' rights. The beneficiary's right to honor or the issuer's right to dishonor arises upon presentation at the place provided in the letter of credit even though it might take the person to whom presentation has been made several days to determine whether honor or dishonor is the proper course. The issuer's time for honor or giving notice of dishonor may be extended or shortened by a term in the letter of credit. The time for the issuer's performance may be otherwise modified or waived in accordance with Section 5-106.

**\*180** The issuer's time to inspect runs from the time of its "receipt of documents." Documents are considered to be received only when they are received at the place specified for presentation by the issuer or other party to whom presentation is made.

Failure of the issuer to act within the time permitted by subsection (b) constitutes dishonor. Because of the preclusion in subsection (c) and the liability that the issuer may incur under Section 5-111 for wrongful dishonor, the effect of such a silent dishonor may ultimately be the same as though the issuer had honored, i.e., it may owe damages in the amount drawn but unpaid under the letter of credit.

3. The requirement that the issuer send notice of the discrepancies or be precluded from asserting discrepancies is new to Article 5. It is taken from the similar provision in the UCP and is intended to promote certainty and finality.

The section thus substitutes a strict preclusion principle for the doctrines of waiver and estoppel that might otherwise apply under Section 1-103. It rejects the reasoning in *Flagship Cruises Ltd. v. New England Merchants' Nat. Bank*, 569 F.2d 699 (1st

Cir. 1978) and *Wing On Bank Ltd. v. American Nat. Bank & Trust Co.*, 457 F.2d 328 (5th Cir. 1972) where the issuer was held to be estopped only if the beneficiary relied on the issuer's failure to give notice.

Assume, for example, that the beneficiary presented documents to the issuer shortly before the letter of credit expired, in circumstances in which the beneficiary could not have cured any discrepancy before expiration. Under the reasoning of *Flagship* and *Wing On*, the beneficiary's inability to cure, even if it had received notice, would absolve the issuer of its failure to give notice. The virtue of the preclusion obligation adopted in this section is that it forecloses litigation about reliance and detriment.

Even though issuers typically give notice of the discrepancy of tardy presentation when presentation is made after the expiration of a credit, they are not required to give that notice and the section permits \*181 them to raise late presentation as a defect despite their failure to give that notice.

4. To act within a reasonable time, the issuer must normally give notice without delay after the examining party makes its decision. If the examiner decides to dishonor on the first day, it would be obliged to notify the beneficiary shortly thereafter, perhaps on the same business day. This rule rejects the reasoning in cases such as *Lennox Indus. v. Mid-American Nat. Bank & Trust Co.*, 49 Ohio App.3d 117, 550 N.E.2d 971 (1988) and accepts the reasoning in cases such as *Datapoint Corp. v. M & I Bank*, 665 F. Supp. 722 (W.D. Wis. 1987) and *Esso Petroleum Canada, Div. of Imperial Oil, Ltd. v. Security Pacific Bank*, 710 F. Supp. 275 (D. Ore. 1989).

By rejecting the reasoning in *Lennox Industries* the section deprives the examining party of the right simply to sit on a presentation that is made within seven days of expiration. The section requires the examiner to examine the documents and make a decision and, having made a decision to dishonor, to communicate promptly with the presenter. Nevertheless, a beneficiary who presents documents shortly before the expiration of a letter of credit runs the risk that it will never have the opportunity to cure any discrepancies.

5. Confirmers, other nominated persons, and collecting banks acting for beneficiaries can be presenters and, when so, are entitled to the notice provided in subsection (b). Even nominated persons who have honored or given value against an earlier presentation of the beneficiary and are themselves seeking reimbursement or honor need notice of discrepancies in the hope that they may be able to procure complying documents. The issuer has the obligations imposed by this section whether the issuer's performance is characterized as "reimbursement" of a nominated person or as "honor."

6. In many cases a letter of credit authorizes presentation by the beneficiary to someone other than the issuer. Sometimes that person is identified as a "payor" or "paying bank", or as an "acceptor" or \*182 "accepting bank", in other cases as a "negotiating bank", and in other cases there will be no specific designation. The section does not impose any duties on a person other than the issuer or confirmer, however a nominated person or other person may have liability at common law if it fails to perform an express or implied agreement with the beneficiary.

7. The issuer's obligation to honor runs not only to the beneficiary but also to the applicant. It is possible that an applicant who has made a favorable contract with the beneficiary will be injured by the issuer's wrongful dishonor. Except to the extent that the contract between the issuer and the applicant limits that liability, the issuer will have liability to the applicant for wrongful dishonor under Section 5-111 as a matter of contract law.

The issuer's obligation to dishonor when there is no apparent compliance with the letter of credit runs only to the applicant. No other party to the transaction can complain if the applicant waives compliance with terms or conditions of the letter of credit or agrees to a less stringent standard for compliance than that supplied by this article.

Waiver of discrepancies by an issuer or an applicant in one or more presentations does not waive similar discrepancies in a future presentation. Neither the issuer nor the beneficiary can reasonably rely upon honor over past waivers as a basis for concluding that a future defective presentation will justify honor. The reasoning of *Courtaulds of North America Inc. v. North Carolina Nat. Bank*, 528 F.2d 802 (4th Cir. 1975) is accepted and that expressed in *Schweibish v. Pontchartrain State Bank*, 389 So.2d 731 (La.App. 1980) and *Titanium Metals Corp. v. Space Metals, Inc.*, 529 P.2d 431 (Utah 1974) is rejected.

8. The standard practice referred to in subsection (e) could consist of the Uniform Customs and Practice and of other practice rules published by associations of financial institutions or others. It is possible that standard practice will vary from one place to another. Where there are conflicting practices, the parties should indicate which practice governs their \*183 rights. A practice may be overridden by agreement or course of dealing. See Section 1-205(4). Where there is no applicable practice, a letter of

credit, confirmation, advice and other undertaking governed by this article should be interpreted like any other engagement but with due consideration of the objectives of this article.

9. The responsibility of the issuer under a letter of credit is to examine documents and to make a prompt decision to honor or dishonor based upon that examination. Nondocumentary conditions have no place in this regime and are better accommodated under contract or suretyship law and practice. In requiring that nondocumentary conditions in letters of credit be ignored as surplusage, Article 5 remains aligned with the UCP (see UCP 500 Article 13c), approves cases like *Pringle-Associated Mortgage Corp. v. Southern National Bank*, 571 F.2d 871, 874 (5th Cir. 1978), and rejects the reasoning in cases such as *Sherwood & Roberts, Inc. v. First Security Bank*, 682 P.2d 149 (Mont. 1984).

Subsection (g) recognizes that letters of credit sometimes contain nondocumentary terms or conditions. Conditions such as a term prohibiting “shipment on vessels more than 15 years old”, are to be disregarded and treated as surplusage. Similarly, a requirement that there be an award by a “duly appointed arbitrator” would not require the issuer to determine whether the arbitrator had been “duly appointed.” Likewise a term in a standby letter of credit that provided for differing forms of certification depending upon the particular type of default does not oblige the issuer independently to determine which kind of default has occurred. These conditions must be disregarded by the issuer. Where the nondocumentary conditions are central and fundamental to the issuer's obligation (as for example a condition that would require the issuer to determine in fact whether the beneficiary had performed the underlying contract or whether the applicant had defaulted) their inclusion may remove the undertaking from the scope of Article 5 entirely. See Section 5-102(a)(10) and Comment 5 to Section 5-102.

Subsection (g) would not permit the beneficiary or the issuer to disregard terms in the letter of \*184 credit such as place, time, and mode of presentation. The rule in subsection (g) is intended to prevent an issuer from deciding or even investigating extrinsic facts, but not from consulting the clock, the calendar, the relevant law and practice, or its own general knowledge of documentation or transactions of the type underlying a particular letter of credit.

Even though nondocumentary conditions must be disregarded in determining compliance of a presentation, an issuer that honors in disregard of nondocumentary conditions may have liability to its applicant for disregarding the conditions, or the applicant may have a defense to its obligation to reimburse because of the nonoccurrence of a nondocumentary condition. That liability or defense would arise only if the applicant could show that it suffered damage in the underlying transaction because of nonoccurrence of a condition. Mere payment does not show such injury. For example, the nonoccurrence of a condition that the goods be carried in ships less than 15 years old would cause no damage where the goods were successfully delivered in a ship older than 15 years.

10. Subsection (f) condones an issuer's ignorance of “any usage of a particular trade”; that trade is the trade of the applicant, beneficiary, or others who may be involved in the underlying transaction. The issuer is expected to know usage that is commonly encountered in the course of document examination. For example, an issuer should know the common usage with respect to documents in the maritime shipping trade but would not be expected to understand synonyms used in a particular trade for product descriptions appearing in a letter of credit or an invoice.

11. Where the issuer's performance is the transfer of something of value other than money, the applicant has an obligation to make the “thing of value” available to the issuer in time for the issuer to perform under the letter of credit.

12. An issuer is entitled to reimbursement from the applicant after honor of a forged or fraudulent drawing if honor was permitted under Section 5-109(a). Absent injunction or irrefutable and conclusive proof \*185 of forgery or material fraud, the issuer may ignore claims and evidence of fraud of the applicant. See Comment 2 to Section 5-109.

13. The last clause of Section 5-108(i)(5) deals with a special case in which the fraud is not committed by the beneficiary, but is committed by a stranger to the transaction who forges the beneficiary's signature. If the issuer pays against documents on which a required signature of the beneficiary is forged, it remains liable to the true beneficiary. If its reimbursement agreement so provides, the issuer will have a right to be reimbursed by the applicant for its payment from the applicant and also to be reimbursed for a later payment against a genuine draw.

#### **SECTION 5-109. FRAUD AND FORGERY.**

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

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

(2) the issuer, acting in good faith, may honor or dishonor the presentation, if the conditions in paragraph (1) are not met.

(b) If an applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, a **\*186** court of competent jurisdiction may temporarily or permanently enjoin the issuer from honoring a presentation or grant similar relief against the issuer or other persons only if the court finds that:

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

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

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

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

#### COMMENTS

1. The new formulation makes clear that fraud must be found either in the documents or must have been committed by the beneficiary on the issuer or applicant. See *Cromwell v. Commerce & Energy Bank*, 464 So.2d 721 (La. 1985).

Secondly, it makes clear that fraud must be "material." Necessarily courts will have to decide the breadth and width of "materiality." The use of the word requires that the fraudulent aspect of a document be material to a purchaser of that document or that the fraudulent act be significant to the participants in the underlying transaction. Assume, for example, that the beneficiary has a contract to deliver 1,000 barrels of salad oil. Knowing that it has delivered only 998, the beneficiary nevertheless submits an invoice showing 1,000 barrels. If two barrels in a 1,000 barrel shipment would be an insubstantial and immaterial breach of the underlying contract, the beneficiary's act, though possibly fraudulent, is not materially so **\*187** and would not justify an injunction. Conversely, the knowing submission of those invoices upon delivery of only five barrels would be materially fraudulent. One must examine the underlying transaction when there is an allegation of material fraud, for only by examining that transaction can one determine whether a document is fraudulent or the beneficiary has committed fraud and, if so, whether the fraud was material.

Material fraud by the beneficiary occurs only when the beneficiary has no colorable right to expect honor and where there is no basis in fact to support such a right to honor. The section indorses articulations such as those stated in *Intraworld Indus. v. Girard Trust Bank*, 336 A.2d 316 (Pa. 1975), *Roman Ceramics Corp. v. People's Nat. Bank*, 714 F.2d 1207 (3d Cir. 1983), and similar decisions. These decisions have been summarized as follows in *Ground Air Transfer v. Westate's Airlines*, 899 F.2d 1269, 1272-73 (1st Cir. 1990):

We have said throughout that courts may not "normally" issue an injunction because of an important exception to the general "no injunction" rule. The exception, as we also explained in *Itek*, 730 F.2d at 24-25, concerns "fraud" so serious as to make it obviously pointless and unjust to permit the beneficiary to obtain the money. Where the circumstances "plainly" show that the underlying contract forbids the beneficiary to call a letter of credit, *Itek*, 730 F.2d at 24; where they show that the contract deprives the beneficiary of even a "colorable" right to do so, *id.*, at 25; where the contract and circumstances reveal that the beneficiary's demand for payment has "absolutely no basis in fact," *id.*; see *Dynamics Corp. of America*, 356 F. Supp. at 999; where the beneficiary's conduct has "" so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served, "" *Itek*, 730 F.2d at 25 (quoting *Roman Ceramics Corp. v. Peoples National Bank*, 714 F.2d 1207, 1212 n.12, 1215 (3d Cir. 1983) (quoting *Intraworld Indus.*, 336 A.2d at 324-25)); then a court may enjoin payment.



**\*188** 2. Subsection (a)(2) makes clear that the issuer may honor in the face of the applicant's claim of fraud. The subsection also makes clear what was not stated in former 5-114, that the issuer may dishonor and defend that dishonor by showing fraud or forgery of the kind stated in subsection (a). Because issuers may be liable for wrongful dishonor if they are unable to prove forgery or material fraud, presumably most issuers will choose to honor despite applicant's claims of fraud or forgery unless the applicant procures an injunction. Merely because the issuer has a right to dishonor and to defend that dishonor by showing forgery or material fraud does not mean it has a duty to the applicant to dishonor. The applicant's normal recourse is to procure an injunction, if the applicant is unable to procure an injunction, it will have a claim against the issuer only in the rare case in which it can show that the issuer did not honor in good faith.

3. Whether a beneficiary can commit fraud by presenting a draft under a clean letter of credit (one calling only for a draft and no other documents) has been much debated. Under the current formulation it would be possible but difficult for there to be fraud in such a presentation. If the applicant were able to show that the beneficiary were committing material fraud on the applicant in the underlying transaction, then payment would facilitate a material fraud by the beneficiary on the applicant and honor could be enjoined. The courts should have an appropriate skepticism about claims of fraud by one who has signed a "suicide" or clean credit and thus granted a beneficiary the right to draw by mere presentation of a draft.

4. The standard for injunctive relief is high, and the burden remains on the applicant to show, by evidence and not by mere allegation, that such relief is warranted. Some courts have enjoined payments on letters of credit on insufficient showing by the applicant. For example, in *Griffin Cos. v. First Nat. Bank*, 374 N.W.2d 768 (Minn. App. 1985), the court enjoined payment under a standby letter of credit, basing its decision on plaintiff's allegation, rather than competent evidence, of fraud.

**\*189** 5. Although the statute deals principally with injunctions against honor, it also cautions against granting "similar relief" and the same principles apply when the applicant or issuer attempts to achieve the same legal outcome by injunction against presentation (see *Ground Air Transfer Inc. v. Westates Airlines, Inc.*, 899 F.2d 1269 (1st Cir. 1990)), interpleader, declaratory judgment, or attachment. These attempts should face the same obstacles that face efforts to enjoin the issuer from paying. Expanded use of any of these devices could threaten the independence principle just as much as injunctions against honor. For that reason courts should have the same hostility to them and place the same restrictions on their use as would be applied to injunctions against honor. Courts should not allow the "sacred cow of equity to trample the tender vines of letter of credit law."

6. Section 5-109(a)(1) also protects specified third parties against the risk of fraud. By issuing a letter of credit that nominates a person to negotiate or pay, the issuer (ultimately the applicant) induces that nominated person to give value and thereby assumes the risk that a draft drawn under the letter of credit will be transferred to one with a status like that of a holder in due course who deserves to be protected against a fraud defense.

7. The "loss" to be protected against--by bond or otherwise under subsection (b)(2)--includes incidental damages. Among those are legal fees that might be incurred by the beneficiary or issuer in defending against an injunction action.

#### **SECTION 5-110. WARRANTIES.**

(a) If its presentation is honored, the beneficiary under a letter of credit warrants:

(1) to the issuer, any other person to whom presentation is made, and the applicant that there is no fraud or forgery of the kind described in Section 5-109(a); and

(2) to the applicant that the drawing does not violate any agreement between the applicant and **\*190** beneficiary or any other agreement intended by them to be secured by the letter of credit.

(b) The warranties in subsection (a) are in addition to warranties arising under Article 3, 4, 7, and 8 because of the presentation or transfer of documents covered by any of those articles.

#### **COMMENT**

1. The warranties in subsection (a) are not given unless a letter of credit has been honored; no warranty under this subsection can ever be a defense to dishonor by the issuer or to nonreimbursement by the applicant.

2. The warranty in 5-110(a)(2) assumes that payment under the letter of credit is final. It does not run to the issuer, only to the applicant. It is not a warranty that the statements made on the presentation of the documents presented are truthful nor is it a warranty that the documents strictly comply under Section 5-108(a). It is a warranty that the beneficiary has faithfully

performed all the acts expressly and implicitly necessary under any underlying agreement to entitle the beneficiary to honor. If, for example, an underlying sales contract authorized the beneficiary to draw only upon “due performance” and the beneficiary drew even though it had breached the underlying contract by delivering defective goods, honor of its draw would break the warranty. By the same token, if the underlying contract authorized the beneficiary to draw only upon actual default or upon its or a third party’s determination of default by the applicant and if the beneficiary drew in violation of its authorization, then upon honor of its draw the warranty would be breached. In many cases, therefore, the documents presented to the issuer will contain inaccurate statements (concerning the goods delivered or concerning default or other matters), but the breach of warranty arises not because the statements are untrue but because the beneficiary has failed to do what it is expressly or implicitly obliged by the underlying contract to do to be entitled to draw.

3. The damages for breach of warranty are not specified in Section 5-111. Courts may find damage \*191 analogies in Section 2-714 in Article 2 and in warranty decisions under Articles 3 and 4.

Unlike wrongful dishonor cases--where the damages usually equal the amount of the draw--the damages for breach of warranty will often be much less than the amount of the draw, sometimes zero. Assume a seller entitled to draw only on proper performance of its sales contract. Assume it breaches the sales contract in a way that gives the buyer a right to damages but no right to reject. The applicant's damages for breach of the warranty in subsection (a)(2) are limited to the damages it could recover for breach of the contract of sale. Alternatively assume an underlying agreement that authorizes a beneficiary to draw only the “amount in default.” Assume a default of \$200,000 and a draw of \$500,000. The damages for breach of warranty would be no more than \$300,000.

**SECTION 5-111. REMEDIES.**

(a) If an issuer wrongfully dishonors or repudiates its obligation to pay money under a letter of credit before presentation, the beneficiary, successor, or nominated person presenting on its own behalf may recover from the issuer the amount that is the subject of the dishonor or repudiation. If the issuer's obligation under the letter of credit was not for the payment of money, the claimant may obtain specific performance or, at the claimant's election, recover an amount equal to the value of performance from the issuer. In either case, the claimant may also recover incidental but not consequential damages. The claimant is not obligated to take action to avoid damages that might be due from the issuer under this subsection. If, despite the lack of a duty to do so, the claimant does avoid damages, its recovery from the issuer shall be reduced by the amount of damages avoided. The issuer shall have the burden of proving the amount of damages avoided. In the case of repudiation the claimant need not present any document.

(b) If an issuer wrongfully dishonors a draft or demand for payment presented under a letter of credit or honors a draft or demand in breach of its obligation to the applicant, the applicant may recover damages \*192 resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach.

(c) If an adviser or nominated person other than a confirmer breaches its obligation under this article or an issuer breaches an obligation not covered in subsection (a) or (b), a person to whom the obligation is owed may recover damages resulting from the breach, including incidental but not consequential damages, less any amount saved as a result of the breach. To the extent of its confirmation, a confirmer has the liability of an issuer specified in subsections (a), (b) and (c).

(d) If an issuer, nominated person, or adviser is found liable under subsection (a), (b), or (c), it shall pay interest on the amount owed thereunder from the date of wrongful dishonor or other appropriate date. Reasonable attorney's fees and other expenses of litigation may be awarded to the prevailing party in an action in which a remedy is sought under this article.

(e) Damages that would otherwise be payable by a party for breach of an obligation under this article may be liquidated by agreement of the relevant parties, but only in an amount or by a formula that is reasonable in light of the then anticipated harm caused by the default or other act or omission.

**COMMENTS**

1. The right to specific performance is new. Also new is the express limitation on the duty of the beneficiary to mitigate damages. Because the letter of credit depends upon speed and certainty of payment, it is important that the issuer not be given an incentive to dishonor. The issuer might have an incentive to dishonor if it could rely on the burden of mitigation falling on

the beneficiary, (to sell goods and sue only for the difference between the price of the goods sold and the amount due under the letter of credit). Under the scheme contemplated by 5-111(a), the beneficiary would present the documents to the issuer. If the issuer chose to dishonor, the beneficiary would have no further duty to the issuer with respect to the goods \*193 covered by documents that the issuer dishonored and returned. The issuer thus takes the risk that the beneficiary will let the goods rot or be destroyed. Of course the beneficiary may have a duty of mitigation to the applicant arising from the underlying agreement, but the issuer would not have the right to assert that duty by way of defense or setoff. See Section 5-117(d). If the beneficiary in fact sells the goods covered by dishonored documents or if the beneficiary in fact sells a draft accepted and then dishonored by the issuer, the net amount so gained should be subtracted from the amount of the beneficiary's damages.

A beneficiary need not present documents as a condition of suit for anticipatory repudiation, but if an issuer or nominated person proves that a beneficiary could never have obtained documents necessary for a presentation conforming to the letter of credit, the beneficiary cannot recover for anticipatory repudiation of the letter of credit. *Doelger v. Battery Park Bank*, 201 A.D. 515, 194 N.Y.S. 582 (1922) and *Decor by Nikkei Int'l, Inc. v. Federal Republic of Nigeria*, 497 F.Supp. 893 (S.D.N.Y. 1980), *aff'd*, 647 F.2d 300 (2d Cir. 1981), *cert. denied*, 454 U.S. 1148 (1982).

Almost all letters of credit, including those that call for an acceptance, are "obligations to pay money" as that term is used in Section 5-111(a).

2. Even though an issuer pays a beneficiary in violation of Section 5-108(a) or of its contract with the applicant, it may have no liability to an applicant. If the underlying contract has been fully performed, the applicant may not have been damaged by the issuer's breach. Such a case would occur when A contracts for goods at \$100 per ton, but, upon delivery, the market value of conforming goods has decreased to \$25 per ton. If the issuer pays over nonconforming documents, there should be no recovery by A for the price differential if the issuer's breach did not alter the applicant's obligation under the underlying contract, i.e., to pay \$100 per ton for goods now worth \$25 per ton. On the other hand, if the applicant intends to resell the goods and must itself satisfy the strict compliance requirements under a \*194 second letter of credit in connection with its sale, the applicant may be damaged by the issuer's payment over an insubstantial defect because the applicant itself may then be unable to procure honor on the letter of credit where it is the beneficiary.

One who inaccurately advises a letter of credit breaches its obligation to the beneficiary, but may cause no damage. If the beneficiary knows the terms of the letter of credit and understands the advice to be inaccurate, the beneficiary will have suffered no damage as a result of the adviser's breach.

3. Since the confirmer has the rights and duties of an issuer, in general it has an issuer's liability, see subsection (c). The confirmer is usually a confirming bank. A confirming bank often also plays the role of an adviser. If it breaks its obligation to the beneficiary, the confirming bank may have liability as an issuer or, depending upon the obligation that was broken, as an adviser. For example, a wrongful dishonor would give it liability as an issuer under Section 5-111(a). On the other hand a confirming bank that broke its obligation to advise the credit but did not commit wrongful dishonor would be treated under Section 5-111(c).

4. Consequential damages are excluded in the belief that these damages can best be avoided by the beneficiary or the applicant and out of the fear that imposing consequential damages on issuers would raise the cost of the letter of credit to a level that might render it uneconomic. A fortiori punitive and exemplary damages are excluded. The bar to consequential damages would not protect an issuer from liability for consequential damages that might be recovered under Article 4. If, for example, the issuer's improper honor of a draft under a letter of credit resulted in a debit to the applicant's bank account which in turn caused some of applicant's checks to be dishonored, this section would not protect the issuer from liability for consequential damages that the applicant might suffer.

Even though an issuer's wrongful dishonor cannot make it liable for consequential damages, the issuer \*195 has sufficient incentive to avoid wrongful dishonor under this section. First, an issuer that wrongfully dishonors has liability for the amount of the draw that it dishonored and there is no duty on the beneficiary to reduce that liability by mitigating. Second, the issuer is liable for interest on the amount of the damages from the date of wrongful dishonor. Third, the court has discretion under subsection (d) to award attorneys' fees and other expenses of litigation, such as fees paid to expert witnesses and other costs typically associated with litigation.

5. The section does not specify a rate of interest. It leaves the setting of the rate to the court. It would be appropriate for a court to use the rate that would normally apply in that court in other situations where interest is imposed by law.

6. The court has discretion to award attorney's fees to the prevailing party, whether that party is an applicant, a beneficiary, an issuer, a nominated person, or adviser. Since the issuer may be entitled to recover its legal fees and costs from the applicant under the reimbursement agreement, allowing the issuer to recover those fees from a losing beneficiary may also protect the applicant against undeserved losses. The party entitled to attorneys' fees has been described as the "prevailing party." Sometimes it will be unclear which party "prevailed," for example, where there are multiple issues and one party wins on some and the other party wins on others. Determining which is the prevailing party is in the discretion of the court. Subsection (d) authorizes attorney's fees in all actions where a remedy is sought "under this article." It applies even when the remedy might be an injunction under Section 5-109 or when the claimed remedy is otherwise outside of Section 5-110.

"Expenses of litigation" may be broader than "costs." For example, expense of litigation would include travel expenses of witnesses, fees for expert witnesses, and expenses associated with taking depositions.

**\*196 SECTION 5-112. TRANSFER OF LETTER OF CREDIT.**

(a) Except as otherwise provided in Section 5-113, unless a letter of credit provides that it is transferable, the right of a beneficiary to draw or otherwise demand performance under a letter of credit may not be transferred.

(b) Even if a letter of credit provides that it is transferable, the issuer may refuse to recognize or carry out a transfer if:

(1) the transfer would violate applicable law; or

(2) the transferor or transferee has failed to comply with any requirement stated in the letter of credit or any other requirement relating to transfer imposed by the issuer which is within standard practice referred to in Section 5-108(e) or is otherwise reasonable under the circumstances.

### COMMENTS

1. In order to protect the applicant's reliance on the designated beneficiary, letter of credit law traditionally has forbidden the beneficiary to convey to third parties its right to draw or demand payment under the letter of credit. Subsection (a) codifies that rule. The term "transfer" refers to the beneficiary's conveyance of that right. Absent incorporation of the UCP (which makes elaborate provision for partial transfer of a commercial letter of credit) or similar trade practice and absent other express indication in the letter of credit that the term is used to mean something else, a term in the letter of credit indicating that the beneficiary has the right to transfer should be taken to mean that the beneficiary may convey to a third party its right to draw or demand payment. Even in that case, the issuer or other person controlling the transfer may make the beneficiary's right to transfer subject to conditions, such as timely notification, payment of a fee, delivery of the letter of credit to the issuer or other person controlling the transfer, or execution of appropriate forms to document the transfer. A nominated person who \*197 is not a confirmer has no obligation to recognize a transfer.

The power to establish "requirements" does not include the right absolutely to refuse to recognize transfers under a transferable letter of credit. An issuer who wishes to retain the right to deny all transfers should not issue transferable letters of credit or should incorporate the UCP. By stating its requirements in the letter of credit an issuer may impose any requirement without regard to its conformity to practice or reasonableness. Transfer requirements of issuers and nominated persons must be made known to potential transferors and transferees to enable those parties to comply with the requirements. A common method of making such requirements known is to use a form that indicates the information that must be provided and the instructions that must be given to enable the issuer or nominated person to comply with a request to transfer.

2. The issuance of a transferable letter of credit with the concurrence of the applicant is *ipso facto* an agreement by the issuer and applicant to permit a beneficiary to transfer its drawing right and permit a nominated person to recognize and carry out that transfer without further notice to them. In international commerce, transferable letters of credit are often issued under circumstances in which a nominated person or adviser is expected to facilitate the transfer from the original beneficiary to a transferee and to deal with that transferee. In those circumstances it is the responsibility of the nominated person or adviser to establish procedures satisfactory to protect itself against double presentation or dispute about the right to draw under the letter of credit. Commonly such a person will control the transfer by requiring that the original letter of credit be given to it

or by causing a paper copy marked as an original to be issued where the original letter of credit was electronic. By keeping possession of the original letter of credit the nominated person or adviser can minimize or entirely exclude the possibility that the original beneficiary could properly procure payment from another bank. If the letter of credit requires presentation of the original \*198 letter of credit itself, no other payment could be procured. In addition to imposing whatever requirements it considers appropriate to protect itself against double payment the person that is facilitating the transfer has a right to charge an appropriate fee for its activity.

“Transfer” of a letter of credit should be distinguished from “assignment of proceeds”. The former is analogous to a novation or a substitution of beneficiaries. It contemplates not merely payment to but also performance by the transferee. For example, under the typical terms of transfer for a commercial letter of credit, a transferee could comply with a letter of credit transferred to it by signing and presenting its own draft and invoice. An assignee of proceeds, on the other hand, is wholly dependent on the presentation of a draft and invoice signed by the beneficiary.

By agreeing to the issuance of a transferable letter of credit, which is not qualified or limited, the applicant loses control over the identity of the person whose performance will earn payment under the letter of credit.

**SECTION 5-113. TRANSFER BY OPERATION OF LAW.**

(a) A successor of the beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in the name of the beneficiary without disclosing its status as a successor.

(b) A successor of the beneficiary may consent to amendments, sign and present documents, and receive payment or other items of value in its own name as the disclosed successor of the beneficiary. Except as otherwise provided in subsection (e), an issuer shall recognize a disclosed successor of the beneficiary as beneficiary in full substitution for its predecessor upon compliance with the requirements for recognition by the issuer of a transfer of drawing rights by operation of law under the standard practice referred to in Section 5-108(e) or, in the absence of such practice, compliance with other reasonable procedures \*199 sufficient to protect the issuer.

(c) An issuer is not obliged to determine whether a purported successor is a successor of the beneficiary or whether the signature of a purported successor is genuine or authorized.

(d) Honor of a purported successor's apparently complying presentation under subsection (a) or (b) has the consequences specified in Section 5-108(i) even if the purported successor is not the successor of the beneficiary. Documents signed in the name of the beneficiary or of a disclosed successor by a person who is neither the beneficiary nor the successor of the beneficiary are forged documents for the purposes of Section 5-109.

(e) An issuer whose rights of reimbursement are not covered by subsection (d) or substantially similar law and any confirmer or nominated person may decline to recognize a presentation under subsection (b).

(f) A beneficiary whose name is changed after the issuance of a letter of credit has the same rights and obligations as a successor of the beneficiary under this section.

**COMMENT**

This section is new. It affirms the result in *Pastor v. Nat. Republic Bank of Chicago*, 76 Ill.2d 139, 390 N.E.2d 894 (Ill. 1979) and *Federal Deposit Insurance Co. v. Bank of Boulder*, 911 F.2d 1466 (10th Cir. 1990).

Evidence to prove a successor's status might be a certificate of merger, a court order appointing a bankruptcy trustee or receiver, a certificate of appointment as bankruptcy trustee, or the like. The issuer is entitled to rely upon such documents which on their face demonstrate that presentation is made by a successor of the beneficiary. It is not obliged to make an independent investigation to determine the fact of succession.

**\*200 SECTION 5-114. ASSIGNMENT OF PROCEEDS.**

(a) In this section, “proceeds” of a letter of credit means the cash, check, accepted draft, or other item of value paid or delivered upon honor or giving of value by the issuer or any nominated person under the letter of credit. The term does not include a beneficiary's drawing rights or documents presented by the beneficiary.

(b) A beneficiary may assign its right to part or all of the proceeds of a letter of credit. The beneficiary may do so before presentation as a present assignment of its right to receive proceeds contingent upon its compliance with the terms and conditions of the letter of credit.

(c) An issuer or nominated person need not recognize an assignment of proceeds of a letter of credit until it consents to the assignment.

(d) An issuer or nominated person has no obligation to give or withhold its consent to an assignment of proceeds, but consent may not be unreasonably withheld if the assignee possesses and exhibits the letter of credit and presentation of the letter of credit is a condition to honor.

(e) Rights of a transferee beneficiary or nominated person are independent of the beneficiary's assignment of the proceeds of a letter of credit and are superior to the assignee's right to letter of credit proceeds.

(f) Neither the rights recognized by this section between an assignee and an issuer, transferee beneficiary or nominated person nor the issuer's or nominated person's payment of proceeds to an assignee or a third person affect the rights between the assignee and any person other than the issuer, transferee beneficiary, or nominated person. The mode of creating and perfecting a security interest in or granting an assignment of a beneficiary's rights to proceeds is governed by Article 9 or other law. Against persons other than the issuer, transferee beneficiary, or nominated person, the rights and \*201 obligations arising upon the creation of a security interest or other assignment of a beneficiary's right to proceeds and its perfection are governed by Article 9 or other law.

#### COMMENT

Subsection (b) expressly validates the beneficiary's present assignment of letter of credit proceeds if made after the credit is established but before the proceeds are realized. This section adopts the prevailing usage-- "assignment of proceeds"--to payment to an assignee. That terminology carries with it no implication, however, that an assignee acquires no interest until the proceeds are paid by the issuer. For example, an "assignment of the right to proceeds" of a letter of credit for purposes of security that meets the requirements of Section 9-203(1) would constitute the present creation of a security interest in that right. This security interest can be perfected by possession (Section 9-305) if the letter of credit is in written form. Although subsection (a) explains the meaning of "proceeds" of a letter of credit, it should be emphasized that those proceeds also may be Article 9 proceeds of other collateral. For example, if a seller of inventory receives a letter of credit to support the account that arises upon the sale, payments made under the letter of credit are Article 9 proceeds of the inventory, account, and any document of title covering the inventory. Thus, the secured party who had a perfected security interest in that inventory, account, or document has a perfected security interest in the proceeds collected under the letter of credit, so long as they are identifiable cash proceeds (Section 9-306(2), (3)). This perfection is continuous, regardless of whether the secured party perfected a security interest in the right to letter of credit proceeds.

An assignee's rights to enforce an assignment of proceeds against an issuer and the priority of the assignee's rights against a nominated person or transferee beneficiary are governed by Article 5. Those rights and that priority are stated in subsections (c), (d), and (e). Note also that Section 4-210 gives first priority to a collecting bank that \*202 has given value for a documentary draft.

**SECTION 5-115. STATUTE OF LIMITATIONS.** An action to enforce a right or obligation arising under this article must be commenced within one year after the expiration date of the relevant letter of credit or one year after the [[claim for relief] [cause of action] accrues, whichever occurs later. A [claim for relief] [cause of action] accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach.

#### COMMENT

This section is based upon Sections 4-111 and 2-725(2).

#### **SECTION 5-116. CHOICE OF LAW.**

(a) The liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction chosen by an agreement that constitutes a record and is signed or otherwise authenticated by the affected parties in the manner

provided in Section 5-104 or by a provision in that person's letter of credit, confirmation, or other undertaking. The jurisdiction whose law is chosen need not bear any relation to the transaction.

(b) Unless subsection (a) applies, the liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction in which the person is located. A person is considered to be located at the address indicated in the person's undertaking. If more than one address is indicated, the issuer, confirmer, or other person is considered to be located at the address from which the person's undertaking was issued. For the purpose of jurisdiction, choice of law, and recognition of interbranch letters of credit, but not enforcement of a judgment, all branches of a bank are considered separate juridical entities and a bank is considered to be located at the place where its relevant branch is considered to be located under this subsection.

(c) Except as otherwise provided in this subsection, the liability of an issuer, nominated ~~\*203~~ person, or adviser is governed by any rules of custom or practice, such as the Uniform Customs and Practice for Documentary Credits, to which the letter of credit, confirmation, or other undertaking is expressly made subject. If (i) this article would govern the liability of an issuer, nominated person, or adviser under subsection (a) or (b), (ii) the relevant undertaking incorporates rules of custom or practice, and (iii) there is conflict between this article and those rules as applied to that undertaking, those rules govern except to the extent of any conflict with the nonvariable provisions specified in Section 5-103(c).

(d) If there is conflict between this article and Article 3, 4, 4A, or 9, this article governs.

(e) The forum for settling disputes arising out of an undertaking within this article may be chosen in the manner and with the binding effect that governing law may be chosen in accordance with subsection (a).

#### COMMENTS

1. Although it would be possible for the parties to agree otherwise, the law normally chosen by agreement under subsection (a) and that provided in the absence of agreement under subsection (b) is the substantive law of a particular jurisdiction not including the choice of law principles of that jurisdiction. Thus, two parties, an issuer and an applicant, both located in Oklahoma might choose the law of New York. Unless they agree otherwise, the section anticipates that they wish the substantive law of New York to apply to their transaction and they do not intend that a New York choice of law principle might direct a court to Oklahoma law. By the same token, the liability of an issuer located in New York is governed by New York substantive law--in the absence of agreement--even in circumstances in which choice of law principles found in the common law of New York might direct one to the law of another state. Subsection (b) states the relevant choice of law principles and it should not be subordinated to some other choice of law rule. Within the states of the United States renvoi will not be a problem once every jurisdiction has enacted section 5-116 because every ~~\*204~~ jurisdiction will then have the same choice of law rule and in a particular case all choice of law rules will point to the same substantive law.

2. Because the confirmer or other nominated person may choose different law from that chosen by the issuer or may be located in a different jurisdiction and fail to choose law, it is possible that a confirmer or nominated person may be obligated to pay (under their law) but will not be entitled to reimbursement from the issuer (under its law). Similarly the rights of an unreimbursed issuer, confirmer, or nominated person against a beneficiary under 5-109, 5-110, or 5-117, will not necessarily be governed by the same law that applies to the issuer's or confirmer's obligation upon presentation. Because the UCP and other practice are incorporated in most international letters of credit, disputes arising from different legal obligations to honor have not been frequent. Since Section 5-108 incorporates standard practice, these problems should be further minimized--at least to the extent that the same practice is and continues to be widely followed.

3. This section does not permit what is now authorized by the nonuniform Section 5-102(4) in New York. Under the current law in New York a letter of credit that incorporates the UCP is not governed in any respect by Article 5. Under revised Section 5-116 letters of credit that incorporate the UCP or similar practice will still be subject to Article 5 in certain respects. First incorporation of the UCP or other trade practice does not override the nonvariable terms of Article 5. Second, where there is no conflict between Article 5 and the relevant provision of the UCP or other trade practice, both apply. Third, provisions of a trade practice incorporated in a letter of credit will not be effective if they fail to comply with Section 5-103(c). Assume, for example, that a trade practice purported to free a party from any liability unless it were "grossly negligent" or that the practice

generally limited the remedies that one party might have against another. Depending upon the circumstances, that disclaimer or limitation of liability might be ineffective because of Section 5-103(c).

4. In several ways Article 5 conflicts with and overrides similar matters governed by Articles 3 and 4. \*205 For example, “draft” is more broadly defined in letter of credit practice than under Section 3-104. The time allowed for honor and the required notification of reasons for dishonor are different in letter of credit practice than in the handling of documentary and other drafts under Articles 3 and 4. The class of innocent third parties entitled to protection as bona fide purchasers under 5-109(a)(1) is not the same as holders in due course under Section 3-302.

**SECTION 5-117. SUBROGATION OF ISSUER, APPLICANT, AND NOMINATED PERSON.**

(a) An issuer that honors a beneficiary's presentation is subrogated to the rights of the beneficiary to the same extent as if the issuer were a secondary obligor of the underlying obligation owed to the beneficiary and of the applicant to the same extent as if the issuer were the secondary obligor of the underlying obligation owed to the applicant.

(b) An applicant that reimburses an issuer is subrogated to the rights of the issuer against any beneficiary, presenter, or nominated person to the same extent as if the applicant were the secondary obligor of the obligations owed to the issuer and has the rights of subrogation of the issuer to the rights of the beneficiary stated in subsection (a).

(c) A nominated person that pays or gives value against a draft or demand presented under a letter of credit is subrogated to the rights of:

(1) the issuer against the applicant to the same extent as if the nominated person were a secondary obligor of the obligation owed to the issuer by the applicant;

(2) the beneficiary to the same extent as if the nominated person were a secondary obligor of the underlying obligation owed to the beneficiary; and

(3) the applicant to same extent as if the nominated person were the secondary obligor of the underlying obligation owed to the applicant.

\*206 (d) Notwithstanding any agreement or term to the contrary, the rights of subrogation stated in subsections (a) and (b) do not arise until the issuer honors or otherwise pays and the rights in subsection (c) do not arise until the nominated person pays or otherwise gives value. Until then, neither the issuer, nominated person, nor the applicant derives rights under this section, present or prospective, that might form the basis of a claim, defense, or excuse.

**COMMENTS**

1. By itself this section does not grant any right of subrogation. It grants only the right that would exist if the person seeking subrogation “were a secondary obligor.” If the secondary obligor would not have a right to subrogation in the circumstances in which one is claimed under this section, none is granted by this section. In effect, the section does no more than to remove an impediment that some courts have found to subrogation because they conclude that the issuer's or other claimant's rights are “independent” of the underlying obligation. If, for example, a secondary obligor would not have a subrogation right because its payment did not fully satisfy the underlying obligation, none would be available under this section. The section indorses the position of Judge Becker in *Tudor Development Group, Inc. v. United States Fidelity and Guaranty*, 968 F.2d 357 (3rd Cir. 1991).

2. To preserve the independence of the letter of credit obligation and to insure that subrogation not be used as an offensive weapon by an issuer or others, the admonition in subsection (d) must be carefully observed. Only one who has completed its performance in a letter of credit transaction can have a right to subrogation. For example, an issuer may not dishonor and then defend its dishonor or assert a setoff on the ground that it is subrogated to another person's rights. Nor may the issuer complain after honor that its subrogation rights have been impaired by any good faith dealings between the beneficiary and the applicant or any other person. Assume, for example, that the beneficiary under a standby letter of credit is a mortgagee. If the mortgagee were obliged to issue \*207 a release of the mortgage upon payment of the underlying debt (by the issuer under the letter of credit), that release might impair the issuer's rights of subrogation, but the beneficiary would have no liability to the issuer for having granted that release.



**\*208 TRANSITION PROVISIONS**

SECTION 1. EFFECTIVE DATE. This Act shall become effective on 12:01 A.M. on \_\_\_\_\_, 199\_\_.

SECTION 2. REPEAL. This Act [repeals] [amends] [insert citation to existing Article 5].

SECTION 3. APPLICABILITY. This Act applies to a letter of credit that becomes enforceable after 12:01 A.M. on \_\_\_\_\_, 199\_. This Act does not apply to a transaction, event, obligation, or duty arising out of or associated with a letter of credit that became enforceable before 12:01 A.M. on \_\_\_\_\_, 199\_.

SECTION 4. CONTINUED VALIDITY. A transaction validly entered into before the effective time specified in Section 1 and the rights, obligations, and interests flowing from them remain valid and may be terminated, completed, consummated, or enforced as required or permitted by any statute or other law amended or repealed by this Act as though repeal or amendment had not occurred.

**\*209 CONFORMING AND MISCELLANEOUS AMENDMENTS TO ARTICLE 1**

SECTION 1-105. TERRITORIAL APPLICATION OF THE ACT; PARTIES' POWER TO CHOOSE APPLICABLE LAW.

....

(2) Where one of the following provisions of this Act specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) to specified:

....

Governing law in the Article on Funds Transfers. Section 4A-507.

Letters of Credit. Section 5-116.

Bulk sales subject to the Article on Bulk Sales. Section 6-103.

....

**\*210 CONFORMING AND MISCELLANEOUS AMENDMENTS TO ARTICLE 2**

SECTION 2-512. PAYMENT BY BUYER BEFORE INSPECTION.

....

(b) despite tender of the required documents the circumstances would justify injunction against honor under the provisions of this Act (Section 5-109(b)).

....

**\*211 COMPLEMENTARY AMENDMENTS TO ARTICLE 9**

§ 9-104. TRANSACTIONS EXCLUDED FROM ARTICLE.

This article does not apply

....

(1) to a transfer of an interest in any deposit account (subsection(1) of Section 9-105), except as provided with respect to proceeds (Section 9-306) and priorities in proceeds (Section 9-312); or

(m) to a transfer of an interest in a letter of credit other than the rights to proceeds of a written letter of credit.

Official Comment

...

[ ]

§ 9-105. Definitions and Index of Definitions.

....

(3) The following definitions in other Articles apply to this Article:

....

“Letter of credit”. Section 5-102.

....

“Letter of credit proceeds” Section 5-114(a)

§ 9-106. Definitions: “Account”; “General Intangibles”.

“Account” means any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance. “General intangibles” means any personal property (including things in action) other than goods, accounts, chattel paper, documents, instruments, letters of credit, letter of credit proceeds, and money. All rights to payment earned or unearned under a charter or other contract involving the use or hire of a vessel and all rights incident to the charter or contract are accounts.

§ 9-304. Perfection of Security Interest in

Instruments, Documents, and Goods Covered by Documents; Perfection by Permissive Filing; Temporary Perfection Without \*212 Filing or Transfer of Possession.

(1) A security interest in chattel paper or negotiable documents may be perfected by filing. A security interest in the rights to proceeds of a written letter of credit can be perfected only by the secured party's taking possession of the letter of credit. A security interest in money or instruments (other than [certificated securities or] instruments which constitute part of chattel paper) can be perfected only by the secured party's taking possession, except as provided in subsections (4) and (5) of this section and subsections (2) and (3) of Section 9-306 on proceeds.

§ 9-305. When Possession by Secured Party Perfects Security Interest Without Filing.

A security interest in goods, instruments [other than certificated securities], money, negotiable documents, or chattel paper may be perfected by the secured party's taking possession of the collateral. A security interest in the right to proceeds of a written letter of credit may be perfected by the secured party taking possession of the letter of credit. If such collateral other than goods covered by a negotiable document is held by a bailee, the secured party is deemed to have possession from the time the bailee receives notification of the secured party's interest. A security interest is perfected by possession from the time possession is taken without a relation back and continues only so long as possession is retained, unless otherwise specified in this Article. The security interest may be otherwise perfected as provided in this Article before or after the period of possession by the secured party.

#### Official Comment

....

1. As under the common law of pledge, no filing is required by this Article to perfect a security interest where the secured party has possession of the collateral. Compare Section 9-302(1)(a). This section permits a security interest to be perfected by transfer of possession only when the collateral is goods, letters of credit (if written), instruments (other than certificated securities, which are governed by Section \*213 8-321), documents or chattel paper: that is to say, accounts and general intangibles are excluded. A security interest in accounts and general intangibles-property not ordinarily represented by any writing whose delivery operates to transfer the claim, may under this Article be perfected only by filing, and this rule would not be affected by the fact that a security agreement or other writing described the assignment of such collateral as a “pledge.” Section 9-302(1) (e) exempts from filing certain assignments of accounts which are out of the ordinary course of financing: such exempted assignments are perfected when they attach under Section 9-303(1); they do not fall within this section.

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