

ALASKA LEGISLATURE COMMITTEE FILES 1999-2000 80/2

9905 HOUSE LABOR & COMMERCE

In accordance with AS 04.06.020, two of the five board members must be actively engaged in the alcoholic beverage industry. As we understand<sup>1</sup> that the board's industry membership is inclined to be more pro-liquor than its public members, we believe there is a built-in perception problem. The board may wish to petition the legislature for a statute change reducing the number of industry members or increasing the number of public members.

We understand that the board considers denial of a license based solely on neighborhood objections to be tantamount to overriding the local governing body's wishes. Yet, as mentioned in our recommendation, only one in thirty of the municipalities responding to our survey indicated that neighborhood objections were considered when deciding whether to file a protest. This lack of coordination may create the perception that these objections are not being heard. During the course of the audit, the director stated he would respond to this problem by increasing his efforts to educate local government and the public about the board's expectations. We support the director in this endeavor.

Another factor that may contribute to a perception problem may be the board's approach to disciplinary action. Even though there were more licensing actions taken in FY 97 than in any year during our audit period, there were only ten<sup>2</sup> actions, and five of those were fines. The "affected public" may view this as low, considering the nature of the industry and the fact that there were 1,801 licenses outstanding. The board should consider how disciplinary actions are perceived. For example, we do not believe local objections to a bar that violates Title 4 would be perceived as being adequately addressed if the bar is allowed to sell its liquor license, rather than have it revoked.<sup>3</sup>

#### Analysis of Public Need

In response to our comment on page 15 that the industry representation on the board may lend itself to bias, the board states that

*... having industry represented on the ABC Board was intended by the State's lawmakers because these persons understand the industry and can act as a bridge between the ABC Board and the alcohol industry. The State takes the same approach on other licensing boards.*

While it is true that other boards do include industry members, we observe that the comparison itself is not valid. It is clearly inappropriate to compare the technical expertise needed in medical, dental, engineering, and similar boards with that required to monitor liquor licenses. The board must understand the liquor laws, but there is no special

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<sup>1</sup> This understanding is based upon interviews. See further discussion below under Analysis of Public Need.

<sup>2</sup> See the table on page 15 of the report.

<sup>3</sup> In addition to its impact on public perception, we believe revocations would also get the industry's attention. Revocation, as oppose to sale, is a tool that would encourage industry-wide Title 4 compliance.

professional expertise needed. We do not believe the board's functions would be compromised by smaller industry representation on the board.

The board also objects to our statement, on page 15, that

*[w]e understand that the board's industry members often cast votes favorable to the licensee, whereas public members are more likely to vote for stronger licensing action, or to deny licensure.*

This was softly written because it was based on interview evidence that could not be confirmed through written documentation. As board minutes are not transcribed and as no vote tabulations are prepared, the only evidence is audiotapes of the meetings. This was deemed to be too time consuming, given the issue at hand. Nevertheless, we believe it to be correct. In fact, the director himself, on two separate occasions, made statements to this effect.

#### Auditor's Comments

DOR points out that the commissioner of public safety appointed ABC Board investigators as special peace officers under AS 18.65.010, and not under AS 04.06.110 as our audit indicates. As an AS 04.06.110 delegation was being considered, we addressed the issue from that perspective. The actual delegation, under AS 18.65.010, occurred after our audit fieldwork was completed.

Even delegations under AS 18.65.010 raise some concerns, as outlined in attorney general opinion number J-66-005-75, dated December 22, 1977. For example, this delegation can only be made when "necessary to assist the division of state troopers in enforcement of criminal laws." [Emphasis Added.] The attorney general states that a "determination of necessity" should be based upon the needs of the troopers, not the requesting agency. However, no such determination was prepared. Further, the attorney general points out that

*[w]hile the statute vests apparently broad discretionary authority in the Commissioner of Public Safety, the legislative history of the bill [CSHB 48, ch. 106 SLA 1961] which originally lead to the enactment of AS 18.65.010 indicates that this authority was to be restrictively exercised within the confines of certain criteria and that the central purpose of the bill was to strengthen state trooper personnel in the more remote areas of Alaska.*

The Committee Report, which accompanied the passage of CSHB 48, emphasized this purpose as follows:

*In the boondocks, it is necessary that there be more law enforcement officers with a minimum of cost; one of the best ways to encourage this is to use the*

*abilities of existing duly qualified police officers. Thus, the village policeman can be utilized beyond the village limits in the enforcement of state laws.*  
[Emphasis Added.]

As the delegation to investigate gambling and prostitution relates to all licensed premises in the State and as the board's enforcement activities have been primarily in urban areas which maintain a police force of their own, we question whether this delegation is consistent with legislative intent.

However, whether the Department of Public Safety delegates police powers under AS 04.06.110 or 18.65.010 and whether such delegations are technically appropriate are not the key issues. The fundamental question that should be addressed is whether this agency should focus on licensing issues or be allowed to evolve into a full-fledged police force.

We thank both the department and the board for their responses. The Auditor's Comments section of the report was intended to spark public debate on this difficult issue. We believe the various perspectives presented here will be helpful in beginning this process.

*Pat Davidson, CPA*

Pat Davidson, CPA  
Acting Legislative Auditor

FEB 23 1999



**Fax Cover Sheet**

DATE: 2/22/99 TIME: \_\_\_\_\_

TO: Wam Rokeberg PHONE: \_\_\_\_\_

FROM: Chris Anderson PHONE: \_\_\_\_\_

Glacier BrewHouse FAX: 465-2040

Glacier BrewHouse FAX: 277-1033

RE: Brew Pst

CC: TI 6:9

Number of pages including cover sheet: \_\_\_\_\_

Message

*Thank you  
Wam*

Norm

This is a possible solution to the Moose's Tooth  
Problem

Soc. 4 AS 04.11.135(a) is amended to read:

- (a) A brewpub license may be issued to the holder of a (G.B.R.)  
Grandfathered Brewery Restaurant license issued on or before the effective date  
of this act
- (b) A brewpub license authorizes the holder of a beverage dispensary  
License to

**Moose's Tooth Brewing Co**

Phone: 278-4999

Fax: 258-4999

Email: [mtbrewco@aol.com](mailto:mtbrewco@aol.com)

**Plant address:**  
2021 Spar Ave.  
Anchorage, AK 99501

**Mailing address:**  
PO Box 202549  
Anchorage, AK 99520

February 23, 1999

Representative Norm Rokeberg  
State Capitol  
Juneau, Alaska 99801-1182

FEB 23 1999

Dear Mr. Rokeberg:

In 1995, we began planning to open a brewpub in Anchorage and applied for a brewery license and a restaurant and eating place license. We were granted these licenses in June and July of 1996 and on October 1, 1996 AS 04.11.450(b) was amended to prohibit the ownership of both a restaurant and eating place license and a brewery license. Although our licenses are currently protected by grandfather rights we are interested in opening a second location but cannot.

Recently Chris Anderson of the Glacier Brewhouse proposed amendments to AS 04.11.135(a) that would allow the original five restaurant/brewery licensees to convert their restaurant and brewery licenses into a brewpub license by purchasing a beverage dispensary license. Although it can be financially difficult for brewpubs that serves only beer and wine to afford a beverage dispensary license we understand the need to address the concerns of the alcohol wholesalers and other beverage dispensary license owners.

We support Mr. Anderson's proposed amendments to AS 04.11.135(a), however our business will be negatively impacted without a small modification to the current proposal. Unlike the other four combination licenses issued prior to October 1, 1996, as the statute presently reads, we cannot opt to convert to a brewpub by purchasing a beverage dispensary license because our restaurant and our brewery are not co-located.

Today Mr. Anderson contacted me and we discussed an amendment to AS 04.11.135(a) that reads:

- (a) A brewpub license may be issued to the holder of a (G.B.R.) Grandfathered Brewery Restaurant license issued on or before the effective date of the act
- (b) A brewpub license authorizes the holder of a beverage dispensary license to:

We believe this language may solve the problems surrounding our unique situation and allow the parties involved to reach an accord.

Please feel free to contact me if you have any questions. We will attend the hearing on HB 69 and look forward to discussing the proposed amendments.

Sincerely,

A handwritten signature in black ink, appearing to read "Matt Jones", with a long horizontal flourish extending to the right.

Matt Jones

PUBLIC OPINION MESSAGE

Mr. Mark Staples  
Midnight Sun Brewing Company  
7329 Arctic Blvd.  
Anchorage, AK 99518

907-261-6419

FEB 24 1998

TO: House committee of Commerce  
Norm Rokeberg


REGARDING: House Bill 69

I am opposed to bill 69 for the following reasons:

1. This bill does not address the problem Restaurant/ Brewery licenses only further complicates it. This bill only helps a small group of special interest. Forcing restaurant/ breweries to buy a beverage dispenser license makes no sense. Economically it will be unfeasible for most small brewer/restaurants to purchase dispensary license. Forcing a business to sell spirits when they only want to serve beer and wine is ludicrous. Also this requirement is out of line with most other states in union. This bill will give my direct competitors Glacier Brew House and Mosaes Tooth an unfair advantage over my operation as it allows them to sell beer at retail prices and also compete with me in liquors stores and the on premiums draft business which I am not allowed to do.
2. Distributing- Requiring a brewery go through a distributor sets a bad precedent. Currently distributors are controlled by the big three breweries (Bud, Miller, Coors). These breweries are increasing there effort to get "100 % piece of mind". They offer distributors incentive packages that local breweries could never compete with. The only thing we have going for us is that if the distributors don't do a good job we can self distribute. If we are forced to use a distributor they will have no motivation to either carry are products or distribute them well.

Thank you.

Sincerely,

  
Mark Staples.

**HB**

**79**

**SPONSOR STATEMENT FOR  
BILL REVISING UNIFORM COMMERCIAL CODE, ARTICLE 5  
(LETTERS OF CREDIT)**

House Labor and Commerce Committee

The basic purpose of the revision of Article 5 of the Uniform Commercial Code is to update the law governing the \$200 billion U.S. letter-of-credit industry. All 50 states and Puerto Rico, Guam, and the District of Columbia have adopted the UCC, including Article 5. It is now necessary for Article 5 to be revised, to recognize changes in technology and in commercial practices, so as to avoid litigation over the increasing number of issues that are no longer adequately dealt with in the decades-old current law. One of the main features of this revision is the simplification of Article 5. Another is its recognition of the Uniform Customs and Practices for Documentary Credits, a body of material that is used in conjunction with most international letters of credit.

Letters of credit are used to obtain payment as a backup to other kinds of credit extension; they are very important in international trade. Prior ambiguities in the law dealing with the concept of fraud in the transaction are clarified. Article 5 becomes much simpler and less detailed because of the explicit reliance upon standards of practice. It continues to provide rules that can be waived or modified by agreement between the parties.

This revision of Article 5, promulgated by the National Conference of Commissioners on Uniform State Laws in 1995, has already been enacted in 39 jurisdictions and, as of January 15 of this year, is pending in the legislature of an additional jurisdiction. It is necessary for Alaska to enact this bill in order to keep up with developments in the commercial law area, and avoid becoming a commercial backwater.

Thank you.

HOUSE COMMITTEE REPORT

(7)

Date Referred to Committee: February 3, 1999

FURTHER REFERRALS:

Judiciary

Date of Committee Action: 3 Mar 1999

The LABOR AND COMMERCE Committee considered:

HB 79

HOUSE BILL NO. 79

UNIFORM COMMERCIAL CODE: LETTERS OF CREDIT

"An Act relating to letters of credit under the Uniform Commercial Code; and providing for an effective date."

recommends it be replaced with the following committee substitute \_\_\_\_\_  the same title  a new title

additional referral to \_\_\_\_\_ Committee  attached amendment(s)

ADOPTS: \_\_\_\_\_ Letter of Intent

ATTACHES NEW FISCAL NOTE(S): \_\_\_\_\_ (Dept)

APPROVES PREVIOUS: \_\_\_\_\_ (Dept/Date)

fiscal note(s) \_\_\_\_\_

fiscal note(s) \_\_\_\_\_

zero fiscal note(s) Dced

zero fiscal note(s) \_\_\_\_\_

SIGNING WITH RECOMMENDATIONS	DP	DNP	NR	AM
<i>[Signature]</i>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<i>[Signature]</i>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<i>[Signature]</i>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<i>[Signature]</i>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
<i>[Signature]</i>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

*[Handwritten initials]* 2-2-99

A Few Facts About  
UCC ARTICLE 5 - LETTERS OF CREDIT

**PURPOSE:** Letters of Credit are used to obtain payment as a backup to other kinds of credit extension; they are very important in international trade. In the revisions there is explicit recognition of standards of practice, so that standards such as the Uniform Customs and Practices for Documentary Credits can govern many of the particulars of letters of credit. Prior ambiguities with the concept of fraud in the transaction are clarified. Damages for a dishonored or repudiated letter of credit are limited to amount of the document plus incidental damages. Consequential damages are not permitted. Article 5 becomes much simpler and less detailed because of the explicit reliance upon standards of practice. Article 5 continues to provide rules that can be waived or modified by agreement between the parties.

**ORIGIN:** Completed by the Uniform Law Commissioners, in conjunction with the American Law Institute, in 1995.

**ENDORSED BY:** American Bar Association

STATE ADOPTIONS:	Alabama	Mississippi
	Arizona	Missouri
	Arkansas	Montana
	California	Nebraska
	Colorado	Nevada
	Connecticut	New Hampshire
	Delaware	New Jersey
	District of Columbia	New Mexico
	Hawaii	North Dakota
	Idaho	Ohio
	Illinois	Oklahoma
	Indiana	Oregon
	Iowa	South Dakota
	Kansas	Tennessee
	Maine	Utah
	Maryland	Vermont
	Massachusetts	Virginia
	Michigan	Washington
	Minnesota	West Virginia
		Wyoming

1999  
**INTRODUCTIONS:** Texas

For any further information about UCC Article 5, Letters of Credit, please contact John McCabe or Katie Robinson at 312-915-0195.

(1/15/99)

*(Please note: This information can also be found on our Web Site at [www.nccusl.org](http://www.nccusl.org))*

## UCC ARTICLE 5 – LETTERS OF CREDIT

– NCCUSL

**WHAT:** Modernizes and clarifies our country's principal law dealing with letters of credit.

**WHY:** Our present law was drafted almost 40 years ago. It is outmoded and no longer reflects commercial practice.

New legal issues have developed which are resolved by the new law.

Revised Article 5 also conforms our law with international law and practice, which facilitates international trade.

Finally, the use of letters of credit has expanded enormously in the past decade or two. They are now used in many large domestic commercial transactions.

**WHEN:** Now.

Revised Article 5 has been approved by the American Law Institute and the National Conference of Commissioners on Uniform State Laws.

American Bar Association approval is anticipated in due course.

The final text of revised Article 5 is available now.

**HOW:** Introduction is anticipated this year or next year in about 20 states, including major money center states such as New York, California and Illinois.

States which do not adopt revised Article 5 will find themselves behind the rest of the country and the rest of the world.

**WHO:** Drafted <sup>by the NCCUSL</sup> with the active participation of advisors from national and international businesses, banks, bar associations and government agencies.

Professor James J. White, co-author of the White & Summers treatise on the Uniform Commercial Code, was the reporter.

## WHY STATES SHOULD ADOPT UCC ARTICLE 5 – LETTERS OF CREDIT

— ACCUSL

The revision to Article 5 of the Uniform Commercial Code – Letters of Credit – updates the law governing the \$200 billion U.S. letter of credit industry. Banks, and occasionally other persons, issue letters of credit to better assure payment to a third party by a customer up to a stated amount, for a stated period of time. Half of all exports outside the U.S. are financed by letters of credit.

Since the 1950s when this article was originally promulgated, the practices and technologies employed with letters of credit have changed substantially, including the use of electronic and computer technology. Litigation has increased as the volume of credits and the uncertainties of the law have stimulated controversies. Thus revision to UCC5 is both appropriate and timely.

There are a number of reasons why every state should adopt revised UCC Article 5:

- ▶ **LETTERS OF CREDIT ARE IMPORTANT** – Letters of credit are very important in international trade. It has become a common method of guaranteeing and obtaining payment. The use of letters of credit has increased in recent years as foreign trade has expanded and increased. The law which regulates letters of credit – UCC Article 5 – is obviously an important component to expansion of foreign trade.
- ▶ **UCC5 RECOGNIZES THE UCP 500** – UCC5 recognizes the Uniform Customs and Practices for Documentary Credits (UCP 500), which is used in most international letters of credit. The UCP 500 was promulgated by the International Chamber of Commerce and provides operational rules and standards that have international acceptance.
- ▶ **STANDARDS OF PRACTICE ARE RECOGNIZED** – Revised UCC5 specifically includes the most commonly used standards of practice. The revision coordinates with current standards of practice by including: deferred payment obligations, reasonable time to examine documents, preclusion, and the return of documents.

- ▶ **UCCS IS MODERNIZED** – Original UCCS in many ways is out of touch with current practice and major gaps cause unnecessary litigation. The revised UCCS authorizes the use of electronic technology; expressly permits deferred payment letters of credit and two-party letters of credit; provides rules for unstated expiration dates and "perpetual" letters of credit; and conforms to existing practice for assignment of proceeds.
- ▶ **UNIFORMITY** – It is important that U.S. law regarding letters of credit be in accord with international rules and practices, but since letters of credit are a major instrument in domestic transactions as well, both international and domestic trade requires uniformity of law. These rules should be consistent within the United States.
- ▶ **CONCLUSION** – The revised UCC Article 5 is a significant improvement over current provisions, and will lessen litigation, clarify matters which had been disputed, and encourage sound practices, promoting international trade. For all of these reasons, UCCS should be adopted by all states as soon as possible.

# LEGAL SERVICES

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Juneau, Alaska 99801-2105

## MEMORANDUM

February 17, 1999

**SUBJECT:** Sectional summary of HB 79 relating to letters of credit (Work Order No. 21-LS0375\D)

**TO:** Representative Norman Rokeberg, Chair  
House Labor and Commerce Committee  
Attn: Janet Seltz

**FROM:** *JB*  
Theresa Bannister  
Legislative Counsel

You have requested a sectional summary of the above-described bill.

As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill. The introductory remarks and the other descriptions of the sections necessarily contain some generalizations and simplifications. As a result, please keep in mind that the bill itself is the best statement of its contents.

Basic description; definitions used in summary. In general, a letter of credit is an agreement by a bank or other person made at the request of a customer that the bank or other person will honor demands for payment (or a demand for delivery of an item of value) when the conditions in the letter of credit are met. As an example, a letter of credit may be used when a bank customer wants to buy some merchandise, but the manufacturer won't ship without assurance of payment. The bank issues a letter of credit and is the "issuer." The customer requesting the letter of credit is the "applicant." The manufacturer (or other person who will be paid) is the "beneficiary."

To obtain the payment or delivery, the beneficiary must present the required documents. This is referred to as a "presentation" of the documents or "presenting" the documents. When the bank pays or delivers the item to the manufacturer, the bank "honors" the letter of credit. If the bank doesn't pay or deliver upon presentation of the documents, the bank "dishonors" the letter of credit.

If the bank authorizes another person to make the payment or deliver under a letter of credit, that person is a "nominated person." If the nominated person also undertakes to honor a letter of credit, that person is a "confirmer."

An "adviser" is a person who notifies the beneficiary (or another "adviser" who will notify the beneficiary) that a letter of credit has been issued, confirmed, or amended.

This bill revises the rules that set up how letters of credit work and the relationships between all of the various parties involved.

**Section 1.** AS 09.30.070(b). Makes an amendment conforming this subsection to proposed AS 45.05.111(d). This bill section deals with interest on a court judgment and establishes when interest starts accruing before the judgment is handed down. Under AS 45.05.111(d), interest on money owed for a liability found under AS 45.05.111(a) - (c) starts when the letter of credit is wrongfully dishonored or on another appropriate date.

**Section 2.** AS 45.01.105(b). Makes an amendment conforming this subsection to the proposed AS 45.05 changes. AS 45.01.105 identifies which state or nation's law governs in certain cases involving more than one state or nation. The amendment states that AS 45.05.116 establishes what law governs for letters of credit.

**Section 3.** AS 45.02.512(a). Makes an amendment conforming this subsection to proposed AS 45.05.109(b). Excuses a buyer from making payment, even if the contract requires payment before inspection and the required documents are tendered, if the circumstances would justify an injunction under AS 45.05.109(b).

**Section 4.** AS 45.05.102. Defines the terms used in the revised chapter on letters of credit (AS 45.05). See the introductory comments to this memo for more simple definitions of the most important terms.

**Section 5.** AS 45.05.103. Defines the scope of AS 45.05.

AS 45.05.103(a). States that the chapter applies to letters of credit and transactions involving letters of credit.

AS 45.05.103(b). States that this chapter, by itself, does not govern how to treat another situation or person not covered by this chapter.

AS 45.05.103(c). States that you can change the provisions of this chapter by an agreement, except as provided by certain listed statutes. States that a general provision to excuse liability or limit remedies won't work to change the obligations imposed by this chapter.

AS 45.05.103(d). States that the rights and obligations of an issuer to a beneficiary, or to a nominated person, are independent of the contracts and arrangements underlying the letter of credit. In other words, the existence, performance, and nonperformance of the underlying contract or arrangement don't affect the rights and obligations under the letter of credit. Includes under this subsection contracts between the issuer and the applicant and between the applicant and the beneficiary.

**Section 6.** AS 45.05.104. Sets out just what a letter of credit and certain related documents must consist of. They must be in a form that can provide a record and must be authenticated

by a signature or authenticated as required under the parties' agreement or by the standard practice referred to in AS 45.05.108(e).

Section 7. AS 45.05.105. States that you don't need consideration (something of value to be received by a party) in order to issue, amend, transfer, or cancel a letter of credit, advice, or confirmation. Contracts usually require that each party receive something as consideration (not necessarily money or other property, but something of value to the party).

Section 8. AS 45.05.106(a). States that a letter of credit becomes enforceable against the issuer when the issuer sends it to the beneficiary or adviser. States that you can't revoke a letter of credit unless the letter says so.

AS 45.05.106(b). States that an amendment or cancellation of a letter of credit does not affect the rights and obligations of certain listed persons (e.g., beneficiary and applicant) unless they consent to the amendment or cancellation, or unless the letter of credit says it is revocable or that the issuer can amend or cancel it without the consent.

AS 45.05.106(c). States when a letter of credit expires if it does not state the date or does not have a provision that determines when it expires. The letter of credit expires one year after its stated date of issuance or, if not stated, one year after the date it is issued.

AS 45.05.106(d). States that a perpetual letter of credit expires five years after its stated date of issuance or, if not stated, five years after the date it is issued.

Section 9. AS 45.05.107(a). States that a confirmer is directly obligated on the letter of credit and has the rights and obligations of the issuer (as far as the letter of confirmation says it does). Also states that the confirmer has rights against, and obligations to, the issuer as if the issuer were the applicant and the confirmer had issued the letter of credit at the request of the issuer.

AS 45.05.107(b). States that a nominated person does not have to honor or give value when the necessary documents are presented to collect under a letter of credit, unless the person is also a confirmer.

AS 45.05.107(c). States that a person requested to advise may decline to act as an adviser. States that an adviser is not required to honor or give value when the necessary documents are presented to collect under a letter of credit, unless the adviser is also a confirmer. States that an adviser's job is to advise accurately about the terms of the letter of credit and related documents, and, with regard to the beneficiary, to check if the request to advise is authentic. States that a letter of credit, confirmation, or amendment is enforceable as issued even if the advice is not accurate.

AS 45.05.107(d). States that a person who notifies a transferee beneficiary (a person to whom the beneficiary has transferred the beneficiary's interest under the letter of credit)

about the terms of a letter of credit or related document has the rights and obligations of an adviser under (e) of this section. States that the terms of the notice to the transferee beneficiary and transferor beneficiary (the beneficiary who transferred the interest in the letter of credit) may be different, as allowed by the letter of credit or related document that is received by the person who notifies the transferee beneficiary.

**Section 10.** AS 45.05.108(a). Except as provided in the section on fraud and forgery, requires an issuer to honor a presentation that appears on its face to comply strictly with the letter of credit. The standard practice of financial institutions determines whether the presentation complies as required. Requires an issuer to dishonor a presentation that does not appear to comply, except as provided in AS 45.05.113 and otherwise agreed with the applicant.

AS 45.05.108(b). States that upon presentation an issuer has a reasonable time to perform certain acts. The reasonable time may not exceed seven business days after the day of receipt. These acts are to honor the presentation, to notify the presenter that there are problems, or, if the letter of credit provides for honor after seven business days after presentation, to accept a draft (check) or incur a deferred obligation.

AS 45.05.108(c). States that in two situations an issuer is prevented from asserting that a problem causes the issuer to dishonor the letter of credit. The first situation is when the issuer does not give timely notice of the problem. The second situation is if the issuer gives notice but the problem is not stated in the notice. This subsection is subject to the fraud, forgery, and expiration assertions under (d).

AS 45.05.108(d). States that an issuer can still assert that there has been fraud or forgery (under AS 45.05.109(a)) or that the letter of credit has expired before presentation in order to dishonor a presentation, even if the issuer failed to give the required notice or to mention the fraud, forgery, or expiration in the notice.

AS 45.05.108(e). Requires an issuer of a letter of credit to comply with the standard practice of financial institutions that regularly issue letters of credit when the issuer handles letters of credit. States that a court is the determiner of whether the issuer has complied with the standard practice. Directs a court to allow the parties to present evidence of what is the standard practice.

AS 45.05.108(f). States what an issuer is not responsible for. An issuer is not responsible for the performance or nonperformance of the contract, arrangement, or transaction underlying the letter of credit. An issuer is not responsible for another person's acts or omissions. An issuer is not responsible for knowing the usage of a particular trade, except for the standard practice of financial institutions issuing letters of credit.

AS 45.05.108(g). Directs an issuer to ignore certain nondocumentary conditions contained in a letter of credit.

AS 45.05.108(h). Requires an issuer who does not honor a presentation under a letter of credit to return the documents presented, or to hold them for the presenter and notify the presenter.

AS 45.05.108(i). Establishes certain rights and limitations for an issuer when the issuer honors a presentation under a letter of credit. The issuer is entitled to be reimbursed by the applicant; the reimbursement must be made in funds that are available immediately to the issuer not later than the date of payment. The issuer takes the documents presented without any claims by the beneficiary or presenter. The issuer may not claim a right of recourse under AS 45.03.414 - 45.03.415 on a draft (check). Except as provided in two other sections, the issuer may not get the money or another valuable back if there was a mistake, if the mistake involves obvious problems in the documents or tender that are apparent on the face of the presentation. The issuer is discharged unless a required signature of the beneficiary was forged.

Section 11. AS 45.05.109(a). Gives an issuer directions on what to do if presentation documents appear to meet the requirements of the letter of credit, but a document is either forged or materially fraudulent, and honoring the documents would result in a material fraud by the beneficiary on the issuer or applicant.

Directs the issuer to honor the presentation of the documents if honor is demanded by certain persons under certain circumstances. The first is a nominated person that has given value in good faith and without notice of the forgery or fraud. The second is a confirmer that has honored its confirmation in good faith. The third is a holder in due course of a draft (check) that was drawn up under the letter of credit and taken by the holder in due course after acceptance by the issuer or nominated person. The fourth is the person who has had the issuer's or nominated person's deferred (doesn't have to be paid immediately) obligation transferred (assigned) to the person, if before the obligation was incurred by the issuer or nominated person, the person gave value to get the assignment and did not have notice of the forgery or fraud.

Allows the issuer to honor or dishonor the request for payment if the issuer acts in good faith and if the situation does not fall under categories (1) - (4) above.

AS 45.05.109(b). Authorizes a court to enjoin an issuer from honoring a request for payment (or grant similar relief against the issuer or other persons) when an applicant claims forgery or fraud, but only if four listed conditions are met. The first is that the relief must not be prohibited under the law governing drafts that have been accepted by the issuer, or governing a deferred obligation incurred by the issuer. The second is that a beneficiary, issuer, or nominated person who may be adversely affected must be adequately protected against loss resulting from the court giving the relief. The third is that all of the conditions for obtaining the court relief in this state must be satisfied. The fourth is that applicant is likely to succeed on the claim of forgery or fraud and the person demanding that the presentation be honored does not qualify for protection under (a)(1).

Section 12. AS 45.05.110(a). Establishes certain things that the beneficiary warrants when the presentation is honored. The beneficiary warrants to the issuer, to another person to whom the presentation is made, and to the applicant that there is no fraud or forgery as those terms are described in AS 45.05.109(a). The beneficiary warrants to the applicant that the payment (or transfer of value) does not violate an agreement between the beneficiary and the applicant or another agreement connected to the letter of credit.

AS 45.05.110(b). States that the warranties in (a) are in addition to other warranties under AS 45.03 (UCC: negotiable instruments), AS 45.04 (UCC: bank deposits and collections), AS 45.07 (UCC: warehouse receipts, bills of lading, and other documents of title), and AS 45.08 (UCC: investment securities) that are related to the presentation or transfer of the documents.

Section 13. AS 45.05.111(a). Allows a beneficiary, successor beneficiary, or a nominated person to recover from the issuer of a letter of credit the amount in dispute if the issuer wrongfully dishonors or states that the issuer will not honor its obligation. If the issuer's obligation is not to pay money, this subsection allows the claimant to make the issuer perform what the issuer was supposed to perform, or, if the claimant elects, to recover an amount of money that equals the value of the performance. Allows the claimant to also recover damages that flow directly and immediately from the dishonor but not more remote damages. States that the claimant does not have to take action to avoid the damages that might result. However, reduces the awarded damages to the extent the claimant does avoid the damages. Requires the issuer to prove the amount of the damages that the claimant avoided. If the claim is based on the issuer repudiating the obligation before presentation of the documents, states that the claimant does not have to present the documents normally required to require the issuer to pay or deliver the value required.

AS 45.05.111(b). Allows the applicant to recover damages from the issuer if the issuer wrongfully dishonors a draft or demand presented under a letter of credit, or if the issuer wrongfully honors a draft or demand under the letter of credit. Allows the claimant to recover damages that flow directly and immediately from the wrongful act, but not the more remote "consequential" damages. Reduces the amount of awarded damages by any amount saved due to the wrongful act.

AS 45.05.111(c). Allows a person to recover from an adviser or nominated person, other than a confirmer, the person's damages resulting from the adviser's or nominated person's breach of an obligation under this chapter or from an issuer's breach of an obligation not covered by (a) or (b). Allows the person to recover only damages that flow directly and immediately from the breach, but not the more remote consequential damages, less any amount the person saves due to the breach. States that a confirmer has the liability of an issuer under (a), (b), and this subsection, to the extent of the confirmation.

AS 45.05.111(d). States that an issuer, a nominated person, or an adviser who is liable under (a) - (c) must pay interest on the amount owed from the date of the wrongful dishonor, or from another appropriate date.

AS 45.05.111(e). Directs the court to award attorney fees and costs to the party who wins a court action for a remedy under this chapter.

AS 45.05.111(f). Allows parties to establish ahead of time by agreement the amount of damages that would result from a breach of an obligation under this chapter. However, the amount or formula for calculating the amount must be reasonable.

Section 14. AS 45.05.112(a). Prohibits transferring the right of a beneficiary to payment or performance under a letter of credit, except when the transfer occurs by operation of law as provided under AS 45.05.113, or unless the letter of credit says the right is transferable.

AS 45.05.112(b). Allows in two circumstances an issuer to refuse to carry out or recognize a transfer, even if allowed under the letter of credit. The first circumstance is that the transfer would violate the law that applies to the situation. The second circumstance is that the transferor or the transferee has failed to comply with the letter of credit, or with another requirement that relates to the transfer, and that is within the standard practice of financial institutions regularly dealing with letters of credit or that is otherwise reasonable under the circumstances.

Section 15. AS 45.05.113(a). Allows a person who succeeds another person as the beneficiary under a letter of credit to perform certain listed acts without having to disclose that it is a successor of the beneficiary. The successor may consent to amendments. The successor may sign and present documents. The successor may receive payment or other items of value in the name of the beneficiary.

AS 45.05.113(b). Allows the successor of a beneficiary to perform certain listed acts in its own name as the disclosed successor to the beneficiary. The disclosed successor may consent to amendments. The disclosed successor may sign and present documents. The disclosed successor may receive payment or other items of value. Except as provided by (e), directs an issuer to recognize a person who is disclosed to be a successor beneficiary as a full beneficiary if the successor beneficiary complies with the standard practice for financial institutions regularly dealing in letters of credit, or, in the absence of the standard practice, with other reasonable procedures that will protect the issuer.

AS 45.05.113(c). States that an issuer does not need to determine whether a person alleging to be a successor beneficiary is actually such a beneficiary or whether the purported successor's signature is genuine or authorized.

AS 45.05.113(d) States that honoring a purported successor's presentation under (a) or (b) that appears to be in compliance has the consequences identified in AS 45.05.108(i) even if

the person is not really the successor of the beneficiary. States that documents signed in the name of the beneficiary or a disclosed successor by a person who is not really the beneficiary or the successor beneficiary are considered to be forged documents when applying AS 45.05.109.

AS 45.05.113(e). Allows an issuer (if the issuer's rights of reimbursement are not covered by (d) or by similar law), any confirmer, and any nominated person to decline a presentation as provided in (b).

AS 45.05.113(f). States that if a beneficiary changes its name after a letter of credit is issued, the beneficiary has the same rights and obligations as a successor beneficiary under this section.

Section 16. AS 45.05.114(a). Defines "proceeds of a letter of credit" for the section.

AS 45.05.114(b). Allows a beneficiary to assign (transfer to another person) its right to the proceeds of a letter of credit. Allows the beneficiary to do this before presentation, by assigning the right to receive proceeds when the conditions are satisfied in the letter of credit.

AS 45.05.114(c). Allows the issuer or nominated person to refuse to recognize an assignment of the proceeds of a letter of credit until the issuer or nominated person agrees to the assignment.

AS 45.05.114(d). States that an issuer or nominated person is not required to give or withhold its consent to an assignment (transfer to another person) of the proceeds of a letter of credit. Prohibits the issuer or nominated person from withholding the consent unreasonably if the assignee has and shows the letter of credit and if presentation of the letter of credit is required before honor.

AS 45.05.114(e). States that the rights of a transferee beneficiary (a subsequent beneficiary to whom a beneficiary's rights have been transferred) or of a nominated person do not depend on the beneficiary's assignment (transfer) of the proceeds of a letter of credit and are superior to the assignee's right to the proceeds.

AS 45.05.114(f). States that the rights under this section between an assignee and an issuer, a transferee beneficiary, or a nominated person, and the issuer's or nominated person's payment of proceeds to an assignee or a third person, do not affect the rights between the assignee and a person other than the issuer, transferee beneficiary, or nominated person. States that the creation and perfecting (making effective) of a security interest (an interest taken to secure a payment) in (or granting) a beneficiary's rights to proceeds, and assignment of (transferring) those rights, are governed by AS 45.09 (UCC: secured transactions) or other law. States that the rights and obligations arising on the creation and perfection of a security interest or arising on another assignment (transfer) of a beneficiary's rights to

proceeds, are governed by AS 45.09 or other law, as against a person other than the issuer, transferee beneficiary, or nominated person.

Section 17. AS 45.05.115. Limits how long a person has to bring an action in court to enforce a right or obligation under this chapter. Limits the time to the later of (1) one year after the expiration date of the letter of credit, or (2) one year after the basis for the action occurs. States that a basis for the action arises when there is a breach (of an obligation) under this chapter, even if the injured party does not know about the breach.

Section 18. AS 45.05.116(a). States that the liability of an issuer, a nominated person, or an adviser is governed by the jurisdiction that the parties choose by agreement if the agreement is in the form of a record signed or otherwise shown to be authentic by the parties under AS 45.05.104 or by a provision in the letter of credit, confirmation, or other undertaking. States that the selected jurisdiction is not required to be related to the transaction involved.

AS 45.05.116(b). States which jurisdiction governs the liability of certain listed persons for their acts or failure to act, unless (a) applies. States that the jurisdiction is the jurisdiction where the person is located. Considers the person to be located at the address stated in the person's promise. States that if more than one address is indicated, the person is considered to be located at the address from which the promise of the person was issued. When dealing with jurisdiction, selection of whose law to apply, and recognition of letters of credit between bank branches, but not a court judgment, the branches of a bank are considered to be separate juridical entities, and a bank is considered to be located where the bank's branch that is related to the matter is considered to be located under this subsection.

AS 45.05.116(c). States that, except as provided otherwise in this subsection, the liability of certain listed persons is governed by rules of custom or practice that the parties expressly select for the letter of credit or confirmation, or undertaking. Gives as an example the Uniform Customs and Practice for Documentary Credits. States that if both this chapter and the rules of custom or practice apply to the liability, the rules govern, unless they conflict with a provision of this chapter that cannot be changed (see AS 45.05.103(c)).

AS 45.05.116(d). States that this chapter governs if a conflict occurs between this chapter and AS 45.03 (UCC: negotiable instruments), AS 45.04 (UCC: bank deposits and collections), AS 45.09 (UCC: secured transactions), and AS 45.14 (UCC: funds transfers).

AS 45.05.116(e). States that the location for settling disputes under this chapter may be chosen in the same manner as the governing law is chosen under (a), and that the selection has the same binding effect.

Section 19. AS 45.05.117(a). States that an issuer who honors a letter of credit is subrogated to the rights of (is substituted for and can claim the rights of) certain listed

persons. The first person is the beneficiary, and the substitution is the same as if the issuer were a back-up debtor on the underlying obligation owed to the beneficiary. The second person is the person who requested the issuer to issue a letter of credit and the subrogation is to the same extent as if the issuer were the back-up debtor on the obligation owed to the applicant.

AS 45.05.117(b). States that an applicant that reimburses an issuer is subrogated to the rights of (is substituted for and can claim the rights of) certain listed persons. The subrogation is to the same extent as if the applicant were the secondary debtor on the obligation owed to the issuer, and the applicant has the subrogation rights of the issuer to the rights of the beneficiary stated in (a).

AS 45.05.117(c). States that a nominated person who pays or gives value against a draft (check) or demand presented under a letter of credit is subrogated to the rights of (is substituted for and can claim the rights of) certain listed parties.

AS 45.05.117(d). States that the right of subrogation in (a) and (b) don't arise until the issuer honors the letter of credit or otherwise pays under the letter of credit. States that the rights of subrogation in (c) don't arise until the nominated person pays or otherwise gives value under the letter of credit. These provisions apply even if there is an agreement that states otherwise. Until the events occur, the persons do not obtain under this section any present or future rights that would form the basis for a claim, defense, or excuse.

Section 20. AS 45.09.103(a). This amendment adds "rights to proceeds of written letters of credit" to the items that are covered by this subsection. The subsection deals with determining which jurisdiction's law applies when perfecting (making effective) secured transactions (agreements where one party transfers an interest in property to secure a contract), and what happens when collateral that is subject to a perfected security interest in another jurisdiction is brought into and kept in this state.

Section 21. AS 45.09.104. States that AS 45.09 (UCC: secured transactions) does not apply to the transfer of an interest in a letter of credit, except for the rights to proceeds of a written letter of credit.

Section 22. AS 45.09.105(c). Adds two definitions to the definitions that apply in AS 45.09 (UCC: secured transactions): "letter of credit" and "proceeds of a letter of credit."

Section 23. AS 45.09.106. Adds "rights to proceeds of written letters of credit" to the definition of "general intangibles" that is used in AS 45.09 (UCC: secured transactions).

Section 24. AS 45.09.304(a). States that to perfect (make effective) a security interest (interest given to a person to secure performance of a contract) in the rights to proceeds of a written letter of credit, the party that is secured must take possession of the letter of credit.

Representative Norman Rokeberg, Chair  
House Labor and Commerce Committee  
February 18, 1999  
Page 11

Section 25. AS 45.09.305. Allows a person to obtain an interest that secures performance of an obligation in the "rights to proceeds of a written letter of credit" by taking possession of the letter of credit.

Section 26. Subsection (a) states that this Act applies to a letter of credit that is issued on or after the effective date of this Act. States that this Act does not apply to a transaction, event, obligation, or duty that is associated with a letter of credit issued before the effective date of this Act.

Subsection (b) states that a transaction associated with a letter of credit issued before the effective date of this Act, and the accompanying rights, obligations, and interests are governed by current law as if this Act had not occurred.

Section 27. Makes the Act effective January 1, 2000.

TLB:glc  
99-066.glc

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January 27, 1999

JAN 27 1999

The Honorable Norman Rokeberg, Chair  
House Labor and Commerce Committee  
Alaska State Legislature  
Room 24, State Capitol  
Juneau, Alaska 99801-1182

HAND DELIVERED

Re: Uniform Commercial Code, Revision of Article 5 -- Letters of Credit  
(Last Legislature's HB 178)

Dear Representative Rokeberg:

As I discussed with your assistant, Janet Seitz, yesterday, last legislature's HB 178 appears ready for re-introduction this session. At her request, you will find attached a "sponsor statement" for the bill. I will not go into the bill here, other than to say that it is basically an update of the law governing the \$200 billion U.S. letter-of-credit industry.

Also attached are three information sheets (one of which is two-sided) provided by the NCCUSL. As usual, I would be happy to provide any additional information that you may need. As you know, however, in Alaska's Uniform Laws delegation, Jerry Kurtz is the one with the most expertise in this area. He can be reached in Anchorage at 276-6100.

Since the bill passed the House unanimously last year, and, despite the lack of opposition, inexplicably got stuck in the Senate Judiciary Committee, I trust that it will pass this year. Thanks again for your support and your work on it.

Yours truly,



Arthur H. Peterson  
Uniform Law Commissioner  
for Alaska

The Honorable Norman Rokeberg, Chair  
January 27, 1999

Page 2

AHP:dv

Enclosures (4)

cc w/encl: Rest of Alaska's ULC Delegation:  
Honorable Jay A. Rabinowitz  
W. Grant Callow, Esq.  
Tamara Brandt Cook, Esq.  
L. S. Kurtz, Jr., Esq.  
Deborah E. Behr, Esq.

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February 22, 1999

Hon. Norman Rokeberg, Chair  
House Labor & Commerce Committee  
Alaska State Legislature  
ATTN: Janet Seitz  
Room 24, State Capitol  
Juneau, Alaska 99801-1182

HAND-DELIVERED

Re: HB 79, Revision of UCC, Article 5 (Letters of Credit)  
-- support

Dear Rep. Rokeberg:

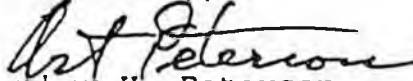
I understand that HB 79 is scheduled for a hearing before your committee this Friday, February 26. Unfortunately, I will be in Anchorage on business that day and cannot attend your hearing.

However, I wanted to repeat my strong SUPPORT for this bill, and I urge your committee to act on it favorably, with a "Do Pass" recommendation.

This bill presents a necessary piece in the ongoing efforts of the National Conference of Commissioners on Uniform State Laws to keep the Uniform Commercial Code up to date. It resolves issues pertaining to modern technology, current business practices, and the interpretation of the decades-old existing law. It is described more specifically in the sponsor statement and attached materials that I provided you with my January 27, 1999 letter.

Thank you.

Yours truly,

  
Arthur H. Peterson  
Uniform Law Commissioner  
for Alaska

cc: Rest of Alaska's ULC Delegation:  
Jay A. Rabinowitz  
W. Grant Callow  
Tamara Brandt Cook  
L. S. (Jerry) Kurtz, Jr.  
Deborah E. Behr

# STATE OF ALASKA

## DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

February 19, 1999

TONY KNOWLES, GOVERNOR

PLEASE REPLY TO:

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P.O. BOX 110300-DIMOND COURT HO  
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PHONE: (907) 465-3600  
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Honorable Norman Rokeberg  
Chair  
House Labor & Commerce Committee  
State Capitol, Rm 24  
Juneau, AK 99801-1182

FEB 19 1999

Re: HB 79 - UCC: Letters of Credit

Dear Representative Rokeberg:

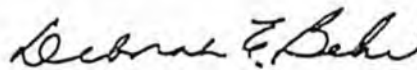
HB 79 (UCC: Letters of Credit) is presently before the House Labor and Commerce Committee. The bill was developed by the National Conference of Commissioners on Uniform State Laws after many years of study and consideration. The bill is important to provide a good business climate for interstate business transactions concerning letters of credit.

If you have questions, please contact me at 465-2122.

Sincerely,

BRUCE M. BOTELHO  
ATTORNEY GENERAL

By:



Deborah E. Behr  
Assistant Attorney General

DEB:jf

cc: Pat Pourchot, Legislative Dir.  
Office of the Governor

Chrystal Smith, Legislative Contact  
Dept. of Law

All Alaska Uniform Law Commissioners

Vince Usera  
Mary Ellen Beardsley  
Assistant Attorneys General  
Juneau/Anchorage

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# UNIFORM COMMERCIAL CODE

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THE AMERICAN LAW INSTITUTE

NATIONAL CONFERENCE OF  
COMMISSIONERS ON UNIFORM  
STATE LAWS

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REVISED ARTICLE 5. LETTERS OF CREDIT

(With Conforming and Miscellaneous Amendments to  
Articles 1, 2, and 9)

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1995 OFFICIAL TEXT  
WITH COMMENTS

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By

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11/13/95

UNIFORM COMMERCIAL CODE  
REVISED ARTICLE 5. LETTERS OF CREDIT

(With Conforming and Miscellaneous Amendments to  
Articles 1, 2, and 9)

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# UNIFORM COMMERCIAL CODE REVISED ARTICLE 5. LETTERS OF CREDIT

## PREFATORY NOTE

### Reason for Revision

When the original Article 5 was drafted 40 years ago, it was written for paper transactions and before many innovations in letters of credit. Now electronic and other media are used extensively. Since the 50's, standby letters of credit have developed and now nearly \$500 billion standby letters of credit are issued annually worldwide, of which \$250 billion are issued in the United States. The use of deferred payment letters of credit has also greatly increased. The customs and practices for letters of credit have evolved and are reflected in the Uniform Customs and Practice (UCP), usually incorporated into letters of credit, particularly international letters of credit, which have seen four revisions since the 1950's; the current version became effective in 1994 (UCP 500). Lastly, in a number of areas, court decisions have resulted in conflicting rules.

Prior to the appointment of a drafting committee, the ABA UCC Committee appointed a Task Force composed of knowledgeable practitioners and academics. The ABA Task Force studied the case law, evolving technologies and the changes in customs and practices. The Task Force identified a large number of issues which they discussed at some length, and made recommendations for revisions to Article 5. The Task Force stated in a foreword:

"As a result of these increases and changes in usage, practice, players, and pressure, it comes as no surprise that there has been a sizable increase in litigation. Indeed, the approximately 62 cases reported in the United States in 1987 constituted double the cumulative reported cases up to 1965 ...

Moreover, almost forty years of hard use have revealed weaknesses, gaps and errors in the original statute which compromise its relevance. U.C.C. Article 5 was one of the few areas of the Uniform Commercial Code which did not benefit from prior codification and it should come as no surprise that it may require some revision ...

Measured in terms of these areas which are vital to any system of commercial law, the current combination of statute and case law is found

wanting in major respects both as to predictability and certainty. What is at issue here are not matters of sophistry but important issues of substance which have not been resolved by the current case law/code method and which admit of little likelihood of such resolution." (45 Bus. Lawyer 1521, at 1532, 1535-6)<sup>1</sup>

The Drafting Committee began its deliberations with the Task Force Report in hand. The final work of the Drafting Committee varies from many of the suggestions of the Task Force.

#### Need for Uniformity

Letters of Credit are a major instrument in international trade, as well as domestic transactions. To facilitate its usefulness and competitiveness, it is essential that U.S. law be in harmony with international rules and practices, as well as flexible enough to accommodate changes in technology and practices that have, and are, evolving. Not only should the rules be consistent within the United States, but they need to be substantively and procedurally consistent with international practices.

Thus, the goals of the drafting effort were:

- conforming the Article 5 rules to current customs and practices;
- accommodating new forms of Letters of Credit, changes in customs and practices, and evolving technology, particularly the use of electronic media;
- maintaining Letters of Credit as an inexpensive and efficient instrument facilitating trade; and
- resolving conflicts among reported decisions.

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<sup>1</sup> The Task Force members were: Professor James E. Byrne (George Mason University School of Law) Chair; Professor Boris Kozolchyk (University of Arizona College of Law); Michael Evan Avidon (Moses & Singer); James G. Barnes (Baker & McKenzie); Arthur G. Lloyd (Citibank N.A.); Janis S. Penton (Rosen, Wachtell & Gilbert); Richard F. Purcell (Connell, Rice & Sugar Co.); Alan L. Bloodgood (Morgan Guaranty Trust Co.); Charles del Busto (Manufacturers Hanover Trust Co.); Vincent Maulella (Manufacturers Hanover Trust Co.).

### Process of Achieving Uniformity

The essence of uniform law revision is to obtain a sufficient consensus and balance among the interests of the various participants so that universal and uniform enactment by the various States may be achieved.

In part this is accomplished by extensive consultation on and broad circulation of the drafts from 1990, when the project began, until approval of the final draft by the American law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL).

Hundreds of groups were invited to participate in the drafting process. Twenty Advisors were appointed, representing a cross-section of interested parties. In addition 20 Observers regularly attended drafting meetings and over 100 were on the mailing list to receive all drafts of the revision.

The Drafting Committee meetings were open and all those who attended were afforded full opportunity to express their views and participate in the dialogue. The Advisors and Observers were a balanced group with ten representatives of users (Beneficiaries and Applicants); five representatives of governmental agencies; five representatives of the U.S. Council on International Banking (USCIB); seven from major banks in letter of credit transactions; eight from regional banks; and seven law professors who teach and write on Letters of Credit.

Nine Drafting Committee meetings were held that began Friday morning and ended Sunday noon. In addition, the draft was twice debated in full by NCCUSL, once by the ALI Council, once considered by the ALI Consultative Group and once by an ad hoc Committee of the Council; and reviewed and discussed by the ABA Subcommittee on Letters of Credit semi-annually and by several state and city bar association committees.

The drafts were regularly reviewed and discussed in *The Business Lawyer*, *Letter of Credit Update*, and in other publications.

The consensus, balance and quality achieved in this lengthy deliberative process is a product of not only its Reporter and the Drafting Committee, but also the faithful and energetic participation of the following Advisors and active participants:

### **Advisors**

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#### Balance of Benefits

Uniform laws can be enacted only if there is a consensus that the benefits achieved advance the public interest in a manner that can be embraced by all users of the law. It appears that as drafted, Revised Article 5 will enjoy substantial support by the participating interests in letter of credit transactions.

#### Benefits of Revised Article 5 in General

**Independence Principle.** Revised Article 5 clearly and forcefully states the independence of the letter of credit obligations from the underlying transactions that was unexpressed in, but was a fundamental predicate for, the original Article 5 (Sections 5-103(d) and 5-108(f)). Certainty of payment, independent of other claims, setoffs or other causes of action, is a core element of the commercial utility of letters of credit.

**Clarifications.** The revision authorizes the use of electronic technology (Sections 5-102(a)(14) and 5-104); expressly permits deferred payment letters of credit (Section 5-102(a)(8)) and two party letters of credit (Section 5-102(a)(10)); provides rules for unstated expiry dates (Section 5-106(c)), perpetual letters of credit (Section 5-106(d)), and non-

documentary conditions (Section 5-108(g)); clarifies and establishes rules for successors by operation of law (Sections 5-102(a)(15) and 5-113); conforms to existing practice for assignment of proceeds (Section 5-114); and clarifies the rules where decisions have been in conflict (Section 5-106, Comment 1; Section 5-108, Comments 1, 3, 4, 7, and 9; Section 5-109, Comments 1 and 3; Section 5-113, Comment 1; and Section 5-117, Comment 1).

#### Harmonizes with International Practice

The UCP is used in most international letters of credit and in many domestic letters of credit. These international practices are well known and employed by the major issuers and users of letters of credit. Revisions have been made to Article 5 to coordinate the Article 5 rules with current international practice (e.g., deferred payment obligations, reasonable time to examine documents, preclusion, non-documentary conditions, return of documents, and irrevocable unless stated to be revocable).

#### Benefits of Revised Article 5 to Issuers

**Consequential Damages.** Section 5-111 precludes consequential and punitive damages. It, however, provides strong incentives for Issuers to honor, including provisions for attorneys fees and expenses of litigation, interest, and specific performance. If consequential and punitive damages were allowed, the cost of letters of credit could rise substantially.

**Statute of Limitation.** Section 5-115 establishes a one year statute of limitation from the expiration date or from accrual of the cause of action, whichever occurs later. Because it is usually obvious to all when there has been a breach, a short limitation period is fair to potential plaintiffs.

**Choice of Law.** Section 5-116 permits the issuer (or nominated party or adviser) to choose the law of the jurisdiction that will govern even if that law bears no relation to the transaction. Absent agreement, Section 5-116 states choice of law rules.

**Assignment of Proceeds.** Section 5-114 conforms more fully to existing practice and provides an orderly procedure for recording and accommodating assignments by consent of the issuer (or nominated party).

**Subrogation.** Section 5-117 clarifies the subrogation rights of an Issuer who has honored a letter of credit. These rights of subrogation also extend to an applicant who reimburses and a nominated party who pays or gives value.

**Recognition of UCP.** Section 5-116(c) expressly recognizes that if the UCP is incorporated by reference into the letter of credit, the agreement varies the provisions of Article 5 with which it may conflict except for the non-variable provisions of Article 5.

#### **Benefits of Revised Article 5 to Applicants**

**Warranties.** Section 5-110 specifies the warranties made by a beneficiary. It gives the applicant on a letter of credit which has been honored a direct cause of action if a drawing is fraudulent or forged or if a drawing violates any agreement augmented by a letter of credit.

**Strict Compliance.** Absent agreement to the contrary, the issuer must dishonor a presentation that does not strictly comply under standard practice with the terms and conditions of the letter of credit (Section 5-108).

**Subrogation.** New Section 5-117 clarifies the parties' rights of subrogation if the letter of credit is honored.

**Limitations on General Disclaimers and Waivers.** Section 5-103(c) limits the effect of general disclaimers and waivers in a letter of credit, or reimbursement or other agreement.

#### **Benefits of Revised Article 5 to Beneficiaries**

**Irrevocable.** A letter of credit is irrevocable unless the letter of credit expressly provides it is revocable (Section 5-106(a)).

**Preclusion.** Section 5-108(c) now provides that the Issuer is precluded from asserting any discrepancy not stated in its notice timely given, except for fraud, forgery or expiration.

**Timely Examination.** Section 5-108(b) requires examination and notice of any discrepancies within a reasonable time not to exceed the 7th business day after presentation of the documents.

**Transfers by Operation of Law.** New Section 5-113 allows a successor to a beneficiary by operation of law to make presentation and receive payment or acceptance.

**Damages.** The damages provided are expanded and clarified. They include attorneys fees and expenses of litigation and payment of the full

amount of the wrongfully dishonored or repudiated demand, with interest, without an obligation of the beneficiary to mitigate damages (Section 5-111).

#### Revisions for Article 9 and Transition Provisions

The draft includes suggested revisions to conform Article 9 to the Article 5 changes. Article 9 itself is under revision and the interface with Revised Article 5 will be more fully examined by the Article 9 drafting committee, as well, in light of changes to Article 9. The Article 9 revisions will probably not be completed until 1998-9. Revised Article 8 (1994) also makes changes to Article 9 so care should be taken to coordinate the changes of both Revised Articles 5 and 8 within each State.

The draft also includes transition provisions and some cross reference changes in other Articles of the UCC.

Lastly, there follows a table showing the changes from the original Article 5 made by the revisions to Article 5.

**UNIFORM COMMERCIAL CODE  
REVISED ARTICLE 5. LETTERS OF CREDIT**

**Table of Disposition of Sections in Former Article 5**

The reference to a section in revised Article 5 is to the section that refers to the issue addressed by the section in former Article 5. If there is no comparable section in Revised Article 5 to a section in former Article 5, that fact is indicated by the word "Omitted" and a reason is stated.

Former Article 5 Section	Revised Article 5 Section
5-101 .....	5-101
5-102(1) .....	5-103(a)
5-102(2) .....	Omitted (inherent in 5-103(a) and definitions)
5-103(3) (first sentence omitted) .....	5-103(b)
5-103(1)(a) .....	5-102(a)(10); 5-106(a); 5-102(a)(8)
5-103(1)(b) ..	5-102(a)(6) ("Document"), and 5-102(a)(14) ("Record"); "Documentary" draft or demand not used
5-103(1)(c) .....	5-102(a)(9)
5-103(1)(d) .....	5-102(a)(3)
5-103(1)(e) .....	5-102(a)(1)
5-103(1)(f) .....	5-102(a)(4)
5-103(1)(g) .....	("Applicant" rather than "Customer") 5-102(a)(2)
5-103(2) .....	Omitted as not applicable
5-103(3) .....	5-102(b)
5-103(4) .....	5-102(c)
5-104 .....	5-104 and 5-102(6) and (14)
5-105 .....	5-105
5-106(1) .....	5-106(a)
5-106(2) .....	5-106(b)
5-106(3) .....	5-106(b)
5-106(4) .....	5-106(b)
5-107(1) .....	5-107(c)
5-107(2) .....	5-107(a)
5-107(3) .....	5-107(c)
5-107(4) .....	Omitted as inadvisable default rule
5-108 .....	Omitted (as outdated)
5-109(1) .....	5-108
5-109(2) .....	5-108
5-109(3) .	Omitted (all issuers required to observe standard practices)
5-110(1) .....	Omitted (covered in definitions and comments)
5-110(2) .....	Omitted (covered in definitions and comments)

5-111(1)	5-110(a)
5-111(2)	5-110(b)
5-112(1)	5-108(b) and (c)
5-112(2)	5-108(h)
5-112(3)	5-102(a)(12)
5-113	Omitted (covered by other contract law)
5-114(1)	5-108(a)
5-114(2)(a)	5-109(a)(1)
5-114(2)(b)	5-109(a)(2)
5-114(3)	5-108(i)
5-114(4), (5)	Omitted; were optional
5-115(1)	5-111
5-115(2)	5-111
5-116(1)	5-112
5-116(2)	5-114
5-116(3)	5-114
5-117	Omitted (covered by other law)

### Table of New Provisions

(Provisions which were not included in former Article 5 and subjects not addressed in former Article 5.)

Subject	Revised Article 5 Section
"Successor to a beneficiary"	5-102(15)
Non-variable terms	5-103(c)
Independence principle	5-103(d)
Unstated expiry date	5-106(c)
Perpetual letter of credit	5-106(d)
Preclusion of unstated deficiencies	5-108(c)
Standard practice	5-108(e)
Independence of obligation	5-108(f)
Non-documentary conditions	5-108(g)
Standards for issuing injunction	5-109(b)
Transfer by operation of law	5-113
Statute of Limitation	5-115
Choice of law	5-116
Subrogation	5-117

## UNIFORM COMMERCIAL CODE REVISED ARTICLE 5. LETTERS OF CREDIT

**SECTION 5-101. SHORT TITLE.** This article may be cited as

Uniform Commercial Code—Letters of Credit.

### Official 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 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.

The subject matter in Article 5, letters of credit, may also be governed by an international convention that is now being drafted by UNCITRAL, the draft Convention on Independent Guarantees and Standby Letters of Credit. The Uniform Customs and Practice is an international body of trade practice that is commonly adopted by international and domestic letters of credit and as such is the "law of the transaction" by agreement of the parties. Article 5 is consistent with and was influenced by the rules in the existing version of the UCP. In addition to the UCP and the international convention, other bodies of law apply to letters of credit. For example, the federal bankruptcy law applies to letters of credit with respect to applicants and beneficiaries that are in bankruptcy; regulations of the Federal Reserve Board and the Comptroller of the Currency lay out requirements for banks that issue letters of credit and describe how letters of credit are to be treated for calculating asset risk and for the purpose of loan limitations. In addition there is an array of anti-boycott and other similar laws that may affect the issuance and performance of letters of credit. All of these laws are beyond the scope of Article 5, but in certain circumstances they will override Article 5.

#### SECTION 5-102. DEFINITIONS.

(a) In this article:

(1) "Adviser" means a person who, at the request of the issuer, a confirmer, or another 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. The term 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 to honor or to take an interim action, such as acceptance of a draft, that may be 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 (i) which 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) which 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 whom 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.

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

(13) "Presenter" means a person making a presentation as or on behalf of a beneficiary or nominated person.

(14) "Record" means information that is inscribed on a tangible medium, or that is stored in an electronic or other medium and is retrievable in perceivable form.

(15) "Successor of a 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.

#### Official Comment

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" for 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 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 recipient's computer printer, facsimile machine, or the like does not under current practice render the data so transmitted a "document." A facsimile or S.W.L.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). Where electronic transmissions are authorized neither by the letter of credit nor by the practice, the beneficiary may transmit the data electronically to its agent who may be able to put it in written form and make a conforming presentation.

3. "Good faith" continues in revised Article 5 to be defined as "honesty in fact." "Observance of reasonable standards of fair dealing" has not been added to the definition. The narrower definition of "honesty in fact" reinforces the "independence principle" in the treatment of "fraud," "strict compliance," "preclusion," and other tests affecting the performance of obligations that are unique to letters of credit. This narrower definition -- which does not include "fair dealing" -- is appropriate to the decision to honor or dishonor a presentation of documents specified in a letter of credit. The narrower definition is also appropriate for other parts of revised Article 5 where greater certainty of obligations is necessary and is consistent with the goals of speed and low cost. It is important that U.S. letters of credit have continuing vitality and competitiveness in international transactions.

For example, it would be inconsistent with the "independence" principle if any of the following occurred: (i) the beneficiary's failure to adhere to the standard of "fair dealing" in the underlying transaction or otherwise in presenting documents were to provide applicants and issuers with an "unfairness" defense to dishonor even when the documents complied with the terms of the letter of credit; (ii) the issuer's obligation to honor in "strict compliance in accordance with standard practice" were changed to "reasonable compliance" by use of the "fair dealing" standard, or (iii) the preclusion against the issuer (Section 5-108(d)) were modified under the "fair dealing" standard to enable the issuer later to raise additional deficiencies in the presentation. The rights and obligations arising from presentation,

honor, dishonor and reimbursement, are independent and strict, and thus "honesty in fact" is an appropriate standard.

The contract between the applicant and beneficiary is not governed by Article 5, but by applicable contract law, such as Article 2 or the general law of contracts. "Good faith" in that contract is defined by other law, such as Section 2-103(1)(b) or Restatement of Contracts 2d, § 205, which incorporate the principle of "fair dealing" in most cases, or a State's common law or other statutory provisions that may apply to that contract.

The contract between the applicant and the issuer (sometimes called the "reimbursement" agreement) is governed in part by this article (e.g., Sections 5-108(i), 5-111(b), and 5-103(c)) and partly by other law (e.g., the general law of contracts). The definition of good faith in Section 5-102(a)(7) applies only to the extent that the reimbursement contract is governed by provisions in this article; for other purposes good faith is defined by other law.

4. 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.

5. The exclusion of consumers from the definition of "issuer" 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 that person would otherwise be either the principal debtor or a guarantor.

6. The label on a document is not conclusive; certain documents labelled "guarantees" in accordance with European (and occasionally, American) practice are letters of credit. On the other hand, even documents that are labelled "letter of credit" may not constitute letters of credit under the definition in Section 5-102(a). 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 and may be enforceable as such. See Sections 5-102(a)(10) and 5-103(d). Therefore, undertakings 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 undertaking the status of letter of credit, that section does not apply to 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 undertaking 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 a 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 an overseas branch. 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.

7. Under the UCP any bank is a nominated bank where the letter of credit is "freely negotiable." A letter of credit might also nominate by the following: "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" or the like.

Several legal consequences may attach to the status of 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. 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).

8. A "record" must be 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 could be a record.

9. Absent a specific agreement to the contrary, documents of a beneficiary delivered to an issuer or nominated person are considered to be presented under 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 a beneficiary's documents for "collection only" or otherwise outside letter of credit law and practice.

10. Although a successor of a 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 a 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 "by operation of law" – such as the sale of assets by one company to another.

11. "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 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 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.

#### Official Comment

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," "accessory," or "suretyship" guarantees. Although the word "guarantee" is sometimes used to describe an independent obligation like that of the issuer of a letter of credit (most often in the case of European bank undertakings but occasionally in the case of undertakings of American banks), in the United States the word "guarantee" is more typically 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 or accessory guarantees and it is important to recognize the distinction between letters of credit and those guarantees. It is often a defense to a secondary or accessory 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 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 are adopted but conflict 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 state explicitly the rule that is to govern. When rules of custom and practice are incorporated by reference, they are considered to be explicit terms of the agreement or undertaking.

Neither the obligation of an issuer under Section 5-108 nor that of an adviser under Section 5-107 is an obligation of the kind that is invariable under Section 1-102(3). Section 5-103(c) and Comment 1 to Section 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 an explicit agreement with its applicant or by a term that explicitly defines its duty, it cannot accomplish by a general disclaimer. The restriction on disclaimers in the last sentence of subsection (c) is based more on procedural than on substantive unfairness. Where, for example, the reimbursement agreement provides explicitly that the issuer need not examine any documents, the applicant understands the risk it has undertaken. A term in a reimbursement agreement which states generally that an issuer will not be liable unless it has acted in "bad faith" or committed "gross negligence" is ineffective under Section 5-103(c). On the other hand, less general terms such as terms that permit issuer reliance on an oral or electronic message believed in good faith to have been received from the applicant or terms that entitle an issuer to reimbursement when it honors a "substantially" though not "strictly" complying presentation, are effective. In each case the question is whether the disclaimer or limitation is sufficiently clear and explicit in reallocating a liability or risk that is allocated differently under a variable Article 5 provision.

Of course, no term in a letter of credit, whether incorporated by reference to practice rules or stated specifically, can free an issuer from a conflicting contractual obligation to its applicant. If, for example, an issuer promised its applicant that it would pay only against an inspection certificate of a particular company but failed to require such a certificate in its letter of credit or made the requirement only a nondocumentary condition that had to be disregarded, the issuer might be obliged to pay the beneficiary even though its payment might violate its contract with its applicant.

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 begin.

4. Section 5-102(2) and (3) of Article 5 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).

#### Official Comment

1. Neither Section 5-104 nor the definition of letter of credit in Section 5-102(a)(10) requires inclusion of all the terms that are normally contained in a letter of credit in order for an undertaking to be recognized as a letter of credit under Article 5. For example, a letter of credit will typically 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. Undertakings that have the formalities required by Section 5-104 and meet the conditions specified in Section 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.

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

3. Many banking transactions, including the issuance of many letters of credit, are now conducted mostly by electronic means. For example, S.W.L.F.T. is currently used to transmit letters of credit from issuing to advising banks. The letter of credit text so transmitted may be 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.

To be a record sufficient to serve as a letter of credit or other undertaking under this section, data must have a durability consistent with that function. Because consideration is not required for a binding letter of credit or similar undertaking (Section 5-105) yet those undertakings are to be strictly construed (Section 5-108), parties to a letter of credit transaction are especially dependent on the continued availability of the terms and conditions of the letter of credit or other undertaking. 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.

**Official Comment**

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

**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.

**Official Comment**

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 possibilities for misleading the parties who deal with them.

2. A person can consent 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 consented 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 consent to performance that does not strictly conform to the original letter of credit, those persons assume the risk that other nonconsenting 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 honor documents presented after the expiration date in the belief that the applicant has consented or will consent to the amendment or will waive presentation after the original expiration date. If that belief is mistaken, the issuer is bound to the beneficiary by the terms of the letter of credit as amended or waived, even though it may be unable to recover from the applicant.

In general, the rights of a recognized transferee beneficiary cannot be altered without the transferee's 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 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.

3. The issuer's right to cancel a revocable letter of credit does not free it from a duty to reimburse a nominated person who has honored,

accepted, or undertaken a deferred obligation prior to receiving notice of the amendment or cancellation. Compare UCP Article 8.

4. 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 had issued the letter of credit at the request and for the account of the issuer.

(h) A nominated person who 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 who notifies a transferee beneficiary of the terms of a letter of credit, confirmation, amendment, or advice has the rights and obligations of an adviser under subsection (c). The terms in the notice to the transferee beneficiary may differ from the terms in any notice to the transferor beneficiary to the extent permitted by the letter of credit, confirmation, amendment, or advice received by the person who so notifies.

#### Official Comment

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 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. Absent a direct agreement between the applicant and a confirmer, normally the obligations of a confirmer are to the issuer not the applicant, but the applicant might have a right to injunction against a confirmer under Section 5-109 or warranty claim under Section 5-110, and either might have claims against the other under Section 5-117.

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 where there is a prior agreement to serve or where the silence of the adviser would 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. "Checking" the apparent authenticity of the request to advise means only that the prospective adviser must attempt to authenticate the message (e.g., by "testing" the telex that comes from the purported issuer), and if it is unable to authenticate the message must report that fact to the issuer and, if it chooses to advise the message, 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. The issuer may then believe that it has undertaken a certain engagement, yet the text 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, then as a confirmer it will be independently liable on the letter of credit as advised and confirmed. If in that situation the beneficiary's ultimate presentation entitled it to honor under the terms of the confirmation but not under those in the original letter of credit, 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 rare 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 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 (c), 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:

- (1) to honor,
- (2) 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

(3) 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 the standard practice is a matter of interpretation for the court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice.

(f) An issuer is not responsible for:

(1) the performance or nonperformance of the underlying contract, arrangement, or transaction,

(2) an act or omission of others, or

(3) 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 Sections 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.

Official Comment

Re: Proposed  
AS 45:05-108  
in 14B 178 (1997)

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 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.

This section does not impose a bifurcated standard under which an issuer's right to reimbursement might be broader than a beneficiary's right to honor. However, the explicit deference to standard practice in Section 5-108(a) and (e) and elsewhere expands issuers' rights of reimbursement where that practice so provides. Also, issuers can and often do contract with their applicants for expanded rights of reimbursement. 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. Similarly, a nominated person may have reimbursement and other rights against the issuer based on this article, the UCP, bank-to-bank reimbursement rules, or other agreement or undertaking of the issuer. These rights may allow the nominated person to recover from the issuer even when the nominated person would have no right to obtain honor under the letter of credit.

The section adopts strict compliance, rather than the standard that commentators have called "substantial compliance," the standard arguably applied in *Banco Español de Crédito 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). Strict compliance does not mean slavish conformity to the terms of the letter of credit. For example, standard practice (what issuers do) may recognize certain

presentations as complying that an unschooled layman would regard as discrepant. By adopting standard practice as a way of measuring strict compliance, this article indorses the conclusion of the court in *New Braunfels Nat. Bank v. Odiome*, 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 in *Tdsco 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.

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 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 the 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 explicitly 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 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. What is a "reasonable time" is not extended to accommodate an issuer's procuring a waiver from the applicant. See Article 14c of the UCP.

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 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), the reasonable time would be less than seven days. 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.

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 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 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).

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 "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 under this article or 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. A good faith extension of the time in Section 5-108(b) by agreement between the issuer and beneficiary binds the applicant even if the applicant is not consulted or does not consent to the extension.

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. Except as otherwise agreed with the applicant, an issuer may dishonor a noncomplying presentation despite an applicant's waiver.

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) includes (i) international practice set forth in or referenced by the Uniform Customs and Practice, (ii) other practice rules published by associations of financial institutions, and (iii) local and regional practice. 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 rights. A practice may be overridden by agreement or course of dealing. See Section 1-205(4).

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 6 to Section 5-102.

Subsection (g) would not permit the beneficiary or the issuer to disregard terms in the letter of 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 (and thus in determining the issuer's duty to the beneficiary), an issuer that has promised its applicant that it will honor only on the occurrence of those nondocumentary conditions may have liability to its applicant for disregarding the conditions.

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 delivery of an item of value other than money, the applicant's reimbursement obligation would be to make the "item of value" available to the issuer.

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).

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.

#### **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 who has given value in good faith and without notice of forgery or material fraud, (ii) a confirmer who 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 in any other case.

(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 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 a person 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).

#### Official Comment

1. This recodification 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 must 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 and would not justify an injunction. Conversely, the knowing submission of those invoices upon delivery of only five barrels would be materially fraudulent. The courts 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 and embraces certain decisions under Section 5-114 that relied upon the phrase "fraud in the transaction." Some of 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.

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 Section 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 be skeptical of 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.

There are at least two ways to prohibit injunctions against honor under this section after acceptance of a draft by the issuer. First is to define honor (see Section 5-102(a)(8)) in the particular letter of credit to occur upon acceptance and without regard to later payment of the acceptance. Second is explicitly to agree that the applicant has no right to an injunction after acceptance – whether or not the acceptance constitutes honor.

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 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 beneficiary or any other agreement intended by them to be augmented 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.

#### Official Comment

1. Since the warranties in subsection (a) are not given unless a letter of credit has been honored, no breach of warranty under this subsection can be a defense to dishonor by the issuer. Any defense must be based on Section 5-108 or 5-109 and not on this section. Also, breach of the warranties by the beneficiary in subsection (a) cannot excuse the applicant's duty to reimburse.

2. The warranty in Section 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. In most cases the applicant will have a direct cause of action for breach of the underlying contract. This warranty has primary application in standby letters of credit or other circumstances where the applicant is not a party to an underlying contract with the beneficiary. 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 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's drawing violated its express or implied obligations in the underlying transaction.

3. The damages for breach of warranty are not specified in Section 5-111. Courts may find damage 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 is 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, although not obligated to do so, the claimant avoids damages, the claimant's recovery from the issuer must be reduced by the amount of damages avoided. The issuer has 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 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 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 an 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 the confirmation, a confirmer has the liability of an issuer specified in this subsection and subsections (a) and (b).

(d) An issuer, nominated person, or adviser who is found liable under subsection (a), (b), or (c) shall pay interest on the amount owed thereunder from the date of wrongful dishonor or other appropriate date.

(e) Reasonable attorney's fees and other expenses of litigation must be awarded to the prevailing party in an action in which a remedy is sought under this article.

(f) Damages that would otherwise be payable by a party for breach of an obligation under this article may be liquidated by agreement or undertaking, but only in an amount or by a formula that is reasonable in light of the harm anticipated.

#### Official Comment

1. The right to specific performance is new. The express limitation on the duty of the beneficiary to mitigate damages adopts the position of certain courts and commentators. 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 Section 5-111(a), the beneficiary would present the documents to the issuer. If the issuer wrongfully dishonored, the beneficiary would have no further duty to the issuer with respect to the goods 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 sells the goods covered by dishonored documents or if the beneficiary sells a draft after acceptance but before dishonor by the issuer, the net amount so gained should be subtracted from the amount of the beneficiary's damages -- at least where the damage claim against the issuer equals or exceeds the damage suffered by the beneficiary. If, on the other hand, the beneficiary suffers damages in an underlying transaction in an amount that exceeds the amount of the wrongfully dishonored demand (e.g., where the letter of credit does not cover 100 percent of the underlying obligation), the damages avoided should not necessarily be deducted from the beneficiary's claim against the issuer. In such a case, the damages would be the lesser of (i) the amount recoverable in the absence of mitigation (that is, the amount that is subject to the dishonor or repudiation plus any incidental damages) and (ii) the damages remaining after deduction for the amount of damages actually avoided.

A beneficiary need not present documents as a condition of suit for anticipatory repudiation, but if 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). The last sentence of subsection (c) does not expand the liability of a confirmer to persons to whom the confirmer would not otherwise be liable under Section 5-107.

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. What damages "result" from improper honor is for the courts to decide. 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 discrepancies, 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 second letter of credit in connection with its sale, the applicant may be damaged by the issuer's payment despite discrepancies because the applicant itself may then be unable to procure honor on the letter of credit where it is the beneficiary, and may be unable to mitigate its damages by enforcing its rights against others in the underlying transaction. Note that an issuer found liable to its applicant may have recourse under Section 5-117 by subrogation to the applicant's claim against the beneficiary or other persons.

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 for breach of obligations under this article 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, however, this section does not bar recovery of consequential or even punitive damages for breach of statutory or common law duties arising outside of this article.

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.