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CODE TREATMENT OF LETTERS OF CREDIT

Henry Harfield*†

INTRODUCTION

This is what you will read (if you do): A few philosophic observations about the nature of letters of credit; a discussion of things as they are now, that is to say: the New York law, the ultra-national law to the extent that it differs from the New York law, and the international practice with respect to letters of credit; and, to end the beginning, some reflections on the question: Why the Code? This paper will deal, in too considerable length, with the scope of the Code in so far as it affects letters of credit; it will treat with each of the 17 sections of article 5 and try to set them in the context of existing law both in New York and abroad and in the context of the Uniform Customs and Practice¹ (or the international consensual rules) and, finally, it will conclude with a few comments as to the practical effect of the Code on the letter of credit business.

THE NATURE OF LETTERS OF CREDIT

Let us recognize the initial distinction between (1) the definitions of letters of credit, which you will find set forth in the Code, in various judicial decisions which antedate the Code, in the Uniform Customs and Practice, in the books and articles which have been written on the subject of letters of credit,—and (2) quite distinct, the "nature" of letters of credit. We shall presently deal with definitions. To do so is to ask and attempt to answer the question "What are they?" At this point, however, we need to deal with the double question "What are they for?" and "How do they work?"

The letter of credit is an assurance of payment upon the performance of certain conditions; it provides a means by which a person, whose own promise to make a payment might be of dubious value, is able to obtain

* John W. Weiser, Esq. of the New York Bar assisted the author in the preparation of this paper. A generous man would have designated him as co-author; a hypocrite would have insisted that the omission to do so was in order to protect Weiser from criticism for such errors or omissions as may be found in the product; the author is neither.—H. H.
¹ Uniform Customs and Practice For Commercial Documentary Credits (13th Cong. of Int'l Chamber of Commerce, 1951), hereinafter referred to as the Uniform Customs and Practice.
the benefit of a richer reputation, a stronger credit, which will be suf-
ficient to produce desired action.

A letter of credit always serves as a guaranty. This does not mean
that it is a guaranty. A letter of credit is an identical twin to a guaranty,
but the fact that the two things look alike and may be used for the
same purpose and are difficult to distinguish one from the other, does
not mean that they are the same thing and does not mean that there are
not differences, which, however subtle, are of major importance.²

Basic to any consideration of the nature of letters of credit is to
realize that they are financial instruments. They are not negotiable
instruments, but they are instruments which contemplate the payment
of money. While they are of enormous utility in facilitating trade and
facilitating the movement of goods, they are financial instruments and
not mercantile instruments.

They are truly international in their origin and scope, truly inter-
national because the origin and primary use of letters of credit was for
many years a means of financing trade between separate economies.
This was true even when the separate economies might be cities rather
than states or nations. In terms of the vast bulk of the volume of letter
of credit business which is now done, this international character (or
perhaps one might say this foreign character, in the sense that the buyer
and seller whose transaction is financed by the letter of credit are fre-
quently strangers, foreign to one another) is still dominant. This is not
to deny that a very large volume of domestic business is done through
letters of credit, nor to suggest that this domestic volume will not sub-
stantially increase. The fact of the matter is, however, that at the present
time the great bulk of letter of credit business is international in char-
acter and in all probability the international volume will not appreciably
lessen even though the domestic volume may increase.

The Letter of Credit as It Is Today

When we talk about letters of credit we are talking about a legal and
practical device which is in international use. Because this is so, it would
be absurd to adopt a parochial attitude toward the laws regarding letters
of credit. There is surprisingly little decisional law in the field of letters
of credit, especially in view of the vast amount of money and the vast
numbers of transactions which take place in this field. In civil law coun-
tries, of course, decisional law is not of primary importance; even so in
many countries where there is a relatively slender statutory scheme, if
any exists at all, there seem to be relatively few disputes. The decisional

literature in Anglo-American jurisprudence is, understandably, much larger. But even here it is tiny in contrast to the volume of decisional literature in other and perhaps less important areas of the law. There is a substantial and consistent body of decisional law in England and throughout the Commonwealth countries; there is a substantial and consistent and clear body of such law in New York; elsewhere in the United States there is a scattering of letter of credit decisions; but it is not too much to say that in almost no state outside of New York is there a comprehensive and cohesive body of common law on letters of credit. Many of the landmark decisions were rendered by courts other than the New York courts or the federal courts, but it would be virtually impossible to look to any court other than those in New York, combined with the Federal Second Circuit, and find a complete body of letter of credit law.

The practice, or the reflexive activity which supports this very important business, primarily derives from international usage and that in its turn has primarily been imported into the United States through New York. Boston, Philadelphia, San Francisco, Chicago and New Orleans, to name only a few important commercial cities, participate substantially in the letter of credit business and are skillful in the customs and usages of that business, but there is no doubt that they have come secondarily into the field and that the primary conduit of the international practice, which all of these banks follow, is the New York banking community.

It is further notable that in New York, which has been the center of the American international banking community for many years and especially the center of the letter of credit community, there is a modicum of litigation, a relatively small amount of dispute, and a low percentage of uncertainty as to the operation of letters of credit. The law of letters of credit in New York is decisional law, yet there are few cases arising from day to day, or even from year to year which, in view of the precedents already on the books, require any serious judicial attention. The customs and usages which govern the daily operation of the vast bulk of letter of credit transactions that never come into dispute, let alone into the law courts, are recorded in the Uniform Customs and Practice. These rules, or more properly speaking, this recording of custom, is as imperfect as all human writings and dictates, but clerks in banks seem reasonably able to understand and to deal with it, and as a result the business goes smoothly and is handled expeditiously and very, very cheaply.

We come then to the basic question: “Why the Code?” We have in New York an international device which is functioning well despite the fact that it involves the laws of foreign countries, the case law of New
York, and a set of international rules with respect to the conduct of the business. Why then should another and local set of statutory rules be added? The draftsmen of the Code attempt to answer this question in the comment to section 5-101, where they say:

Letters of credit have been known and used for many years, in both international and domestic transactions, and in many forms; but except for a few provisions, like Section 135 of the Negotiable Instruments Law, they have not been the subject of statutory enactment, and the law concerning them has been developed in the cases.

This provision of the Negotiable Instruments Law is no longer in the Code . . . The other source of law respecting letters of credit is the law of contracts with occasional unfortunate excursions into the law of guaranty. This Article is intended within its limited scope . . . to set an independent theoretical frame for the further development of letters of credit.3

There are those who feel that the proposed addition of a new set of local statutory rules, either to be superimposed upon or somehow wedged into the existing international industrial rules and the complex of case law, is not a good idea. They feel it will only add confusion to a presently relatively clear area. These critics of article 5 of the Code, and they include in their number skilled and intelligent as well as merely respectable persons, might well adopt as their slogan the language from Macbeth (Act II, Scene III)

Confusion now hath made her masterpiece!
Most sacrilegious murder hath broke ope
The lord's annointed temple and stole thence
The life o the building

The foregoing comes from the mouth of Macduff, and is therefore not an inappropriate reference for one who comments on the letter of credit article of the Code, for it is to be remembered that the quoted remarks were made by Macduff when he discovered the body.

Against this background and as a preliminary to an examination of article 5 of the Code section by section, the scope of this article must be considered.

Section 5-102 of the Code, entitled "scope" may well be regarded as the most extraordinary statutory statement ever made. Its effect is to subordinate the entire article to another set of rules. The subordination is not to another statute, but to another set of rules which are not enacted by any public body but by an industry. The subordination is not merely to another set of rules established by an industry, but to whatever rules that industry may choose to adopt from time to time in the future. This

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is neither clumsiness nor inadvertence. In its supplementary report on the Uniform Commercial Code (made to the Legislature of the State of New York and dated January 24, 1962), the Commission on Uniform State Laws said that the amendment to the 1958 edition of the Code, which creates this subordination of the statute law of New York to whatever rules the International Chamber of Commerce may choose to adopt, "makes clear and unequivocal the ability and right of banks to continue to operate under the Uniform Customs and Practice in lieu of the provisions of this Article, when they choose to do so."

Now, it is a matter of record that the New York Clearing House recommended that the article on letters of credit in its entirety be deleted from the Code. The banks which are members of the Clearing House, in common with substantially all of the banks in the United States which do any letter of credit business, uniformly provide in their letters of credit that the credits are subject to the Uniform Customs and Practice. The opposition of the Clearing House banks in New York was eliminated by the peculiar "New York" amendment to the letter of credit article of the Code. In fact, while the sponsors of the Code would not go so far as to acquiesce in the withdrawal of this article, they capitulated absolutely in providing that the article would apply only if selected. As pointed out, all of the banks in New York which do any letter of credit business have, over the years, and as a matter of course, subjected their letters of credit to the Uniform Customs and Practice.

The obvious result of this is that there is very little purpose for the student of bank credits to examine the Uniform Commercial Code at all, as it is quite evident that the banks will continue in their practice of operating under the Uniform Customs and Practice and by this very fact render the Uniform Commercial Code inapplicable to their operations.

Omitting the so-called New York amendment to article 5, however, one returns to the 1958 official edition of the Code for an examination of its initial and intended scope. Even omitting the New York amendment it is obvious that the Letter of Credit article of the Code is not an ambitious project. Subdivision 3 of section 5-102 frankly states that

This Article deals with some but not all of the rules and concepts of letters of credit as such rules or concepts have developed prior to this act or may hereafter develop. The fact that this Article states a rule does

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5 The article also does not apply if the credit is subject "in whole or in part" to the Uniform Customs and Practice. Quaere whether reference to one article of the Uniform Customs and Practice renders inapplicable the entire article. The article is also inapplicable to credits which are subject "by custom" to the Uniform Customs and Practice.
not by itself require, imply or negate application of the same or a converse rule to a situation not provided for or to a person not specified by this Article.

It is thus clear that the Code is not intended to be a definitive and comprehensive treatment of the field of letters of credit. When this reservation, which is made express in section 5-102(3) is coupled with the extraordinary legislative innovation found in section 5-102(1)—the deference to the Uniform Customs and Practice—it becomes obvious that the study of article 5 of the Uniform Commercial Code as presently enacted in New York is, in its relation to commercial credits, nothing more than a study of the Uniform Customs and Practice. It is conceivable, of course, that issuers of commercial documentary credits other than banks will enter the field to a significant extent and if and when they do it is conceivable that they will choose to elect the Code rather than the Uniform Customs and Practice.

In my view, these are wholly unlikely contingencies. The banks which have voluntarily subjected themselves to the provisions of the Uniform Customs and Practice for nearly a quarter of a century are unlikely to abandon this procedure in order to adopt what is admittedly an incomprehensive collection of rules intended only “to set an independent theoretical frame” for the “further development” of letters of credit. Indeed, the banks can scarcely be expected to do this, for they cannot afford to do so. So long as they must continue to operate in an atmosphere which is stimulated primarily by earnings statements and by the necessity of operating in conjunction with their corresponding banks in international trade, they cannot, even if they would, afford the luxury of shifting to academic exercise within “an independent theoretical frame” for an intensely practical and competitive business.

It is highly probable, therefore, if not virtually certain, that the parties now skilled in the issuance and handling of letters of credit will continue to operate under the international usage which they have followed for so many years, and it seems almost equally apparent that even in the unlikely event that raw beginners and callow youths attempt to enter this business, their very inexperience will make it inexpedient for them to abandon the accepted usage in favor of the admittedly limited and tentative Commercial Code.

For these reasons, I repeat, this paper should be, in effect, a comment on the Uniform Customs and Practice. It was not so advertised, however, and, as a matter of fact, as good a way as any to consider the Uniform Customs and Practice is to go through the letter of credit article of the Code section by section in order to contrast those sections with
the comparable provisions of the Uniform Customs and Practice. In so doing one must be continually mindful of the fact that the Uniform Customs and Practice cover a great deal more ground than the Code purports to do, yet the Code deals with matters ignored by the Uniform Customs and Practice. The two are not congruent.

With this cautionary background let me now proceed to take you through the Code section by section.

Section 5-101 consists merely of the statutory reference,—the short title of the Code.

Section 5-102 is the section which defines the scope of the Code and to which we have already addressed ourselves.

Section 5-103 sets forth the definitions. There are those who suggest there is a lack of precision in these definitions, especially in the treatment of authorities to pay or purchase. It should also be noticed that this section states that "a credit may be either revocable or irrevocable." This is not a helpful definition, for it does not in any way aid the uninitiate to decide whether a particular piece of paper is a revocable or an irrevocable credit. To some extent alternative consequences as to the irrevocable or revocable credit are set forth in the article (as for example in section 5-106(2) and (3)) but the Code's casual reference in these sections to revocable or irrevocable credits is to be contrasted to articles 2 and 3 of the Uniform Customs and Practice. Article 2 of the Uniform Customs and Practice states: "Commercial documentary credits may be either: (a) revocable or (b) irrevocable." Article 3 thereupon states "All credits, unless clearly stipulated as irrevocable, are considered revocable even though an expiry date is specified."

It has often been suggested, and probably correctly, that this is an outrageous rule and that, indeed, a credit should be treated as irrevocable unless it conspicuously states that it is revocable. Whether the rule is good or not, it is clear. The same cannot be said for the proposed new law of New York.6

Section 5-104 deals with formal requirements and the signature of letters of credit. This section makes no appreciable change from the case law of New York and is entirely consistent with the Uniform Customs and Practice, although its precise intent is not specifically repeated in the Customs and Practice.7

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6 It should be noted that the 1952 edition of the UCC followed the Uniform Customs and Practice. Uniform Commercial Code, Official Draft § 5-105 (1952). The section was eliminated to meet criticisms advanced by the Law Revision Commission. It also appears that, in the absence of the Uniform Customs and Practice, some earlier cases leaned to a presumption of irrevocability. See Ernesto Foglino & Co. v. Webster, 217 App. Div. 282, 276 N.Y. Supp. 225 (1st Dep't), modified, 244 N.Y. 516, 155 N.E. 878 (1926).

7 Lamborn v. National Park Bank, 240 N.Y. 520, 526, 148 N.E. 664, 666 (1925); Bank of
Section 5-105, which provides that no consideration is necessary to establish a credit or to enlarge or otherwise modify its terms, restates what has always been the law of letters of credit and in particular the case law of New York. This particular issue has seldom, if ever, been raised, but the student will look in vain for a case in which a letter of credit was held invalid for want of consideration. Once again the Uniform Customs and Practice makes no specific provision with respect to this theoretical concept of letters of credit, but the whole idea that a letter of credit requires no consideration is consistent with the philosophy of the Uniform Customs and Practice.

Section 5-106, dealing with the time and effect of the establishment of a credit, is consistent in its subdivisions (1) through (3) with the present case law of New York.\textsuperscript{8} There are no comparable provisions in the Uniform Customs and Practice. Subdivision (4) represents a variation from the international practice and from the English law. There the rule as to revocable credits is that they may be modified or revoked at any time, even after presentation of documents.\textsuperscript{9} Only where a credit of this nature has been transmitted to the beneficiary through a bank is there a requirement that notice of the modification or revocation be received by the negotiating bank prior to negotiation, payment or acceptance.\textsuperscript{10}

Section 5-107, relating to advice of credit, confirmation and error in statement of terms, is consistent with the Uniform Customs and Practice and with New York law in subdivisions (1) and (2).\textsuperscript{11} Subdivision (3) represents a new concept, possibly inconsistent with section 5-106(1)(a) and (b). Subdivision (4) is consistent with New York law insofar as that law is reflected in decisions, although the precise point is not squarely covered.\textsuperscript{12} This subdivision is also consistent with Article 12, the comparable provision of the Uniform Customs and Practice, although it provides less protection.

Section 5-108, which creates the concept of a "notation credit," and deals with the exhaustion of a credit, represents a totally new concept in its introduction of the "notation credit." In one sense it is perhaps

\textsuperscript{10} Uniform Customs and Practice, article 4.
\textsuperscript{11} Uniform Customs and Practice, articles 5, 6; Dullen Steel Prods., Inc. v. Bankers Trust Co., supra note 8, at 927; Bril v. Suomen Pankki Finlands Bank, supra note 7; Sweden v. New York Trust Co., 197 Misc. 431, 96 N.Y.S.2d 779 (Sup.Ct. N.Y. County 1949).
unfair to say that this is a new concept. It amounts instead to a resurrection of a concept once used, but abandoned by letter of credit bankers in the light of their experience. The only purpose of requiring that drawings under a credit be noted on the instrument itself is to protect the issuer against the risk of double negotiation. Double negotiation is, of course, a fraud. In the several centuries that letters of credit have been used in international transactions there are not more than three or four frauds recorded in the case books. It was on the basis of this rather surprising honesty among the beneficiaries of letters of credit that most issuing banks who would, of course, have been the prime victims of the fraud resulting from multiple negotiations under letters of credit, decided to dispense with the requirement that drawings be noted on the instruments. This dispensation was due in large measure to the fact that the requirement of notation was honored in the breach more than in the observance and that, in consequence, the specific requirement of the notation was so often waived that the waiver became the rule rather than the contrary. 

13 In any event, about twenty years ago, banks in the United States and their correspondents abroad began as a matter of practice to dispense with the requirement that drawings under a letter of credit be endorsed upon the instrument. Their reliance was upon the conviction, which may now almost be taken as a concept of law, that drawings after exhaustion of the aggregate amount of the credit were uncollectable in any event.

This, of course, is the rule which is stated in section 5-108 but unfortunately the emphasis is placed where it has long since been abandoned in practice, i.e., upon the requirement of notation and thus the salubrious rule, that one who draws and presents his draft after the credit has been exhausted is without rights, is weakened by the suggestion that it applies only if the negotiator has taken the pains to record the drawing on the credit instrument itself. This is, so far as can be ascertained, the first time that a “notation credit” has been honored by a definition and thus introduced as an accepted concept; let alone a concept which becomes a statutory requirement. If the definition is in effect as a statutory requirement then obviously section 5-108(2) is essential because the existence of the definition as a statutory concept requires some rule to regulate it. Unfortunately, the rule which section 5-108(2) attempts to state is confusing, and in view of this writer, totally unnecessary. Subdivision (3), which is an afterthought in section 5-108, is in fact an

13 Dixon, Irmaos & Cia v. Chase Nat'l Bank, 144 F.2d 759 (2d Cir.), cert. denied, 324 U.S. 850 (1945), discussed in Backus & Harfield, "Custom and Letters of Credit: The Dixon, Irmaos Case," 52 Colum. L. Rev. 589 (1952), is illustrative of the trap which inadvertent "custom" may provide for banks in the letter of credit field.
attempt to state the total existing law and practice. In this respect again it represents an initial effort at statement of a rule. There are cases which are not inconsistent with this statutory rule, but this is the first attempt to make a rule of written law. There are those who would suggest the rule stated by section 5-108(3) is one which carries rough justice to the point of brutality. It must, however, be noted that any rule may do violence to one party or another.

Section 5-109, dealing with the issuer's obligation to its customer, is a muddled and incomplete statement of the New York case law. With respect to subdivision (1), subsections (b) and (c) may be regarded as desirable. But the over-all injection of the concept of "good faith" into the letter of credit transaction is unnecessary, confusing and wholly inappropriate. Subdivision (2) of this section presents a problem in its reference to the requirement that documents be examined "with care" but this problem exists in the Uniform Customs and is probably inherent in the letter of credit business. Subdivision (3) gives the non-bank issuer a rather extraordinary advantage because such issuers will obtain the immunities or privileges given banks by the Article, but are exempt from the responsibilities which banks must accept in terms of the banking usages and customs, which, over the centuries, have developed into a rather valuable assurance of decency for the benefit both of customer and beneficiary.

Section 5-110 states two rules: Subdivision (1) provides that unless otherwise specified a credit may be used in portions in the discretion of the beneficiary. This rule is consistent with articles 36 and 37 of the Uniform Customs and Practice and represents an improvement over the rule as there stated. Article 36 of the Uniform Customs and Practice provides that unless otherwise expressly stipulated partial shipments are permitted. The Code's choice of the words "portion of the credit" instead of "shipment" is preferable. It gives effect to the broadened use of the term "documentary draft" and emphasizes the letter of credit as a financial instrument, rather than the mercantile aspect of the underlying transaction. A question which has existed under the Uniform Customs and Practice and which will continue unresolved under the Code is whether or not partial utilization of a credit must be proportional. Where a unit price is specified, there seems little question but that the

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15 See Ward & Harfield, supra note 2, at 76-77 for a discussion of the essentially conflicting positions of the bank in a letter of credit transactions.
drawing must be proportional; otherwise an operating problem is presented if the credit permits partial shipments or partial utilization, but the initial drawing is disproportionate to the amount of the shipment or the terms on which it is made.

Subdivision (2) of Section 5-110 has no direct counterpart in the Uniform Customs and Practice nor does there appear to be any judicial precedent in the law of New York. Certainly the rule would express the understanding of letter of credit bankers and if there is no precise judicial precedent, neither is there anything in the New York law which would be inconsistent with this rule.

Section 5-111 deals with warranties on transfer and presentment. There is no precisely comparable provision in the Uniform Customs and Practice. Subdivision (1) is consistent with the basic rule in New York, although it perhaps goes a little beyond that rule as presently laid down by the courts. It is to be noted that the Code imposes upon the beneficiary a warranty "to all interested parties." Under the present law of New York, a negotiating bank clearly has rights against the beneficiary unless it has taken the draft without recourse; and probably even a paying or issuing bank may recover back payment against nonconforming documents on the theory of a mutual mistake of fact. There is grave doubt, however, as to this latter conclusion if the nonconformity in question arises out of defects apparent on the face of the documents (and it is hard to conceive of any other nonconformity which would have justified non-payment in the first instance), for in such case the beneficiary might well argue that the bank's payment against the documents as presented constituted acceptance of them and waiver of any discrepancies.

Subdivision (2), while not paralleled in the Uniform Customs and Practice, is consistent with the New York law and the British law.16

Section 5-112 introduces for the first time a rigid rule with respect to the time within which an issuer must pay or dishonor a draft presented under a credit. The prior law in New York was found in the Negotiable Instruments Law relating to drafts presented for acceptance17 but the 24-hour rule there imposed ran only from the time that the presenter demanded that the instrument and accompanying documents, if any, be returned to him. Thus, in effect, a demand for return in addition to the mere presentation was necessary in order to start the 24-hour period run-

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ning against the bank. No comparable rule existed in the case of a sight draft nor in the presentation of an accepted draft for payment.

Section 5-112 (1) starts the arbitrary 3-day period running from the time of presentation and the deadline can be tolled only by an express or implied consent of the presenter. The most that the rule appears to do, therefore, is to shift from the presenter the burden of demanding return of documents and to impose on the paying bank the burden of requesting an extension of time in those peak periods when the physical volume of documents is such as to make current inspection well-nigh impossible.

Subdivision (2) finds a partial parallel in article 10 of the Uniform Customs and Practice.

Subdivision (3) defines the term "presenter" in a manner which finds no parallel in the Uniform Customs and Practice nor in the prior New York case law, but which is unobjectionable.

Section 5-113 purports to authorize banks to give indemnities in connection with imperfect performance of letters of credit, in order to obtain honor, negotiation or reimbursement. The right of a bank to give such indemnity on its own behalf has always been recognized but to do so on behalf of another has frequently involved exploration of the troublesome issue as to whether a bank is authorized to issue a guaranty on behalf of another; to encroach to this extent upon the business of suretyship. No comparable provision is found in the Uniform Customs and Practice; ordinarily the problem would not arise outside of the United States. Bankers in most countries are just as shocked to learn of the limitations in the United States upon what they regard as a normal incident of the banking business, as are American bankers when they learn that a "bank guaranty" is a routine and popular financial instrument abroad. Increasingly the right of banks in the United States to issue indemnities, which are truly incidental to the banking services which they normally provide for their customers, is coming to be recognized. The Code provision is decidedly a step in the right direction, even though the corporate power thus conferred is necessarily limited to banks incorporated in a Code state.

Section 5-114, dealing with the issuer's duty and privilege to honor, and right to reimbursement, essentially follows the existing New York law.19 There is no comparable provision in the Uniform Customs and Practice unless article 10 be so broadly construed (as perhaps it might

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well be) as to reach substantially the same result. In its essence, however, section 5-114 properly endeavors to set out a statutory framework covering when an issuer may and when he must honor a draft, whereas the Uniform Customs and Practice, being by definition a recording of the practice rather than a statement of legal rules, does not expressly attempt to cover the same ground.

Section 5-115 represents an attempt to deal with the troublesome question of damages available under a letter of credit. There is no comparable provision in the Uniform Customs and Practice (as indeed there could not be) and the rule which is attempted to be stated in section 5-115(1) is a peculiar one indeed. There is little law in New York on this question of damages for breach of a letter of credit contract; what there is looks toward a simple and consistent rule which probably will not be changed by section 5-115(1).

Section 5-116, dealing with transfer and assignment of letters of credit and rights thereunder, covers approximately the same ground that is the subject of article 49 of the Uniform Customs and Practice. Neither rule satisfactorily disposes of this delicate and often exasperating problem.

Subdivision (1) of section 5-116 states the basic rule found in article 49 of the Uniform Customs and Practice and enshrined in the case of Eriksson v. Refiners Export Co.

Subdivision (3), unless this writer has misconstrued it, merely saves out the negotiability of drafts and demands drawn under a letter of credit and if that is all it does, it is commendable.

Subdivision (2), however, represents an excursion in compromise which winds up in Subdivision (c) with the mutual displeasure usually found in such situations. It is to be noted, however, that subdivision (2) deals only with an assignment or transfer of the proceeds of the credit. The right to perform the credit is retained and thus unless the original beneficiary performs there will be no proceeds. In most instances of serious dispute, there is usually inadequate or no performance of the terms of the credit and, as a result, no proceeds. As a practical matter, therefore, it is to be hoped and it seems that there will not be a substantial volume of problems which will necessitate reference to this section.

Section 5-117 has no parallel in the Uniform Customs and Practice but is quite consistent with the New York law. What its effect would

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be if it came in conflict with the Bankruptcy Act is, of course, conjectural, but many of the cases dealing with insolvency of banks arose in the Federal courts and the rule of section 5-117 which, as stated, is believed to be consistent with the New York law, appears also to be consistent with the law in the Second Federal Circuit.23

CONCLUSION

The problem of adaptation to article 5 of the Code varies according to the point of view of those who try to solve it. In the judgment of this writer, it will not present a serious problem to any of the groups affected by it.

A letter of credit is a contract. In operation, it involves a complex of contracts. It is itself a contract between issuer and beneficiary. It is initiated by a contract between the issuer and the account party. It ordinarily arises out of, but is separate and independent from, a sales contract or other agreement between the account party and the beneficiary.

Accordingly, the problem of adaptation to article 5 will vary depending upon whether the person seeking to make the adaptation is the account party, the issuer, or the beneficiary (including for this purpose in the term "beneficiary" negotiators and bona fide holders of drafts drawn under negotiation credits). In one sense it may be said that it would be in the interest of all beneficiaries and all persons who negotiate drafts drawn under letters of credit that the letter of credit be drawn as nearly as possible in terms of a negotiable instrument, emphasizing the absolute character of the obligation to pay and minimizing the importance of the conditions upon which payment depends. Conversely it might be said that the general interest of the account party is to emphasize the conditions of payment and to minimize the obligation to pay. A moment's reflection, however, will indicate that unless these opposing demands are neutralized, the letter of credit will lose most of its value. The beneficiary who is in a position to insist upon reduction or absence of conditions might equally well insist upon payment involving the use of a negotiable instrument rather than a letter of credit; conversely, the account party who is in the position to dictate extensive and onerous conditions may not need a letter of credit to obtain his objectives.

The primary effect of article 5, therefore, will be upon the issuers of letters of credit and upon those who negotiate drafts drawn under letters

of credit, in reliance upon the credit itself. At the present time this seems to mean that the primary impact of article 5 will be upon banks and bankers.

The option offered by section 5-102(1) virtually eliminates the effect of article 5 on bankers' commercial documentary credits. It does not totally eliminate the problem of adaptation, because some question may be raised as to the inclusion in article 5 of credits which would be regarded as documentary within the scope of that article but not as commercial documentary letters of credit within the scope of the Uniform Customs and Practice. For example, it is not now customary for banks to designate their traveler's letters of credit or many so called "clean credits" as subject to the Uniform Customs and Practice. Many of the "clean credits," however, require as a condition to payment the presentation of some sort of writing which might well cause the draft drawn under the credit to be a "documentary draft" within the meaning of article 5. It is even conceivable that where a traveler's letter of credit requires notation on the instrument and ultimate return of the exhausted instrument, this might be construed as causing the drawing to be one which would be sufficiently conditioned on documentary transactions as to come within the scope of article 5. The simplest solution would appear to be a subjection of all letters of credit to the Uniform Customs and Practice, notwithstanding the fact that most of its provisions will be irrelevant to traveler's letters of credit or others which do not arise out a commercial transaction. Put differently, the relevance of the Uniform Customs and Practice will be in direct ratio to the relationship of the particular letter of credit to a commercial transaction, but even in the case of a traveler's letter of credit, subjection to the Uniform Customs and Practice would not be meaningless.

Alternatively, failure to divert the impact of article 5 on traveler's and clean letters of credit through reference to the Uniform Customs and Practice, would probably result in few dislocations from the existing manner in which such instruments are handled.

In short, it is the view of this writer that article 5 will have little effect upon the conduct of the letter of credit business in New York. With respect to the bulk of that business, the probable continuance of the present selection by banks of the Uniform Customs and Practice as the governing regulation means that the article will have no application whatsoever. To the extent that some phases of the business are not covered by the Uniform Customs and Practice, there will be little need for change in the practical, day-to-day operation of that sort of credit. So far as nonbankers are concerned, that is to say the account parties
and the beneficiaries, as most of them deal with banks the conclusion with respect to the effect of the article on banks will apply as well to nonbank users of the letter of credit.

Whether or not the article applies, the task of the prudent businessman will continue to be the same; he must, with respect to each specific letter of credit transaction, satisfy himself as to what his commercial necessities are and as to the extent to which the issuer of the credit is prepared to incorporate those necessities as terms of the credit; he must satisfy himself as to the kind of obligation, if any, he has received from the issuer; and in short must continue to exercise reasonable discretion in the conduct of his affairs.

In considering article 5 of the Code it may well be said that the product of the mountainous effort which has gone into the project is a mouse, but it is a white mouse and not altogether disagreeable.