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JUDICIAL DEVELOPMENT OF LETTERS OF CREDIT LAW: A REAPPRAISAL

The unique nature of letters of credit¹ and the need for commercial flexibility² they serve have traditionally deterred legislators from over-structuring the laws that control their use.³ Absent legislative guidance,⁴ courts have exercised great discretion in reconciling customs,⁵ statutes,⁶ and relevant principles of contract and surety law⁷ to resolve letter of credit disputes.⁸ However,

¹ A letter of credit is a commitment undertaken by a bank or other entity (the "issuer") issued in accordance with instructions from and for the account of the applicant (the "customer") in favor of a third party (the "beneficiary"). The commitment obligates the issuer for a specific time period to make payments to or to pay drafts drawn by the beneficiary upon the presentation of stipulated documents, provided the beneficiary has complied with the letter of credit's terms and conditions.

Formal definitions vary. *See, e.g.*, B. KOZOLCHYK, *COMMERCIAL LETTERS OF CREDIT IN THE AMERICAS* 9, 599 (1966). Recent literature explores definitional aspects and the various types of letters of credit. *See generally* Arnold & Bransilver, *The Standby Letter of Credit—The Controversy Continues*, 10 U.C.C. L.J. 272, 272-81 (1978); Justice, *Letters of Credit: Expectations and Frustrations—Part I*, 94 BANKING L.J. 424, 425-30 (1977); Verkuil, *Bank Solvency and Guaranty Letters of Credit*, 25 STAN. L. REV. 716, 717-21 (1973); Comment, *Letters of Credit: Current Theories and Usages*, 39 LA. L. REV. 581, 582-87 (1979).

² H. HARFIELD, *BANK CREDITS AND ACCEPTANCES* 16-19 (5th ed. 1974).

³ Letters of credit have long been used in international sales transactions. *See, e.g.*, J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* 704 (2d ed. 1980); Comment, *Commercial Letters of Credit: Development and Expanded Use of Modern Commercial Transactions*, 4 CUM.-SAM. L. REV. 134, 145-51 (1973). The rapid growth of diverse letter of credit uses within this country, however, has been a more recent phenomenon. *See, e.g.*, Harfield, *The Increasing Domestic Use of the Letter of Credit*, 4 U.C.C. L.J. 251 (1972). This Note focuses on the problems of their use within the United States.

⁴ *See* notes 27-30 and accompanying text *infra*.

⁵ Custom has exerted a strong impact on the long-term development of commercial letters of credit. *See* B. KOZOLCHYK, *supra* note 1, at 75-97. For an historical survey, *see generally id.* at 3-19; H. GUTTERIDGE & M. MEGRAH, *THE LAW OF BANKERS' COMMERCIAL CREDITS* (4th ed. 1968); Comment, *supra* note 3, at 134, 135-40.

⁶ The basic legal principles governing letters of credit are codified in Article Five of the UNIFORM COMMERCIAL CODE ("UCC") and in the UNIFORM CUSTOMS AND PRACTICES FOR COMMERCIAL DOCUMENTARY CREDITS FIXED BY THE THIRTEENTH CONGRESS OF THE INTERNATIONAL CHAMBER OF COMMERCE (1974 rev.) ("UCP").

⁷ Contract principles are relevant to many aspects of letter of credit transactions, such as the obligations between customer and beneficiary and between customer and issuer. Although the letter of credit relationship itself (between issuer and beneficiary) is not exclusively contractual (*see* J. WHITE & R. SUMMERS, *supra* note 3, at 711), many contract principles apply by analogy in defining duties and resolving, for example, ambiguities in a written letter of credit agreement. *See* note 64 and accompanying text *infra*. Courts apply surety principles to differentiate letters of credit issued by national banks from traditional guarantees. *See* notes 66, 69, and accompanying text *infra*. *See generally* Comment, *supra* note 1, at 588-92.

⁸ Courts receive guidance from regulatory agencies as well as legislatures. For example, the Federal Deposit Insurance Corporation (FDIC), the Federal Reserve Board (FRB),

the recent increase in domestic use of letters of credit,⁹ and their more diverse applications,¹⁰ have exacerbated the problems courts encounter in adjudicating letter of credit claims and have left the courts with increased responsibility for developing fundamental letter of credit principles.

Expansive judicial power in developing letter of credit law has produced two adverse effects. First, legislative inaction has forced courts to assume an inappropriate policymaking role.¹¹ Second, judicial reliance on equitable principles to resolve disputes has prevented development of consistent letter of credit law. This threatens to undermine the stability and predictability letters of credit otherwise provide for the parties that use them.¹²

This Note examines areas of letter of credit law in which broad judicial discretion has compromised fundamental letter of credit principles. It concludes by suggesting that only legislative guidance will enable the courts to preserve the advantages that letters of credit offer in commercial transactions.

and the Comptroller of the Currency regulate issuances of letters of credit by national banks. Recently, each agency has responded to concerns about the dangers of unregulated bank issuances of standbys by issuing regulations establishing guidelines and requirements. See note 72 and accompanying text *infra*.

⁹ See J. WHITE & R. SUMMERS, *supra* note 3, at 752. The most rapid increase in domestic use has occurred with standby letters of credit. National banks, for example, had less than \$1.5 billion worth of standby credits outstanding in 1973. By 1978, the value of outstanding standbys had increased to over \$10 billion. *Second Meeting on the Condition of the Banking System: Hearing Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 95th Cong., 2d Sess. 157 (1978). In the absence of legislative restrictions, this trend appears likely to continue.

¹⁰ The increased use of standby credits has accounted for much of the increasing versatility of letters of credit. See note 9 *supra*. Standby credits have been used, *inter alia*, as collateral security for loans, as a substitute for performance and libel bonds, to guarantee payments of salaries, for interim financing, as a security device for repurchase agreements, to finance real estate transactions, and to finance the issuance of commercial paper. For discussion of the varied uses of standby credits, see Joseph, *Letters of Credit: The Developing Concepts and Financing Functions*, 94 BANKING L.J. 816 (1977); Verkuil, *supra* note 1, at 721-24; Note, *Guaranty Letters of Credit: Problems and Possibilities*, 16 ARIZ. L. REV. 822, 825-29 (1974).

¹¹ Where letter of credit principles are familiar and accepted, considerable judicial discretion in resolving disputes is appropriate. See notes 27-30 and accompanying text *infra*. Where letter of credit policies are uncertain and in seeming conflict with other established legal principles, the propriety of broad judicial discretion becomes questionable. For example, bank issuances of standby letters of credit (defined in note 57 *infra*) conflict with the traditional rule against banks acting as guarantors. See notes 66-71 and accompanying text *infra*.

¹² One commentator characterizes the dilution of letter of credit principles caused by judicial resort of equitable doctrines as "conceptual pollution." Harfield, *Code, Customs and Conscience in Letter of Credit Law*, 3 U.C.C. L.J. 7, 8 (1971). See notes 89-95 and accompanying text *infra*.

I

THE RATIONALE FOR BROAD JUDICIAL DISCRETION

Certain aspects of the letter of credit transaction¹³ insure its utility in the commercial setting. First, the obligation between issuer and beneficiary is independent of the underlying transaction between beneficiary and customer.¹⁴ Making payment contingent solely upon fulfillment of conditions stipulated in the letter of credit¹⁵ restricts possible justifications for an issuer's default¹⁶ and makes the financing mechanism reliable.¹⁷ Second, it is exclusively a documentary transaction.¹⁸ The issuer must pay the

¹³ A letter of credit transaction typically involves three distinct agreements—the letter of credit relationship itself, which involves the issuer and the beneficiary, the underlying agreement between the customer and the beneficiary (*e.g.*, for the sale and delivery of goods), and the customer's obligation to reimburse the issuer for payments made to the beneficiary. Harfield, *supra* note 3, at 257-58.

If additional parties become involved, applications become more complex. For example, a customer seeking a letter of credit to buy goods is often a wholesaler who may arrange for immediate resale of the goods through a second letter of credit arrangement that depends in part upon completion of the first. This arrangement is typically known as back-to-back letters of credit. *See, e.g.*, B. KOZOLCHYK, *supra* note 1, at 28, 488-90, J. WHITE & R. SUMMERS, *supra* note 3, at 752. A second, "confirming" bank may assume the obligations of the issuer and become directly responsible to the beneficiary. *See, e.g.*, U.C.C. § 5-107(2). The beneficiary may "transfer" the letter of credit or "assign" his rights thereunder, but only when the credit is "expressly designated as transferable or assignable," U.C.C. § 5-116(1), or, in the case of assignment, upon fulfillment of other conditions specified by U.C.C. § 5-116(2).

¹⁴ *See, e.g.*, U.C.C. § 5-114(1); Justice, *supra* note 1, at 426. Letters of credit necessarily involve contractual relationships among the customer, issuer, beneficiary and other interested parties. *See* note 13 *supra*. The relationship between issuer and beneficiary, however, is not strictly contractual. First, because the two typically have no prior contact with one another before the actual presentation of documents, they do not manifest mutual assent in the normal contractual sense. *See* Comment, *supra* note 1, at 588-90. Second, the issuer-beneficiary obligations require no consideration. *See id.*; U.C.C. § 5-105. Third, the issuer cannot assert, in an action by the beneficiary, the defenses usually available against third party beneficiaries. *See* J. WHITE & R. SUMMERS, *supra* note 3, at 711-12. The peculiarity of the issuer-beneficiary relationship gives rise to the unique laws that govern letter of credit transactions. *See, e.g., id.* at 712.

¹⁵ *See* U.C.C. §§ 5-109(1)(a), (2), 5-114 Comment 1; U.C.P. Articles Nine, Ten, Eleven (1974 Rev.). The issuer determines whether or not documents comply with the letter of credit's terms, but must exercise good faith and reasonable care in his evaluation. *See* U.C.C. § 5-109 Comment 1.

¹⁶ The issuer can refuse to pay only if the documents presented do not comply with the letter of credit's terms, or if there is "fraud," "forgery" or "fraud in the transaction." U.C.C. § 5-114(1), (2)(b). Absent explicit contrary agreement, an issuer cannot refuse to pay for various other reasons, such as involency of the customer from whom it will seek reimbursement. The issuer, therefore, bears responsibility for investigating the credit and solvency of his customer before issuing the requested letter of credit.

¹⁷ *See, e.g.*, Note, *supra* note 10, at 841-42.

¹⁸ The provisions in Article Five of the UCC reflect the draftsmen's intent to preserve this important aspect. *See* U.C.C. §§ 5-109(1), (2); 5-114(1).

face amount of the draft when the beneficiary presents complying documents.¹⁹ This discourages disputes about actions of other parties, particularly of the customer,²⁰ who remains outside the letter of credit relationship.²¹ Because they tend to prevent litigation, and can be obtained easily,²² letters of credit are convenient and economical. Third, the letter of credit, which can serve either a payment or financing function,²³ is permitted to operate in the nature of a guaranty,²⁴ subject to restrictions. Such flexibility makes the letter of credit adaptable to a broad range of commercial uses.²⁵

¹⁹ "Documentary" credits require the beneficiary to present both a draft or demand for payment and complying documents. At a customer's request, the requirement of complying documents may be omitted; the result is a "clean" credit, which requires only that the beneficiary present the draft or demand for payment to the issuer. *See* B. KOZOLCHYK, *supra* note 1, at 23 n.54; Note, *supra* note 10, at 824.

²⁰ *See, e.g.*, Justice, *supra* note 1, at 427-29.

²¹ *See* note 14 *supra*. The obligations between issuer and beneficiary are independent not only from the underlying transaction, but from the contractual agreement between issuer and customer as well. Unfairness can result. For example, the issuer usually has no obligation to pay the beneficiary unless the presented documents strictly comply with the letter of credit's terms. *See* notes 42-43 and accompanying text *infra*. In certain jurisdictions, however, the issuer can escape liability in a customer's action for wrongful honor merely by showing that the presented documents achieved substantial compliance. *See, e.g.*, *Far Eastern Textile, Ltd. v. City Nat'l Bank & Trust Co.*, 430 F. Supp. 193, 196 (S.D. Ohio 1977); J. WHITE & R. SUMMERS, *supra* note 3, at 731-32 (citing 3 N.Y. STATE LAW REVISION COMM'N 1955 REPORT 1571, 1634-35 (1955) (critique of 1952 official text of Article Five for New York Law Revision Commission by Professor Rudolf B. Schlesinger)). This bifurcated standard of compliance creates the anomalous possibility that when presented with documents that do not strictly comply, the issuer might wrongfully pay the beneficiary and still recover from the customer in an action for reimbursement. Alternatively, when strictly complying documents are presented, the issuer must pay the beneficiary, even when customer insolvency precludes his reimbursement. *See, e.g.*, *Courtaulds North America Inc. v. North Carolina Nat'l Bank*, 387 F. Supp. 92 (M.D.N.C.) (issuer held liable to beneficiary despite customer's insolvency), *rev'd on other grounds*, 528 F.2d 802 (4th Cir. 1975).

²² The UCC requires only that they be in writing and signed by the issuer. *See* U.C.C. § 5-104(1). Administrative regulations impose other guidelines on the issuance of standby credits. *See, e.g.*, notes 60, 72 *infra*.

²³ *See* note 14 *supra*.

²⁴ Guarantee or "standby" letters of credit significantly differ from conventional commercial credits. *See* notes 58, 60-65, and accompanying text *infra*. In conventional letter of credit transactions, the parties contemplate payment upon performance or completion of some act (*e.g.*, delivery of goods). Parties to a standby letter of credit, however, condition payment upon some default of performance or payment in the underlying transaction. *See, e.g.*, Katskee, *The Standby Letter of Credit Debate—The Case for Congressional Resolution*, 92 BANKING L.J. 697, 699 (1975). *See also* note 57 and accompanying text *infra*.

²⁵ Standby credits have been used as substitutes not only for traditional letters of credit, but for other devices as well. The use of standby credits in the domain of suretyship has generated much debate concerning the legality and desirability of such devices. *See* note 24 *supra* and note 71 *infra*.

The advantage of letters of credit—reliability, convenience, economy, and flexibility—would be lost if the laws governing them were highly complex and restrictive. Statutory codifications,²⁶ consequently, are general and incomplete.²⁷ Applicable sections of the Uniform Commercial Code (UCC) merely attempt to provide a broad theoretical framework, leaving to courts the responsibility for developing interstitial areas of letter of credit law.²⁸

²⁶ Two codifications typically apply to letter of credit transactions in the United States: the UNIFORM COMMERCIAL CODE and the UNIFORM CUSTOMS AND PRACTICE FOR COMMERCIAL DOCUMENTARY CREDITS (1974 Rev.). The UCC, drafted by the National Conference of Commissioners on Uniform State Laws and the American Law Institute, "gives statutory recognition to the fundamental principles [of letters of credit] and it is thus consistent both with the antecedent common law of letters of credit and . . . with the commercial and financial practices out of which the device has developed." H. HARFIELD, *supra* note 2, at 228 (footnote omitted). The UCP, drafted in 1929 and updated periodically by the International Chamber of Commerce, "set[s] forth a series of fairly generalized rules expressing the understanding of bankers as to the mechanics of operating" commercial letters of credit. *Id.* at 225. Although recognized within the United States as well as internationally, the UCP rules are usually binding domestically only to the extent that they do not conflict with the UCC and are "incorporated by reference" by the parties. Thus, the UCP does not always govern parties' rights in letters of credit disputes within the United States. *See* note 18 *infra*.

²⁷ U.C.C. Article Five, for example, states:

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

U.C.C. § 5-102(3). Comments accompanying various provisions of Article Five explicitly reserve specific questions for resolution by the courts. *See, e.g.*, U.C.C. § 5-103 Comment 1 (leaving to courts the issue of how to identify a letter of credit as revocable or irrevocable in the absence of express provision in the agreement); U.C.C. § 5-116, Comment I (due to "general confusion of thought," as to the meaning of "assignment or transfer of a credit," the "law remains uncertain."); note 45 and accompanying text *infra*. As one expert has noted, the Code's draftsmen "did their best to devise a two-way stretch girdle instead of a plaster cast." H. HARFIELD, *supra* note 2, at 228.

²⁸ *See* U.C.C. § 5-101 Comment. Many commentators recognize that the UCP, like the UCC, leaves considerable discretion to the parties in a transaction and to the courts. Kozolchyk asserts, "[u]seful as the text of the U.C.P. has been and is as a guideline for bankers and immediate parties to the letters of credit transaction, its claim to the status of a fully binding codification is not supported by the tenor of its provisions." B. KOZOLCHYK, *supra* note 1, at 88. Kozolchyk reports the more unequivocal view of two British commentators, Gutteridge and Megrah, who conclude that "nowhere do the Uniform Customs have the force of law." *Id.* (citing H. GUTTERIDGE & M. MEGRAH, *THE LAW OF BANKER' COMMERCIAL CREDITS* 176 (3d ed. 1962)). Harfield explains that "[the UCP provisions] do not purport to be mandates, and consequently each successive alteration of the written [UCP] rules represented a recognition of a change in custom rather than a directive as to the ways the business thereafter should be done." H. HARFIELD, *supra* note 2, at 227 (footnote omitted). *See generally* B. KOZOLCHYK, *supra* note 1, at 94-95; Note, *Documentary Letters of Credit and the Uniform Customs and Practice for Documentary Credits (1974 Rev.): A Selective Analysis*, 3 J. CORP. L. 147 (1977); Comment, *supra* note 3, at 154-60.

Draftsmen of the UCC asserted in Comments that "no statute can effectively or wisely codify all the possible law of letters of credit without stultifying further development of this useful financing device."²⁹ Keeping general principles in mind, courts applying Article Five of the Code are to follow the "canon of liberal interpretation," so that judicial decisions advance "underlying purposes and policies"³⁰ of letter of credit law. Unfortunately, this broad judicial discretion has begun to undermine, rather than promote, the letter of credit's basic utility.

II

JUDICIAL POLICYMAKING

In several areas, the UCC has left to the courts the responsibility for creating guidelines for implementing letter of credit principles.³¹ The courts, however, have failed to perform this task adequately. The few reported letter of credit cases³² reflect inconsistent, confusing doctrine in important areas,³³ and suggest that legislative action is necessary to restore predictability to commercial transactions.

Parties frequently incorporate the UCP into letter of credit agreements. See J. WHITE & R. SUMMERS, *supra* note 3, at 717. In four states, stipulation by the parties that the letter of credit is partially or wholly subject to the UCP will preclude applicability of the UCC, and render the UCP exclusively controlling. ALA. CODE tit. 7, § 5-102(4) (1975); ARIZ. REV. STAT. ANN. § 44-2702(D) (1967); MO. REV. STAT. § 400.5-102(4) (1978); N.Y. U.C.C. § 5-102(4) (McKinney 1964). See, e.g., *Capehart Corp. v. Shanghai Commercial Bank, Ltd.*, 49 A.D.2d 521, 369 N.Y.S.2d 751 (1st Dep't 1975) (holding the UCC inapplicable to a letter of credit that expressly designated the UCP as controlling). In other states, the UCC will apply whether or not the letter of credit agreement incorporates the UCP by reference.

²⁹ U.C.C. § 5-102 Comment 2.

³⁰ *Id.*

³¹ The UCC draftsmen carefully preserved the parties' "freedom of contract" through repeated use of the phrase "unless otherwise agreed." J. WHITE & R. SUMMERS, *supra* note 3, at 717 (citing Comment, "Unless Otherwise Agreed" and Article 5: An Exercise in Freedom of Contract, 11 ST. LOUIS U. L.J. 416 (1967)). Thus, many UCC provisions will not apply if parties have provided alternative arrangements in their letter of credit agreement. Article Five, moreover, does not address every contingency. Courts must therefore resolve ambiguities in areas where both codified rules and the parties' express provisions are silent, and often look to contract and suretyship principles to reach decisions. Parties can enhance legal certainty in most cases through careful drafting. As one commentator has noted, however, "effective letter of credit usage requires imposition of prophylactic rules to prevent abuses." Note, *supra* note 10, at 855.

³² See, e.g., *Joseph*, *supra* note 10, at 848 (noting paucity of letter of credit cases).

³³ See *Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank*, 569 F.2d 699 (1st Cir. 1978); *Banco Espanol de Credito v. State St. Bank & Trust Co.*, 385 F.2d 230 (1st Cir. 1967), *cert. denied*, 390 U.S. 1013 (1968); *United States Indus., Inc. v. Second New Haven*

A. Standards of Compliance

Letter of credit litigation most frequently arises from disputes about whether presented documents comply with the terms and conditions specified in the credit agreement.³⁴ The issuer is usually responsible for drafting the letter of credit's provisions.³⁵ Although courts will construe any ambiguous terms as strongly as possible against him,³⁶ the issuer retains the power to decide initially whether documents presented by the beneficiary comply with the letter of credit's conditions.³⁷ This may induce him to look beyond the documents themselves to facts concerning the underlying transaction to justify dishonor of presented drafts.³⁸ A court evaluating his actions, in turn, must also look beyond the documents to ascertain the propriety of honor or dishonor.³⁹

Bank, 462 F. Supp. 662 (D. Conn. 1978); *Wichita Eagle & Beacon Publishing Co. v. Pacific Nat'l Bank*, 343 F. Supp. 332 (N.D. Cal. 1971), *rev'd* 493 F.2d 1285 (9th Cir. 1974); *United Bank Ltd. v. Cambridge Sporting Goods Corp.*, 41 N.Y.2d 254, 360 N.E.2d 943, 392 N.Y.S.2d 265 (1976); *Fair Pavilions, Inc. v. First Nat'l City Bank*, 19 N.Y.2d 512, 227 N.E.2d 839, 281 N.Y.S.2d 23 (1967). See notes 40-53, 57-59, 64-71, 89-96, & 99-105, and accompanying text *infra*.

³⁴ J. WHITE & R. SUMMERS, *supra* note 3, at 729.

³⁵ Bank issuers customarily stipulate the conditions on a standard form. For samples of forms used, see H. GUTTERIDGE & M. MEGRAH, *supra* note 5, at 224-41. See note 36 *infra*.

³⁶ For example, in *East Girard Sav. Ass'n v. Citizens Nat'l Bank & Trust Co.*, 593 F.2d 598 (5th Cir. 1979), the issuing bank had used a letter of credit form designed for a sale of goods transaction as a guaranty to finance construction of an apartment complex. Resulting confusion about compliance conditions prompted the court to dispense with the documentation requirement. *Id.* at 602-03.

³⁷ U.C.C. § 5-109(2) states: "[a]n issuer must examine documents with care so as to ascertain that on their face they appear to comply with the terms of the credit . . ." An issuer uncertain about the sufficiency of submitted documents may reasonably ask for additional supporting information. Absent adequate supporting material, the issuer "pays at its peril." See, e.g., *Chase Manhattan Bank v. Equibank*, 550 F.2d 882, 886 (3d Cir. 1977); *First Nat'l Bank v. Rosebud Hous. Auth.*, 291 N.W.2d 41, 44 (Iowa Sup. Ct. 1980).

³⁸ The issuer might, for example, look for "fraud," "forgery," or "fraud in the transaction," even though he had no obligation to do so to defend his refusal to pay under § 5-114(2). See Note, *supra* note 5, at 838; notes 89-90 and accompanying text *infra*.

Many aspects of standby credits make the issuer especially reluctant to honor drafts or demands for payment. First, in a typical standby credit transaction, the parties do not anticipate payment unless something goes wrong—default of performance, for example. See note 24 *supra*. By contrast, in a conventional letter of credit situation, the issuer and the parties expect payment following completion of the underlying transaction. Second, unlike the issuer of a traditional letter of credit, who receives documents of title before paying out money, the standby issuer receives only notice of default, and must pay before being reimbursed and without receiving anything of value. See, e.g., *Verkuil*, *supra* note 1, at 723. Third, the insolvency of the customer often causes a default in the underlying transaction that prompts the demand for payment. In such a case, the standby issuer's prospects of reimbursement after payment are minimal. *Id.* at 723-24.

³⁹ In *Bank of N.C. v. Rock Island Bank*, 570 F.2d 202 (7th Cir. 1978), the court upheld, as a valid letter of credit, an arrangement in which one bank agreed to purchase a

The UCC draftsmen explicitly left to the judiciary the task of choosing an appropriate standard of compliance.⁴⁰ Case law, however, illustrates the inability of courts to reconcile their responsibility to promote fairness in particular cases with promoting the commercial reliability that letters of credit should provide in transactions.⁴¹ Responding to the silence of Article Five, many courts have continued to apply an objective pre-Code test of "strict compliance,"⁴² which requires that presented documents scrupulously adhere to the letter of credit's terms.⁴³ Nevertheless, some courts have deviated from the stringent standard to achieve fair results in particular cases.⁴⁴ The parties themselves

promissory note pursuant to a previously executed instrument. The parties had agreed, however, that the issuer would honor the credit upon presentation of "a promissory note" and only "in an amount not to exceed [the] unpaid balance of principal and interest due upon presentation." *Id.* at 204. As Judge Bauer noted in dissent, the "unpaid balance" could not be discerned from the face of the presented note alone, and "no other 'document' [was] required by the letter to affirmatively settle what the 'unpaid balance of principal and interest' [was]." *Id.* at 209. Judge Bauer concluded:

[B]ecause the issuing bank cannot ascertain the extent of its liability under the letter by relying on the required documents alone and must ascertain facts extrinsic to the documents in which it is dealing, this instrument cannot be deemed a "letter of credit," at least in its normative commercial sense.

Id. Judge Bauer praised the majority's goal but took issue with its strategy: "Perhaps the Court is straining to do what it perceives as equity. If so, it does so in an inequitable manner . . ." *Id.* at 210.

⁴⁰ "The more important areas not covered by this Article revolve around the question of when documents in fact and in law do or do not comply with the terms of the credit." U.C.C. § 5-102 Comment 2.

⁴¹ The desire of courts to achieve fair results has adversely affected not only certainty of compliance standards, but of remedies for wrongful honor as well. For the related problem of equity's intrusion into the practical fashioning of remedies, see note 103 *infra*.

⁴² The strict compliance doctrine long preceded the UCC. See, e.g., *Camp v. Corn Exch. Nat'l Bank*, 285 Pa. 337, 342, 132 A. 189, 191 (1926). Early versions of the UCP sought to preserve the judicially developed standard by emphasizing that banks should exercise great care in ascertaining compliance. See UCP art. 9 (1951 rev.), discussed in B. Kozolchyk, *supra* note 1, at 260. Cases decided under the UCC reflect widespread judicial reaffirmance of the doctrine. See, e.g., *Corporacion de Mercadeo Agricola v. Mellon Bank Int'l*, 608 F.2d 43, 47-48 (2d Cir. 1979); *Sisalcords Do Brazil, Ltd. v. Fiacao Brasileira De Sisal, S.A.*, 450 F.2d 419, 422 (5th Cir. 1971), *cert. denied*, 406 U.S. 919 (1972); *Venizelos S.A. v. Chase Manhattan Bank*, 425 F.2d 461, 465 (2d Cir. 1970).

⁴³ Even courts that faithfully apply the strict compliance rule do not achieve absolute strictness in all cases. For a discussion of the unavailability of complications in the commercial setting, see B. Kozolchyk, *supra* note 1, at 259, 262-69.

⁴⁴ See *Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank*, 569 F.2d 699, 705 (1st Cir. 1978); *Banco Espanol de Credito v. State St. Bank & Trust Co.*, 385 F.2d 230, 234 (1st Cir. 1967), *cert. denied*, 390 U.S. 1013 (1968); *United States Indus., Inc. v. Second New Haven Bank*, 462 F. Supp. 662, 664-65 (D. Conn. 1978). In *Banco*, the First Circuit noted that the strict compliance standard seemed to have "mellowed" in the English courts. 385 F.2d at 234 n.3. For discussion of the general relaxation of the traditional strict adherence to letter of credit principles, see Harfield, *supra* note 12, at 13-14.

may include in the letter of credit a stipulation that "substantial compliance" is sufficient.⁴⁵ This increases the probability that a court, as well as the parties, will look beyond the documents to other conditions and events in the transaction.⁴⁶

The broad judicial discretion that the UCC permits may tempt courts to relax the strict compliance standard where that standard would not protect the legitimate interests of the par-

⁴⁵ Judicial adoption of a substantial compliance standard differs from a stipulation made by the parties in the agreement that the presented documents must "substantially satisfy" the issuer. The latter introduces into the relationship the subjective judgment of the issuer which, in effect, gives him broad power to cancel or dishonor the credit, subject only to the UCC's requirement of "good faith" (U.C.C. § 1-203). In the case of "irrevocable" credits, the UCC prohibits the issuer from drafting such a provision into the agreement. See U.C.C. § 5-114(1); U.C.C. § 5-114 Comment 1; J. WHITE & R. SUMMERS, *supra* note 3, at 728-30.

The substantial compliance standard, like the test of strict compliance, arose long before states enacted the UCC. See, e.g., *Bank of America Nat'l Trust & Sav. Ass'n v. Liberty Nat'l Bank & Trust Co.*, 116 F. Supp. 233, 243 (W.D. Okla. 1953), *aff'd*, 218 F.2d 831 (10th Cir. 1955). Early critics of the UCC lamented that Article Five did not require application of any one standard. See Comment, *Letters of Credit Under the Proposed Uniform Commercial Code: An Opportunity Missed*, 62 YALE L.J. 227, 243-50 (1953). Similarly, recent revisions of the UCP clearly allow banks considerable discretion in ascertaining compliance. See B. KOZOLCHYK, *supra* note 1, at 260. Although post-Code case law reflects the predominance of the strict compliance standard, some courts recognize exceptions, such as the expressed or implied waiver by the customer of the requirements stipulated in the letter of credit. See, e.g., *Barclays Bank D.C.O. v. Mercantile Nat'l Bank*, 481 F.2d 1224, 1236-37 (5th Cir. 1973), *cert. denied*, 414 U.S. 1139 (1974). But see *Courtaulds North American Inc. v. North Carolina Nat'l Bank*, 387 F. Supp. 92 (M.D.N.C.), *rev'd on other grounds*, 528 F.2d 802 (4th Cir. 1975).

⁴⁶ In *Banco Espanol de Credito v. State St. Bank & Trust Co.*, 385 F.2d 230, 231 (1st Cir. 1967), *cert. denied*, 390 U.S. 1013 (1968), letters of credit for a transaction involving the sale of goods explicitly required the presentation of inspection certificates specifying that the goods sent were "in conformity with the order." The certificates actually presented to the bank stated that the goods were found "'conforming to the conditions estipulated [*sic*] on the Order-Stock-sheets.'" *Id.* at 233. The seller-beneficiary had given the inspectors samples instead of the actual goods, but the seller claimed under oath that the samples "corresponded" with goods that the buyer had approved when the parties originally executed the agreement. *Id.* at 236. Despite documentary deviations from the letter of credit terms (which appeared to have required that the goods themselves be inspected), the First Circuit held that the presented inspection certificates "conformed in all significant respects" to the requirements of the letter of credit. *Id.* at 237. The court commented, "[W]e note some leaven in the loaf of strict construction. Not only does *haec verba* not control absolutely . . . but some courts now cast their eyes on a wider scene than a single document." *Id.* at 234 (citation omitted) (footnote omitted).

During various stages of a letter of credit transaction, the parties themselves may be tempted to look beyond the presented documents at facts surrounding the underlying contract. This can occur, for example, when parties at the drafting stage seek to define conditions of compliance. See Harfield, *supra* note 12, at 15; Note, *supra* note 10, at 836-37 n.94. It can also occur later, when the issuer evaluates the compliance of documents presented by the beneficiary. See note 102 and accompanying text *infra*.

ties.⁴⁷ One court has held that discrepancies between stipulated conditions and documents presented would not justify dishonor of drafts where "there is *no* possibility that the documents could mislead the paying bank to its detriment."⁴⁸ In that case, the issuer-bank clearly knew that all conditions of the credit had been fulfilled; nonetheless, the bank sought to escape its obligation to pay because of minor defects in the documents.⁴⁹

Although some courts that overlook minor documentary defects deny they have diluted the objective standard,⁵⁰ they have injected a "subjective element" into the requirement of compliance.⁵¹ According to one commentator, "once courts begin inquiring into the state of mind of the issuing bank, the doctrine of strict compliance has lost its starch."⁵² Decisions that allow such exceptions may "introduce the kind of uncertainty [in letter of credit transactions] that the doctrine of strict compliance was designed to eliminate."⁵³ If courts become uncertain about compliance standards, they may look to the terms of the underlying contract, thereby violating the letter of credit's independence.⁵⁴ Ad hoc policy-oriented decisions that impose individually-tailored solutions undercut the stability and certainty that are generally important in commercial transactions, and essential in letter of credit transactions.⁵⁵

Because neither the UCC nor the state legislatures have articulated a policy of strict compliance, dilution of the strict compliance standard is not demonstrably inconsistent with current law. The state legislatures should settle the issue by requiring a strict compliance standard. Such guidance will restore predictability by divesting the courts of their policymaking role in this area.

⁴⁷ See, e.g., *Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank*, 569 F.2d 699 (1st Cir. 1978).

⁴⁸ *Id.* at 705 (emphasis in original).

⁴⁹ The court concluded that the drawer of drafts had "complied with the requirements of the letter of credit in every material respect." *Id.*

⁵⁰ See, e.g., *id.* ("We do not see these rulings as retreats from rigorous insistence on compliance with letter of credit requirements.")

⁵¹ *Letters of Credit: How Strict Is the Rule of Strict Compliance?*, 3 LENDING L.F. No. 8, August, 1979, at 7, 8 (1979).

⁵² *Id.*

⁵³ *Id.*

⁵⁴ See, e.g., Note, *supra* note 10, at 842-45, 854 n.184.

⁵⁵ See, e.g., *Harfield*, *supra* note 12, at 9-10. See also notes 80-82 and accompanying text *infra*.

B. Control of Standby Letters of Credit

The courts have played an active and influential role in developing the law governing standby letters of credit.⁵⁶ In a typical standby arrangement, the issuer's obligation to pay is contingent upon the customer's own default in payment or performance.⁵⁷ Applied in many diverse contexts, standby credits involve more risks than traditional credits.⁵⁸ Although the UCC makes no explicit reference to them, courts have interpreted Article Five of the UCC as governing standby credits.⁵⁹

Standby credits tend to encroach on principles that are basic to the notions of traditional letters of credit, raising serious doubt about the propriety of holding the UCC applicable to standby

⁵⁶ The challenge for courts stems primarily from the definitional problems, *see* note 24 *supra*; notes 66-71 and accompanying text *infra*, and the increased variety of uses of standby letters of credit, *see* notes 9-10 *supra*.

⁵⁷ Although standby letters of credit are readily distinguishable from conventional letters of credit, *see* note 24 *supra*, they closely resemble guaranties. The standby letter of credit, like the conventional credit, establishes an independent, quasi-contractual arrangement directly between the issuer and the beneficiary. The issuer's obligation, always to pay money, is primary with respect to the beneficiary and arises upon the presentation of complying documents. The issuer's obligation is secondary with respect to the underlying transaction and is related to, although not always dependent upon, the customer's own duties and obligations. A guaranty, on the other hand, is "a contract that is ancillary to some other contract or relationship. . . ." H. HARFIELD, *supra* note 2, at 164. The guarantor's obligation is usually to pay money, and is primary with respect to the underlying contract. It arises upon the occurrence of some agreed condition related to the underlying contract, typically default in payment or performance. The guarantor's obligations, therefore, must be determined by reference to the underlying contract. *Id.* However justifiable theoretically, the practical distinction between standby letters of credit and "true" guaranties often collapses when applied by the courts. *See* notes 66-73 and accompanying text *infra*.

⁵⁸ Issuers in particular face greater risks. *See* note 38 *supra*. Any adverse effects on issuers, particularly large banks (which are the major issuers of standby credits), also have repercussions throughout the economy. The insolvency of the U.S. National Bank of San Diego, which occurred unexpectedly in 1973, is a good example. *See* First Empire Bank v. FDIC, 572 F.2d 1361 (9th Cir.), *cert. denied*, 439 U.S. 919 (1978); *Failure of the U.S. National Bank of San Diego: Hearings Before the Subcomm. on Bank Supervision and Insurance of the House Comm. on Banking and Currency*, 93d Cong., 2d Sess. (1973); Verkuil, *Bank Solvency and Standby Letters of Credit: Lessons from the USNB Failure*, 53 *TUL. L. REV.* 314 (1979).

⁵⁹ The Official Comment to the scope provision of Article Five states that presented documents may include "a notice of default of some kind. . ." U.C.C. § 5-102 Comment 1. U.C.C. § 5-102 itself provides "Unless the engagement meets the requirements of subsection (1), this Article does not apply to . . . guarantees. . ." U.C.C. § 5-102(2). For cases upholding as legitimate bank obligations letters of credit serving the guarantee function, *see* Barclays Bank D.C.O. v. Mercantile Nat'l Bank, 481 F.2d 1224, 1231-32 & n.10 (5th Cir. 1973) (and cases cited therein), *cert. dismissed*, 414 U.S. 1139 (1974); American Empire Ins. Co. v. Hanover Nat'l Bank, 409 F. Supp. 459, 463-65 (M.D. Pa. 1976), *aff'd*, 556 F.2d 564 (3d Cir. 1977).

credits. For example, standby credits often fail to identify a single, named beneficiary.⁶⁰ This conflicts with the nature of a letter of credit as a clearly defined, independent contractual agreement between issuer and beneficiary.⁶¹ In addition, expansive use of standby credits encourages parties to draft the documents in excessive detail,⁶² which in turn invites subsequent litigation.⁶³

The expanding use of standby credits has created many problems for courts.⁶⁴ This is largely due to the functional overlaps between standby credits issued by national banks and illegal

⁶⁰ See Verkuil, *supra* note 1, at 724. The Comptroller of the Currency has sought to remedy this by promulgating 12 C.F.R. § 7.7016 (1980), which permits a national bank to issue credits only "to or on behalf of its customer." See Comment, *supra* note 1, at 616.

⁶¹ Verkuil, *supra* note 1, at 724.

⁶² *Id.* See also Harfield, *The Standby Letter of Credit Debate*, 94 BANKING L.J. 293, 294-95 (1977).

⁶³ See generally *Wichita Eagle & Beacon Publishing Co. v. Pacific Nat'l Bank*, 493 F.2d 1285, 1286-87 (9th Cir. 1974), *rev'g per curiam*, 343 F. Supp. 332 (N.D. Cal. 1971); Verkuil, *supra* note 1, at 724.

⁶⁴ See *Republic Nat'l Bank v. Northwest Nat'l Bank*, 566 S.W.2d 358, 362 (Tex. Civ. App.), *rev'd*, 578 S.W.2d 109 (Tex. 1978), citing *Border Nat'l Bank v. American Nat'l Bank*, 282 F. 73 (5th Cir. 1922), *cert. denied and dismissed for want of jurisdiction*, 260 U.S. 701 (1922) (instrument held void as an illegal guaranty although the parties had labelled it letter of credit); *New Jersey Bank v. Palladino*, 77 N.J. 33, 389 A.2d 454 (1978) (guaranty instrument upheld as a standby letter of credit although the parties had not labelled it as a such). The credit agreement in *Palladino* did not call for written notice of default to the issuer as a prerequisite for payments. Nevertheless, the court, resorting to contract principles, read a written notice requirement into the agreement and construed the instrument as a standby letter of credit: "Terms will be implied in a contract where the parties must have intended them because they are necessary to give business efficacy to the contract as written." *Id.* at 46, 389 A.2d at 461. In *Wichita Eagle & Beacon Publishing Co. v. Pacific Nat'l Bank*, 493 F.2d 1285, 1286-87 (9th Cir. 1974), *rev'g per curiam*, 343 F. Supp. 332 (N.D. Cal. 1971), the Ninth Circuit expressly refused to follow the pattern set by other courts in distinguishing standby credits from guaranties on the basis of primary as opposed to secondary liability.

Judicial power to interpret ambiguous language gives the courts great discretion in resolving standby disputes. In *Beathard v. Chicago Football Club, Inc.*, 419 F. Supp. 1133 (W.D. Ill. 1976), the court held that the standby letter of credit was not irrevocable, even though the parties had used the word "guarantee" in the standby instrument; the validity of a revocation that had occurred before the documents were presented was held to be valid. The intentions of the parties constituted relevant evidence, but were not dispositive. In *Prudential Ins. Co. of America v. Marquette Nat'l Bank*, 419 F. Supp. 734 (D. Minn. 1976), the court found that a loan commitment standby fee was an illegal penalty provision with respect to the underlying transaction between customer and beneficiary. Nevertheless, the court held that the issuing bank was obligated, upon presentation of the necessary documents, to honor the letter of credit issued in that amount. Emphasizing the independence of the letter of credit transaction and the risk of the customer's insolvency assumed by the issuing bank, the court said: "[We are] . . . not unmindful of defendant's argument that payment on the letter of credit will allow plaintiff a 'windfall' profit. This argument, in [our] opinion, has no legal significance . . . and does not prevent the entry of summary judgment in favor of the plaintiff." *Id.* at 736.

guaranties.⁶⁵ Courts created a theoretical distinction between standby credits and illegal guaranties,⁶⁶ but in practice the distinction has proven untenable.⁶⁷ By definition, a letter of credit relationship creates a primary obligation on the part of the issuer to pay the beneficiary.⁶⁸ In contrast, a guaranty creates a secondary obligation in the guarantor "to answer for another's debt."⁶⁹ Standby letters of credit typically contemplate payment by the issuer when the customer himself has defaulted in paying the beneficiary.⁷⁰ In this respect, standby credits are functionally equivalent to guaranties.⁷¹

⁶⁵ National banks (and most state banks) may exercise only those powers expressly granted by statute, and "all such incidental powers as shall be necessary to carry on the business of banking." National Bank Act of 1864 Art. I, § 13 (empowering section) (codified at 12 U.S.C. § 24 (1976)). Some courts during the nineteenth century construed the Act to permit national banks to issue guaranties when the exercise of such power is a "necessary incident" to the pursuit of banking business, or the protection of rights. *See, e.g., Cochran v. United States*, 157 U.S. 286, 297 (1895); *People's Bank v. Manufacturers' Nat'l Bank*, 101 U.S. 181, 183 (1879). However, courts thereafter abandoned this view and have uniformly held that the issuance of guaranties by national banks is *ultra vires*. *See, e.g., Kimen v. Atlas Exch. Nat'l Bank*, 92 F.2d 615, 617-18 (7th Cir. 1937), *cert. denied*, 303 U.S. 650 (1938); *Merchants' Bank v. Baird*, 160 F. 642, 645 (8th Cir. 1908). *See* 120 CONG. REC. 29796-97 (1974) (memorandum submitted by Timothy D. Naegele). *See generally* H. HARFIELD, *supra* note 2, at 162-63.

⁶⁶ *See, e.g., Border Nat'l Bank v. American Nat'l Bank*, 282 F. 73, 77-78 (5th Cir. 1922) ("guaranty" held not to be incompatible with letter of credit), *cert. denied and dismissed for want of jurisdiction*, 260 U.S. 701 (1922). *See generally* Campbell, *Guaranties and the Suretyship Phases of Letters of Credit*, 85 U. PA. L. REV. 165, 261-67 (1936-37). Although "it is still asserted that any practice that resembles a guarantee or lending of someone else's credit is *ultra vires* for the bank," B. KOZOLCHYK, *supra* note 1, at 630, "the conclusion need not necessarily be that 'a national or state bank or trust company clearly has no power to guarantee contracts made by others.'" *Id.* at 632 (quoting ZOLLMAN, *BANKS AND BANKING* 5122 (1936)). *Cf. Russel Grader Mfg. Co. v. Farmers Exch. State Bank*, 49 N.D. 999, 1002, 194 N.W. 387, 389 (1923) (banks are impliedly authorized to issue letters of credit). The judicially-developed prohibition against bank issuances of guaranties arose in the nineteenth century to prevent monopolies, avoid undue bank participation in land speculation, and generally to prevent banks from exercising greater powers than those conferred by statute and their corporate charters. Lord, *The No-Guaranty Rule and the Standby Letter of Credit Controversy*, 96 BANKING L.J. 46, 52-54 (1979). Courts continue to apply the rule without reevaluating its rationale. *See* note 79 *infra*.

⁶⁷ *See* Lord, *supra* note 66, at 46-47 & n.3 (citing recent cases); *id.* at 63 (suggesting that the distinction drawn by courts is "artificial"); note 64 *infra*.

⁶⁸ *Arnold & Bransilver, supra* note 1, at 279-80. *See, e.g., Asociacion de Azucareros de Guat. v. United States Nat'l Bank*, 423 F.2d 638, 641 (9th Cir. 1970); note 57 *supra*.

⁶⁹ L. SIMPSON, *HANDBOOK ON THE LAW OF SURETYSHIP* 8 n.9 (1950). *See* *Dubuque Packing Co. v. Fitzgibbon*, 27 U.C.C. REP. 188, 189-90 (Okla. Ct. App. 1979); *Border Nat'l Bank v. American Nat'l Bank*, 282 F. 73, 77 (5th Cir. 1922), *cert. denied and dismissed for want of jurisdiction*, 260 U.S. 701 (1922) (discussed in H. HARFIELD, *supra* note 2, at 155); Note, *supra* note 10, at 831 n.66; note 57 *supra*.

⁷⁰ *See, e.g., Jarvis, Standby Letters of Credit—Issuers' Subrogation and Assignment Rights—Part I*, 9 U.C.C. L.J. 356, 359 (1977); Katskee, *supra* note 24, at 699, 702 (quoting Harfield, *supra* note 3, at 258); note 57 and accompanying text *supra*.

⁷¹ Verkuil, *supra* note 1, at 725. Disagreement among commentators about whether guaranties and standby credits differ, and if so, how they are distinguishable, reflects the

Unfortunately, administrative agencies have followed the judicial distinction between standby credits and guaranties instead of resolving the ambiguity.⁷² The fungibility of the two concepts increases the potential for arbitrary decisions based on policy con-

confusion and uncertainty surrounding standby credits. See Katskee, *supra* note 24, at 697-714. To differentiate courts look to the "phraseology of the writing, the object sought to be accomplished thereby, and the precise obligation and conditions imposed on and assumed by the parties thereto." 6 MICHIE, BANKS AND BANKING 414, ch. 12, & 13 (1975). See, e.g., Republic Nat'l Bank v. Northwest Nat'l Bank, 566 S.W.2d 358, 362 (Tex. Civ. App.), *rev'd*, 578 S.W.2d 109 (Tex. 1978). Commentators, meanwhile, have observed that such efforts may be futile. See, e.g., Lord, *supra* note 66, at 61-63; Sayre, "Clean" Letters of Credit, J. COM. BANK LENDING 56, 62 (1973) (cited in Note, *supra* note 10, at 831 n.65); Verkuil, *supra* note 1, at 724-26.

⁷² The Comptroller of the Currency, the FDIC, and the Federal Reserve Board have each issued regulations which, following the case law, recognize a distinction between standby credits and illegal guaranties. Each has promulgated a formal definition of standby letters of credit. The Comptroller, for example, defines the standby letter of credit as any letter of credit, or similar arrangement however named or described, which represents an obligation to the beneficiary on the part of the issuer (1) to repay money borrowed by or advanced to or for the account of the account party or (2) to make payment on account of any indebtedness undertaken by the account party, or (3) to make payment on account of any default by the account party in the performance of an obligation.

12 C.F.R. § 7.1160 (1980) (footnote omitted). See the definitions adopted by the Federal Reserve Board (12 C.F.R. § 208.8(d)(1) (1980)) and the FDIC (12 C.F.R. § 337.2(a) (1980)). The Comptroller has also issued guidelines regulating the use of standby credits. 12 C.F.R. § 7.7016 (1980) affirms the power of national banks to issue letter of credit of all types under the UCC or UCP, subject to five conditions. First, banks can only issue credits to or on behalf of their own identified customers. *But see* note 60 *supra*. Second, the letter of credit must specifically state that it is a letter of credit or be conspicuously so entitled. Third, the credit must be limited to a definite time period. Fourth, the bank's obligation may arise only upon presentation of a draft or other documents stated in the credit and must be limited in amount. Fifth, the bank's customer has an unqualified obligation to reimburse the bank for appropriate payments. For a discussion of these requirements, and some complications caused by their application, see Note, *supra* note 1, at 615-21.

Despite their promulgation of regulations defining and setting guidelines for standby credits, the administrative agencies, like the courts, have emphasized but not resolved the confusing similarity between standby credits and guaranties. The Comptroller of the Currency has adopted the view of Professor Lord, *supra* note 66, at 62-63, that "the courts . . . should reconsider the nonguaranty rule and determine if it is still viable in today's banking world." *Comptroller of the Currency Staff Interpretive Ruling 71.010*, Letter No. 121 (Sept. 19, 1979), *Standby Letter of Credit*, [1979] FED. BANKING L. REP. (CCH) ¶ 85,207. The Comptroller suggests that banks should "observe the formalities" prescribed in current regulations and rulings "[u]ntil the Congress or the courts . . . act to clarify or change the legal ground rules. . . ." *Id.* As one expert has noted, "[t]he bank regulatory agencies have moved timidly at best in regulating standby letters of credit and other similar obligations; and there is no reason to believe they will do otherwise in the absence of congressional prodding." SENATE COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, 94TH CONG., 1ST SESS., COMPENDIUM OF MAJOR ISSUES IN BANK REGULATION 674 (Comm. Print 1975) (report submitted by Timothy D. Naegele). Further, "it is questionable whether the agencies have sufficient statutory authority to implement [proposed changes] even if they were prodded into doing so." *Id.* Thus, it may be fruitless to rely upon the agencies alone to initiate, in unified fashion, the necessary changes in letter of credit law.

siderations. The absence of a principled and reliable method of distinguishing between guaranties and standby credits has thus seriously undermined predictability in this area.⁷³

The high risks created by excessive bank issuances of standby credits have generated recent reform efforts.⁷⁴ Congress has considered but not enacted various bills that would limit, depending on the value of available bank assets, the total volume of standby credits a bank could issue.⁷⁵ Advocates of reform have emphasized the dangers of bank insolvency⁷⁶ and other harmful

⁷³ See note 67 *supra*.

⁷⁴ The unexpected insolvency of the United States National Bank of San Diego in 1974 (see note 58 *supra*), its drastic repercussions, and the continuing rapid increase in total volume of domestic standby credits issued, see note 9 *supra*, have prompted the introduction of various proposals in Congress. See note 75 and accompanying text *infra*.

⁷⁵ The 93d Congress considered but did not act upon a bill sponsored by Senator Brooke that would have made standby credits subject to the federal statutory limits on total liabilities of a national bank. See S. 3949, 93d Cong., 2d Sess., 120 CONG. REC. 29791-95 (1974). Proponents of S. 3949 viewed the insolvency risks of standby credits to justify the imposition of reserve requirements. See, e.g., 120 CONG. REC. 29792-93 (1974) (remarks of Sen. Brooke).

The federal law requires that national banks refrain from becoming indebted "to an amount exceeding the amount [100%] of its capital stock . . . plus 50 percent of the amount of its unimpaired surplus fund, [subject to listed exceptions]." 12 U.S.C. § 82 (1976). Reserve requirements serve the dual purpose of facilitating control over monetary policy and insuring that banks have funds available to meet their obligations. See AMERICAN BANKER REPRINT SERV., THE RECOMMENDATIONS OF THE PRESIDENTIAL COMMISSION ON FINANCIAL STRUCTURE AND REGULATION (THE HUNT COMMISSION) 17 (pamphlet 1972) (reprinting AMERICAN BANKER, Dec. 17, 23, and 24, 1971); Katskee, *supra* note 24, at 708-10.

The 94th Congress, after extensive hearings, failed to enact a bill (S.2347) substantially similar to the earlier proposal. See *Regulation of Standby Letters of Credit: Hearings on S.2347 Before the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 2d Sess. (1976) [hereinafter cited as *Hearings on S.2347*]. In the 95th Congress, the Senate passed the Financial Institutions Supervisory Act Amendments of 1977, which, like earlier proposals, set forth guidelines and limitations for the issuance of standby credits. S.71, 95th Cong., 1st Sess., 123 CONG. REC. 27398-411 (1977). Due to inaction by the House, however, the bill was not enacted into law. For a review of Congress' activity and a discussion of its proposed measures, see Verkuil, *supra* note 58, at 319-23, 325-27.

The most recent bill considered, S. 71, would include standby credits as well as other presently excluded bank liabilities (e.g., ineligible surety agreements and bank acceptances) in the calculation of a bank's total liabilities. The legal limit for all liabilities of a national bank would be 50% of the bank's surplus plus 50% of its capital stock. See Verkuil, *supra* note 58, at 320-21.

⁷⁶ See generally *Hearings on S.2347, supra* note 75. Commentators advocating reform have dwelled more on the economic dangers arising from the absence of controls over standby credits than on the problems courts face in applying whatever controls currently exist. The arguments by commentators for and against controls reflect opposing philosophical views about the general role of letters of credit in the economy. One writer characterizes the nonreformists as "commercial progressives" and the reformists as "economic conservatives." Katskee, *supra* note 24, at 697.

economic consequences associated with standby credits.⁷⁷ Legislatures, however, have not addressed the judicially unresolved problem of adequately distinguishing standby letters of credit from guaranties.

In the absence of legislative reform, courts will probably continue to manipulate the tenuous distinction between standby credits and illegal guaranties to achieve fair results. The policy considerations that have generated legislative reform efforts will probably also influence judicial decisionmaking. Courts, however, are not competent to make the proper policy choices, and judicial decisions based upon equitable considerations will not promote certainty in commercial transactions. A New Jersey Supreme Court justice, dissenting from the court's approval of a disputed standby letter of credit transaction,⁷⁸ recently expressed apprehension over excessive judicial policymaking in this area:

Whether or not the letter in litigation here is as a matter of form classifiable as a standby letter of credit, its substantial identity with a guaranty as commonly understood is so obvious that one would desire more explicit legislative approval of its validity as a bank obligation than was evident in 1972 when the instant transaction took place. I do not favor erosion of an apparently salutary statutory policy against bank guaranties through judicial ratification of a contrary commercial practice. *It may well be that a new emerging policy of commercial convenience should swing the law in a new direction. But I should hope for a clear legislative signal to that effect.*⁷⁹

⁷⁷ Excessive standby issuances may increase the rate of inflation. One expert, advocating congressional action to regulate standby credits, commented in 1974:

More than at any other time in the past decade, . . . the dampening of inflation is of paramount importance. If banks are to be permitted by law to issue standby letters of credit, those liabilities should be subject to reserve requirements—whether or not funds are actually received and maintained by the bank—in order to prevent this form of bank credit from further fueling inflation.

Letter of Timothy D. Naegle to Sen. Brooke, reprinted in *Hearings on S.2347, supra* note 75, at 233. The inflationary effects of standby credits are particularly acute during periods of tight monetary policy. See, e.g., *Hearings on S.2347, supra* note 75, at 105-06 (statement of Alvin Zises, President, Prullease, Inc.). As one writer states: "Establishing clear demarcation lines between the two forms [i.e., standby credit and guaranty] is essential to the development of a documentary security device that can effectively protect the intent of the parties." Note, *supra* note 10, at 828 (emphasis added).

⁷⁸ *New Jersey Bank v. Palladino*, 77 N.J. 33, 389 A.2d 454 (Sup. Ct. 1978) (Conford, Temp. J., dissenting).

⁷⁹ *Id.* at 48-49, 389 A.2d at 462 (Conford, Temp. J., dissenting) (emphasis added).

The legislatures, however, have ignored such entreaties for guidance from the judiciary.

Legislatures should reexamine the rationale of the rule against guaranties. If the rule is retained, the lawmakers should delineate clearer guidelines by which courts can categorize a particular device as a standby or guaranty. Only more structured laws can restrict judicial discretion and restore predictability in the commercial setting.

III

RESORT TO EQUITABLE REMEDIES: CUSTOMER'S REMEDY FOR WRONGFUL HONOR

Henry Harfield, a leading authority on letters of credit, stated almost a decade ago, "[t]he right to enforce express terms, *without reference to equities*, has long been recognized in letter-of-credit law, and is essential to the proper functioning of the letter-of-credit device."⁸⁰ Harfield displayed a prophetic pessimism, predicting that the increasing diversity of letter of credit applications would create temptation for courts to err⁸¹ by "contaminat[ing]" letter of credit principles with equitable doctrines to achieve fair results.⁸²

As Harfield predicted, courts have introduced equitable considerations in adjudicating letter of credit disputes. These principles often conflict with the letter of credit's strictly documentary nature, and with the notion that the letter of credit is independent from the underlying transaction. Consequently, the influx of equity has compromised the chief virtues of letters of credit: reliability, convenience, simplicity and predictability.

The absence of explicit statutory guidance has left courts with the task of determining what remedies are available to customers

⁸⁰ Harfield, *supra* note 12, at 14 (emphasis added).

⁸¹ Mr. Harfield states:

The cases that I see on tomorrow's calendar are those in which the constructive ingenuity of lawyers and bankers has used the letter-of-credit device to accomplish results that previously had to be accomplished by performance bonds, or repurchase agreements, or in other ways will use the letter-of-credit device to solve problems that hitherto have not been, but should be, solved. It is in this class of case, in which the facts are sufficiently different from the facts in the case that made the law, and in this atmosphere of instant equity, that the courts will find what I fear may be an almost irresistible opportunity to go wrong.

Id.

⁸² *Id.* at 8, 9-10, 11.

claiming wrongful honor by the issuer.⁸³ The confines of legal remedies, but not equitable remedies, are fairly well established. The customer may recover damages for wrongful honor, whether the issuer's payment is accidental or intentional.⁸⁴ Accidental payment may occur when the issuer mistakenly believes that presented documents conform satisfactorily with the letter of credit's terms. Intentional honor of non-complying documents may result from an issuer's desire to foster or improve a commercially profitable relationship with the beneficiary that is unrelated to the particular letter of credit transaction.⁸⁵

Because the contract between the customer and issuer is independent of the letter of credit arrangement, a customer may recover damages from the issuer for money wrongfully paid to a beneficiary.⁸⁶ Under the theory that he should be made whole again, the customer might recover an amount equal to the face value of the letter of credit, plus incidental damages.⁸⁷ The customer may also have a claim against the beneficiary for breach of the underlying contract.

The UCC, however, does not clearly define the circumstances in which a customer can obtain equitable relief against the issuer's

⁸³ See J. WHITE & R. SUMMERS, *supra* note 3, at 742. An issuer generally has the duty of examining the presented documents "with care so as to ascertain that on their face they appear to comply with the terms of the credit." U.C.C. § 5-109(2). The lack of explicit provisions governing wrongful honor cases contrasts with the Code's express provisions dealing with the beneficiary's rights against the issuer for wrongful dishonor. See, e.g., U.C.C. § 5-115(1). Commentators have suggested that Article Five's "remarkable" silence about customers' remedies for wrongful honor is in part due to the fact that "lawyers for issuers greatly influenced the drafting" of the Article's provisions. J. WHITE & R. SUMMERS, *supra* note 3, at 741 (citing Schlesinger, *Critique of Article V*, 3 N.Y. STATE LAW REVISION COMM'N, 1955 REPORT 1571, 1630 (1955)).

⁸⁴ See J. WHITE & R. SUMMERS, *supra* note 3, at 728 (indicating that an issuer's honor may be "inadvertent but wrongful").

⁸⁵ If the issuer pays upon the presentation of documents that are clearly non-conforming, the customer may be entitled to injunctive relief under U.C.C. § 5-114. See notes 89-96 and accompanying text *infra*.

⁸⁶ Such relief does not interfere with the obligations established by the letter of credit relationship itself; it is consistent with the policy of construing ambiguous terms included in the letter of credit against the drafter (usually the issuer) and requiring the issuer to exercise good faith to ascertain the compliance *vel non* of presented documents. See U.C.C. § 5-109(1).

⁸⁷ However, "unless otherwise agreed," the issuer cannot be held liable "for any act or omission of any person other than itself or its own branch or for loss or destruction of a draft, demand or document in transit or in the possession of others." U.C.C. § 5-109(1)(b). Although responsible for "any general banking usage," issuers are not subject to liability "based on knowledge or lack of knowledge of any usage of any particular trade." U.C.C. § 5-109(1)(c). The contract with the customer generally defines the extent of the issuer's obligations. See U.C.C. § 5-109, Comment 1.

wrongful honor. The Code provides for injunctive relief in certain circumstances when fraud is present,⁸⁸ but fails to define "fraud" adequately. Similarly, the statute does not indicate whether a court can enjoin an issuer's wrongful honor in the absence of fraud.

A. *Injunctions in the Presence of Fraud*

Section 5-114(2) of the UCC gives issuers the option to honor presented documents that comply with the terms of the letter of credit, despite notification from the customer that the documents are "forged" or "fraudulent" or that there is "fraud in the transaction."⁸⁹ A court in its discretion, however, may enjoin such honor.⁹⁰

The Code's failure to define "fraud," has prompted varying judicial responses. Some courts have required a showing of scienter as a condition for finding fraud.⁹¹ Others state that intent is not necessary, and contend that courts can exercise broad discretion in applying equitable principles.⁹² Article Five's general policy of liberal construction,⁹³ combined with the absence of specific guidelines for finding fraud,⁹⁴ leaves courts free to apply a broad definition.⁹⁵

⁸⁸ U.C.C. § 5-114(2)(b).

⁸⁹ U.C.C. § 5-114(2); *See* note 100 *infra*. Unless the parties have stipulated otherwise, the issuer has an absolute duty to honor complying documents despite notification of "forgery," "fraud" or "fraud in the transaction," if the presenting party is a "holder in due course" (U.C.C. § 3-302), "a person to whom a document of title has been duly negotiated" (U.C.C. § 7-502), or a "bona fide purchaser of a certificated security". U.C.C. § 5-114(2)(a). In "all other cases," the issuer exercising his option to honor or dishonor must make his choice "in good faith" (defined in U.C.C. § 1-201(19)). U.C.C. § 5-114(2)(b).

⁹⁰ U.C.C. § 5-114(2)(b).

⁹¹ This comports with the common-law definition. In *West Virginia Hous. Dev. Fund v. Sroka*, 415 F. Supp. 1107, 1114 (W.D. Pa. 1976), the court noted the ambiguity of U.C.C. § 5-114 and concluded "intentional misrepresentation" is a necessary element of fraud.

⁹² The New York Court of Appeals, in *United Bank Ltd. v. Cambridge Sporting Goods*, 41 N.Y.2d 254, 259, 360 N.E.2d 943, 948, 392 N.Y.S.2d 265, 270 (1976), interpreted the Code's failure to define fraud as an implicit rejection of a dogmatic approach and applied a flexible standard instead.

⁹³ *See* notes 29-30 and accompanying text *supra*.

⁹⁴ Mechanical application of the common law fraud definition (*see* note 96 and accompanying text *supra*) is inappropriate because it fails to take into account the unique independence and documentary nature of the letter of credit relationship.

⁹⁵ From the "disparate case law" one commentator disterns that to find fraud that warrants issuance of an injunction, "some degree of intent" must be present, and that mere default in the underlying contract is insufficient. Note, *Letters of Credit: Injunction As A Remedy For Fraud in U.C.C. Section 5-114*, 63 MINN. L. REV. 487, 500 (1979). "[B]reach shades into fraud," he concludes, "in the 'narrowly limited' situation where 'the legitimate

Many kinds of beneficiary misconduct, therefore, can give rise to inferences of fraud. This may encourage the issuer and customer who is unwilling to pay the beneficiary to look beyond the documents presented for evidence that will support an allegation of fraud. Such a fluid exception to the documentary nature and commercial independence of the letter of credit relationship can impair the reliability of the transaction from the beneficiary's point of view. Moreover, different standards in different jurisdictions can increase a beneficiary's uncertainty, particularly when the customer and beneficiary transact business from distant, unfamiliar locales.⁹⁶

By allowing injunctions against honor when the beneficiary has acted fraudulently, section 5-114(2) appropriately affords customers protection from irreparable harm. However, the Code's failure to carefully circumscribe the contours of fraud has created a loophole that may undermine the fundamental purposes of letters of credit. Unbridled judicial discretion to find fraud threatens the letter of credit transaction's documentary nature and independence from the underlying transaction. This detracts from the letter of credit's assurances of reliability and predictability. It is unrealistic to expect courts to eschew equitable principles in the absence of legislative restrictions.

B. *Equitable Remedies in the Absence of Fraud*

The UCC does not define a court's power to enjoin an issuer from wrongful honor when fraud does not taint the documents or the underlying transaction.⁹⁷ Article Five does not expressly be-

purposes of the independence of the issuer's obligation would no longer be served.'" *Id.* (citing *Intraworld Indus. Inc. v. Girard Trust Bank*, 461 Pa. 343, 336 A.2d 316 (1975)). In an effort to establish the vital element of certainty in this area, he proposes structural modifications of § 5-114. *Id.* at 513-16. By looking beyond the documents presented to find fraud, courts can presently ignore the basic independence and documentary nature of the letter of credit agreement and apply equity principles to achieve fairness in particular cases.

⁹⁶ The issuer, selected by the customer, is usually located closer to the customer than the beneficiary. Because various risks associated with commercial sales may result from the great geographical distance between seller-beneficiary and buyer-customer, the issuer and the beneficiary rarely have prior contact with each other, or familiarity with the jurisdictional rules of each other's courts, especially in international transactions.

⁹⁷ See note 83 *supra*. Various provisions in Article Five incorporate the Code's general requirement of "good faith" (U.C.C. § 1-201(19)). Section 5-109(1), for example, provides that "[a]n issuer's obligation to its customer includes good faith and observance of any general banking usage. . . ." This and similar provisions, however, do not clarify whether or not a customer can obtain equitable remedies against an issuer for the wrongful honor of noncomplying documents when the issuer is exercising good faith and "fraud" is *not* present.

stow injunctive powers upon the courts, except in the instance of fraud under section 5-114(2). Section 5-114(2), however, has opened the door to equitable relief and some courts have granted equitable remedies in situations where fraud is not present.⁹⁸

The silence of the Code and other statutes allows the courts to apply equitable principles to prevent possible unjust enrichment of the beneficiary.⁹⁹ This may diminish the reliability of letters of credit, particularly for a beneficiary who must worry about misconduct on the part of the issuer from whom he expects payment.¹⁰⁰ One court recently issued an injunction prohibiting future installment payments by an issuer, basing its decision on a finding of issuer misconduct.¹⁰¹ Another court granted a preliminary injunction enjoining an issuer from making payments without notifying the customer of receipt of the demand and giving the customer ten days to show evidence of fraud or non-conformity of the presented documents.¹⁰² One court even en-

⁹⁸ See notes 101-03 and accompanying text *infra*.

⁹⁹ See, e.g., *Stromberg-Carlson Corp. v. Bank Melli Iran*, 467 F. Supp. 530 (S.D.N.Y. 1979); Note, *supra* note 95, at 490; note 102 *infra*.

¹⁰⁰ In an installment letter of credit arrangement, the beneficiary may not be aware that the issuer, whom he did not select and often does not know, is wrongfully honoring his drafts and demands for payment. The issuer, for example, may honor complying documents, despite notification by the customer of fraud in the transaction, unless the customer convinces a court to enjoin such honor. See U.C.C. § 5-114(2)(b); notes 89-90 and accompanying text *supra*. If the issuer neglects to request correction of noncomplying documents, and the customer obtains an injunction preventing future payments without showing "fraud," "forgery," or "fraud in the transaction," (required for relief under U.C.C. § 5-114(2)(b)), the beneficiary may find his payments terminated unexpectedly, without any intentional misconduct on his part. Meanwhile, the customer, who enjoyed the advantage of choosing the issuer, would escape accountability for the issuer's mistakes. Such risk-shifting from customer to beneficiary contravenes the primary purpose of the letter of credit arrangement: to lessen the risks that the seller-beneficiary incurs in transacting business with the buyer-customer and, by substituting the credit of the issuer for that of the customer, to assure the beneficiary of payment. The absence of UCC limitations on the issuance of injunctions outside of § 5-114 leaves courts free to apply equitable remedies that, over time, may upset the balance of risks sought in letter of credit transactions.

¹⁰¹ *Interco, Inc. v. Schwartz*, 20 U.C.C. REP. 716 (D. Mass. 1976), *rev'd on other grounds*, 560 F.2d 480 (1st Cir. 1977). In *Interco*, the issuing bank had paid installments to the beneficiary upon demand, even though the latter failed to present conforming documents. The bank communicated its intention to continue such payments. The plaintiff-customer alleged, but did not prove, fraud. The court, however, found that because there was no certainty of an adequate remedy at law the customer-plaintiff would suffer "irreparable harm" if an injunction did not issue. Because of the UCC's silence on the issue, the court relied on these equitable principles to grant an injunction. *Id.* at 721. The court cited the UCC scope provision's "cannon of liberal interpretation" to support its exercise of discretion. *Id.* See notes 29-30 and accompanying text *supra*.

¹⁰² *Stromberg-Carlson Corp. v. Bank Melli Iran*, 467 F. Supp. 530 (S.D.N.Y. 1979). In this case, the political turmoil in Iran created the possibility that the new government,

joined the beneficiary from making demands for payment.¹⁰³

The cases have failed to establish any universal, mandatory facts that a complaining customer must show to obtain relief.¹⁰⁴ The lack of standards governing the availability of equitable relief introduces harmful uncertainty into letter of credit relationships.¹⁰⁵ Again, legislative guidance establishing the contours of equitable relief is necessary to preserve the advantages of the letter of credit.

CONCLUSION

Broad judicial discretion has introduced uncertainty into important areas of letter of credit law. Insufficient statutory guid-

which had assumed the role of beneficiary to outstanding guaranty credits, would demand payment from the issuing bank although the underlying contract had been substantially performed. The letters of credit in *Stromberg Carlson* were secured in connection with bank guaranties that guaranteed the customer-plaintiff's performance of the contract as well as repayment of the advances it received should it fail to perform. (For a discussion of standby letters of credit and performance guaranties, see note 57 *supra*.) The court granted the customer-plaintiff a preliminary injunction against the issuer's payment. In allowing the equitable remedy, the court read into the letter of credit a "notice" provision, requiring the issuer to give the customer notice of demands for payment and an opportunity to show fraud sufficient to justify issuance of a permanent injunction against wrongful payments. *Id.* at 532. The mere possibility of fraud provided the grounds for equitable relief. For an extensive discussion of the letter of credit litigation spawned by the chaos in revolutionary Iran, see Note, "Fraud in The Transaction": *Enjoining Letters of Credit During the Iranian Revolution*, 93 HARV. L. REV. 992 (1980).

¹⁰³ *Steinmeyer v. Warmer Consol. Corp.*, 42 Cal. App. 3d 515, 116 Cal. Rptr. 57 (1974) (discussed in Note, *supra* note 5, at 850 n.165).

¹⁰⁴ See, e.g., notes 101-03 and accompanying text *supra*.

¹⁰⁵ Extending the availability of injunctive relief for customers claiming wrongful honor may adversely affect letter of credit arrangements. Willful misconduct by an issuer resulting in wrongful honor rarely occurs without collusion or at least tacit awareness on the part of the beneficiary. On the other hand, issuer misconduct that is merely negligent is likely to occur without the beneficiary's involvement. If a customer claiming wrongful honor can obtain an injunction against future payments by showing mere negligence, the issuer and beneficiary may assume that they can rely upon the customer himself to exercise initiative in policing the transaction. Thus, rather than becoming more scrupulous, the issuer and beneficiary may relax their diligence in adhering to "strict compliance" of the documents, thus leaving the burden of exacting strict documentary compliance upon the customer.

Usually, the issuer exercises care in making payments to preserve his opportunity to recover later from the customer in an action for reimbursement. The beneficiary is usually careful to present documents properly because he anticipates that a court will hold him to a strict compliance standard. If injunctive remedies become too readily available, the absence of a protest from the customer at the time of payment will tend to encourage leniency on the part of an issuer examining documents and may allow the issuer to invoke the defense of estoppel against a later action by the customer for wrongful honor. The customer's responsibility to oversee the letter of credit transaction would most likely give rise to a concomitant duty to mitigate any reasonably foreseeable damages of wrongful honor. Responsibility that currently rests with the issuer would in effect shift to the customer, which may damage the application of, and adherence to, the "strict compliance" standard. Judicial enforcement of "strict compliance" would necessarily become more complicated and subjective. See notes 44-53 and accompanying text *supra*.

ance allows courts to exercise an inappropriate policymaking function. Article Five of the UCC is broad enough to permit courts to inject subjectivity into application of the strict compliance standard¹⁰⁶ and manipulate the tenuous definitional distinction between a standby credit and a guaranty.¹⁰⁷ The Code permits equitable remedies in cases of fraud, but fails to establish guidelines for ascertaining its presence.¹⁰⁸ Code silence about equitable remedies in other areas allows courts to apply equitable principles without restriction.¹⁰⁹ Consequently, courts are compromising the documentary nature and independence of the letter of credit relationship, and thus impairing the letter of credit's virtues—reliability, convenience, simplicity and flexibility.

Dilution of letter of credit doctrines has thus far not stirred widespread commercial distrust of the device.¹¹⁰ Nevertheless, despite its desirable flexibility, the letter of credit remains "an instrument whose usefulness is directly proportional to its certainty."¹¹¹ The trend towards extraordinarily diverse uses might foreshadow continued deviation from strict objectivity and increased judicial reliance on equitable principles. Ironically, the judicial autonomy that has traditionally been instrumental in preserving letter of credit principles is now threatening to erode those same principles.

Legislatures should reevaluate the broad judicial discretion exercised in the development of letter of credit law. Only legislative action can diminish or eliminate ambiguities in the UCC and place appropriate limits upon judicial discretion. In particular, the definitional problems of standby credits and the usefulness of the no-guaranty rule demand reconsideration. The legislatures, not the courts, should decide whether to permit subjectivity in evaluating documentary compliance,¹¹² and whether various applications of injunctive relief are proper.¹¹³ Only with reinforced legislative guidance can the courts promote the utility of the letter of credit.

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¹⁰⁶ See notes 40-53 and accompanying text *supra*.

¹⁰⁷ See notes 57-59, 66-73, and accompanying text *supra*.

¹⁰⁸ See notes 89-96 and accompanying text *supra*.

¹⁰⁹ See notes 99-105 and accompanying text *supra*.

¹¹⁰ See notes 9-10 *supra*.

¹¹¹ B. KOZOLCHUK, *supra* note 1, at 603.

¹¹² Occasional deviations from strict objectivity, which protects the independence and documentary nature of the letter of credit agreement, may be appropriate. Because fundamental letter of credit principles are at stake, however, the legislatures, not the courts, should establish the guiding policies. See text accompanying notes 78-79 *supra*.

¹¹³ Legislative initiative in policymaking would not only enhance fairness, consistency and predictability, but would better serve the doctrine of separation of powers.