
UNIFORM COMMERCIAL CODE

THE AMERICAN LAW INSTITUTE

NATIONAL CONFERENCE OF
COMMISSIONERS ON UNIFORM
STATE LAWS

REVISED ARTICLE 5. LETTERS OF CREDIT

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

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WITH COMMENTS

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and

NATIONAL CONFERENCE OF COMMISSIONERS
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UNIFORM COMMERCIAL CODE
REVISED ARTICLE 5. LETTERS OF CREDIT

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UNIFORM COMMERCIAL CODE REVISED ARTICLE 5. LETTERS OF CREDIT

PREFATORY NOTE

Reason for Revision

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

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

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

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

Measured in terms of these areas which are vital to any system of commercial law, the current combination of statute and case law is found wanting in major respects both as to predictability and certainty. What is at issue here are not matters of sophistry but important issues of substance which have not been

resolved by the current case law/code method and which admit of little likelihood of such resolution." (45 Bus. Lawyer 1521, at 1532, 1535-6)⁰

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

Need for Uniformity

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

Thus, the goals of the drafting effort were:

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

Process of Achieving Uniformity

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

⁰ The Task Force members were: Professor James E. Byrne (George Mason University School of Law) Chair; Professor Boris Kozolchik (University of Arizona College of Law); Michael Evan Avidon (Moses & Singer); James G. Barnes (Baker & McKenzie); Arthur G. Lloyd (Citibank N.A.); Janis S. Penton (Rosen, Wachtell & Gilbert); Richard F. Purcell (Connell, Rice & Sugar Co.); Alan L. Bloodgood (Morgan Guaranty Trust Co.); Charles del Busto (Manufacturers Hanover Trust Co.); Vincent Maulella (Manufacturers Hanover Trust Co.).

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

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

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

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

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

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

Advisors

Professor Gerald T. McLaughlin, Loyola Law School, ABA,
Section of Business Law
James G. Barnes, Baker & McKenzie/U.S. Council on International
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James E. Byrne, George Mason University, Institute of International
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Henry N. Dyhouse, U.S. Central Credit Union
David P. Goch, Treasury Management Association

Thomas J. Greco, American Bankers Association
Henry Harfield, Shearman & Sterling
Oliver I. Ireland, Board of Governors of Federal Reserve Board
James W. Kopp, Shell Oil Company/Treasury Management Association
Professor Boris Kozolchik, University of Arizona/National Law Center
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Bradley K. Sabel, Federal Reserve Bank of New York
Joseph H. Sommer, Federal Reserve Bank of New York
Jamileh Soufan, American General Corporation/Treasury Management
Association
Dan Taylor, U.S. Council on International Banking, Inc.
William H. Thornton, Security Pacific National Bank/California Bankers
Association
Paul S. Turner, Occidental Petroleum Corporation/Treasury Management
Association
Stanley M. Walker, Exxon Company U.S.A./Treasury Management
Association

Active Participants

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Walter B. Baker, ABN AMRO Bank, N.V.
Thomas C. Baxter, Jr., Federal Reserve Bank of New York
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Frank P. Curran, Treasury Management Association
Carol R. Dennis, Office of Federal Procurement Policy, OFMB
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Sidney S. Goldstein, New York State Bar Association
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Carter H. Klein, Jenner & Block
Arthur G. Lloyd, ABA, Section of Business Law, Committee on UCC,
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Article 5 Revision
Rebecca S. McCulloch, ABN AMRO Bank, N.V.
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James E. Roselle, First National Bank of Chicago
R. David Whitaker, ABA, Section of Business Law, Committee on UCC,
Subcommittee on ECP, Working Group on EDC
Brooke Wunnicke, ABA, Section of Business Law, Committee on UCC,
Subcommittee on Letters of Credit

Balance of Benefits

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

Benefits of Revised Article 5 in General

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

Clarifications. The revision authorizes the use of electronic technology (Sections 5-102(a)(14) and 5-104); expressly permits deferred payment letters of credit (Section 5-102(a)(8)) and two party letters of credit (Section 5-102(a)(10)); provides rules for unstated expiry dates (Section 5-106(c)), perpetual letters of credit (Section 5-106(d)), and non-documentary conditions (Section 5-108(g)); clarifies and establishes rules for successors by operation of law (Sections 5-102(a)(15) and 5-113); conforms to existing practice for assignment of proceeds (Section 5-114); and clarifies the rules where decisions have been in conflict (Section 5-106, Comment 1; Section 5-108, Comments 1, 3, 4, 7, and 9; Section 5-109, Comments 1 and 3; Section 5-113, Comment 1; and Section 5-117, Comment 1).

Harmonizes with International Practice

The UCP is used in most international letters of credit and in many domestic letters of credit. These international practices are well known and employed by the major issuers and users of letters of credit. Revisions have been made to Article 5 to coordinate the Article 5 rules with current international practice (e.g., deferred payment obligations, reasonable time to examine

documents, preclusion, non-documentary conditions, return of documents, and irrevocable unless stated to be revocable).

Benefits of Revised Article 5 to Issuers

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

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

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

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

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

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

Benefits of Revised Article 5 to Applicants

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

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

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

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

Benefits of Revised Article 5 to Beneficiaries

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

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

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

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

Damages. The damages provided are expanded and clarified. They include attorneys fees and expenses of litigation and payment of the full amount of the wrongfully dishonored or repudiated demand, with interest, without an obligation of the beneficiary to mitigate damages (Section 5-111).

Revisions for Article 9 and Transition Provisions

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

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

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

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REVISED ARTICLE 5. LETTERS OF CREDIT

Table of Disposition of Sections in Former Article 5

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

Former Article 5 Section	Revised Article 5 Section
5-101	5-101
5-102(1)	5-103(a)
5-102(2)	Omitted (inherent in 5-103(a) and definitions)
5-103(3) (first sentence omitted)	5-103(b)
5-103(1)(a)	5-102(a)(10); 5-106(a); 5-102(a)(8)
5-103(1)(b)	5-102(a)(6) ("Document"), and 5-102(a)(14) ("Record"); "Documentary" draft or demand not used
5-103(1)(c)	5-102(a)(9)
5-103(1)(d)	5-102(a)(3)
5-103(1)(e)	5-102(a)(1)
5-103(1)(f)	5-102(a)(4)
5-103(1)(g)	("Applicant" rather than "Customer") 5-102(a)(2)
5-103(2)	Omitted as not applicable
5-103(3)	5-102(b)
5-103(4)	5-102(c)
5-104	5-104 and 5-102(6) and (14)
5-105	5-105
5-106(1)	5-106(a)
5-106(2)	5-106(b)
5-106(3)	5-106(b)
5-106(4)	5-106(b)
5-107(1)	5-107(c)
5-107(2)	5-107(a)
5-107(3)	5-107(c)
5-107(4)	Omitted as inadvisable default rule
5-108	Omitted (as outdated)
5-109(1)	5-108
5-109(2)	5-108
5-109(3)	Omitted (all issuers required to observe standard practices)
5-110(1)	Omitted (covered in definitions and comments)
5-110(2)	Omitted (covered in definitions and comments)
5-111(1)	5-110(a)
5-111(2)	5-110(b)

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

Table of New Provisions

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

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