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Letters of Credit: A Solution to the Problem of Documentary Compliance

Jonathan D. Thier

LETTERS OF CREDIT: A SOLUTION TO THE PROBLEM OF DOCUMENTARY COMPLIANCE

INTRODUCTION

The letter of credit is a payment mechanism whereby an obligation of payment or performance is assured by substituting a stable credit source for the potential financial instability of the promisor.[1] The letter is the third agreement in a transactional sequence that is initially comprised of two independent contracts.[2] The first contract is between the customer, the person applying for the letter of credit,[3] and

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1. Insurance Co. of N. Am. v. Heritage Bank, N.A., 595 F.2d 171, 173 (3d Cir. 1979) (per curiam); Intraworld Indus. v. Girard Trust Bank, 461 Pa. 343, 357, 336 A.2d 316, 323 (1975); H. Harfield, Bank Credits and Acceptances 29-31 (1974) [hereinafter cited as H. Harfield I]; H. Harfield, Letters of Credit 1-2 (1979) [hereinafter cited as H. Harfield II]; 1 A. Lowenfeld, International Private Trade §§ 5.1, 5.3 (1977); Kozolchyk, *Letters of Credit*, in 9 International Encyclopedia of Comparative Law ch. 5, at 3, 139 (1979). A letter of credit can be either revocable or irrevocable in nature. *See* U.C.C. § 5-106 (1977); Int'l Chamber of Commerce, Uniform Customs and Practice for Documentary Credits (UCP) art. 1(A) (Publ. No. 290 rev. ed. 1974) (effective Oct. 1, 1975) [hereinafter cited as U.C.P.]. Rarely issued, a revocable letter of credit can be cancelled or modified at will by the issuer. U.C.C. § 5-106(3) (1977); U.C.P. art. 2 (1974). The irrevocable letter of credit is a binding engagement by the issuer that, once established, requires consent, U.C.C. § 5-106(2) (1977); U.C.P. art. 3(c) (1974), and a writing, U.C.C. § 5-104(1) (1977), to be cancelled or amended. One district court has labelled the revocable letter of credit as "an illusory contract." West Virginia Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107, 1111 (W.D. Pa. 1976); *accord* U.C.C. § 5-106 official comment 2 (1977); H. Harfield II, *supra*, at 15-16. Under the UCP, in the absence of any indication of revocability, "the credit shall be deemed to be revocable." U.C.P. art. 1(c); *see* Beathard v. Chicago Football Club, Inc., 419 F. Supp. 1133, 1137-38 (N.D. Ill. 1976). The UCC expressly ignores the issue and "intentionally [leaves it] to the courts for decision in the light of the facts and general law." U.C.C. § 5-103 official comment 1 (1977); *see* West Virginia Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107, 1112 (W.D. Pa. 1976) (reasoning that the thrust of Article 5 requires construing letter as irrevocable).

2. East Girard Sav. Ass'n v. Citizens Nat'l Bank, 593 F.2d 598, 601 (5th Cir. 1979); Baker v. National Boulevard Bank, 399 F. Supp. 1021, 1024 (N.D. Ill. 1975); Justice, *Letters of Credit: Expectations and Frustrations*, 94 Banking L.J. 424, 425 (1977); Verkuil, *Bank Solvency and Guaranty Letters of Credit* (pt. 1), 25 Stan. L. Rev. 716, 719 (1973); *see, e.g.*, Barclays Bank D.C.O. v. Mercantile Nat'l Bank, 481 F.2d 1224, 1239 n.21 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); First Nat'l Bank v. Wynne, 149 Ga. App. 811, 814, 256 S.E.2d 383, 385 (1979); Colorado Nat'l Bank v. Board of County Comm'rs, 634 P.2d 32, 36 (Colo. 1981) (en banc).

3. A customer is defined as "a buyer or other person who causes an issuer to issue a credit. The term also includes a bank which procures issuance or confirmation on behalf of that bank's customer." U.C.C. § 5-103(1)(g) (1977). By nature of the customer-bank relationship, the customer has been found an indispensable party to an action for injunctive relief against an issuer. Edgewater Constr. Co. v. Percy Wilson Mtge. & Fin. Corp., 44 Ill. App. 3d 220, 227-28, 357 N.E.2d 1307, 1313-14 (1976).

the beneficiary, the party to whom the letter of credit is issued.[4] This contract usually involves a promise by the customer to pay a certain sum of money to the beneficiary[5] incident to either a sales transaction or a service contract.[6]

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4. A beneficiary is defined as "a person who is entitled under [the letter of credit] to draw or demand payment." U.C.C. § 5-103(1)(d) (1977); *see* H. Harfield II, *supra* note 1, at 12.

5. *See* H. Harfield II, *supra* note 1, at 1.

6. *See* J. White & R. Summers, Handbook of the Law Under the Uniform Commercial Code § 18-1, at 708-09 (2d ed. 1980). The utility of the letter of credit as a stable payment mechanism is well evidenced by the evolution of diverse usages outside the area of commercial sales transactions. *See* Armstrong, *The Letter of Credit as a Lending Device in a Tight Money Market*, 22 Bus. Law. 1105, 1105 (1967); Murray, *Letters of Credit in Non-Sale of Goods Transactions*, 30 Bus. Law. 1103, 1103-05 (1975); Comment, *Commercial Letters of Credit: Development and Expanded Uses In Modern Commercial Transactions*, 4 Cum.-Sam. L. Rev. 134, 135 (1973) [hereinafter cited as *Letters of Credit*]; Comment, *Recent Extensions in the Use of Commercial Letters of Credit*, 66 Yale L.J. 902, 902 (1957) [hereinafter cited as *Recent Extensions*]. *See generally* J. White & R. Summers, *supra*, § 18-1, at 708-10 (outlining various uses of letter of credit). The most utilized alternative type of credit is the standby letter of credit. A standby letter is defined as "any letter of credit . . . which represents an obligation to the beneficiary on the part of the issuer . . . to make payment on account of any indebtedness undertaken by the account party, or . . . to make payment on account of any default by the account party in the performance of an obligation." 12 C.F.R. § 7.1160(a) (1981). Similar definitions have been stated by the Federal Reserve Board, *id.* § 208.8(d), and by the FDIC. *Id.* § 337.2(a). Under a standby letter, the issuer is obligated to honor a demand for payment when there has been a failure of performance in the underlying transaction. *See* Bossier Bank & Trust Co. v. Union Planters Nat'l Bank, 550 F.2d 1077, app. A, at 1081 (6th Cir. 1977) (per curiam) (adopting memorandum decision of lower court); Harfield, *The Increasing Domestic Use of the Letter of Credit*, 4 U.C.C. L.J. 251, 258 (1972) [hereinafter cited as Harfield III]. The standby letter differs from a guarantee in that the issuer's obligation to the beneficiary under the letter is primary and, therefore, not triggered by the customer's inability to pay. Barclays Bank D.C.O. v. Mercantile Nat'l Bank, 481 F.2d 1224, 1236 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); United Bank v. Quadrangle, Ltd., 42 Colo. App. 486, 487-88, 596 P.2d 408, 409 (1979); Republic Nat'l Bank v. Northwest Nat'l Bank, 578 S.W.2d 109, 114 (Tex. 1978). Furthermore, issuance of a guarantee is beyond the power of a national bank. 12 U.S.C. § 24 (1976 & Supp. IV 1980); *see* Kimen v. Atlas Exch. Nat'l Bank, 92 F.2d 615, 617-18 (7th Cir. 1937), *cert. denied*, 303 U.S. 650 (1938); Lord, *The No-Guaranty Rule and the Standby Letter of Credit Controversy*, 96 Banking L.J. 46, 62 (1979). The standby letter of credit has been adopted for use in a wide variety of financing situations. *See, e.g.*, Insurance Co. of N. Am. v. Heritage Bank, N.A., 595 F.2d 171, 172 (3d Cir. 1979) (substitute for appeal bond); National Sur. Corp. v. Midland Bank, 551 F.2d 21, 23-24 (3d Cir. 1977) (per curiam) (substitute for performance bond); Chase Manhattan Bank v. Equibank, 550 F.2d 882, 884 (3d Cir. 1977) (used for long-term financing); Beathard v. Chicago Football Club, Inc., 419 F. Supp. 1133, 1135 (N.D. Ill. 1976) (guarantee of salary payment); West Virginia Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107, 1108-09 (W.D. Pa. 1976) (collateral for loan). A "notice of default" is expressly included as a type of documentary draft, thus bringing the standby letter of credit within the scope of Article 5. U.C.C. § 5-103(1)(b) (1977).

The second contract is formed between the customer and a bank, or issuer.[7] The customer applies for the letter of credit, specifies the terms and conditions of the letter[8] and promises to reimburse the issuer upon honor of the beneficiary's draft.[9] The issuer's right to reimbursement is conditioned upon its "duly honoring" the draft.[10] When the beneficiary submits the draft,[11] it must comply with the terms and conditions supplied by the customer in its contract with the issuer.[12] Further, if the documents tendered by the seller comply, the

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7. The "issuer" is defined as "a bank or other person issuing a credit." U.C.C. § 5-103(1)(c) (1977). The issuer's obligations to the customer are detailed in *id.* § 5-109, and the obligations owed the beneficiary in *id.* § 5-114. National banks are empowered to issue both commercial and financial letters of credit. 12 C.F.R. §§ 7.1160, 208.8(d) (1981).

8. Anglo-South Am. Trust Co. v. Uhe, 261 N.Y. 150, 156, 184 N.E. 741, 742-43 (1933); J. White & R. Summers, *supra* note 6, § 18-4, at 722; *see, e.g.*, H. Harfield I, *supra* note 1, at 310-11 (model application form); 1 A. Lowenfeld, *supra* note 1, supp. at 207 (same). *See generally* 3 R. Anderson, Uniform Commercial Code § 5-101:7 (1971) (discussing an issuer's right to refuse a customer's application for issue of a letter of credit).

9. The Code expressly provides for reimbursement unless otherwise agreed. U.C.C. § 5-114(3) (1977); *accord* U.C.P. art. 8(b) (1974); 12 C.F.R. § 7.7016(c) (1980); H. Harfield II, *supra* note 1, at 49-50.

10. U.C.C. § 5-114(3) & official comment 3 (1977). An issuer duly honors a draft where the documents facially comply or where the issuer is privileged to pay, even though the customer has alleged fraud in the transaction. *Id.* official comment 3; *see* Bossier Bank & Trust Co. v. Union Planters Nat'l Bank, 550 F.2d 1077, app. A at 1081 (6th Cir. 1977) (per curiam) (adopting memorandum decision of lower court); Dynamics Corp. v. Citizens & S. Nat'l Bank, 356 F. Supp. 991, 995-96 (N.D. Ga. 1973).

11. As defined in U.C.C. § 5-103(1)(b) (1977), "[a] 'documentary draft' or a 'documentary demand for payment' is one honor of which is conditioned upon the presentation of a document or documents. 'Document' means any paper including document of title, security, invoice, certificate, notice of default and the like." *Id.* The term documentary draft was intended by the drafters to be construed in an extremely broad fashion. *See id.* § 5-103 official comment 2; *see, e.g.*, First Am. Nat'l Bank v. Alcorn, Inc., 361 So. 2d 481, 487 (Miss. 1978) (invoice held to be a "documentary draft"); Marfa Nat'l Bank v. Powell, 512 S.W.2d 356, 359 (Tex. Civ. App. 1974) (bill of sale held to be a doumentary draft). *But see* Housing Sec., Inc. v. Maine Nat'l Bank, 391 A.2d 311, 318 & n.9 (Me. 1978) (written notice of default not a "documentary draft").

12. *See* Corporacion de Mercadeo Agricola v. Mellon Bank Int'l, 608 F.2d 43, 46-48 & n.1 (2d Cir. 1979); Insurance Co. of N. Am. v. Heritage Bank, N.A., 595 F.2d 171, 173-74 (3d Cir. 1979); Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802, 805-06 (4th Cir. 1975); International Leather Distribs. v. Chase Manhattan Bank, N.A., 464 F. Supp. 1197, 1201 & n.9 (S.D.N.Y.), *aff'd*, 607 F.2d 996 (2d Cir. 1979); AMF Head Sports Wear, Inc. v. Ray Scott's All-American Sports Club, Inc., 448 F. Supp. 222, 223 (D. Ariz. 1978); It's Devine Indus. v. Bank Leumi Trust Co., 22 U.C.C. Rep. Serv. (Callaghan) 130, 131-32 (N.Y. Sup. Ct. 1977); U.C.C. § 5-114(1) (1977).

issuer "must" pay;[13] no interference from the customer is allowed.[14] The letter of credit is thus an "engagement"[15] by the issuer to the beneficiary, on account of the customer, to support the customer's agreement to pay money under the customer-beneficiary contract.[16]

It is a basic tenet of letter of credit law that the issuer is concerned exclusively with the documents required to satisfy the conditions of the letter, not the performance obligations created by the customer-beneficiary contract.[17] The issuer's entire engagement is contained in

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13. U.C.C. § 5-114(1) (1977); *e.g.*, Pringle-Associated Mtge. Corp. v. Southern Nat'l Bank, 571 F.2d 871, 875 (5th Cir. 1978); Bossier Bank & Trust Co. v. Union Planters Nat'l Bank, 550 F.2d 1077, app. A at 1081 (6th Cir. 1977) (per curiam) (adopting memorandum decision of lower court); AMF Head Sports Wear, Inc. v. Ray Scott's All-American Sports Club, Inc., 448 F. Supp. 222, 223 (D. Ariz. 1978); Baker v. National Boulevard Bank, 399 F. Supp. 1021, 1024 (N.D. Ill. 1975); Schweibish v. Pontchartrain State Bank, 389 So. 2d 731, 734-35 (La. Ct. App. 1980); CNA Mtge. Investors, Ltd. v. Hamilton Nat'l Bank, 540 S.W.2d 238, 242-43 (Tenn. Ct. App. 1975).

14. U.C.C. § 5-114 official comment 1 (1977). "The duty of the issuer to honor where there is factual compliance with the terms of the credit is . . . independent of any instructions from its customer once the credit has been issued and received by the beneficiary." *Id.* This rule may not be varied by contractual agreement. *Id.* § 5-114(1) official comment 1; J. White & R. Summers, *supra* note 6, § 18-2, at 711. The customer, however, may seek to enjoin honor of the beneficiary's draft when there is "fraud in the transaction." U.C.C. § 5-114(2) (1977). Because the letter of credit is totally separate from the underlying contract, courts require active fraud that "vitiate[s] the entire transaction" before an injunction will be granted. Intraworld Indus. v. Girard Trust Bank, 461 Pa. 343, 359, 336 A.2d 316, 324-25 (1975); *see* United Bank Ltd. v. Cambridge Sporting Goods Corp., 41 N.Y.2d 254, 260-61, 360 N.E.2d 943, 949-50, 392 N.Y.S.2d 265, 270-71 (1976); Sztejn v. J. Henry Schroder Banking Corp., 177 Misc. 719, 722, 31 N.Y.S.2d 631, 634 (1941); *see also* Harfield, *Enjoining Letter of Credit Transactions*, 95 Banking L.J. 596, 596 (1978) (injunctions against honor should only issue when the fraud is intentional and egregious); Note, *Judicial Development of Letter of Credit Law: A Reappraisal*, 66 Cornell L. Rev. 144, 165 (1981) (advocating legislative guidance in the area of injunctions to establish a uniform standard of application) [hereinafter cited as *Judicial Development*].

15. U.C.C. § 5-103(1)(a) (1977); *see* Baker v. National Boulevard Bank, 399 F. Supp. 1021, 1024 (N.D. Ill. 1975).

16. *See* Pringle-Associated Mtge. Corp. v. Southern Nat'l Bank, 571 F.2d 871, 874 (5th Cir. 1979); Venizelos S.A. v. Chase Manhattan Bank, 425 F.2d 461, 464-65 (2d Cir. 1970); West Virginia Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107, 1109-12 (W.D. Pa. 1976); Baker v. National Boulevard Bank, 399 F. Supp. 1021, 1024 (N.D. Ill. 1975); Dynamics Corp. v. Citizens & S. Nat'l Bank, 356 F. Supp. 991, 995 (N.D. Ga. 1973).

17. U.C.P. art 8(c) (1974). U.C.C. § 5-114 official comment 1 (1977) states that "[t]he letter of credit is essentially a contract between the issuer and the beneficiary and is recognized by this Article as independent of the underlying contract between the customer and the beneficiary." *Id.* The overwhelming majority of courts have interpreted this language to require total separation of the letter of credit from the underlying transaction. *See, e.g.*, KMW Int'l v. Chase Manhattan Bank, 606 F.2d 10, 16 (2d Cir. 1979); Chase Manhattan Bank v. Equibank, 550 F.2d 882, 885 (3d Cir. 1977); Fidelity Bank v. Lutheran Mut. Life Ins. Co., 465 F.2d 211, 214 (10th

the terms of the letter.[18] Thus, the letter of credit must always be conceptualized as an entity unto itself;[19] the bank is neither obliged nor licensed to concern itself with the actual operation of the underlying transaction.[20]

Total insulation of the letter of credit was designed to facilitate the absolute certainty required in the letter arrangement.[21] To involve the issuer in any of the myriad of performance problems in the underlying transaction would frustrate the definite nature of the payment promise.[22] Letter of credit insulation emphasizes that performance under a letter is entirely a "paper" transaction.[23]

Cir. 1972); Decor by Nikkei Int'l v. Federal Rep. of Nigeria, 497 F. Supp. 893, 907 (S.D.N.Y. 1980); Prudential Ins. Co. v. Marquette National Bank, 419 F. Supp. 734, 736 (D. Minn. 1976); West Virginia Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107, 1114 (W.D. Pa. 1976); New York Life Ins. Co. v. Hartford Nat'l Bank & Trust Co., 173 Conn. 492, 497-99, 378 A.2d 562, 566 (1977); First Nat'l Bank v. Rosebud Hous. Auth., 291 N.W.2d 41, 46 (Iowa 1980); Maurice O'Meara v. National Park Bank, 239 N.Y. 386, 395-96, 146 N.E. 636, 639 (1925). *See generally* H. Harfield I, *supra* note 1, at 107 (analysis of the "fundamental proposition" that the issuer is immune from the underlying transaction).

18. Dulien Steel Prods., Inc. v. Bankers Trust Co., 298 F.2d 836, 840 (2d Cir. 1962); *see* Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802, 805-06 (4th Cir. 1975); Colorado Nat'l Bank v. Board of County Comm'rs, 634 P.2d 32, 36-37 (Colo. 1981) (en banc); U.C.C. § 5-109 (1977).

19. Joseph, *Letters of Credit: The Developing Concepts and Financing Functions*, 94 Banking L.J. 816, 850-51 (1977); *see* authorities cited *supra* note 17.

20. *See* U.C.C. § 5-109(1)(a) (1977). Under the UCP, valid performance of the letter of credit is determined "on the basis of the documents alone." U.C.P. art. 8(c) (1974). The issuer, therefore, may not raise defenses available to either party in the underlying transactions. *See, e.g.*, East Girard Sav. Ass'n v. Citizens Nat'l Bank & Trust Co., 593 F.2d 598, 602 (5th Cir. 1979); Bossier Bank & Trust Co. v. Union Planters Nat'l Bank, 550 F.2d 1077, app. A at 1081-82 (6th Cir. 1977) (per curiam) (adopting memorandum decision of lower court); Cappaert Enters. v. Citizens & S. Int'l Bank, 486 F. Supp. 819, 826 (E.D. La. 1980).

21. *See* Insurance Co. of N. Am. v. Heritage Bank, N.A., 595 F.2d 171, 173 (3d Cir. 1979); Pringle-Associated Mtge. Corp. v. Southern Nat'l Bank, 571 F.2d 871, 874 (5th Cir. 1978); Far E. Textile, Ltd. v. City Nat'l Bank & Trust Co., 430 F. Supp. 193, 195 (S.D. Ohio 1977); *cf.* Asociacion De Azucareros De Guatemala v. United States Nat'l Bank, 423 F.2d 638, 641 (9th Cir. 1970) (holding that "[i]n the interests of certainty and stability," a bilateral modification of the underlying agreement has no effect on the letter of credit).

22. In the influential case of Maurice O'Meara Co. v. National Park Bank, 239 N.Y. 386, 146 N.E. 636 (1925), the court held that allowing or requiring a bank to monitor performance of the underlying agreement "would impose upon a bank a duty which in many cases would defeat the primary purpose of such letters of credit. This primary purpose is an assurance to the seller of merchandise of prompt payment against documents." *Id.* at 397, 146 N.E. at 639; *accord* Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802, 805 (4th Cir. 1975); *see* Pringle-Associated Mtge. Corp. v. Southern Nat'l Bank, 571 F.2d 871, 874 (5th Cir. 1978); Far E. Textile, Ltd. v. City Nat'l Bank & Trust Co., 430 F. Supp. 193, 195 (S.D. Ohio 1977).

23. *See* 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

Article 5 of the Uniform Commercial Code (Code) governs performance in letter of credit transactions.[24] Three states adopted a version of the Code which provides that the Uniform Customs and Practices for Commercial Documentary Credits (UCP)[25] would control letter of credit transactions "unless otherwise agreed."[26] The UCP is a codification of custom, not a code of law.[27] It does, how-

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Manhattan Bank, 425 F.2d 461, 465 (2d Cir. 1970); Dulien Steel Prods., Inc. v. Bankers Trust Co., 298 F.2d 836, 840-41 (2d Cir. 1962); U.C.C. § 5-114(1) (1977); U.C.P. art. 8(a) (1974).

24. *See* U.C.C. §§ 5-101, 5-102(1) (1977). Code treatment of letters of credit is the ultimate exercise of freedom of contract; the phrase "unless otherwise agreed" appears fifteen times in the provisions of Article 5. J. White & R. Summers, *supra* note 6, § 18-3, at 717. *See generally* Works, *Otherwise Agreed and Article Five: An Exercise in Freedom of Contract*, 11 St. Louis U. L.J. 416 (1967). The majority of provisions are "gap fillers" to be taken into account anywhere the parties did not provide for a contrary or additional requirement in their agreement. *See* U.C.C. § 5-106 (1977) (establishment of credit); *id.* § 5-107 (advise of credit and confirmation); *id.* § 5-109 (issuer obligation to the customer); *id.* § 5-110 (availability of credit); *id.* § 5-111 (warranties); *id.* § 5-113 (indemnities); *id.* § 5-114 (issuer's duty to honor); Works, *supra*, at 422.

25. Created and published by the International Chamber of Commerce in 1930, the UCP has undergone numerous revisions. H. Harfield II, *supra* note 1, at 3. Publication number 290, the most recent revision, was promulgated in 1974, and will be the edition used throughout this Note. *See generally* Jhirad, *Uniform Customs and Practice for Documentary Credits, 1974 Revision: The Principal Emendations of the 1962 Text*, 9 U.C.C. L.J. 109 (1976) (discussing the 1974 revisions); Kozolchyk, *supra* note 1, at 12-16 (same).

26. Ala. Code § 7-5-102(4) (1975); Mo. Ann. Stat. § 400.5-102(4) (Vernon Supp. 1982); N.Y. U.C.C. § 5-102(4) (McKinney 1964). In the absence of direct conflict with the UCP, the Code, as the codification of case law, continues to govern in New York. *See* United Bank Ltd. v. Cambridge Sporting Goods, Corp., 41 N.Y.2d 254, 258 & n.2, 360 N.E.2d 943, 947-48 & n.2, 392 N.Y.S.2d 265, 269-70 & n.2 (1976). New York bankers were vehemently opposed to the adoption of Article 5 of the Code. It was felt that the UCP was adequate for international transactions and was, thus, sufficient to regulate domestic letters of credit. *See* Penney, *New York Revisits the Code: Some Variations in the New York Enactment of the Uniform Commercial Code*, 62 Colum. L. Rev. 992, 1004-07 (1962). The New York Law Revision Commission was of a similar opinion. "The Commission . . . doubts whether any codification of the law of documentary letters of credit is needed. The great usefulness of the letter of credit device stems largely from its flexibility. Most letter of credit transactions, moreover, take place in international trade. The desirable objective of uniformity, both nationally and internationally, is now obtained to a high degree by decisional law and commercial usage. Legislation in such a field even if it purports to be declaratory of existing law, should not be adopted unilaterally by American jurisdictions . . . ." State of N.Y. Law Revision Comm'n, Report of the Law Revision Commission to the Legislature Relating to the Uniform Commercial Code, Legislative Doc. No. 65(A), at 5, 36 (1956), *reprinted in* State of N.Y. Law Revision Comm'n, Report and Appendices Relating to the Uniform Commercial Code, at 15, 46 (1956). *See generally*, 1 A. Lowenfeld, *supra* note 1, § 5.72, at 113-14 (discussing areas of divergence between the Code and the UCP).

27. H. Harfield I, *supra* note 1, at 225-27; H. Harfield II, *supra* note 1, at 3; Kozolchyk, *supra* note 1, at 14 & n.54.

ever, generally outline the liabilities and responsibilities of all participants to a letter of credit agreement.[28]

The Code treatment of letters of credit is essentially a codification of preexisting case law,[29] viewed by the drafters as "an independent theoretical frame for the further development of letters of credit."[30] Article 5 was not intended to be an all-inclusive codification of the law of letters of credit;[31] it "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."[32] Thus, as stated by one commentator, Article 5 is merely "a skeletal structure on or around which letters of credit may develop."[33] Letter of credit law has, consequently, been left to the vagaries of the common law.

Under traditional letter of credit law, the letter is viewed as merely a conduit for payment.[34] Recently, however, courts have embraced a contractual characterization of the letter of credit.[35] By construing a letter in this manner, courts have frequently lost sight of the original financing purpose and function of the letter mechanism.[36] It is the contention of this Note that a letter of credit is not a contract. Although some contract principles applicable to any bilateral obligation properly apply to letters of credit, others dilute the certainty essential to a purely paper transaction. Thus, application of contract principles

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28. *See* U.C.P. arts. 7-13 (1974). It should be noted that the majority of these articles are merely exculpatory provisions for the issuer. *See id.*

29. United Bank Ltd. v. Cambridge Sporting Goods Corp., 41 N.Y.2d 254, 258 n.2, 360 N.E.2d 943, 947-48 n.2, 392 N.Y.S.2d 265, 269-70 n.2 (1976); U.C.C. § 5-101 official comment 1 (1977); *see* H. Harfield II, *supra* note 1, at 4.

30. U.C.C. § 5-101 official comment (1977); *see Letters of Credit*, *supra* note 6, at 161.

31. *See* Barclays Bank D.C.O. v. Mercantile Nat'l Bank, 481 F.2d 1224, 1230-32 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); Data Gen. Corp. v. Citizens Nat'l Bank, 502 F. Supp. 776, 783 (D. Conn. 1980); New Jersey Bank v. Palladino, 77 N.J. 33, 40-41, 389 A.2d 454, 458 (1978); New York Life Ins. Co. v. Hartford Nat'l Bank & Trust Co., 173 Conn. 492, 497-98, 378 A.2d 562, 566 (1977); *cf.* U.C.C. § 5-102 official comment 2 (1977) (it would be unwise to codify all the possible law of letters of credit).

32. U.C.C. § 5-102(3) (1977).

33. H. Harfield II, *supra* note 1, at 4.

34. *See* H. Harfield I, *supra* note 1, at 16; 1 A. Lowenfeld, *supra* note 1, § 5-1; H. Harfield II, *supra* note 1, at 1.

35. *E.g.*, Bank of N.C., N.A. v. Rock Island Bank, 570 F.2d 202, 207 (7th Cir. 1978); Venizelos, S.A. v. Chase Manhattan Bank, 425 F.2d 461, 465-66 (2d Cir. 1970); Data Gen. Corp. v. Citizens Nat'l Bank, 502 F. Supp. 776, 784 (D. Conn. 1980); West Virginia Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107, 1112 (W.D. Pa. 1976); Harvey Estes Constr. Co. v. Dry Dock Sav. Bank, 381 F. Supp. 271, 274 (W.D. Okla. 1974); Colorado Nat'l Bank v. Board of County Comm'rs, 634 P.2d 32, 36-37 (Colo. 1981) (en banc).

36. *See* Harfield, *Code, Customs and Conscience in Letter-of-Credit Law*, 4 U.C.C. L.J. 7, 9-11 (1971) [hereinafter cited as Harfield IV]; *Judicial Development*, *supra* note 14, at 145.

must be selective and gauged entirely upon the effect such application will have on the letter transaction.

The modern contractual approach in letter of credit law has abandoned the requirement of strict compliance[37] with the terms of the letter in favor of a standard of substanial performance.[38] Under the theory of substantial performance,[39] courts are requiring banks to make discretionary determinations concerning a beneficiary's documentary compliance with the terms of the letter.[40] In attempting to do equity for the beneficiary,[41] courts have undermined the certainty so central to the letter of credit.[42]

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37. Traditional letter of credit law requires a beneficiary to strictly comply with the terms and conditions of the letter. *See, e.g.*, Insurance Co. of N. Am. v. Heritage Bank, N.A., 595 F.2d 171, 175 (3d Cir. 1979) (per curiam); Courtaulds N.Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802, 805-06 (4th Cir. 1975); Far E. Textile, Ltd. v. City Nat'l Bank & Trust Co., 430 F. Supp. 193, 196-97 (S.D. Ohio 1977); H. Harfield I, *supra* note 1, at 56-57. A substantial number of courts have held that any discrepancy in a draft, no matter how trivial, is less than strict compliance and therefore will allow the issuer to dishonor the beneficiary's draft. *E.g.*, Bank of Italy v. Merchants Nat'l Bank, 236 N.Y. 106, 108-09, 140 N.E. 211, 213 (1923) (raisins versus dried grapes); Oriental Pac. (U.S.A.), Inc. v. Toronto Dominion Bank, 78 Misc. 2d 819, 820, 357 N.Y.S.2d 957, 958-59 (Sup. Ct. 1974) (woolen knitwears versus ladies sweaters, dresses, pants and skirts); Bank Melli & Iran v. Barclays Bank, [1951] 2 T.L.R. 1057 (K.B.) (goods new versus 100 new goods); J.H. Rayner & Co. v. Hambro's Bank, Ltd., [1943] 1 K.B. 37, 40 (C.A.) (machine-shelled groundnut kernels versus Coromandel groundnuts).

38. *See, e.g.*, Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank, 569 F.2d 699, 703 (1st Cir. 1978); Crocker Comm'l Servs., Inc. v. Countryside Bank, No. 81 C 1257 (N.D. Ill. Dec. 30, 1981) (available on LEXIS, Genfed library, Dist. Ct. file); U.S. Indus. v. Second New Haven Bank, 462 F. Supp. 662, 665 (D. Conn. 1978); First Nat'l Bank v. Wynne, 149 Ga. App. 811, 815-16, 256 S.E.2d 383, 386 (1979); First Arlington Nat'l Bank v. Stathis, 90 Ill. App. 3d 802, 814-15, 413 N.E.2d 1288, 1298 (1980).

39. J. Calamari & J. Perillo, The Law of Contracts § 11-22, at 410-12 (2d ed. 1977); L. Simpson, Handbook on the Law of Contracts § 156, at 323-25 (2d ed. 1965); *see* Backus & Harfield, *Custom and Letters of Credit: The Dixon, Irmaos Case*, 52 Colum. L. Rev. 589, 589 (1952). For a discussion of the doctrine of substantial performance, see *infra* notes 103-13 and accompanying text.

40. *See, e.g.*, Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank, 569 F.2d 699, 703 (1st Cir. 1978); Crocker Comm'l Servs., Inc. v. Countryside Bank, No. 81 C 1257 (N.D. Ill. Dec. 30, 1981) (available on LEXIS, Genfed library, Dist. Ct. file); U.S. Indus. v. Second New Haven Bank, 462 F. Supp. 662, 665 (D. Conn. 1978); First Nat'l Bank v. Wynne, 149 Ga. App. 811, 815-16, 256 S.E.2d 383, 386 (1979); First Arlington Nat'l Bank v. Stathis, 90 Ill. App. 3d 802, 814-15, 413 N.E.2d 1288, 1298 (1980).

41. *See* Harfield IV, *supra* note 36, at 9-10; *Judicial Development*, *supra* note 14, at 145; *cf.* Crocker Comm'l. Servs., Inc. v. Countryside Bank, No. 81 C 1257 (N.D. Ill. Dec. 30, 1981) (available on LEXIS, Genfed library, Dist. Ct. file) (equating the bank's "hypertechnical" strict compliance defense with the unregenerate banker in Frank Capra's film, *It's A Wonderful Life*).

42. *See* AMF Head Sports Wear, Inc. v. Ray Scott's All-American Sports Club, Inc., 448 F. Supp. 222, 225 (D. Ariz. 1978); *Judicial Development*, *supra* note 14, at 166.

If the letter of credit is to retain its utility as a financing device, the standard of strict compliance must be revitalized and consistently applied. Such a standard ensures that prior to honor, the beneficiary has performed the protective conditions prescribed by the customer,[43] while insulating the issuer from disputes unrelated to its ministerial function.[44] This Note proposes that the flexibility which recommends a substantial performance standard can be achieved instead by imposing affirmative obligations on the customer and the issuer to facilitate the beneficiary's literal compliance with the letter's terms.

I. Legal Characterization of the Letter of Credit

Legal characterization of the letter of credit transaction is not a mere sophistic exercise. The rights and obligations of the parties to a letter of credit are to a large extent determined by the legal approach a court adopts.[45] If the letter is viewed as a contract, the issuer is vested with discretionary powers that will affect every facet of the transaction. The terms of the letter become the issuer's terms,[46] and performance is governed by both contract law and relevant equitable considerations.[47] A traditional mercantile characterization of the letter of credit, on the other hand, provides solely for an issuer payment

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43. International Leather Distribs. v. Chase Manhattan Bank, 464 F. Supp. 1197, 1201 (S.D.N.Y.), *aff'd*, 607 F.2d 996 (2d Cir. 1979); North Am. Foreign Trading Corp. v. General Elecs., Ltd., 67 A.D.2d 890, 891, 413 N.Y.S.2d 700, 702 (1979); J.H. Rayner & Co. v. Hambro's Bank, Ltd., [1943] 1 K.B. 37, 40 (C.A.); *see* Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802, 806 (4th Cir. 1975); Key Appliance, Inc. v. First Nat'l City Bank, 37 N.Y.2d 826, 827-28, 339 N.E.2d 888, 888-89, 377 N.Y.S.2d 482, 483 (1975).

44. Insurance Co. of N. Am. v. Heritage Bank, N.A., 595 F.2d 171, 173 (3d Cir. 1979); Chase Manhattan Bank v. Equibank, 550 F.2d 882, 885 (3d Cir. 1977); Dulien Steel Prods., Inc. v. Bankers Trust Co., 298 F.2d 836, 840 (2d Cir. 1962); Data Gen. Corp. v. Citizens Nat'l Bank, 502 F. Supp. 776, 781 (D. Conn. 1980); Far E. Textile, Ltd. v. City Nat'l Bank & Trust Co., 430 F. Supp. 193, 196 (S.D. Ohio 1977); Backus & Harfield, *supra* note 39, at 590; *see* Joseph, *supra* note 19, at 850-51.

45. *See* Kozolchyk, *supra* note 1, at 135. *Compare* First Nat'l Bank v. Wynne, 149 Ga. App. 811, 816-17, 256 S.E.2d 383, 386-87 (1979) (letters of credit are contracts and, therefore, substantial performance is the applicable standard of documentary compliance), *with* Corporacion de Mercadeo Agricola v. Mellon Bank Int'l, 608 F.2d 43, 47 & n.1 (2d Cir. 1979) (issuer is only allowed to pay if the documents submitted strictly comply because the bank's obligation is defined and controlled by the issuer-customer contract).

46. *See* Chase Manhattan Bank v. Equibank, 550 F.2d 882, 886-87 (3d Cir. 1977).

47. *See* U.S. Indus. v. Second New Haven Bank, 462 F. Supp. 662, 666 (D. Conn. 1978); Titanium Metals Corp. v. Space Metals, Inc., 529 P.2d 431, 433 (Utah 1974); First Nat'l Bank v. Wynne, 149 Ga. App. 811, 816, 256 S.E.2d 383, 386 (1979); Schweibish v. Pontchartrain State Bank, 389 So. 2d 731, 737 (La. Ct. App. 1980).

obligation absent any vestige of contractual discretion;[48] the issuer is empowered only to execute the customer's terms in a literal fashion.[49]

Neither the Code nor the UCP clearly characterize the legal nature of the letter of credit. The UCP, as merely a codification of banking practices,[50] does not attempt to define the legal derivation of the letter.[51] In the Code, an internal inconsistency or lack of consensus as to the actual legal nature of a letter of credit is apparent. Section 5-103, the definitional section, avoids a contractual description by referring to the letter as "an engagement" between the issuer and the beneficiary.[52] Moreover, the Code provides that there need not be consideration to create a valid and binding agreement between the issuer and the beneficiary.[53] Yet, in the majority of instances, the comments refer to the letter of credit as a contract.[54] In addition, Article 5 expressly refers to the Article 2 breach of contract provisions for guidance in cases of wrongful dishonor.[55]

Without clear guidance on the appropriate characterization of the letter of credit, courts and commentators have reached divergent

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48. Dulien Steel Prods., Inc. v. Bankers Trust Co., 298 F.2d 836, 840-41 (2d Cir. 1962); Data Gen. Corp. v. Citizens Nat'l Bank, 502 F. Supp. 776, 781 (D. Conn. 1980); *see* Laudisi v. American Exch. Nat'l Bank, 239 N.Y. 234, 239, 146 N.E. 347, 348 (1924); 1 A. Lowenfeld, *supra* note 1, § 5.92, at 125-26 (quoting Judgment of Feb. 6, 1950, Tribunal de Commerce, Seine, 1950 Dalloz *Jurisprudence* [D. Jur.] 323, 324).

49. Corporacion de Mercadeo Agricola v. Mellon Bank, Int'l, 608 F.2d 43, 47-48 & n.1 (2d Cir. 1979); Sisalcords do Brazil, Ltd. v. Fiacao Brasileira De Sisal, S.A., 450 F.2d 419, app. at 422 (5th Cir. 1971) (per curiam) (affirming and reprinting unpublished lower court opinion), *cert. denied*, 406 U.S. 919 (1972); *see* J.H. Rayner & Co. v. Hambro's Bank, Ltd., [1943] 1 K.B. 37, 42 (C.A.) (Goddard, L.J., concurring) ("If the bank accepts the mandate which its customer gives it, it must do so on the terms which he imposes.").

50. *See* H. Harfield II, *supra* note 1, at 3-4; Kozolchyk, *supra* note 1, at 12; J. White & R. Summers, *supra* note 6, § 18-3, at 717.

51. *See* U.C.P. art. 3(a) (1974) (vaguely defining a letter of credit as a "definite undertaking").

52. U.C.C. § 5-103(1)(a) (1977). The engagement "may be by way of agreement, that is, a promise to honor, or by way of an authority to honor, thus including within the definition of letter of credit, papers called 'authorities to purchase or pay.' " *Id.* official comment 1.

53. U.C.C. § 5-105 (1977) ("No consideration is necessary to establish a credit or to enlarge or otherwise modify its terms."); *see* Bank of N.C., N.A. v. Rock Island Bank, 570 F.2d 202, 207 (7th Cir. 1978) (discussing similar Illinois rule).

54. *E.g.*, U.C.C. § 5-106 official comment 2 (1977) ("so far as the customer or beneficiary are concerned establishment of [a revocable] credit has no legal significance unless the parties provide otherwise in their contracts with the issuer"); *id.* § 5-114 official comment 1 ("the letter of credit is essentially a contract between the issuer and the beneficiary"); *id.* § 5-116 official comment 3 (the letter of credit should be "treated like any other contract"). *But see id.* § 5-103 official comment 1 (letter of credit is an "engagement").

55. U.C.C. § 5-115(1) (1977) (citing §§ 2-707 to -710).

conclusions. Numerous courts and scholars have sought to categorize the letter of credit as a contract,[56] however, no valid formulation has been offered. The issuer's promise under an irrevocable letter of credit has been regarded as an offer to the beneficiary to be accepted by his tender of the required documents[57]— in essence, a unilateral contract where performance, rather than a return promise, operates as acceptance.[58] Many other commentators view this proposition as unsatisfactory because it fails to explain how, "in the absence of consideration flowing from the [beneficiary] to the [issuer], the latter is bound from the moment the former has received the [letter]."[59] Moreover, the required contractual element of mutual assent is lacking in a letter of credit transaction.[60]

Another attempt to characterize the letter of credit as a contract analogizes it to a third-party creditor beneficiary contract;[61] such a characterization, however, conflicts with certain basic principles of

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56. Bank of N.C., N.A. v. Rock Island Bank, 570 F.2d 202, 207 (7th Cir. 1978); Savarin Corp. v. National Bank of Pakistan, 447 F.2d 727, 731 (2d Cir. 1971); Data Gen. Corp. v. Citizens Nat'l Bank, 502 F. Supp. 776, 784 (D. Conn. 1980); Decor by Nikkei Int'l v. Federal Rep. of Nigeria, 497 F. Supp. 893, 907 (S.D.N.Y. 1980); Far E. Textile, Ltd. v. City Nat'l Bank & Trust Co., 430 F. Supp. 193, 195 (S.D. Ohio 1977); West Virginia Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107, 1112 (W.D. Pa. 1976); Harvey Estes Constr. Co. v. Dry Dock Sav. Bank, 381 F. Supp. 271, 274 (W.D. Okla. 1974); *see* G. Gilmore & C. Black, The Law of Admiralty § 3-23, at 120 (1957); H. Harfield I, *supra* note 1, at 52-53. For a compilation of older treatises and articles on the legal nature of letters of credit, see *id.* at 52 n.6.

57. *See* Asociacion de Azucareros de Guatemala v. United States Nat'l Bank, 423 F.2d 638, 641 (9th Cir. 1970); Baker v. National Boulevard Bank, 399 F. Supp. 1021, 1024 (N.D. Ill. 1975); Colorado Nat'l Bank v. Board of Comm'rs, 634 P.2d 32, 36-37 (Colo. 1981) (en banc); First Nat'l Bank v. Wynne, 149 Ga. App. 811, 814, 256 S.E.2d 383, 385 (1979).

58. Under the classic view of a unilateral contract, the promise is revocable until the act constituting performance is completed. J. Calamari & J. Perillo, *supra* note 39, § 2-24, at 82; L. Simpson, *supra* note 39, § 6, at 5-6. Under the modern view, once the offeree begins to perform, the offeror's promise becomes irrevocable. Restatement (Second) of Contracts § 45 (1981). Nevertheless, under either view, some affirmative act by the promisee is required to bind the promisor. *See* J. Calamari & J. Perillo, *supra* note 39, § 2-24, at 82-83.

59. Kozolchyk, *supra* note 1, at 135-36; *see* J. White & R. Summers, *supra* note 6, § 18-2, at 711; Joseph, *supra* note 19, at 850-51; Comment, *Letter of Credit: Current Theories and Usages*, 39 La. L. Rev. 581, 588-90 (1979) [hereinafter cited as *Current Theories*].

60. J. White & R. Summers, *supra* note 6, § 18-2, at 711; Kozolchyk, *supra* note 1, at 135-36; Joseph, *supra* note 19, at 850-51; *Current Theories*, *supra* note 59, at 588-90. The Code demands that the issuer "must honor a draft or demand for payment which complies with the . . . credit"; the beneficiary's state of mind is, therefore, meaningless. U.C.C. § 5-114(1) (1977).

61. West Virginia Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107, 1109-10 (W.D. Pa. 1976); Savage v. First Nat'l Bank & Trust Co., 413 F. Supp. 447, 451 (N.D. Okla. 1976); Harvey Estes Constr. Co. v. Dry Dock Sav. Bank, 381 F. Supp. 271, 274 (W.D. Okla. 1974).

the letter of credit relationship.[62] In a third-party beneficiary contract, the rights and obligations of the third party depend upon the validity of the contract between the promisee and the promisor.[63] The promisor can assert any defense against the third-party beneficiary that he could assert against the promisee.[64] In a letter of credit transaction, however, the issuer-promisor has no such right. Rather it must honor demands for payment that comply with the letter regardless of the validity of the customer-issuer contract.[65] The letter of credit is an obligation totally independent of the underlying contracts that it facilitates,[66] while a third-party beneficiary contract is a tripartite arrangement with interrelated obligations and liabilities.[67]

Most commentators have been sensitive to the inherent contradictions in analogizing the letter of credit to a contract. To many scholars, a letter of credit is definitely not a contract, but rather an "engagement"[68] or "undertaking,"[69] and consequently, "nothing more than a written promise by a bank."[70] This contention, though premised upon the technical deficiencies of characterizing the letter of credit as a contract, is much influenced by the uncertainty that results from a contractual approach to letter transactions.[71] Many courts and commentators, therefore, maintain that letters of credit serve only a ministerial financing function[72] and as such are "largely bottomed upon the legal concept of strict performance."[73]

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62. *See* J. White & R. Summers, *supra* note 6, § 18-2, at 714; Joseph, *supra* note 19, at 850-51; *Current Theories*, *supra* note 59, at 590.

63. J. Calamari & J. Perillo, *supra* note 39, § 17-9, at 628; G. Grismore, Principles of the Law of Contracts § 243, at 397-98 (rev. ed. 1965); L. Simpson, *supra* note 39, § 121, at 254-55.

64. J. Calamari & J. Perillo, *supra* note 39, § 17-8; *see* Rotermund v. United States Steel Corp., 474 F.2d 1139, 1142 (8th Cir. 1973).

65. East Girard Sav. Ass'n v. Citizens Nat'l Bank, 593 F.2d 598, 602 (5th Cir. 1979); U.C.C. § 5-114(1) (1977).

66. *See supra* notes 18-21 and accompanying text.

67. *See* J. Calamari & J. Perillo, *supra* note 39, § 17-8 (promisor's defenses); *id.* § 17-9 (vesting); *id.* § 17-10 (rights of the beneficiary against the promisee); *id.* § 17-11 (rights of the promisee against the promisor).

68. Mentschicoff, *How to Handle Letters of Credit*, 19 Bus. Law. 107, 107-08 (1963).

69. Malcolm, *Panel Discussion on the Uniform Commerical Code, Report of the New York Law Revision Commission—Areas of Agreement and Disagreement*, 12 Bus. Law. 49, 60-61 (1956).

70. Wiley, *How To Use Letters of Credit in Financing the Sale of Goods*, 20 Bus. Law. 495, 496 (1965). In no section of Article 5 is it provided that the beneficiary must make a promise of any kind in exchange for the issuer's promise to pay. The beneficiary need only present conforming documents to obtain payment. U.C.C. § 5-114(1) (1977).

71. *See* Backus & Harfield, *supra* note 39, at 589-91.

72. Insurance Co. of N. Am. v. Heritage Bank, N.A., 595 F.2d 171, 173 (3d Cir. 1979); Dulien Steel Prods., Inc. v. Bankers Trust Co., 298 F.2d 836, 840 (2d Cir. 1962); Data Gen. Corp. v. Citizens Nat'l Bank, 502 F. Supp. 776, 781 (D. Conn.

Though not a contract, a letter of credit can be viewed as a distant cousin with thoroughly unique legal characteristics:[74] "Probably the best explanation is simply to call a letter of credit a transaction *sui generis*—a relationship with no perfect analogies but nevertheless a well defined set of rights and obligations."[75] One advocate of the *sui generis* concept is Boris Kozolchyk.[76] Sensitive to both "the socioeconomic forces that prompted its use and to the legal conceptualization that made it operative,"[77] he proposes that the letter of credit be conceptualized as a new type of mercantile currency.[78] Kozolchyk argues that if viewed as a type of negotiable instrument, the letter would embody a high degree of certainty and the terms of the credit would be inviolate.[79] This formulation demands that the letter of credit be a formal and abstract payment mechanism quite alien to the malleability of a contractual transaction.[80]

Despite the theoretical and practical problems, courts in recent years have held that a letter is a contract between the issuer and the beneficiary governed by traditional principles of contract law.[81] The

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1980); Far E. Textile, Ltd. v. City Nat'l Bank & Trust Co., 430 F. Supp. 193, 196 (S.D. Ohio 1977); Backus & Harfield, *supra* note 39, at 590; *see* Chase Manhattan Bank v. Equibank, 550 F.2d 882, 885 (3d Cir. 1977); Joseph, *supra* note 19, at 850-51.

73. Backus & Harfield, *supra* note 39, at 590.

74. *See* Joseph, *supra* note 19, at 850 ("The letter of credit evolved as a mercantile specialty, and the only way to understand all its facets is to recognize that it is an entity unto itself.").

75. 1 A. Lowenfeld, *supra* note 1, § 5.53, at 103 (footnote omitted); *accord* H. Harfield I, *supra* note 1, at 53; *see* Farmers' Nat'l Bank v. Sutton Mfg. Co., 52 F. 191, 194-95 (6th Cir. 1892).

76. Kozolchyk, *supra* note 1, at 137.

77. *Id.* at 139.

78. *Id.* at 139-40.

79. *Id.* at 140. Kozolchyk maintains that the letter of credit can be viewed as a negotiable instrument because it meets the definition of a negotiable instrument in Article 3. *Id.* (citing U.C.C. § 3-104(1)(b) (1977) (a negotiable instrument must "contain an unconditional promise or order to pay a sum certain in money")). Kozolchyk posits that the conditions of a letter of credit are merely formalities required for payment, apparently equating them to a signature under an ordinary bank check. *See id. Contra* Shaffer v. Brooklyn Park Garden Apts., 311 Minn. 452, 457-58, 250 N.W.2d 172, 176-77 (1977) ("[T]he existence of conditions precedent to payment as well as the duty of the issuing bank to reject non-complying documents take it out of the purview of an unconditional promise to pay.").

80. *See* Kozolchyk, *supra* note 1, at 140.

81. *E.g.*, Bank of N.C., N.A. v. Rock Island Bank, 570 F.2d 202, 207 (7th Cir. 1978); Venizelos, S.A. v. Chase Manhattan Bank, 425 F.2d 461, 465-66 (2d Cir. 1970); Data Gen. Corp. v. Citizens Nat'l Bank, 502 F. Supp. 776, 784 (D. Conn. 1980); West Virginia Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107, 1112 (W.D. Pa. 1976); Dynamics Corp. v. Citizens & S. Nat'l Bank & Trust Co., 356 F. Supp. 991, 999 (N.D. Ga. 1973); J. Zeevi & Sons, Ltd. v. Grindlays Bank (Uganda) Ltd., 37 N.Y.2d 220, 225, 333 N.E.2d 168, 172, 371 N.Y.S.2d 892, 897, *cert. denied*, 423 U.S. 866 (1975); Titanium Metals Corp. of Am. v. Space Metals Inc., 529 P.2d 431, 433 (Utah 1974).

letter of credit has been construed against the drafter[82] and interpreted in a manner that tends to uphold, rather than defeat, the credit.[83] Moreover, the issuer's failure to perform under a letter has been treated as a contractual repudiation that requires all the elements of an action for breach of contract.[84]

The most problematical area of contract law application, however, concerns documentary compliance with the letter of credit.

II. Documentary Compliance

A. *Waiver of Terms on Presentment: Returning to Strict Compliance*

Article 5 of the Uniform Commerical Code expressly avoids setting a minimum standard of documentary compliance, leaving adjudication of the issue to the courts.[85] The Code provides only that the issuer *must* honor drafts which comply "on their face" with the terms of the letter.[86] The UCP is also quite general in providing for a standard of documentary compliance. Article 7 requires that docu-

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82. *E.g.*, United States v. Sun Bank, 609 F.2d 832, 833 (5th Cir. 1980) (per curiam); East Girard Sav. Ass'n v. Citizens Nat'l Bank & Trust Co., 593 F.2d 598, 602 (5th Cir. 1979); Bank of N.C., N.A. v. Rock Island Bank, 570 F.2d 202, 207 (7th Cir. 1978); Bossier Bank & Trust Co. v. Union Planters Nat'l Bank, 550 F.2d 1077, app. A at 1082 (6th Cir. 1977) (per curiam) (adopting memorandum decision of lower court); Venizelos, S.A. v. Chase Manhattan Bank, 425 F.2d 461, 467 (2d Cir. 1970); West Virginia Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107, 1112 (W.D. Pa. 1976).

83. *E.g.*, Bank of N.C., N.A. v. Rock Island Bank, 570 F.2d 202, 207-08 (7th Cir. 1978); Venizelos, S.A. v. Chase Manhattan Bank, 425 F.2d 461, 465 (2d Cir. 1970); West Virginia Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107, 1112 (W.D. Pa. 1976).

84. Decor by Nikkei Int'l, Inc. v. Federal Rep. of Nigeria, 497 F. Supp. 893, 907 (S.D.N.Y. 1980); *see* National Bank & Trust Co. v. J.L.M. Int'l, Inc., 421 F. Supp. 1269, 1272-73 (S.D.N.Y. 1976); North Am. Foreign Trading Corp. v. General Elecs., Ltd., 67 A.D.2d 890, 891-92, 413 N.Y.S.2d 700, 702 (1979); *cf.* U.C.C. § 5-115(2) (1977) (providing Article 2 damage remedies for breach of letter of credit).

85. U.C.C. § 5-102 official comment 2 (1977) ("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."); *see* U.S. Indus. v. Second New Haven Bank, 462 F. Supp. 662, 664 (D. Conn. 1978). Critics of Article 5 maintain that the Code should have, as a minimum, provided a standard by which the conformity of documents could be determined. *See* State of N.Y. Law Revision Comm'n, Study of Uniform Commercial Code: Article 5—Documentary Letters of Credit, Legislative Doc. No. 65(F), at 66 (1955), *reprinted in* 3 State of N.Y. Law Revision Comm'n, Report of the Law Revision Commission for 1955, at 1569, 1634 [hereinafter cited as 1955 Report]; J. White & R. Summers, *supra* note 6, § 18-6, at 729; Comment, *Letters of Credit Under the Proposed Uniform Commercial Code: An Opportunity Missed*, 62 Yale L.J. 227, 248 (1953) [hereinafter cited as *Opportunity Missed*].

86. U.C.C. § 5-109(2) (1977), *construed in* Chase Manhattan Bank v. Equibank, 550 F.2d 882, 885 (3d Cir. 1977); U.C.C. § 5-114(1) (1977).

ments be examined by the issuer "with reasonable care to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit."[87]

In the absence of statutory or codified guidance, the majority of courts require strict compliance with the terms of a letter of credit.[88] The doctrine of strict compliance demands that issuer verification of documents upon presentment must be both literal and exacting.[89] As stated by Lord Summer in the prominent English case of *Equitable Trust Co. v. Dawson Partners*,[90] "[t]here is no room for documents which are almost the same, or which will do just as well."[91] Following the lead of the First Circuit in *Banco Espanol de Credito v. State Street Bank and Trust Co.*,[92] however, courts have added "leaven [to] the loaf of strict construction."[93] By emphasizing the crucial importance of flexibility in commercial transactions,[94] courts now attempt to distinguish between material and immaterial variations from the terms of the letter.[95] As a result, a draft that reasonably complies with the letter's terms will be considered in strict compliance absent a finding that the issuer has been misled to his detriment.[96] For example, in *U.S. Industries v. Second New Haven Bank*,[97] the District

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87. U.C.P. art. 7 (1974).

88. First Arlington Nat'l Bank v. Stathis, 90 Ill. App. 3d 802, 814-15, 413 N.E.2d 1288, 1298 (1980); *see* cases cited *supra* note 37.

89. Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802, 805-06 (4th Cir. 1975) ("as the predominant authorities unequivocally declare, the beneficiary must meet the terms of the credit—and precisely—if it is to exact performance of the issuer"); *see* H. Harfield I, *supra* note 1, at 73.

90. [1927] 27 Lloyd's List L.R. 49.

91. *Id.* at 52.

92. 385 F.2d 230 (1st Cir. 1967), *cert. denied*, 390 U.S. 1013 (1968).

93. *Id.* at 234; *see, e.g.*, Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank, 569 F.2d 699, 704 & n.7 (1st Cir. 1978); U.S. Indus. v. Second New Haven Bank, 462 F. Supp. 662, 664-65 (D. Conn. 1978); First Arlington Nat'l Bank v. Stathis, 90 Ill. App. 3d 802, 814-15, 413 N.E.2d 1288, 1298 (1980).

94. H. Harfield II, *supra* note 1, at 50-51.

95. *See* Corporacion de Mercadeo Agricola v. Mellon Bank Int'l, 608 F.2d 43, 47 n.1 (2d Cir. 1979) (documents must "strictly comply with the *essential* requirements of the letter of credit" (emphasis added)); Banco Espanol de Credito v. State Street Bank & Trust Co., 385 F.2d 230, 237 (1st Cir. 1967) (enforceable compliance when the documentary draft "conformed in all significant respects"), *cert. denied*, 390 U.S. 1013 (1968); U.S. Indus. v. Second New Haven Bank, 462 F. Supp. 662, 664 (D. Conn. 1978) (although the submitted documents did not strictly comply, they put the issuer "on notice" and were therefore sufficient); First Arlington Nat'l Bank v. Stathis, 90 Ill. App. 3d 802, 816, 413 N.E.2d 1288, 1299 (1980) (compliance is sufficient where the documentary draft did not "deviate significantly" from the letter's requirements).

96. Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank, 569 F.2d 699, 705 (1st Cir. 1978); U.S. Indus. v. Second New Haven Bank, 462 F. Supp. 662, 665 (D. Conn. 1978).

97. 462 F. Supp. 662 (D. Conn. 1978).

Court of Connecticut held that the documents tendered by the beneficiary strictly complied[98] even though the draft omitted the required certification evidencing that payment had been demanded of the issuer's customer.[99] The court held that the rule of strict compliance, when viewed in terms of letter of credit policy, must only control where there is a "fatal" variance in the documents.[100] It seems that "almost the same or . . . just as well"[101] is now good enough.[102]

Courts, by viewing a letter of credit as a contract, have made the error of equating substantial performance of a contract with substantial compliance under a letter of credit.[103] Not one of the underlying principles and traditional justifications that recommend the contractual doctrine of substantial performance exists in the letter of credit situation. The doctrine is designed to prevent forfeiture by a promisee when a promisor has received substantially all the performance for which he bargained.[104] In such cases, courts will enforce the contract so as to fulfill the justifiable expectations of the parties.[105] Yet, in a letter of credit transaction, when a draft is rightfully dishonored due to less than strict compliance, the issuer is not unjustly enriched. As a payment intermediary, the issuer provides the service for a small fee[106] and has little to gain in the case of either honor or dishonor.[107] The beneficiary suffers no true forfeiture for he either retains ownership of the goods or the customer waives the non-compliance and accepts delivery.[108]

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98. *Id.* at 665.

99. *Id.* at 664.

100. *Id.* at 665 (quoting Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank, 569 F.2d 699, 705 (1st Cir. 1978)).

101. Equitable Trust Co. v. Dawson Partners, [1927] 27 Lloyd's List L.R. 49, 52.

102. *See supra* notes 95-96 and accompanying text.

103. *See* cases cited *supra* note 38.

104. Hadden v. Consolidated Edison Co., 34 N.Y.2d 88, 97, 312 N.E.2d 445, 449-50, 356 N.Y.S.2d 249, 255 (1974); *see* 3A A. Corbin, Corbin on Contracts §§ 704-707; L. Simpson, *supra* note 39, § 156, at 325-26; 6 S. Williston, A Treatise on the Law of Contracts § 843 (3d ed. 1961).

105. G. Grismore, *supra* note 63, § 144 at 203; *see* Ballou v. Basic Constr. Co., 407 F.2d 1137, 1140 (4th Cir. 1969); *In re* Kinney Aluminum Co., 78 F. Supp. 565, 567-68 (S.D. Cal. 1948); Hadden v. Consolidated Edison Co., 34 N.Y.2d 88, 98-99, 312 N.E.2d 445, 450-51, 356 N.Y.S.2d 249, 256-57 (1974).

106. H. Harfield I, *supra* note 1, at 58.

107. *Cf.* U.C.C. § 5-109 official comment 1 (1977) ("the issuer receives compensation for a payment service rather than for a guaranty of performance").

108. J. White & R. Summers, *supra* note 6, § 18-6, at 728; *see* H. Harfield I, *supra* note 1, at 72-73; *supra* notes 17-20 and accompanying text. A far greater risk of forfeiture exists, however, in a standby letter of credit situation. *See supra* note 6 (discussing standby letters). Should the beneficiary's draft be dishonored due to less than strict compliance, there would be no goods to retain or attach. Yet, as in any other letter of credit transaction, the customer's default is still actionable by way of the underlying contract. J. White & R. Summers, *supra* note 6, § 18-6, at 728 ("the beneficiary may still recover from the customer in an action on the underlying

Moreover, the doctrine of substantial performance was designed only to excuse the performance of constructive conditions.[109] Such conditions are not the expressed intentions of the parties, but are imposed by law to do justice.[110] Thus, "no difficulty is encountered in an objection that the doctrine of substantial performance in permitting a recovery is a departure from the terms of the contract."[111] A letter of credit, however, embodies express terms and conditions designed to ensure the adequacy of the beneficiary's return performance.[112] Because the doctrine of substantial performance is not applicable to express conditions of contractual obligations,[113] it is an inappropriate standard for performance under a letter of credit.

By requiring the issuer to accept even minor defects in the beneficiary's draft, courts are implicitly granting the issuer the discretion to waive those terms of the letter that it believes are unimportant.[114] In fact, in the opinion of one code commentator, issuer waiver is authorized as an implied term of the customer-issuer contract.[115] Under this rationale, the waiver of documentary noncompliance is acceptable as long as the issuer exercised good faith.[116] This approach

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contract"); *see* H. Harfield I, *supra* note 1, at 72-73; *cf.* KMW Int'l v. Chase Manhattan Bank, 606 F.2d 10, 15 (2d Cir. 1979) (preliminary injunction vacated because action on the underlying contract negates possibility of irreparable harm where fraudulent letter of credit is honored); U.C.C. § 5-109 official comment 1 (1977) ("[t]he customer will normally have direct recourse against the beneficiary if performance fails").

109. J. Calamari & J. Perillo, *supra* note 39, § 11-22, at 410; L. Simpson, *supra* note 39, § 156; *see* Pasquel v. Owen, 186 F.2d 263, 270 (8th Cir. 1950).

110. J. Calamari & J. Perillo, *supra* note 39, § 11-11, at 395; G. Grismore, *supra* note 63, § 132, at 184-85; L. Simpson, *supra* note 39, § 152, at 318.

111. L. Simpson, *supra* note 39, § 156, at 324.

112. *See supra* note 43 and accompanying text.

113. *See* J. Calamari & J. Perillo, *supra* note 39, § 11-7, at 389; L. Simpson, *supra* note 39, § 151, at 313; 5 S. Williston, *supra* note 104, § 675. In cases of extreme forfeiture, the doctrine of substantial performance has been applied to express conditions. *See* Jacob & Youngs, Inc. v. Kent, 230 N.Y. 239, 243-44, 129 N.E. 889, 891 (1921). The primary application of this exception is in the area of construction contracts where the substantially completed structure cannot be returned to the contractor. J. Calamari & J. Perillo, *supra* note 39, § 11-22, at 411. In a sales contract, however, the goods can, if defective, be returned or refused. *See* U.C.C. § 2-601 (1977). Moreover. an action on the underlying contract can always be maintained. *See supra* note 108 and accompanying text. Thus, no true forfeiture exists in a letter transaction, and this exception is not applicable.

114. *See Judicial Development*, *supra* note 14, at 152-53. Waiver after defective performance is the election by the promisor to continue his performance after a failure of an express condition or material failure of a constructive condition. *See* J. Calamari & J. Perillo, *supra* note 39, § 11-37, at 449. Waiver is discretionary by definition because "the promisor has a choice between alternative courses of conduct." L. Simpson, *supra* note 39, § 171, at 352 (footnote omitted).

115. *See* 3 R. Anderson, *supra* note 8, § 5-109:8, at 394.

116. *Id.*; *see* U.C.C. § 5-109 official comment 1 (1977) (issuer-customer contract "includes the obligation of good faith imposed by Section 1-203").

contradicts the custom and usage of trade in the banking industry, which observes the strict compliance standard[117] and is an implied term of the customer-issuer contract.[118]

Moreover, the contractual principles of waiver belie its applicability to a letter of credit transaction. An effective waiver must arise from the conduct of a party "for whose benefit the condition exists."[119] Under a letter of credit, however, the terms and conditions are selected by, and are for the benefit of, the customer.[120] When the issuer honors a draft that less than strictly complies, it is waiving terms or conditions that exist for the customer's benefit; clearly a case of improper party waiver.[121] In addition, the issuer is not a party to a contract with the beneficiary[122] and thus can possess no discretionary powers to waive the terms of the letter.[123]

Allowing the issuer to waive terms or conditions that exist for the benefit of the customer would frustrate the purpose of the letter transaction by diminishing the customer's chances of receiving satisfactory performance of the underlying transaction.[124] The rationale behind requiring strict compliance with the terms of the letter of credit is assurance—assurance of payment for the beneficiary[125] and

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117. *See supra* note 88 and accompanying text.

118. U.C.C. § 5-109 official comment 1 (1977) (the issuer-customer contract includes "the observance of any course of dealing or usage of trade made applicable by Section 1-205").

119. J. Calamari & J. Perillo, *supra* note 39, § 11-37, at 449; *accord* 3A A. Corbin, *supra* note 104, § 752, at 532 (Supp. 1980); G. Grismore, *supra* note 63, § 169, at 249.

120. Corporacion de Mercadeo Agricola v. Mellon Bank Int'l, 608 F.2d 43, 47-48 & n.1 (2d Cir. 1979); *see* Anglo-South Am. Trust Co. v. Uhe, 261 N.Y. 150, 156-57, 184 N.E. 741, 743 (1933). "It is essential for the protection of the interests of the [customer] that the issuer of the credit not interpret its instructions, but execute them literally . . . ." Judgment of Feb. 6, 1950, Tribunal de Commerce, Seine, 1950 D. Jur. 323, 324, *translated in* 1 A. Lowenfeld, *supra* note 1, § 5.92, at 125-26.

121. Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802, 807 (4th Cir. 1975); International Leather Distribs. v. Chase Manhattan Bank, 464 F. Supp. 1197, 1201-03 (S.D.N.Y.), *aff'd mem.*, 607 F.2d 996 (2d Cir. 1979); *see* North Am. Foreign Trading Corp. v. General Elecs., Ltd., 67 A.D.2d 890, 892, 413 N.Y.S.2d 700, 702-03 (1979).

122. *See* Baker v. National Boulevard Bank, 399 F. Supp. 1021, 1024 & n.3 (N.D. Ill. 1975); J. White & R. Summers, *supra* note 6, § 18-2, at 711; *supra* notes 68-75 and accompanying text.

123. Corporacion de Mercadeo Agricola v. Mellon Bank Int'l, 608 F.2d 43, 47-48 & n.1 (2d Cir. 1979); Insurance Co. of N. Am. v. Heritage Bank, N.A., 595 F.2d 171, 176 (3d Cir. 1979); Interco, Inc. v. First Nat'l Bank, 560 F.2d 480, 483 (1st Cir. 1977); Dulien Steel Prods., Inc. v. Bankers Trust Co., 298 F.2d 836, 840 (2d Cir. 1962); Anglo-South Am. Trust Co. v. Uhe, 261 N.Y. 150, 156-57, 184 N.E. 741, 743 (1933).

124. *See* North Am. Foreign Trading Corp. v. General Elecs., Ltd., 67 A.D.2d 890, 892, 413 N.Y.S.2d 700, 703 (1979).

125. *See, e.g.*, Insurance Co. of N. Am. v. Heritage Bank, 595 F.2d 171, 173 (3d Cir. 1979); Pringle-Associated Mtge. Corp. v. Southern Nat'l Bank, 571 F.2d 871,

assurance of performance for the customer.[126] A number of courts have begun to acknowledge the improper party waiver implicit in the application of the substantial compliance standard.[127] For example, in a recent New York decision,[128] the court held that "common sense" demanded that the terms of a letter of credit be considered as an essential protective device for the customer and as such should be strictly complied with absent customer waiver.[129]

No better evidence exists for the proposition that the doctrine of substantial performance erodes the certainty of the letter of credit transaction than the frequency of litigation in the area of documentary compliance.[130] In the letter of credit field, "whatever litigation there is, usually is caused by some actual or alleged variance between the documents specified in the credit and the documents actually presented, rather than by doubts concerning the applicable legal principles."[131] Strict compliance invites certainty by setting a standard by which all parties to the transaction can gauge conforming perform-

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874 (5th Cir. 1978); Venizelos, S.A. v. Chase Manhattan Bank, 425 F.2d 461, 464 (2d Cir. 1970); West Virginia Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107, 1109-10 (W.D. Pa. 1976); Dynamics Corp. of Am. v. Citizens & S. Nat'l Bank, 356 F. Supp. 991, 995 (N.D. Ga. 1973).

126. H. Harfield I, *supra* note 1, at 57; *see* North Am. Foreign Trading Corp. v. General Elecs., Ltd., 67 A.D.2d 890, 891, 413 N.Y.S.2d 700, 703 (1979); J.H. Rayner & Co. v. Hambro's Bank, Ltd., [1942] 1 K.B. 37 (C.A.).

127. International Leather Distribs. v. Chase Manhattan Bank, 464 F. Supp. 1197, 1201-02 (S.D.N.Y.), *aff'd mem.*, 607 F.2d 996 (2d Cir. 1979); North Am. Foreign Trading Corp. v. General Elecs., Ltd., 67 A.D.2d 890, 891, 413 N.Y.S.2d 700, 702-03 (1979); Key Appliance, Inc. v. First Nat'l City Bank, 46 A.D.2d 622, 622, 359 N.Y.S.2d 886, 887 (1974) (per curiam), *aff'd mem.*, 37 N.Y.2d 826, 339 N.E.2d 888, 377 N.Y.S.2d 482 (1975).

128. North Am. Foreign Trading Corp. v. General Elecs., Ltd., 67 A.D.2d 890, 413 N.Y.S.2d 700 (1979).

129. *Id.* at 891-92; 413 N.Y.S.2d at 702-03; *see* Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802, 807 (4th Cir. 1975).

130. State of N.Y. Law Revision Comm'n, *supra* note 85, at 64, *reprinted in* 1955 Report, *supra* note 85, at 1632; *see* J. White & R. Summers, *supra* note 6, § 18-6, at 729; *Current Theories*, *supra* note 59, at 597-98; *Opportunity Missed*, *supra* note 85, at 247; *see, e.g.*, Insurance Co. of N. Am. v. Heritage Bank, N.A., 595 F.2d 171 (3d Cir. 1979) (per curiam); Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank, 569 F.2d 699 (1st Cir. 1978); Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802 (4th Cir. 1975); Venizelos, S.A. v. Chase Manhattan Bank, 425 F.2d 461 (2d Cir. 1970); Banco Espanol de Credito v. State St. Bank & Trust Co., 385 F.2d 230 (1st Cir. 1967), *cert. denied*, 390 U.S. 1013 (1968); Crocker Comm'l Servs. Inc. v. Countryside Bank, No. 81 C 1257 (N.D. Ill. Dec. 30, 1981) (available on LEXIS, Genfed library, Dist. Ct. file); Far E. Textile, Ltd. v. City Nat'l Bank & Trust Co., 430 F. Supp. 193 (S.D. Ohio 1977); New York Life Ins. Co. v. Hartford Nat'l Bank & Trust Co., 173 Conn. 492, 378 A.2d 562 (1977); First Arlington Nat'l Bank v. Stathis, 90 Ill. App. 3d 802, 413 N.E.2d 1288 (1980).

131. State of N.Y. Law Revision Comm'n, *supra* note 85, at 64, *reprinted in* 1955 Report, *supra* note 85, at 1632 n.167.

ance.[132] Substantial compliance, on the other hand, invites discretion by the issuer, who must determine whether compliance under the vague standard of "almost as good" is good enough.[133] By diluting the traditional literal standard of compliance, courts have forced issuers to assume the role of judges of first impression who must calculate, in a short period of time,[134] whether the beneficiary would have an action for wrongful dishonor[135] or, conversely, whether honor would be a bar to reimbursement.[136] Such uncertainty guarantees lawsuits, not payment, and therefore, frustrates the basic purpose of the letter of credit.[137]

In addition to engendering uncertainty, the doctrine of substantial compliance directly conflicts with Article 5 of the Code. Although Article 5 avoids setting a standard of documentary compliance,[138] it

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132. *See* Kozolchyk, *supra* note 1, at 77; Barclays Bank D.C.O. v. Mercantile Nat'l Bank, 481 F.2d 1224, 1239 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974).

133. Insurance Co. of N. Am. v. Heritage Bank, N.A., 595 F.2d 171, 175-76 (3d Cir. 1979). "[T]he bank assumes a primary obligation in part because its commitment is clearly defined within the four corners of the letter. If courts deviate from the rule of strict compliance and insist in certain undefined situations that banks make payments [although] the beneficiary failed to comply with the terms stipulated in the letter of credit, the certainty that makes this device so attractive and useful may well be undermined, with the result that banks may become reluctant to assume the additional risks of litigation." *Id.* at 176.

134. Banco Espanol de Credito v. State St. Bank & Trust Co., 266 F. Supp. 106, 109 (D. Mass.), *rev'd on other grounds*, 385 F.2d 230 (1st Cir. 1967), *cert. denied*, 390 U.S. 1013 (1968). The Code provides that the issuer must determine compliance by "the close of the third banking day following receipt of the documents." U.C.C. § 5-112(1)(a) (1977). UCP article 8(d), however, requires that "the issuing bank shall have a reasonable time to examine the documents." U.C.P. art. 8(d) (1974). Henry Harfield finds the reasonable time standard to be more in line with the "expectations of businessmen." H. Harfield II, *supra* note 1, at 67.

135. *See* U.C.C. § 5-114(1) (1977). Wrongful dishonor occurs when "a draft or demand for payment which complies with the terms of the relevant credit" is not honored by the issuer. *Id.* Beneficiary remedies are explicitly provided for in *id.* § 5-115. *See generally* J. White & R. Summers, *supra* note 6, § 18-6 (analysis of types of wrongful dishonor and the remedies that are available to the beneficiary); H. Harfield I, *supra* note 1, at 109-10 (same).

136. *See* Chase Manhattan Bank v. Equibank, 550 F.2d 882, 886 (3d Cir. 1977). The remedies available to a customer claiming wrongful honor by the issuer are not specified in the Code. To many commentators, this statutory void is well explained by the fact that "lawyers for issuers greatly influenced the drafting of Article Five." J. White & R. Summers, *supra* note 6, § 18-7, at 741 (footnote omitted); *accord* State of N.Y. Law Revision Comm'n, *supra* note 85, at 62, *reprinted in* 1955 Report, *supra* note 85, at 1630; *Judicial Development*, *supra* note 14, at 160-62.

137. Insurance Co. of N. Am. v. Heritage Bank, N.A., 595 F.2d 171, 176 (3d Cir. 1979) (per curiam); *see* J. White & R. Summers, *supra* note 6, § 18-6, at 728.

138. U.C.C. § 5-102 official comment 2 (1977) ("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.").

does govern both the issuer's obligations under the issuer-customer contract[139] and the issuer's right to amend the letter of credit.[140] Comment 1 to section 5-109 states that "[t]he extent of the issuer's obligation to its customer is based upon the agreement between the two."[141] Because the letter of credit is issued specifically on the basis of the terms of the customer-issuer contract,[142] the Code demands that honor of the beneficiary's draft also be conditioned on these terms.[143] By honoring a defective draft, the issuer has not fulfilled its contractual obligations to the customer.[144] Moreover, the comments to section 5-114 expressly limit the issuer's duties to the customer to the examination of documents.[145] The issuer is not the agent of the customer;[146] no discretionary power to vary the letter is expressed or implied.[147] Thus court enforcement of issuer waiver of letter terms upon presentment is per se the enforcement, if not the creation, of a breach of the issuer-customer contract.

The Article 5 requirements for valid amendments to the letter of credit are also violated by the doctrine of substantial compliance. On the most basic level, issuer waiver of terms on presentment constitutes a unilateral modification in direct conflict with the requirements of Code section 5-106[148] and, in light of court interpretation, UCP article 3(c).[149] According to section 5-106 of the Code, the significance

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139. *Id.* § 5-109.

140. *Id.* § 5-106(2), (3).

141. *Id.* § 5-109 official comment 1.

142. Corporacion de Mercadeo Agricola v. Mellon Bank Int'l, 608 F.2d 43, 47-48 & n.1 (2d Cir. 1979); Anglo-South Am. Trust Co. v. Uhe, 261 N.Y. 150, 156-57, 184 N.E. 741, 743 (1933); *see* U.C.P. general provision and definition (b) (1974).

143. U.C.C. § 5-114(1) (1977); *see id.* § 5-109(2).

144. *See* Corporacion de Mercadeo Agricola v. Mellon Bank Int'l, 608 F.2d 43, 47-48 & n.1 (2d Cir. 1979); Chase Manhattan Bank v. Equibank, 550 F.2d 881, 886 (3d Cir. 1977); Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802, 805-06 (4th Cir. 1975); Venizelos, S.A. v. Chase Manhattan Bank, 425 F.2d 461, 465 (2d Cir. 1970).

145. U.C.C. § 5-114 official comment 2 (1977).

146. H. Harfield I, *supra* note 1, at 103-05. Unlike an agent, the issuer of a letter of credit is directly and primarily liable to the beneficiary. *Id.* at 104. Moreover, agents owe their principals a fiduciary duty while an issuer must split his loyalty between customer and beneficiary. *Id.*

147. Dulien Steel Prods., Inc. v. Bankers Trust Co., 298 F.2d 836, 840 (2d Cir. 1962). "The duties of a bank under a letter of credit are created by the document itself, the bank being deprived of any discretion not granted therein." *Id.*; *accord* Corporacion de Mercadeo Agricola v. Mellon Bank Int'l, 608 F.2d 43, 47-48 & n.1 (2d Cir. 1979); Insurance Co. of N. Am. v. Heritage Bank, N.A., 595 F.2d 171, 176 (3d Cir. 1979) (per curiam); Laudisi v. American Exch. Nat'l Bank, 239 N.Y. 234, 239, 146 N.E. 347, 348 (1924); CNA Mtge. Invs., Ltd. v. Hamilton Nat'l Bank, 540 S.W.2d 238, 240 (Tenn. Ct. App. 1975).

148. U.C.C. § 5-106(2) (1977); *see* National Bank & Trust Co. v. J.L.M. Int'l, Inc., 421 F. Supp. 1269, 1272 (S.D.N.Y. 1976).

149. U.C.P. art. 3(c) (1974); *see* KMW Int'l v. Chase Manhattan Bank, N.A., 606 F.2d 10, 16 (2d Cir. 1979) ("The issuing bank's obligation under an international

of acquiring a letter of credit is that, once established, no modification of the terms of the letter is binding absent consent.[150] At the point of establishment, "the issuer is no longer free to take unilateral action with respect to the cancellation of the credit or the modification of its terms."[151] Under the UCP, irrevocable letters of credit can be modified or cancelled only with the consent of "all parties thereto."[152] A majority of courts view a unilateral modification of an irrevocable letter of credit as legally unacceptable.[153] If allowed, the distinction between revocable and irrevocable letters of credit would be rendered meaningless.[154] Under an irrevocable credit, the issuer makes a binding promise to the customer to enforce the terms provided in the issuer-customer contract[155] and a binding promise of payment to the

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irrevocable letter of credit may not be modified without the consent of both the customer and the beneficiary."); AMF Head Sports Wear, Inc. v. Ray Scott's All-American Sports Club, Inc., 448 F. Supp. 222, 224 (D. Ariz. 1978) ("The UCP plainly requires the consent of all, not just two parties to the letter of credit.").

150. The Code specifies that "a [letter of] credit is established (a) as regards the customer as soon as a letter of credit is sent to him or the letter of credit or an authorized written advice of its issuance is sent to the beneficiary; and (b) as regards the beneficiary when he receives a letter of credit or an authorized written advice of its issuance." U.C.C. § 5-106(1) (1977); *see* Goodwin Bros. Leasing v. Citizens Bank, 587 F.2d 730, 733-34 (5th Cir. 1979) (once the letter of credit left the issuer's control it was established as regarded the customer, and the bank was thereafter powerless to modify or cancel it even though the beneficiary had yet to receive the letter). *But see* Chase Manhattan Bank v. Equibank, 550 F.2d 882, 886-87 (3d Cir. 1977) (bank empowered to modify terms of letter).

151. U.C.C. § 5-106 official comment 1 (1977).

152. U.C.P. art. 3(c) (1974). It could be argued that the customer is not a party to the letter of credit. The customer is usually not a named party to the credit instrument, nor can he legally force the issuer to honor the draft submitted by the beneficiary. Kozolchyk, *supra* note 1, at 108. Moreover, the customer is not a necessary party to an action by the beneficiary for wrongful dishonor. Housing Sec., Inc. v. Maine Nat'l Bank, 391 A.2d 311 (Me. 1978). The Maine Supreme Court has held that complete relief could be accorded the beneficiary in a case of wrongful dishonor without making the customer a party to the action. *Id.* at 316. The basis for this decision was that "[t]he issuer's obligation to the beneficiary is completely independent of both the relationship between the issuer and its customer in regard to the letter of credit and the relationship between the customer and the beneficiary on the underlying transaction." *Id.* Applying this reasoning, a court could obviate the requirement of customer consent for a valid amendment of the letter. Kozolchyk, *supra* note 1, at 108; *cf.* Chase Manhattan Bank v. Equibank, 550 F.2d 882, 886-87 & n.7 (3d Cir. 1977) (allowing issuer-beneficiary modification of a letter of credit governed by the UCP).

153. *E.g.*, Goodwin Bros. Leasing v. Citizens Bank, 587 F.2d 730, 733-34 (5th Cir. 1979); Interco, Inc. v. First Nat'l Bank, 560 F.2d 480, 483 (1st Cir. 1977); National Bank & Trust Co. v. J.L.M. Int'l, Inc., 421 F. Supp. 1269, 1272 (S.D.N.Y. 1976); *see* Barclays Bank D.C.O. v. Mercantile Nat'l Bank, 481 F.2d 1224, 1238 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974).

154. *See* Data Gen. Corp. v. Citizens Nat'l Bank, 502 F. Supp. 776, 782 (D. Conn. 1980); U.C.C. § 5-106(3) (1977).

155. U.C.C. § 5-109(2) & official comment 2 (1977); *see* Corporacion de Mercadeo Agricola v. Mellon Bank Int'l, 608 F.2d 43, 47-48 & n.1 (2d Cir. 1979); Interna-

beneficiary if these terms are met.[156] To sanction unilateral amendment of the letter of credit would destroy the certainty of payment—the raison d'être of both customer and beneficiary participation in the letter transaction.[157]

Even if the issuer waiver inherent in a substantial compliance standard is conceptualized as a bilateral modification with the beneficiary, it would be unenforceable against the customer, absent his consent, under either the UCP or the Code. All courts have interpreted the Code[158] and the UCP[159] as requiring the consent of the customer to effect a modification enforceable against him in an action for reimbursement by the issuer.

B. *Ameliorating Strict Compliance*

1. Estoppel: Curing Defective Performance Before Expiration of the Letter

Application of the strict compliance standard can be quite burdensome to the beneficiary:[160] Even trivial defects in the documentary

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tional Leather Distribs. v. Chase Manhattan Bank, N.A., 464 F. Supp. 1197, 1201 n.9 (S.D.N.Y.), *aff'd mem.*, 607 F.2d 996 (2d Cir. 1979).

156. U.C.C. § 5-114(1) (1977); *see supra* notes 13-14 and accompanying text.

157. *See supra* notes 125-26 and accompanying text.

158. *See* KMW Int'l v. Chase Manhattan Bank, N.A., 606 F.2d 10, 16 (2d Cir. 1979); Barclays Bank D.C.O. v. Mercantile Nat'l Bank, 481 F.2d 1224, 1238 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); AMF Head Sports Wear, Inc. v. Ray Scott's All-American Sports Club, Inc., 448 F. Supp. 222, 224 (D. Ariz. 1978); Dulien Steel Prods., Inc. v. Bankers Trust Co., 189 F. Supp. 922, 927 (S.D.N.Y. 1960), *aff'd*, 298 F.2d 836 (2d Cir. 1962); City Nat'l Bank v. Westland Towers Apts., 107 Mich. App. 213, 221, 309 N.W.2d 209, 214 (1981); J. Zeevi & Sons, Ltd. v. Grindlays Bank (Uganda), Ltd., 37 N.Y.2d 220, 225-26, 333 N.E.2d 168, 172, 371 N.Y.S.2d 892, 897, *cert. denied*, 423 U.S. 866 (1975); It's Devine Indus. v. Bank Leumi Trust Co., 22 U.C.C. R. Serv. (Callaghan) 130, 131 (N.Y. Sup. Ct. 1977). *But cf.* Chase Manhattan Bank v. Equibank, 550 F.2d 882, 886-87 (3d Cir. 1977) (court held that a bilateral modification between the issuer and beneficiary merely "jeopardizes [the issuer's] right to reimbursement from the customer").

159. *E.g.*, KMW Int'l v. Chase Manhattan Bank, N.A., 606 F.2d 10, 16 (2d Cir. 1979) ("The issuing bank's obligation under an international irrevocable letter of credit may not be modified without the consent of both the customer and the beneficiary."); AMF Head Sports Wear Inc. v. Ray Scott's All-American Sports Club, Inc., 448 F. Supp. 222, 224 (D. Ariz. 1978) ("The U.C.P. plainly requires the consent of all, not just two parties to the letter of credit.").

160. *See* Insurance Co. of N. Am. v. Heritage Bank, N.A., 595 F.2d 171, 175 (3d Cir. 1979) (per curiam) (court acknowledged that strict compliance can be "harsh" but posited that the beneficiary "must . . . assume responsibility for [any] unfortunate result"); AMF Head Sports Wear, Inc. v. Ray Scott's All-American Sports Club, Inc., 448 F. Supp. 222, 225 (D. Ariz. 1978) (summary judgment granted in favor of the bank even though "the conduct of the bank [was] inequitable"). If the beneficiary finds the customer's terms in a letter of credit too onerous, he may refuse it. Under the Code, "[f]ailure of the [customer] to furnish an agreed letter of credit is a breach of the contract for sale." U.C.C. § 2-325(1) (1977). Moreover, the UCP advises issuing banks to "discourage any attempt by the [customer] . . . to include excessive

draft will force dishonor.[161] He must, therefore, diligently monitor his performance if honor is to be effectuated.[162] As the party solely responsible for determining compliance, the issuer should have a concomitant obligation to facilitate the functioning of the exacting standard advocated by this Note.

In the area of issuer dishonor for documentary deficiency, the courts have begun to insist that the issuer make full disclosure of all documentary defects at the time of honor or dishonor or be estopped from raising them at trial.[163] When the issuer places dishonor on one ground, all others are waived,[164] or when the issuer is silent until the time of expiration of the credit, no non-conformity may be raised at trial for wrongful dishonor.[165] This application of equitable waiver and estoppel is premised on the beneficiary's justifiable reliance upon issuer representations as the sole indication of documentary compliance.[166]

Application of estoppel is usually conditioned upon proof that the beneficiary could have cured the defect, not raised by the issuer,

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detail." U.C.P. general provisions and definitions (d) (1974). These provisions should temper the potential for onerous documentary requirements.

161. *See supra* notes 37, 89-91 and accompanying text.

162. Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802, 805-06 (4th Cir. 1975); *see supra* notes 88-91 and accompanying text.

163. *See, e.g.*, Corporacion de Mercadeo Agricola v. Mellon Bank Int'l, 608 F.2d 43, 48-49 (2d Cir. 1979); Barclays Bank D.C.O. v. Mercantile Nat'l Bank, 481 F.2d 1224, 1236 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); Bank of Canton, Ltd. v. Republic Nat'l Bank, 509 F. Supp. 1310, 1317 (S.D.N.Y.), *aff'd*, 636 F.2d 30 (2d Cir. 1980); Data Gen. Corp. v. Citizens Nat'l Bank, 502 F. Supp. 776, 785-86 (D. Conn. 1980); U.S. Indus. v. Second New Haven Bank, 462 F. Supp. 662, 665-66 (D. Conn. 1978); *see* East Bank v. Dovenmuehle, Inc., 196 Colo. 422, 429, 589 P.2d 1361, 1366 (1978).

164. Barclays Bank D.C.O. v. Mercantile Nat'l Bank, 481 F.2d 1224, 1236 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); Bank of Taiwan, Ltd. v. Union Nat'l Bank, 1 F.2d 65, 66 (3d Cir. 1924); Bank of Canton, Ltd. v. Republic Nat'l Bank, 509 F. Supp. 1310, 1317 (S.D.N.Y.), *aff'd*, 636 F.2d 30 (2d Cir. 1980); Colorado Nat'l Bank v. Board of County Comm'rs., 634 P.2d 32, 41 (Colo. 1981) (en banc); Siderius, Inc. v. Wallace Co., 583 S.W.2d 852, 862 (Tex. Civ. App. 1979); *see* North Valley Bank v. National Bank, 437 F. Supp. 70, 74 (N.D. Ill. 1977).

165. U.S. Indus. v. Second New Haven Bank, 462 F. Supp. 662, 666 (D. Conn. 1978) ("the defendant is estopped from asserting any defense it may have had concerning non-conformity of the documentary demand for payment without calling the discrepancy to the attention of the plaintiff prior to the expiration of the letter of credit"); Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 387 F. Supp. 92, 105 (M.D.N.C.) ("the issuer cannot be permitted to deal with a beneficiary over an extended period of time, realizing a potential discrepancy exists and, in effect, lie in wait to ambush the beneficiary with this defense if the transaction goes sour"), *rev'd on other grounds*, 528 F.2d 802 (4th Cir. 1975).

166. Barclays Bank D.C.O. v. Mercantile Nat'l Bank, 481 F.2d 1224, 1236 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974); U.S. Indus. v. Second New Haven Bank, 462 F. Supp. 662, 666 (D. Conn. 1978); East Bank v. Dovenmuehle, Inc., 196 Colo. 422, 429, 589 P.2d 1361, 1366 (1978).

within the effective period of the letter.[167] If cure was not possible, the reliance was, by definition, not detrimental.[168] This standard was enunciated in *Barclays Bank D.C.O. v. Mercantile National Bank*,[169] in which the Fifth Circuit held that

> [the issuer] cannot lull [the customer] into believing that there was no problem with the documentation when there was still time for [the customer] to have attempted to cure the technical defect and then turn around and assert the lack thereof as a defense to the suit on the draft.[170]

If courts apply the standard of strict compliance, the beneficiary should be given every opportunity to meet the letter's requirements. Under a letter of credit, time is of the essence;[171] a documentary demand for payment must occur before the letter of credit expires.[172]

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167. Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank, 569 F.2d 699, 703-04 (1st Cir. 1978). In *Flagship Cruises*, the court held that "confining protestors to their stated reasons is limited to situations where the statements may have misled drawers, who could have remedied defects but relied on the statement . . . to their injury." *Id.; accord* Corporacion de Mercadeo Agricola v. Mellon Bank, Int'l, 608 F.2d 43, 48-49 (2d Cir. 1979); Wing On Bank, Ltd. v. American Nat'l Bank & Trust Co., 457 F.2d 328, 328-29 (5th Cir. 1972) (per curiam); Siderius, Inc. v. Wallace Co., 583 S.W.2d 852, 862 (Tex. Civ. App. 1979); *see* Chase Manhattan Bank v. Equibank, 550 F.2d 882, 887 (3d Cir. 1977) (court denies summary judgment due to material question of fact concerning the beneficiary's ability to prove detrimental reliance when only three hours remained to cure performance under the letter).

168. Colorado Nat'l Bank v. Board of County Comm'rs., 634 P.2d 32, 41 (Colo. 1981) (en banc). The Colorado Supreme Court held that "[t]he [beneficiary] could not have cured the defect since the presentment would have then been untimely. Consequently, the [beneficiary] did not detrimentally rely on the Bank's failure to state as one ground for its dishonor of the drafts that the [beneficiary] presented demand instruments rather than fifteen-day sight drafts." *Id.* (citations omitted); *accord* Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank, 569 F.2d 699, 703-04 (1st Cir. 1978); Chase Manhattan Bank v. Equibank, 550 F.2d 882, 887 (3d Cir. 1977).

169. 481 F.2d 1224 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974).

170. *Id.* at 1237. The court held that "§ 5-102(3) provides an adequate source for the conclusion that [the] rule of waiver may be applied in appropriate cases." *Id.* Additionally, U.C.C. § 5-104 official comment 1 (1977) states that "[q]uestions of mistake, waiver or estoppel are left to supplementary principles of law." *Id.*

171. Liberty Nat'l Bank & Trust Co. v. Bank of Am. Nat'l Trust & Sav. Ass'n, 218 F.2d 831, 840-41 (10th Cir. 1955); *see* United Technologies Corp. v. Citibank, N.A., 469 F. Supp. 473, 480 (S.D.N.Y. 1979); Hyland Hills Metro. Park & Recreational Dist. v. McCoy Enters., Inc., 38 Colo. App. 23, 26, 554 P.2d 708, 710 (1976); Banco Tornquist, S.A. v. American Bank & Trust Co., 71 Misc. 2d 874, 874-75, 337 N.Y.S.2d 489, 489-90 (1972).

172. *See* Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank, 569 F.2d 699, 703-04 (1st Cir. 1978); Chase Manhattan Bank v. Equibank, 550 F.2d 882, 887 (3d Cir. 1977); Barclays Bank D.C.O. v. Mercantile Nat'l Bank, 481 F.2d 1224, 1237 (5th Cir. 1973); Colorado Nat'l Bank v. Board of County Comm'rs, 634 P.2d 32, 41-42 (Colo. 1981) (en banc); Siderius, Inc. v. Wallace Co., 583 S.W.2d 852, 862 (Tex. Civ. App. 1979).

An equitable approach to a strict compliance standard demands that the issuer promptly communicate all documentary defects to the beneficiary, when time exists under the letter to remedy the nonconformity.[173] An obligation to invite cure of minor deficiencies in the beneficiary's draft would ameliorate the burden imposed by the strict compliance standard.

The drafters of Article 5, however, did not impose an affirmative obligation upon the issuer to inform the beneficiary of deficiencies in his documentary presentment. Section 5-112 merely provides that issuer honor or dishonor must be determined by "the close of the third banking day following receipt of the documents"[174] or a later date if the beneficiary so consents.[175] Failure to honor within this time period will be held to constitute dishonor of the draft.[176] At no point in the letter transaction, therefore, is the issuer expressly obligated to communicate the status of the letter to the beneficiary.

It could be argued that the good faith standard implied in all Code-governed transactions[177] already obligates the issuer to inform the beneficiary of any deficiency that could be remedied before the expiration of the letter. Non-communication of a curable defect would not seem to comport with the "honesty in fact" required by the Code.[178] No court has yet adopted this particular application of the good faith standard. Although by use of estoppel courts are creating a duty to inform the beneficiary of documentary non-compliance when time exists to cure,[179] an express standard would promote the efficacy of the letter of credit.

Though absent under the Code, express provision is made in the UCP for an issuer obligation to notify the beneficiary of any claim of non-conformity. Article 8 provides that if dishonor "is to be made, notice to that effect, stating the reasons therefore, must, without delay, be given by cable."[180] By requiring the issuer to promptly specify its reasons for dishonor, the UCP implicitly invites cure of any alleged deficiencies.[181] Many letters of credit provide for the applicability of the UCP,[182] and courts in such cases should recognize the issuer obligation required therein. The doctrine of strict compliance

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173. *See* U.C.P. art. 8(e) (1974); cases cited *supra* note 165.
174. U.C.C. § 5-112(1)(a) (1977).
175. *Id.* § 5-112(1)(b).
176. *Id.* § 5-112(1).
177. *Id.* § 1-203.
178. *Id.* § 1-201(19).
179. *See supra* notes 164-65 and accompanying text.
180. U.C.P. art. 8(e) (1974).
181. *See* Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank, 569 F.2d 699, 703 (1st Cir. 1978) (dictum).
182. H. Harfield II, *supra* note 1, at 3; T. Quinn, Uniform Commercial Code Commentary and Law Digest ¶ 5-101[A][1][a] (1978); J. White & R. Summers, *supra* note 6, § 18-3, at 717.

demands that the beneficiary precisely fulfill his obligations under the letter of credit; quite properly, the issuer should be required to function on the same level.

2. Customer Waiver: Excusing Defective Performance After Expiration of the Letter

When the time for performance of a letter of credit has expired, a strict compliance standard would preclude a beneficiary from curing any non-conformity, even those de minimus in nature.[183] One approach to this problem would be to require the issuer to seek a waiver of such defects from the customer.[184] If the customer waives the documentary variance, the issuer would be obligated to honor the draft as if strict compliance had been originally realized upon presentment.[185] Should the customer, for whatever reason, insist on literal enforcement of the letter's requirements, the issuer would dishonor the letter leaving the beneficiary to his rights in the underlying transaction.[186] If the beneficiary initiates an action for issuer wrongful dishonor, summary judgment should be granted in the issuer's favor.[187] This disposition could be conditioned on the issuer's produc-

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183. *See supra* notes 171-72 and accompanying text.

184. Requiring customer waiver is not a radical deviation from current letter of credit practice. Some courts already condition honor of less than strictly complying drafts upon customer waiver of the non-conformity. Corporacion de Mercadeo Agricola v. Mellon Bank Int'l, 608 F.2d 43, 46-47 (2d Cir. 1979); Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802, 806-07 (4th Cir. 1975); International Leather Distribs., Inc. v. Chase Manhattan Bank, 464 F. Supp. 1197, 1201 (S.D.N.Y.), *aff'd mem.*, 607 F.2d 996 (2d Cir. 1979); North Am. Foreign Trading Corp. v. General Elecs., Ltd., 67 A.D.2d 890, 891-92, 413 N.Y.S.2d 700, 702 (1979) (mem.); J. White & R. Summers, *supra* note 6, § 18-6, at 732-33; *see* Chairmasters, Inc. v. Public Nat'l Bank & Trust Co., 283 A.D. 704, 704-05, 127 N.Y.S.2d 806, 807 (1954) (per curiam); H. Harfield I, *supra* note 1, at 105. In fact an international survey conducted by Boris Kozolchyk found that "[a]bout 20 per cent of the [issuers responding] to the Questionaire indicated that they consulted their customers to determine whether to accept irregularities." Kozolchyk, *supra* note 1, at 81 & n.451.

185. *See* Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank, 528 F.2d 802, 807 (4th Cir. 1975); International Leather Distribs. v. Chase Manhattan Bank, 464 F. Supp. 1197, 1201-03 (S.D.N.Y.), *aff'd*, 607 F.2d 996 (2d Cir. 1979); North Am. Foreign Trading Corp. v. General Elecs., Ltd., 67 A.D.2d 890, 891, 413 N.Y.S.2d 700, 702 (1979) (mem.).

186. J. White & R. Summers, *supra* note 6, § 18-6, at 728; *see, e.g.*, Corporacion de Mercadeo Agricola v. Mellon Bank Int'l, 608 F.2d 43, 47 (2d Cir. 1979); Sisalcords Do Brazil, Ltd. v. Fiacao Brasileria de Sisal, S.A., 450 F.2d 419, 422 (5th Cir. 1971), *cert. denied*, 406 U.S. 919 (1972); Far E. Textile, Ltd. v. City Nat'l Bank & Trust Co., 430 F. Supp. 193, 195-96 (S.D. Ohio 1977); *cf.* Insurance Co. of N. Am. v. Heritage Bank, N.A., 595 F.2d 171, 173 (3d Cir. 1979) (per curiam) (customer right to sue on the underlying transaction if the goods delivered are non-conforming).

187. West Virginia Hous. Dev. Fund v. Sroka, 415 F. Supp. 1107, 1110 (W.D. Pa. 1976). "Liability on the letter of credit presents solely *legal* issues and thus can be

tion of an affidavit reflecting the customer's refusal to waive the noncompliance. In effect, absent customer waiver, dishonor due to less than strict compliance will extinguish all of the issuer's obligations under the letter of credit.[188]

Under present law, however, a customer has no good faith obligation to waive an immaterial deficiency in a beneficiary's documentary draft. Unfortunately, customers have a propensity to find deviations in the documentary presentment when a sharp decline in the market price of the goods purchased occurs, or when the customer becomes insolvent.[189] At least one defect in a draft can usually be isolated by a thorough examination.[190] To eliminate this possible abuse of the strict compliance standard, it is proposed that a provision be added to Article 5 to confer a remedy upon the beneficiary in cases of bad faith customer refusal to waive insignificant terms of the letter of credit. When litigating the underlying contract, the beneficiary could then raise this provision as a preliminary matter for adjudication, and if this claim were substantiated, it would be determinative in an action for the price. Although every contract or credit under the Code contains an implied good faith obligation,[191] a bad faith waiver provision would ensure court acknowledgement and control of the possible abuses inherent in the doctrine of strict compliance.

CONCLUSION

The right to enforce absolutely the express terms and conditions of a letter of credit, without reference to the equities of a particular case, has long been recognized as essential to the utility of this financial instrument. When parties provide for a letter of credit, their mutual

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disposed of by the court on a motion for summary judgment." *Id.* (emphasis in original); *see, e.g.*, Bossier Bank & Trust Co. v. Union Planters Nat'l Bank, 550 F.2d 1077, 1078 (6th Cir. 1977) (per curiam); Barclays Bank D.C.O. v. Mercantile Nat'l Bank, 481 F.2d 1224, 1226 (5th Cir. 1973), *cert. denied*, 414 U.S. 1139 (1974); Venizelos, S.A. v. Chase Manhattan Bank, 425 F.2d 461, 463 (2d Cir. 1970); Dulien Steel Prods., Inc. v. Bankers Trust Co., 298 F.2d 836, 837 (2d Cir. 1962); Beathard v. Chicago Football Club, Inc., 419 F. Supp. 1133, 1136 (N.D. Ill. 1976) (mem.); *cf.* Dovenmuehle, Inc. v. East Bank, 563 P.2d 24, 27 (Colo. Ct. App. 1977) (evidence offered by issuer to prove the intent of the parties to the letter of credit was excluded), *aff'd*, 196 Colo. 422, 589 P.2d 1361 (1978) (en banc). *But see* Chase Manhattan Bank v. Equibank, 550 F.2d 882, 887 (3d Cir. 1977) (denial of summary judgment where detrimental reliance upon an issuer waiver was a material question of fact).

188. Corporacion de Mercadeo Agricola v. Mellon Bank Int'l, 608 F.2d 43, 47-48 & n.1 (2d Cir. 1979); *see supra* notes 171-72 and accompanying text.

189. Kozolchyk, *supra* note 1, at 82.

190. 1 A. Lowenfeld, *supra* note 1, § 5.55(d), at 106 (citing G. Gilmore & C. Black, *supra* note 56, at 120); *accord* State of N.Y. Law Revision Comm'n, *supra* note 85, at 66-67, *reprinted in* 1955 Report, *supra* note 85, at 1634-35.

191. U.C.C. § 1-203 (1977).

intention is to limit the risks of their transaction by channelling performance through an independent third party. It is inconsistent with the expectations of the parties and the proper functioning of the letter to inject discretion into the issuer's performance. The importance of the traditional strict compliance standard to letter of credit law has not been obviated by the passage of time or the introduction of equitable considerations into commercial law. "Just as good" is still just not good enough.

Letter of credit law, of course, should not ignore either the frailties of human nature or the realities of the market place. By allowing issuers or customers to defeat a letter on the basis of trival defects, a standard of strict compliance will, perforce, breed the controversies it is designed to avoid. A solution to the problem of minor documentary non-compliance, however, can be achieved within the confines of the traditional strict compliance standard. By imposing affirmative obligations on all three parties to the letter transaction, minor deviations can be cured by the beneficiary or excused by the customer so as to facilitate the proper functioning of the letter of credit mechanism. By adopting this approach, courts can reduce the litigation in this area and provide the financial community with a standard under which letters of credit can flourish.

Jonathan D. Thier