Influence of International Practice on the Revision of Article 5 of the UCC

James J. White
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The topic of this symposium is the influence that international law has had on domestic law of the United States. I believe that the story of the revision of Article 5 of the Uniform Commercial Code fits here, but some might dispute that. Although it is certainly fair to say that international practice—in a sense international law—was a powerful influence on the revision of Article 5 of the Uniform Commercial Code, that practice, and the way in which that influence was exerted were almost entirely *sui generis* to the letter of credit law, practice and history.

I focus today on the influence of the Uniform Customs and Practice¹ (UCP) on the revision of Article 5 of the Uniform Commercial Code (UCC). The Uniform Customs and Practice constitute international or transnational law, but unique law. Let me explain. First is the question whether trade practice adopted by a group such as the International Chamber of Commerce constitutes law. If one adopts Justice Holmes' definition of law—what influences courts—and particularly if one agrees that the real law of any transaction is the contract between the parties, the UCP are clearly law. The UCP are incorporated in a large percentage of all letters of credit in the United States and in other countries. As incorporated, they become part of

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¹ Except where otherwise stated, all references are to UCP 500 adopted by the International Chamber of Commerce in 1993 and “in force as of January 1, 1994.”
the letter of credit engagement and rule the parties' obligations more fully than law enacted by any legislature could. As a legal realist, I happily classify such a trade practice as law even though it has never been adopted by the legislative body of any state.

Even admitting that the UCP are law, they are still unusual. They arose as domestic American practice initially drafted by representatives of New York banks and adopted to govern those banks' behavior in letter of credit transactions. Only in their third incarnation did the UCP acquire an international fragrance—from their acceptance by the British, and their adoption by the International Chamber of Commerce in Paris.

The UCP had an enormous influence on the revision of Article 5. Nothing else, not American common law, local practice, the law of another country, or even the UNICTRAL draft, had anything like the influence the UCP had. In fact, the UCP may have had a greater influence on the redraft of Article 5 than existing Article 5 of the UCC.

To understand the background of the negotiations that took place over the revision of Article 5, one should know a little of the history of Article 5. The debate between the drafters of the revision and the U.S. Council on International Banking, Inc. (the bankers) was a repetition of the same debate that took place—particularly in New York—at the time of original adoption of the Uniform Commercial Code. Then, as

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5 The U.S. Council on International Banking, Inc. (the USCIB) is a trade association that represents more than 350 banks that are involved in international banking operations. A primary focus of members is the issuance of letters of credit. The credits issued by its members make up more than 80 percent of the credits issued by banks in the United States. The USCIB is also the American representative to the International Chamber of Commerce for the drafting of revisions to the Uniform Customs and Practice. Several representatives of the USCIB attended most of the meetings of the Article 5 Drafting Committee. Dan Taylor, the President of the USCIB attended all or almost all of the meetings. Dennis Noah and Vincent Maulella, chairmen of the USCIB at different times during the drafting process, also attended many of the meetings.

6 One gets a taste of the debate between bankers and drafters that went on in 1954 by reading the conclusion of the report of the subcommittee of the New York Clearing House Association on Article 5. That report was delivered by Mr. O'Halloran, Vice President of Manufacturer's Trust at the April 20, 1954 hearings of the New York Law Revision Commission:

In summary, the Subcommittee of the New York Clearing House Association has found that Article 5 contains a number of ambiguities, a number of conflicts with existing custom and practice and several very undesirable changes in the principles of letters of credit, and that as written, and apart from other reasons, the proposed Article is not satisfactory. Apart
today, the banks were protective of the UCP, skeptical of the lawyer drafters, and slow to concede that clear statutory law might help instead of hurt.

Although Article 5 was adopted by every state of the United States, the opponents maimed Article 5 in New York, our most important letter of credit jurisdiction. At the opponents' insistence, New York adopted a nonuniform section 5-102(4) that reads in full as follows:

(4) Unless otherwise agreed, this Article 5 does not apply to a letter of credit or a credit if by its terms or by agreement, course of dealing or usage of trade such letter of credit or credit is subject in whole or in part to the Uniform Customs and Practice for Commercial Documentary

from the unsatisfactory features of Article 5, we have concluded that it is highly undesirable for any one or more states to attempt legislation in this particular area of trade and finance. The Banks which are members of this Subcommittee have very active and very large letter of credit departments and close contact with trade and business here and abroad which use the letter of credit device. We know of no demand or need for legislation and it is our experience that the institutions and persons who use documentary letters of credit are for the most part thoroughly familiar with this financing medium and with its terms, customs and practices.

The proposed Article deals with only a very small area in the letter of credit field and even were it to be so limited and to correctly state recognized customs and practices here and abroad, we feel that legislation would inevitably lead to rigidity. The usefulness of the letter of credit device depends upon its flexibility and adaptability to many kinds of transactions and developing trade practices in this country and abroad. We feel that banks and businesses which engage in letter of credit transactions must deplore any attempt to crystallize by statute the device and the related customs and practices. Finally, since letters of credit involve, in the main, international and interstate transactions, involving a number of parties and institutions, we believe that the opportunities for conflicts of laws and for misunderstandings and controversies between parties would be greatly augmented by attempted legislation in this field by one or more states in this country and that the ability of banking institutions in such states to furnish this important service to world-wide trade and business would be seriously impaired.


In her 1956 Chicago Law Review article, Professor Mentschikoff, the associate reporter for the UCC, responds with a bit of sarcasm as follows:

Of recent years, largely as a result of opposition by a few New York banking counsel to the inclusion in the Uniform Commercial Code of an article on documentary letters of credit, a number of myths have arisen and by virtue of constant repetition by this small but vocal group have gained considerable credence. This paper will examine the nature and validity of these myths:

Myth 1.—Practices and customs as to international documentary letters of credit are uniform
(a) among nations
(b) among banks in this nation.

Myth 2.—The law of letters of credit has become
(a) clear
(b) well settled
(c) known to bank, merchant, bar and bench
(d) uniform among states
(e) probably uniform among nations

Myth 3.—Domestic use of letters of credit is and will remain non-significant.

Credits fixed by the Thirteenth or by any subsequent Congress of the International Chamber of Commerce.\(^7\)

Identical nonuniform sections were later added in Alabama, Arizona, and Missouri.\(^8\)

The nonuniform amendment in New York greatly reduced the influence of Article 5 there, but did not eliminate it.\(^9\) Because the courts of New York have looked to Article 5 in cases where the UCP do not specifically direct otherwise, Article 5 has probably had an impact on decisions in New York and the New York common law. Moreover, the fact that courts in forty-six of the fifty states are bound by Article 5 and produce decisions governed by Article 5 has meant that New York courts looking elsewhere for guidance find guidance influenced by Article 5 as enacted in other states.

The stimulus for the revision of Article 5 was a study done by the Task Force on the Study of Uniform Commercial Code Article 5. The task force was appointed by the Chairman of the American Bar Association Letter of Credit Subcommittee. The study is published as a monograph, "An Examination of U.C.C. Article 5 (Letters of Credit)," in the June 1990 edition of the Business Lawyer.\(^10\) In some cases the Task Force endorsed particular positions. In the most controversial cases it merely raised the issues, reported the opposing arguments and stated that no agreement was reached.\(^11\) Nevertheless,\


\(^8\) ALA. CODE § 7-5-102(4) (1993); ARIZ. REV. STAT. ANN. § 47-5102(d) (1988); MO. ANN. STAT. § 400.5-102(4) (Vernon 1994).


\(^11\) In the following cases the Task Force failed to come up with a consensus opinion on how to deal with a particular problem. The section numbers in brackets refer to sections in the Task Force Report. With regard to U.C.C. § 5-102, the Task Force did not reach a consensus of what should be the consequences if nondocumentary conditions are present in a document purporting to be a letter of credit [§ 2]. On the same section, the Task Force could not reach consensus on
deliberations and discussions in the Task Force caused various persons who later would be involved in the revision of Article 5, to stake out particular positions, reject others, and perhaps even to feel some antipathy that would later infect the deliberation of the Article 5 drafting committee.\(^\text{12}\)

The suspicion between the advocates of the UCC and others that resulted in the nonuniform New York amendment more than forty years ago persisted, and in some ways intensified, after the appointment of the drafting committee for the revision of Article 5. Since I was not a part of the ABA Task Force, I was only dimly aware of the potential disputes between the lawyer drafters, on the one hand, and the banks, on the other. As reporter for the revision, I entered the process as a thorough naïf.

Shortly after my appointment I learned that the USCIB was concerned that a person unknown to them had been appointed. Since I had no position on any of the disputed issues, I was surprised to be the object of opposition. Concerned about the same issues that had divided the parties forty years before, and perhaps bothered by some of the things that had happened during deliberations of the ABA Task Force, the USCIB wanted a reporter familiar with and sympathetic to

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\(^{12}\) For example, the dispute about warranties \([\text{§ 24}]\) continued in the Article 5 Drafting Committee.
its interests, as expressed in the UCP. My unbiased ignorance was not enough.

Only after several meetings of the drafting committee did the concern of the USCIB become obvious to me. They were deeply suspicious of me and of the entire drafting committee. Doubtless they saw ulterior motives in many of the proposals that I put on the table quite innocently as an uninformed law professor. Between 1991 and 1993 the revision went through several drafts, each of which was greatly modified and each of which was presumably quite unsatisfactory to the USCIB representatives. Mostly the USCIB representatives expressed displeasure; they seldom put forward specific alternative proposals.

At the drafting meeting of February 1993, the USCIB sent the Commissioners the letter that is quoted in the footnote. The letter was properly construed to be an ultimatum and it rightly concerned the Commissioners. The Commissioners understood that the USCIB could probably block the adoption of any revision proposed without their participation or agreement. The need for uniformity—i.e. for adoption of its product by every state legislature if it is truly to be "uniform"—greatly weakens the bargaining position of the Commissioners on Uniform Laws—at least against an opponent who understands that.

In direct response to the negotiations that grew out of that letter, the USCIB appointed James G. Barnes, a Chicago lawyer, as their counsel. Thereafter many of the draft revisions arose out of bilateral negotiations between me, as representative of the Commissioners and Jim Barnes, as representative of the USCIB.

A. Influence of the UCP on Article 5

The disputes of forty years ago and those aired in the ABA Task Force between 1986 and 1990 made the USCIB alert, active and more than a little suspicious. Several representatives of the USCIB attended and participated in every meeting of the drafting committee. Their plausible threat to withdraw and their later appointment of Jim Barnes as their counsel was properly construed to be an ultimatum and it rightly concerned the Commissioners. The Commissioners understood that the USCIB could probably block the adoption of any revision proposed without their participation or agreement. The need for uniformity—i.e. for adoption of its product by every state legislature if it is truly to be "uniform"—greatly weakens the bargaining position of the Commissioners on Uniform Laws—at least against an opponent who understands that.

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A. Influence of the UCP on Article 5

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13 The last paragraph of the February 24, 1993 USCIB letter addressed to Fred Miller, Executive Director, NCCUSL, and signed by Dennis L. Noah, Chairman, and Dan Taylor, President, of USCIB read as follows:

We have decided that further participation in the current process would be pointless and are prepared to make public a detailed explanation of our position in due course. We will be present at the upcoming meeting solely in an observer capacity. Should you so desire, we are prepared to discuss our position.

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Barnes as their spokesperson and negotiator further enhanced the influence of the USCIB.

The upshot is that the Uniform Customs and Practice—the international rules of custom and practice that are promulgated by the International Chamber of Commerce and drafted with the participation of the USCIB among others—had an influence on almost every change in Article 5. Many of those changes would have been adopted without the presence of the UCP or their advocates because those changes would have been dictated by American practice in any event, but I can identify at least seven times where the UCP or their advocates took one position and a substantial number of advisers and committee members took another. The UCP had various degrees of influence on each of these seven items, but it is fair to say that each one of them would have been treated differently in the statute and comments had the USCIB representatives not been at the meetings to urge the UCP rules.

The seven points follow:

1. definition of honor;
2. incorporation of the standard practice and reference in the choice of law provision of Article 5 to the UCP;
3. the elimination of any references in Article 5 to ordinary care and omission—except in unusual cases—of any rules that bar modification of statutory rules;
4. substantial restrictions on assignment of proceeds, on transfer of other rights under a letter of credit, voluntarily and involuntarily;
5. the omission of any specific duties imposed on nominated parties;
6. restriction of the definition of good faith;
7. warranties given to the issuer and applicant by the beneficiary.

I consider the seven issues in order.

1. Honor

Section 1-201(21) generally defines honor:

To 'honor' is to pay or to accept and pay, or where a credit so engages to purchase or discount a draft complying with the terms of the credit. Should honor be considered to have occurred at the time the issuer accepts a time draft or should the letter of credit not be considered "honored" until both acceptance and payment of the accepted draft

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14 Article 3 of the U.C.C. defines dishonor in Section 3-502, but does not define honor.
have occurred? The latter conclusion sustains Article 5 liability until an accepted draft has been paid. Under the former conclusion any Article 5 liability is satisfied by acceptance and the beneficiary is then left with an Article 3 claim on the accepted draft but with no claim under Article 5.

The UCP provide that honor does not occur until an accepted draft has been paid\(^{15}\) and the UCP advocates argued successfully that that definition should be incorporated in revised Article 5. The definition in revised Article 5 reads in full as follows:

"Honor" of a letter of credit means performance of the issuer's undertaking in the letter of credit to pay or deliver an item of value. Unless the letter of credit otherwise provides, "honor" occurs:

(i) upon payment
(ii) if the letter of credit provides for acceptance upon acceptance of a draft and, at maturity, its payment, or
(iii) if the letter of credit provides for incurring a deferred obligation, upon incurring the obligation and, at maturity, its performance.\(^{16}\)

The legal consequences of choosing one as opposed to another of the two times for honor are subtle, possibly insignificant, but the issue was a topic of repeated and long debate in the Committee. In fact, the issue was one of the rawest points of debate, not because of its significance, but because the USCIB's arguments failed to persuade some of their strongest opponents, and the USCIB had to depend upon their power to achieve their wish when reason seemed to give them no edge.

Arguing for the more traditional definition of honor (and the one I favored as most consistent with other law), Henry Harfield suggested that it was sensible, logical and neat to say that a letter of credit obligation had been satisfied when the draft was accepted. He argued that the parties should thereafter be treated as having a contractual relation (on the acceptance) of the kind embodied by Article 3 and no other. In his view, that idea comported both with the law under Article 3 and with the expectation of the parties.\(^{17}\)

But what legal difference does it make? Under the revised Code there could be a considerable difference. The first and most troublesome problem is the question whether honor can be "enjoined" under Article 5 after acceptance. If honor has already occurred on acceptance, obviously it can no longer be enjoined and anyone wishing the

\(^{15}\) U.C.P. art. 9(a)(ii) & (iii) (1993).
\(^{16}\) § 5-102(a)(8)(revised). Cites to the existing code are marked "(1989)."
\(^{17}\) Memorandum from Henry Harfield to Professor James J. White, University of Michigan Law School, dated November 2, 1993.
issuer not to pay must proceed through a more difficult thicket in Article 3 to have payment of the draft enjoined, an almost unheard of event.

That issue was dealt with by section 5-109.\textsuperscript{18} In effect that section says that there will be no injunction if the person seeking the injunction could not get one against an acceptor under Article 3. Many are not satisfied with that outcome—particularly those in California who would amend section 5-109 to provide that no injunction is possible after acceptance of a draft.

Because revised Article 5 has its own remedies that bar consequential damages, but permit recovery of costs and lawyers' fees, the remedies available to one suing under Article 3 might be different from those available to a plaintiff under Article 5. That is less the case under existing Article 5 where there is no provision for lawyers' fees and no explicit statement about costs.

Another potential legal difference arising out of the definition of honor lies in the power of the acceptor to assert defenses of the applicant against the beneficiary. Those defenses would be clearly foreclosed to the issuer in a suit under Article 5. That, after all, is the whole idea of Article 5. Under Article 3 the same is probably true, but less clearly so.\textsuperscript{19}

Additional legal consequences might flow from the differing statutes of limitations under Article 3 and Article 5. Under revised Article 5 a suit for wrongful dishonor must be brought within one year of the dishonor. On the breach of an acceptance, the party would have six years under section 3-118(a) to sue on the acceptance. Since Article 5 overrides other articles when they conflict, arguably the one-year statute, not the six-year statute, would govern if both Articles 3 and 5 applied.\textsuperscript{20}

In any event, the UCP provide that honor does not occur until the acceptance has been paid. The drafting committee agreed to a

\textsuperscript{18} U.C.C. § 5-109(b)(1).

\textsuperscript{19} For example, if the acceptor now can argue that it is effectively an "accommodation party," it could raise an applicant's defenses under U.C.C. § 3-305(d) (1989) in the suit on the acceptance. I do not believe that the issuer who has become an acceptor is an accommodation party, but I would not be embarrassed to make that argument. If the acceptor is not an accommodation party, U.C.C. § 3-305(c) (1989) generally cuts off its right to raise the applicant's defense even if it joins the applicant as a co-defendant. See also § 3-418(c) (1989).

\textsuperscript{20} Of course, the payee on the draft would argue that there was no conflict here and would argue that its cause of action under Article 3 survives even in circumstances in which its Article 5 cause of action had been cut off.
similar term though, in my view, it was never quite persuaded of the wisdom of that decision.

2. Standard Practice, Choice of Law

An important symbolic concession made to the UCP that may ultimately have significant consequences is the explicit reference to standard practice and implicit reference to the UCP in several sections of revised Article 5. Most important is revised section 5-108(e) that reads in part as follows:

An issuer shall observe standard practice of financial institutions that regularly issue letters of credit.

Section 5-108(a) specifically incorporates the standard practice and tells courts that they should listen to and follow the standard practice of banks. The most widely known and authoritative statement of that practice today is the Uniform Customs and Practice.

Section 5-108(e) is largely symbolic, for Article I authorizes modification by agreement of terms in all of the articles of the UCC. Since any incorporation of the UCP is an enforceable agreement to abide by the UCP, it is unclear that section 5-108’s specific reference and incorporation has any direct legal consequence. Nevertheless, the reference was important to the advocates of the UCP, and it may encourage courts to listen more closely to bank practice and to take the UCP more seriously.

Even more symbolic than the reference in section 5-108 is the reference in section 5-116; the latter specifically allows an incorporated practice to override the law except where the law is not variable. This section does not change the substantive law under Article 5, but even in the later stages of drafting, the inference from section 5-116 that the UCP was “law” continued to be the subject of dispute.²¹

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²¹ An April 28, 1994 letter to Fred Miller from Donald J. Rapson reads:

Dear Fred:

Thanks for your letter of April 21, 1994. I remain concerned.

You indicate that proposed § 5-115(b) [Until August 1994, section 5-116 was 5-115 ed.] does no more than implement § 1-102(3) in allowing the parties to vary the statute by agreement. You say this “requires an affirmative agreement”. Section 5-115(b), however, provides that the UCP will “govern the liability of an issuer” if “the letter of credit *** is expressly made subject” thereto. It says nothing about an “agreement”, affirmative, express or otherwise.

What and whose agreement are you referring to? The issuer with the applicant or with the beneficiary or both? How then would the agreement of the applicant be manifested? How would the agreement of the beneficiary be manifested? Is the thought that the beneficiary “agrees” unless it rejects the L/C? Suppose the beneficiary objects. Is there still an agreement? If the beneficiary does nothing, is there an agreement by its inaction or silence?

As a practical matter, many banks will (as they do now), put “subject to UCP” clauses in the printed boilerplate of the L/C. It seems to me that proposed § 5-115(b) will work,
Notwithstanding aesthetic objections to a redundant blessing of contractual modification in one article of a code whose Article 1 already invites such modification in all articles of the code, the explicit reference may have a salutary effect. Surely the courts should be sensitive to and should encourage banks and other players in the letter of credit arena to follow the practice norms. Where the big boys play with a rigid and hard-edged set of rules, the law should follow those rules—here even more than elsewhere in commercial law. Thus, to the extent that the explicit reference to practice in sections 5-108(a) and (e) causes courts to recognize that practice where they would not otherwise do so, it will be desirable, even if not pretty. I am more dubious of the explicit reference in section 5-116, but I doubt even that reference will hurt.

3. Freedom of Contract, Removal of Nonvariable Terms

Related to the symbolic argument over the incorporation of practice is the more important and practical question: what elements of Article 5 can be modified by agreement? Section 1-102(3) generally authorizes variation of the UCC by agreement, but it warns "that the obligation of good faith, diligence, reasonableness and care prescribed by this act may not be disclaimed by agreement . . . ." Of course, section 1-203 adds good faith to all Code obligations; accordingly, good faith modifies every obligation of an issuer or any other party under Article 5.

Due care is explicitly mentioned in only one place in existing Article 5. Section 5-109(2) states that an issuer must examine docu-
ments “with care.” The banks were concerned about the disclaimability of this obligation of care under section 1-102(3) and were anxious to have it removed so that parties could contract about the kind of documentary inspection they wished to undertake without fear of section 1-102(3)’s interference. They wanted assurance that agreements concerning idiosyncratic documentary examination would not founder on a due care obligation. Banks were understandably nervous about clauses in their reimbursement agreements that allowed them to recover against their applicants even if they had been negligent as long as they had not been “grossly negligent,” and had not acted in bad faith. (Although no one ever said as much at our meetings, I suspect that bank lawyers tell their clients that those terms will probably not override the due care requirement in section 5-109(2).)

The drafters agreed to take out the reference to due care, but they restricted the power of the issuer in the reimbursement agreement to disclaim its liability:

A term in an agreement or undertaking generally excusing liability or generally limiting remedies for failure to perform obligations is not sufficient to vary obligations prescribed by this article.

The section is backed up by the following Comment to section 5-103:

Neither the obligation of an issuer under Section 5-108 nor that of an adviser under Section 5-107 is an obligation of the kind that is invariable under Section 1-102(3). Section 5-103(c) and Comment 1 to 5-108 make it clear that the applicant and the issuer may agree to almost any provision establishing the obligations of the issuer to the applicant. The last sentence of subsection (c) limits the power of the issuer to achieve that result by a nonnegotiated disclaimer or limitation of remedy.

What the issuer could achieve by an explicit agreement with its applicant or by a term that explicitly defines its duty, it cannot accomplish by a general disclaimer. The restriction on disclaimers in the last sentence of subsection (c) is based more on procedural than on substantive unfairness. Where, for example, the reimbursement agreement provides explicitly that the issuer need not examine any documents, the applicant understands the risk it has undertaken. A term in a reimbursement agreement which states generally that an issuer will not be liable unless it has acted in “bad faith” or committed “gross negligence” is ineffective under section 5-103(c). On the other hand, less general terms such as terms that permit issuer reliance on an oral or electronic message be-

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23 Ironically, there is a reference to due care in Article 13a of the UCP:
Banks must examine all documents stipulated in the Credit with reasonable care to ascertain whether or not they appear on their face to be in compliance with the terms and conditions of the Credit.

24 U.C.C. § 5-103(c).
lieved in good faith to have been received from the applicant or terms that entitle an issuer to reimbursement when it honors a "substantially" though not "strictly" complying presentation, are effective. In each case the question is whether the disclaimer or limitation is sufficiently clear and explicit in reallocating a liability or risk that is allocated differently under a variable Article 5 provision.

The issuer and the applicant can agree to any rule on documentary examination, but the issuer must be forthcoming with its applicant. Courts will and should pay little respect to disclaimers in general terms particularly to those buried in the fine print of a reimbursement agreement.

The language of section 5-103 and of the comment were the subject of more than a year of discussion and negotiation. The representatives of applicants and beneficiaries were not concerned with disclaimers or limitations of liability in letters of credit or confirmations. They believed that the market would control the form and content of such public documents. The market will probably not tolerate a letter of credit that contains an explicit disclaimer of the issuer's liability. On the other hand, the representatives of applicants were fearful of losing the edge given by the due care requirement. Noting the due care requirement in section 5-109 and its nonvariability (because of section 1-102(3)), applicants rightly concluded that the common terms in reimbursement agreements that disclaimed liability for all but "gross negligence" were probably unenforceable under the UCC. With the removal of "due care" from section 5-109, they feared disclaimers (unfettered by section 1-102 because they would not be disclaiming a duty of care) would undercut the issuer's strict responsibility stated in section 5-108(a).

The applicants' quid pro quo for abandoning the due care requirement was some other protection against expansive disclaimers in the reimbursement agreement. That protection is the last sentence of section 5-103(c) and the comments that augment it. Here the language both of the statute and the comment were carefully negotiated, almost word by word. The key point is that the restriction in section 5-103(c) "is based more on procedural than on substantive grounds." Applicants are rational business people, sometimes powerful rational business people. The draft demands only that the issuer make clear to the applicant what the issuer proposes to do. As the comments indicate, the parties are perfectly free to agree that the issuer will not examine documents at all (we were told that one national retailer makes such an agreement now in certain circumstances with a Chicago bank) or that examination be by electrical-optical means only.
The language is intended to discourage issuers from immunizing their mistakes by obscure or general disclaimers that might not be understood or observed by an applicant who might too swiftly sign a reimbursement agreement containing fine print.

I hope that issuers who consciously avoid open negotiation of their responsibilities with their applicants and who rely instead on boilerplate disclaimers will have some anxiety about how a court might later treat such an agreement. Here I think it inappropriate for the law to give in to the general counsel's wish for certainty.

4. Restriction on Assignment of Proceeds and Transfer of Letters of Credit

Existing section 5-116 is inconsistent with bank practice and with issuers' conception of their obligations when a beneficiary wishes to transfer its rights under a transferable letter or to assign its rights to proceeds under a nontransferable letter of credit. In the latter case beneficiaries may think they are entitled to assign proceeds—without the concurrence of the issuer. Issuers, on the other hand, seem to believe they need not honor such assignments of proceeds unless (1) the assignor (not the assignee) presents the documents to the bank, (2) the assignment is on the form of and (3) with the concurrence of the bank. Section 5-116 appears to grant the right to the beneficiary to assign proceeds without the consent of the issuer, and implicitly, to require the issuer to recognize the assignment.25

Article 48 of the UCP contains an elaborate set of rules on transferable credits. Article 48c explicitly grants the "transferring bank" the right to refuse to transfer: "[the] . . . bank shall be under no obligation to effect such transfer except to the extent and the manner expressly consented to by such bank."

In a section that was apparently stimulated by existing section 5-116, Article 49 of the UCP appears to endorse existing law on assignment of proceeds: "the fact that a Credit is not stated to be transferable shall not affect the Beneficiary's right to assign the proceeds to which he may be, or may become, entitled under such credit in accordance with the provisions of the applicable law." One might bend Article 49 to require a bank to recognize any assignment of proceeds that complies with applicable law, but the Article does not quite say so, and issuers would not so read it.

As indicated above, some banks interpret the UCP and the UCC to permit them to refuse to recognize all assignments of proceeds. Revised sections 5-112 and 5-114 essentially adopt the issuing banks' position. They remove the contrary inference that now exists in section 5-116 (i.e., that the beneficiary has a unilateral right to assign proceeds and that the issuer must recognize that assignment even if it does not agree to it). The new sections also grant considerable control to the issuer both in cases of transfer of a transferable letter of credit and in the assignment of proceeds.

Earlier drafts required issuing banks to recognize assignment of proceeds, at least where they had been properly notified of the assignment. But the contrary arguments ultimately prevailed. The banks emphasized their need for clarity and certainty about the identity of the legitimate payee. In an argument that cut both ways, they reported that assignment of proceeds were infrequent and were routinely authorized by issuing banks—at least if the assignor made out the appropriate documents and paid the appropriate fee.

The arguments on the other side were made mainly by lawyers who represent banks as lenders. When banks are lenders, they often seek assignments of letter of credit proceeds as security. In that role, the banks would like to be able to take an assignment of proceeds that would have to be recognized by the issuer—even in circumstances where they have not signed the issuer's assignment documents or paid a fee. So, we had the unusual debate where one group of bank representatives (purporting to represent banks and other lenders' interests as secured creditors) were pitted against another group also speaking for banks (but as issuers of letters of credit). The issuers' position prevailed and the revised rules give an issuer more control over the transaction and more comfort in declining to recognize a disfavored assignment than they would enjoy under the current UCC.

Whether this is the most sensible outcome or whether it is merely a recognition of which wing of the banks was most heavily represented at the bargaining table, I am uncertain. If the data presented at the table about the number and type of assignments of proceeds was accurate, and particularly if issuers' willingness to recognize assignments is as represented, the changes from section 5-116 to revised sections 5-112 and 5-114 will be insignificant.

Left to my own devices, I would have favored a rule on assignments similar to the analogous rule in section 9-318. Under section 9-318, an account debtor must recognize any assignment of which it is properly notified. It was not to be.
5. Duties of Nominated Parties

The existing Code is silent on the rights and obligations of nominated parties. The UCP give nominated parties the same obligations that confirmers and issuers have upon presentation, but free nominated parties from the penalties that issuers and confirmers suffer if they do not conform to those obligations. To understand the problem, consider a case. Assume that a Japanese bank issues a letter of credit to a small Illinois Manufacturer. The Manufacturer goes to First Chicago as a nominated bank (one authorized to pay or otherwise give value by the letter of credit). As the nominated bank, First Chicago will typically examine the documents when they are presented by the beneficiary (Manufacturer) and, if there are defects in the documents, will inform the beneficiary. In some cases, the nominated bank may even advise the beneficiary how to produce conforming documents. The Chicago bank may charge a fee for its service. To the unsophisticated Illinois beneficiary the transaction that occurs at First Chicago may seem identical to what would have happened had it presented directly to the issuer. If First Chicago fails to discover a defect that causes the presentation to be dishonored by the Japanese bank when the documents are presented there, the beneficiary will be just as unhappy as if First Chicago had been a negligent confirmer or issuer.

I thought that a nominated bank that takes up the documents should have the same obligation as an issuer or confirmer. The early drafts so provided. The USCIB opposed the imposition of preclusion or other sanctions on nominated persons who failed to discover discrepancies, and it was successful in getting all the statutory responsibilities on non-confirmer nominated persons removed from the later drafts of revised Article 5.

Like the UCP, revised Article 5 does not punish nominated parties for failure to discover defects or failure to give notice of defects. Revised Article 5 is even weaker than the UCP, for it omits even the hortatory provisions of the UCP telling nominated parties that they "should" be careful to examine the documents and "should" give notice of any defects.

26 U.C.P. art. 14.
27 U.C.P. arts. 14b, 14d. Note that arts. 14b and 14d list duties for issuing, confirming and nominating banks, but art. 14e imposes liability for failure to perform these obligations only on issuing and confirming banks. Of course, a nominated bank that misbehaves might have contract or tort liability from outside the U.C.C.
6. Good Faith

Under section 1-201(19) "good faith" means honesty in fact in the conduct or transaction concerned. The revisions to Articles 3 and 4 have incorporated a broader definition of good faith: "'Good faith' means honesty in fact and the observance of reasonable commercial standards of fair dealing." In part as a result of the USCIB opposition (there is no similar obligation under the UCP), the more narrow definition of good faith has been adopted in the revision.

The advocates of the narrowed definition put forward several arguments. First, they argued that issuers must often use discretion—for example, on defective presentation to ask for a waiver in some circumstances but not others. The USCIB argued that issuers should not be bound to act exactly the same way in every case—even in successive cases with the same beneficiary. They feared that a broad good faith requirement would so command. Moreover, they pointed out that the issuer's proper refusal to pay when documents substantially, but not strictly, conform might be construed by a layman to be a lack of good faith. Finally, they argued that Europeans and other non Americans were frightened by the threat of a runaway good faith doctrine, particularly by American courts' applying good faith in unforeseen cases.

The Committee was split, but it finally adopted the narrow definition. Here I side with the USCIB; in my opinion Professor Llewellyn played a successful trick on all of us by convincing a generation that "good faith" can be defined.

7. Warranties

The warranty in existing section 5-111(1) given by the beneficiary to "all interested parties" that "the necessary conditions of the credit have been complied with" is unique to the Uniform Commercial Code. There are no warranties in the UCP nor, apparently, in the European law or in the common law of the United States. More troublesome, the meaning of the warranty has been the subject of considerable academic debate and of some confusion in the courts of the United States. For the first thirty years of the Code, the section lay ungerminated, but within the last ten years there has been a series of cases that interpreted it in different ways, sometimes with threat-

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ening possibilities. Particularly scary is the Philadelphia Gear\textsuperscript{29} dictum which suggested that the breach of warranty could be asserted as a defense by an issuer that had dishonored.

The debate over warranties was aired in the Task Force subcommittee and extensively summarized in the Task Force report.\textsuperscript{30} The report did not suggest that the section 5-111 warranty should be repealed, only that it was unsatisfactory in its existing form.

Reading the ABA report, I assumed that everyone believed there should be a warranty in revised Article 5 and—armed with the debate in the Task Force, with the cases, and with the academic commentary—I spent three years drafting various forms of warranties.\textsuperscript{31} The ABA debate was repeated in the drafting committee, but I never fully understood the hostility to warranties.

Following the USCIB’s ultimatum in February of 1993, I discovered that warranty was an important issue for the USCIB and drafts dated December 15, 1993 and May 23, 1994 had no warranty section.

\textsuperscript{29} Philadelphia Gear Corp., 717 F.2d at 238.


\textsuperscript{31} December 8, 1992: Section 5-108. Warranties

(a) If its presentment is honored, the beneficiary under a letter of credit warrants to the issuer, any other person to whom presentment is made, and the applicant, that there is no fraud, the documents are what they purport to be, and the statements and representations in the documents are true in all material respects. These warranties are in addition to any warranties arising under [Articles] 3, 4, 7, and 8 because of the presentment of documents covered by any of those [articles]. Notwithstanding any term in the letter of credit or agreement to the contrary, the beneficiary does not give a warranty of the kind described in the first sentence of this subsection if the beneficiary’s presentment is dishonored.

(b) Unless otherwise agreed, when its presentment is honored, an adviser, nominated person, or other transferor of documents who is not a beneficiary, warrants only the matters warranted by collecting banks under [Article] 4 and a transferor transferring a document covered by Article 7 or 8 warrants only the matters warranted by an intermediary under those [articles].


(a) If its presentment is honored, the beneficiary under a letter of credit warrants to the issuer, any other person to whom presentment is made, and the applicant, that there is no fraud, the documents are what they purport to be, and the statements and representations in the documents are true in all material respects. Those warranties are in addition to warranties arising under [Articles] 3, 4, 7, and 8 because of the presentment of documents covered by any of those [articles]. Except as otherwise provided in subsection (b) and notwithstanding any term in the letter of credit or agreement to the contrary, the beneficiary does not give a warranty of the kind described in the first sentence of this subsection if the beneficiary’s presentment is dishonored.

(b) If a beneficiary’s presentment is dishonored by the issuer but the beneficiary has received value from a nominated person upon presentment to that person, the beneficiary under the letter of credit makes the warranties specified in subsection (a) to the nominated person.

(c) Unless otherwise agreed, when presentment is honored, a nominated person or other transferor of documents who is not a beneficiary warrants only the matters warranted by collecting banks under [Article] 4 and a transferor transferring a document covered by [Article] 7 or 8 warrants only the matters warranted by an intermediary under those [articles].
The drafting committee vetoed the broad warranty of section 5-111(1) and all like it. Still some pushed for a warranty.\textsuperscript{32}

The USCIB argued that warranties were unnecessary because anyone (usually the applicant) who was injured could recover from the beneficiary via common law restitution or under some other theory, often on the underlying contract. Presumably, the typical plaintiff in the warranty action would not be the issuer, but the applicant. That is because the issuer would have reimbursed itself from the applicant's account as provided by the reimbursement agreement; the applicant would then be seeking to recover its money from the beneficiary because the beneficiary had drawn when it had no right to do so.

The most unusual argument of the USCIB was that an expansive warranty would disfigure American letters of credit like a pimple on Miss America's cheek. Since the UCP imposed no warranties and since the Europeans did not recognize any such rights, the American banks would be at a disadvantage in competition with European banks, and those banks would ridicule this weird American obligation that carried a pimple called a warranty. Because of the warranty, it was argued, certainty of payment would be reduced and beneficiaries would spurn the letters of American banks.

Proponents of warranties argued that restitution was a weak reed for the cheated applicant. They pointed out that in some cases the applicant would have no underlying contract against the beneficiary and—particularly in standby cases—would need some way of recovering from an undeserving beneficiary after payment had been made. They noted that certainty of payment was not reduced, for, as drafted, the warranty would not arise unless payment had been made. Moreover they noted that forty years of section 5-111's warranties had not seemed to hurt American letters of credit.

On the day before the proposed final version was put before the annual meeting of the National Conference of Commissioners in August 1994, the USCIB agreed to the warranty that now appears in section 5-110(a). This is the only case that I can recall in which the drafters included a term that was in conflict with the UCP and generally opposed by the USCIB. Why the USCIB relented at the end is unclear. Of all the hotly debated issues, this is the only one that went against the USCIB and the UCP.

The foregoing seven issues were disputed, some hotly disputed, between the proponents of the UCP, on the one hand, and advisers or

\textsuperscript{32} Memorandum from William B. Davenport to the National Conference of Commissioners on Uniform State Laws (June 8, 1994).
members of the drafting committee, on the other. The latter group, of course, was not nearly as cohesive as the advocates of the UCP. Different coalitions were formed in the committee and among the advisers around different issues. Those coalitions changed from time to time depending upon who attended the meetings and on the nature of the issue.

B. Bank Practice, the UCP and Uncontroversial Changes

A second series of changes from the current Article 5 also arose mainly from the UCP and from bank practice. These were not controversial. Most of these changes were included in the earliest drafts and retained thereafter.

1. Strict Performance

Section 5-108(a) requires an issuer to honor a presentation that "appears on its face strictly to comply with the terms and conditions of the letter of credit" and requires dishonor if the presentation does not strictly comply. Although the UCP have no explicit term requiring strict compliance, that is the implication of certain of the UCP provisions and is the practice of bankers in the United States and elsewhere. The strict compliance standard was added early and quickly agreed upon.

2. Preclusion

Under Article 5, an issuer that dishonors but fails to give notice to the beneficiary of discrepancies in documents, may have liability to the beneficiary—but only if the beneficiary can show that it was injured by the issuer's failure to give notice of the discrepancies. Assume an issuer who presents its documents ten days before the expiration of its letter could procure a complying document on notice of discrepancy. That beneficiary may have been injured by the issuer's failure to give it notice. On the other hand, a beneficiary who made the same defective presentation the day before the expiration and—who who would have learned of the discrepancy only after the expiration—would not have been injured, for even timely notice would not enable a complying presentation. In the former, but not the latter case, American courts are likely to say the beneficiary had a claim against the issuer. See Schweibish v. Pontchartrain State Bank, 389 So.2d 731 (La. App. 1980), cert. den., 396 So. 2d 885 (La. 1981); Colorado Nat'l Bank v. Board of County Comm'rs, 634 P.2d 32 (Colo. 1981).
that the presentation complied. Since estoppel requires reliance, the right would exist in the first but not the second case.

The rule under the UCP is "preclusion"; an issuer that fails to give notice of discrepancy is "precluded" from defending its dishonor by showing the discrepancy whether or not there was reliance by the beneficiary. The Committee adopted early the preclusion standard of the UCP in place of estoppel. It is sometimes maintained that the preclusion rule, however harsh on the issuer (and perhaps ultimately on the applicant who has to reimburse) is an appropriate and offsetting obligation to the beneficiary's duty strictly to comply with the terms of letters of credit.

3. No Silent Confirmer

The UCP require that a confirmer be authorized or identified by the issuer; the same rule was adopted early in the drafting of Article 5. The rule says, in effect, that an issuer need not deal with someone as a confirmer whom the issuer has not chosen for that role. Thus, if an issuer is distrustful of a particular bank, it may insist that its letter be confirmed by another bank and need not recognize the distrusted bank as a confirmer whether or not that person gave value against documents.

4. Nondocumentary Conditions

Article 13c of the UCP states that nondocumentary conditions must be treated as "not stated." There was some debate in the Committee on the question whether that rule should be adopted, but debate was not between the UCP advocates and others. Always in the Committee there was substantial support from those not aligned with the UCP for disregarding nondocumentary conditions. Section 5-108(g) now states the same rule as is stated in the UCP.

The only difference between the UCP and the UCC is that the UCC recognizes the possibility both in revised section 5-108(g) and in the definition of letter of credit in revised 5-102(a)(10) that certain nondocumentary conditions can be so powerful that they deprive the
document of its status as a letter of credit entirely and throw the entire transaction out of Article 5.\textsuperscript{34}

5. Definite

Finally there is the adjective "definite" in revised section 5-102(a)(10). A letter of credit must be a "definite" undertaking. That word was put into Article 5 over the objection of certain people on the floor of the National Conference of Commissioners of Uniform State Laws. It is the most direct (but perhaps the least principled addition) of all the words and thoughts added from the UCP. It carries the inference that certain undertakings can still be "undertakings" yet not definite.

Evidently it has meaning to bankers, but I doubt it has meaning to bank lawyers or judges; it may become a mischievous addition. Jim Barnes defends its addition by suggesting it was necessary to insure the outcome in cases like \textit{Transparent Products Corp. v. Paysaver Credit Union}.\textsuperscript{35} I am doubtful.

So ends the litany of sections that I believe were deeply influenced by the UCP and by the advocates of the UCP. Surely it is desirable that American law be aligned with international practice and transnational law. To the extent that these changes did that, they are salutary and important. Particularly because the parties are sophisticated on all sides of letter of credit transactions, I doubt that our mistakes will do real harm. In the few cases where revised Article 5 is most likely to change the law (damages and subrogation) the UCP have nothing to say and the USCIB, who are bankers not lawyers, had little to say.

C. Lessons from the Revision of Article 5 for the Impact of International and Transnational Law on Domestic Legislation

The interesting questions from the revision of Article 5 have nothing to do with the substantive rules that appear in revised Article 5; they deal with the process. Only the tiny group of people who routinely engage in letter of credit practice or litigation care a cent whether, for example, nondocumentary conditions are to be disregarded. Because of the wide powers to vary rights by agreement, even

\textsuperscript{34} Wichita Eagle and Beacon Publishing Co. v. Pacific National Bank, 493 F.2d 1285, 1286-87 (9th Cir. 1974).

\textsuperscript{35} 864 F.2d 60 (7th Cir. 1988).
persons involved daily in letter of credit transactions are probably less concerned with law than they claim.

But what is unique here? What gives the transnational law and practice such dominance? Surely the Convention on the International Sale of Goods will have no impact on the redraft of Article 2 remotely like the effect of the UCP on Article 5. Nor is there any evidence that European or Asian law has significantly affected the revisions of Articles 3, 4, or 8. It is even less likely the antiquated European or Asian law will have any impact on Article 9.

I see several reasons for the powerful influence of the UCP on the revision to Article 5. Most obvious, a large share of all letter of credit transactions are transnational. One of the parties among the issuer, applicant, beneficiary, or confirmer is often in a different country than the others. In some cases three or more countries may be involved. Despite the rapid growth of domestic letters of credit within the United States (particularly standbys), I suspect that international use still predominates.

A fortiori, one might say domestic law must take account of such international practice—but recent experience does not necessarily confirm that conclusion. For example, Article 4A and Article 4 involve many transactions that are transnational, yet, so far as I can tell, transnational rules had little or no influence on their drafting. So the mere fact that the law being drafted will apply in transactions where parties are in different countries does not insure that the domestic lawmakers will pay attention to and be influenced by transnational law.

The real reason for the power of the UCP is that it is already the American law, influenced and revered by United States banks and, more to the point, by a subset of United States bankers, namely, the U.S. Council on International Banking, Inc. The USCIB takes part in its drafting and regards it as vital compilation of practice that has the status of law.

Equally important is the ancient history of Article 5 in New York and the recent experience in the ABA Task Force. These experiences forewarned members of the USCIB.

One can look at the negotiation between the representatives of the USCIB and the Drafting Committee as no more than an example of negotiations that occur every day in the legislative process at the federal and state level in the United States and in other countries. It is now a cliché to recognize that a small, highly focused and intensely interested group will always defeat a much larger, but diffuse and dis-
interested group. The negotiation here fit that paradigm. The representatives of the USCIB knew what they wanted, wished it intensely, and were highly motivated. Ultimately they were willing to devote considerable time and money to protect their interests.

On the other side were advisers and committee members pursuing the abstract principle of "good law." Sometimes nonbank advisers were divided because the same advisers spoke for the conflicting views of applicants and beneficiaries. In many cases, applicants might indorse one outcome and beneficiaries another. Those advisers were not focused like the USCIB. In some cases they favored USCIB proposals; in other cases they were opposed, but they were often schizophrenic.

Members of the committee, of course, were not experts in Article 5 and had no vested interest in any particular law. Mostly they wanted wise commercial law—particularly commercial law that is uniform from state to state.

The Commissioners' interest in nationwide enactment weakens the bargaining position of the Commissioners against a determined group like the USCIB. A credible threat to oppose legislation—to stall it in even one big state like New York or California—influences the Commissioners. By definition, the Commissioners want uniform law, and by definition, a law not enacted in an important commercial state cannot be uniform. Thus, when the USCIB threatened to withdraw from the process and implicitly to oppose the adoption of anything that came out of the process, the Commissioners made concessions that they might not otherwise have made. On the Commissioners' behalf, it should be stated that the specific requests and demands of the USCIB were not very clearly stated prior to the threat to withdraw. After that time they expressed their wishes in a much more coherent and persuasive way out of the mouth of a well informed representative, Jim Barnes.

Why was the USCIB so interested? After all, commercial law mostly can be obviated by agreement. It is only the pathological transaction that ultimately has to rely upon law; many business people pass through their entire lives violating civil, statutory rules without any knowledge of the rules or concern about whether they comply with them. For example, few business people are concerned with implied warranties in Article 2. Most regard express warranty as the beginning and end of their obligation and are quite surprised by the rare case in which they get sued on implied warranties or speak to their lawyer about implied warranties.
Part of the USCIB’s interest arises from the fact that the letter of credit is itself a product whose attributes are “the law.” It is as though the USCIB were selling Cadillacs and the legislature in the state of Michigan threatened to pass a law that every Cadillac be painted pink. Repeatedly the USCIB representatives made the argument that certain provisions—unalterable warranties are a good example—would become attributes of American letters of credit that Europeans and Asians would regard as deviant. American banks would be at a disadvantage and might lose business to their European and Asian competitors.

Finally, a couple of other factors may have affected the debate and enhanced the UCP’s influence. First, the debate over law is among lawyers, not scientists, and is almost completely devoid of reliable empirical data. At every drafting meeting advisers made empirical assertions about American practice, practice in Oklahoma, practice in Europe or Asia; not one of those assertions was ever empirically verified.

The little empirical digging that I did suggested—contrary to assertions sometimes made at committee meetings—that the American practice, at least as to certain events, is quite varied. Chicago practice is different from that in New York City and, as with other things, the Californians live a life of their own. Having experts at the table both helps and hurts. The “experts” tend to be experts only in their own region but they are often quite free to assert and to assume that the cases they have seen—even though small in number—are the norm everywhere. So one problem in allowing international practice and transnational law and practice to influence domestic legislation is to get sound understanding of the underlying facts and transactions. This is not easy to do, and I have no reliable or inexpensive suggestion for those seeking good empirical information. Of course, this too magnifies the UCP’s influence. The UCP are a written compilation of international practice, and when the UCP speak, they mitigate the problem of regional diversity.

A final idiosyncratic factor in the drafting process enlarged the UCP’s role. That was the role played by my colleague on the panel, Jim Barnes. Jim Barnes is a letter of credit expert. I doubt there is any lawyer in the United States or elsewhere that knows more about letter of credit law than he does and there are few that know as much. He has a quick and lively mind, and he is a hard worker. After its ultimatum, the USCIB hired Jim Barnes to represent it in drafting and negotiating with me in future drafts. But for that I am not sure that
we would have had a successful revision. To have those with opposing views speak clearly and with a single voice is helpful. By their appointment of Jim Barnes, they identified the person with whom to negotiate, and they gave us an avenue through which to communicate. Though I am not privy to any of Jim's negotiations with his client the USCIB, I assume there were some cases where he advised them to drop their opposition to particular points because they were wrong, because the proposal we had made was better than theirs, or because it was unimportant. In other cases he was able to communicate to me and to the Committee what was important to the USCIB and why it was important.

I also give considerable credit to his imagination and cleverness in finding solutions to problems that separated the Committee and the USCIB. I am certain there are a few clever points buried in his suggestions for statutory language and for the comments that have consequences foreseen only by him and overlooked by me and the Committee.

**Conclusion**

The influence of international law in the form of the UCP on the revision to Article 5 cannot be exaggerated. Unfortunately the utility of this process as an example for the influence of international law on domestic American law is limited because of the unique factors here. Specifically I refer to the history of conflict between the UCP advocates and the drafters of the UCC, the presence of the USCIB, a local group intensely interested in the letter of credit, and to the fact that the letter of credit is itself a commodity whose color and appearance are determined by law.