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Internationalization of Revised UCC Article 5 (Letters of Credit)

*James G. Barnes**

The 1995 revision of Article 5 of the Uniform Commercial Code (UCC) was heavily influenced by international practice as reflected in the Uniform Customs and Practice for Documentary Credits (UCP). The Reporter for Revised UCC Article 5, Professor James J. White,¹ acknowledges the heavy influence of international practice, views it as a mixed blessing, and attributes it to the focused efforts of the letter of credit bankers' trade association, the United States Council on International Banking, Inc. (USCIB). This article further explains and welcomes the internationalization of Revised UCC Article 5.

I. THE ONCE-IN-A-LIFETIME CHANCE TO HARMONIZE DOMESTIC AND INTERNATIONAL LETTER OF CREDIT LAW AND PRACTICE

During 1989-1995, the codification and revision of the law and practice of letters of credit and independent guarantees proceeded on multiple fronts:

A. UCP 500 — The 1993 Revision of the Uniform Customs and Practice for Documentary Credits

The UCP, which was last revised in 1983, was substantially revised by a working group that began deliberations in 1989 and re-

* Partner, Baker & McKenzie, Chicago, Illinois. This article is based upon a paper given at the 5th Annual Conference of the Journal of Contract Law, held in Chicago in September, 1994. The conference was sponsored by Northwestern University School of Law, Emory School of Law and Freehill Hollingdale and Page, Sydney, N.S.W., Australia.

¹ James J. White, *The Influence of International Practice on the Revision of Article 5 of the UCC*, 16 NW. J. INT'L L. & BUS. 189 (1995).

leased a series of redrafts for comment in 1991 and 1992. The 1993 UCP revision (UCP 500) was approved and published in 1993 with an effective date of January 1, 1994.² The UCP, as revised about every 10 years, is incorporated into substantially all cross-border commercial letters of credit, studied and observed by letter of credit bankers and users worldwide, and treated as quasi-law in the many countries that have little or no statutory law governing letters of credit.

B. The Uniform Rules for Demand Guarantees

The Uniform Rules for Demand Guarantees (URDG) were drafted during the period 1988 to 1991 and published in mid-1992.³ The URDG covers a bank product that is widely used outside the United States. Demand guarantees are intended to be independent of the underlying transaction and are functionally and legally similar to standby letters of credit. However, national laws and practice rules for independent guarantees are less developed than for letters of credit.⁴

C. The United Nations Convention on Independent Guarantees and Stand-by Letters of Credit

The United Nations Convention on Independent Guarantees and Stand-by Letters of Credit was drafted during the period 1989 to 1995 and approved by the United Nations Commission on International Trade Law (UNCITRAL) in May 1995 (UNCITRAL Convention).⁵ It provides a basic legal framework for independent undertakings, in-

² International Chamber of Commerce, *Uniform Customs and Practice for Documentary Credits*, ICC PUBLICATION No. 500 (1993). The drafting history and intended effect of UCP 500 are summarized in International Chamber of Commerce, *Documentary Credits: UCP 500 and 400 Compared*, ICC PUBLICATION No. 511 (1993). In a subsequent related effort, the USCIB's statement of practice on interbank reimbursement under UCP 500 Article 19 have been revised, internationalized, and published as *Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits*, ICC PUBLICATION No. 525 (1995).

³ International Chamber of Commerce, ICC PUBLICATION No. 458 (1992). The drafting history and intended effect of the URDG are summarized in Roy Goode, *Guide to the ICC Uniform Rules for Demand Guarantees*, ICC PUBLICATION No. 510 (1992).

⁴ It remains to be seen whether the URDG will be much used and whether the market in Europe and elsewhere will come to prefer undertakings that qualify as letters of credit. The 1978 forerunner to the URDG, *Uniform Rules for Contract Guarantees*, ICC PUBLICATION No. 325 (1978), has not been much used.

⁵ *UNCITRAL Convention*, reprinted in 11 LETTER OF CREDIT UPDATE 39 (Aug. 1995). The drafting history and intended effect of the UNCITRAL Convention are summarized in the periodic reports of the UNCITRAL Working Group, e.g., those reprinted in 10 LETTER OF CREDIT UPDATE 25 (Apr. 1994) and *id.* at 27 (May 1994).

cluding those subject to practice rules such as those included in the URDG and the UCP.

D. The Revision of UCC Article 5

Revised UCC Article 5 was drafted during the period 1991-1995. The revised statutory sections were substantially completed in mid-1994 and finally approved in mid-1995. The 1995 Official Text of Revised Article 5 with Comments was published in October 1995.⁶ As discussed more fully below, Revised UCC Article 5 was drafted by a committee appointed in 1990 by the National Conference of Commissioners on Uniform State Laws (NCCUSL) following publication of a task force report on the problems with the original UCC Article 5.

Although important projects to record practice remain to be done,⁷ the large scale projects of this generation to codify the domestic and international law of independent undertakings have now been completed. In any event, the revision of UCC Article 5 was a part of this unprecedented, world-wide effort and, as a matter of timing, was on both the following and the leading edge of the effort. Moreover, as discussed next, a number of the participants in domestic law revision also participated in the projects initiated by the ICC and/or UNCTRAL, and, throughout this effort, they were strong proponents of internationalizing letter of credit law and practice.

II. THE TASK FORCE ON UCC ARTICLE 5 REVISION

During 1987-1989, seven lawyers from the American Bar Association and three bankers from the USCIB (Task Force)⁸ studied UCC Article 5 and published a comprehensive report on it (Task Force Re-

⁶ Reprinted in 12 LETTER OF CREDIT UPDATE (Jan. 29, 1996). The drafting history of Revised U.C.C. Article 5 is summarized in its Prefatory Note. Each draft was reprinted in LETTER OF CREDIT UPDATE.

⁷ As contemplated by U.C.C. REVISED § 5-112(b)(2), § 5-113(b), and § 5-114(d), the practices for effecting transfer of beneficiary drawing rights (whether to a permitted transferee or to a successor by operation of law) and for effecting assignment of letter of credit proceeds (whether outright or as security) will be more fully identified and recorded.

⁸ The Task Force members appointed by the Subcommittee on Letters of Credit of the American Bar Association Business Law Section U.C.C. Committee were: James E. Byrne (George Mason University School of Law), Chair, Michael Evan Avidon (Moses & Singer), James G. Barnes (Baker & McKenzie), Boris Kozolchik (University of Arizona College of Law), Arthur G. Lloyd (Citibank, N.A.), Janis S. Penton (Rosen, Wachtell & Gilbert), and Richard F. Purcell (Connell Rice & Sugar Co., Inc.). The USCIB appointees were: Alan Bloodgood (Morgan Guaranty Trust Co.), Charles del Busto (Manufacturers Hanover Trust Co.), and Vincent Maulella (Manufacturers Hanover Trust Co.).

port).⁹ The Task Force collected and disseminated considerable information relevant to domestic and international law and practice. The topics before the Task Force quickly became topics at USCIB meetings and workshops and in Letter of Credit Update, a monthly publication edited by the Task Force chair, Professor James E. Byrne. Moreover, the Task Force members, individually and as members of relevant committees of the USCIB and other organizations,¹⁰ remained active in the revision of letter of credit law and practice after the Task Force Report was completed in late 1989.

Several members of the Task Force, together with the USCIB's president, played significant roles in the 1993 revision of the UCP.¹¹ Half of the Task Force and half of the UCP revision working group put on a two-day program in late 1990 on the UCP, UCC and UNCITRAL initiatives.¹² Five Task Force members regrouped in mid-1992 to draft standby letter of credit rules for use in drafting the UNCITRAL Convention.¹³ Three Task Force members were on the U.S. delegation to the United Nations working group that drafted the UNCITRAL Convention.¹⁴ Several wrote extensive articles on the progress being made in the letter of credit field to harmonize

⁹ Task Force on the Study of U.C.C. Article 5, *An Examination of U.C.C. Article 5 (Letters of Credit)*, 45 Bus. Law. 1521 (1990). The Task Force Report identified 49 problems under original U.C.C. Article 5, summarized the different solutions and the factors for and against each, and in some cases expressed opinions as to the preferred solutions. As mandated, the Task Force Report did not bind any organization, insist on any particular solution, or recommend any particular statutory language. *Id.* at 1521-1643.

¹⁰ Vincent Maulella currently chairs the USCIB and, like Alan Bloodgood, has chaired the USCIB's Letter of Credit Committee. Charles del Busto currently chairs the ICC's Commission on Banking Technique and Practice. Janis Penton co-chairs with Dean Gerald T. McLaughlin the Working Group on International Guarantees and Standby Letters of Credit of the American Bar Association Business Law Section's UCC Committee. I am the chair and Professor Byrne is the vice chair of its Subcommittee on Letters of Credit. Michael Avidon chairs the New York State Bar Association, Banking Law Committee, Subcommittee on Letters of Credit.

¹¹ USCIB president Dan Taylor and Task Force member Professor Boris Kozolchyk undertook substantial responsibility for UCP revision. Task Force member Charles del Busto chaired the ICC's Commission on Banking Technique and Practice during the effort to revise the UCP.

¹² Conference on "New World of Letters of Credit," (Nov. 15-17, 1990) held in New Orleans, Louisiana. The speakers included James Barnes, James Byrne, Boris Kozolchyk, Janis Penton, Salvatore Maccarone, Vincent Maulella, Dan Taylor, Joachim Weichbrodt, and Bernard Wheble.

¹³ See *A Proposal to UNCITRAL: Standby Letter of Credit Rules*, reprinted in 8 LETTER OF CREDIT UPDATE 10 (Sept. 1992). It was drafted by Messrs. Barnes, Bloodgood, Byrne, Kozolchyk, and Maulella. See also, *Select Advisory Group Proposed Draft Standby Letter of Credit Rules*, 9 ARIZ. J. INT'L & COMP. L. 372 (1992).

¹⁴ The U.S. delegation to the United Nations working group was chaired by Professor Byrne. Professor Kozolchyk was a member of the delegation throughout. I joined the delegation for half of the working sessions in 1993 through 1995.

international and national laws and practices¹⁵ as well as shorter pieces providing insight into the drafting of UCP 500.¹⁶ Six of the ten members of the Task Force wrote articles for the 1990 Brooklyn Law Review's symposium on various topics to be considered in revising UCC Article 5.¹⁷

The Task Force both influenced and was influenced by international developments during and after preparation of the Task Force Report. In particular, the Task Force recognized the increasing extent to which letters of credit included nondocumentary conditions, publicized the problem and the possible solutions, and developed a consensus, on which UCP 500 Article 13(c) would be based, that nondocumentary conditions must be disregarded.¹⁸ The "reasonable document checker" concept reflected in the Task Force Report was the basis for the "international standard banking practice" of UCP 500 Article 13(a).¹⁹ (The "seven banking day" ceiling of UCP 500 Article 13(b) was not anticipated by the Task Force, but the Task Force Report had indicated that U.S. banks would accept a five banking day ceiling, coupled with the sanction of "preclusion" for delay.²⁰)

Nine of the ten members of the Task Force were advisors or active participants during the four years of meetings of the Uniform Law Commissioners' Drafting Committee to revise UCC Article 5 (Drafting Committee). None was a member of the Drafting Committee it-

¹⁵ See, e.g., James E. Byrne, *Domestic and International Harmonization of Letter of Credit Law: UCP, UCC Article 5, and the UNCITRAL Convention — An Evaluation at Midstream*, COMM. LAW ANN. 1993, 325; Boris Kozolchyk, *Towards New Customs and Practices for Documentary Credits: The Methodology of the Proposed Revision*, COMM. LAW ANN. 1993, 377; James E. Byrne, *Critical Issues in the International and Domestic Harmonization of Letter of Credit Law and Practice*, COMM. LAW ANN. 1995, 389.

¹⁶ See, e.g., Vincent Maulella, *Standby Letters of Credit*, 11 LETTER OF CREDIT UPDATE 26 (Nov. 1995) (regarding UCP 500 Articles 41 and 43 as applied to standby letters of credit); *A Conversation with Boris Kozolchyk re UCP Article 13(a) & the ICC's National Banking Practices Initiative*, 11 LETTER OF CREDIT UPDATE 32 (Nov. 1995) (regarding the reference in UCP 500 Article 13(a) to "international standard banking practice").

¹⁷ Michael Evan Avidon, *Subrogation in the Letter of Credit Context*, 56 BROOK. L. REV. 129 (1990); James G. Barnes, *Nonconforming Presentations Under Letters of Credit: Preclusion and Final Payment*, 56 BROOK. L. REV. 103 (1990); James E. Byrne, *The Revision of U.C.C. Article 5: A Strategy for Success*, 56 BROOK. L. REV. 13 (1990); Boris Kozolchyk, *Strict Compliance and the Reasonable Document Checker*, 56 BROOK. L. REV. 45 (1990); Arthur G. Lloyd, *Sounds of Silence: Emerging Problems of Undisclosed Confirmation*, 56 BROOK. L. REV. 139 (1990); Janis Penton Soshuk, *The Consequences of Nondocumentary Conditions*, 56 BROOK. L. REV. 33 (1990).

¹⁸ Task Force on the Study of U.C.C. Article 5, *An Examination of U.C.C. Article 5 (Letters of Credit)*, 45 BUS. LAW. 1527, 1546 (1990).

¹⁹ *Id.* at 1608. See Boris Kozolchyk, *Strict Compliance and the Reasonable Document Checker*, 56 BROOK. L. REV. 45 (1990).

²⁰ Task Force on the Study of U.C.C. Article 5, *supra* note 18, at 1599.

self. The Drafting Committee members were practicing lawyers and academics with considerable experience and expertise in revising other articles of the UCC as well as in applying them in practice, but not necessarily in handling international transactions or working with letters of credit.²¹ There were, of course, Drafting Committee members and advisors, especially those involved in developing and revising laws on electronic commercial transactions who, although not letter of credit specialists, were sensitive to the need to internationalize letter of credit law.

In mid-1993 — more than two years after the Drafting Committee began work — the Task Force members advising the Drafting Committee had substantial reservations about UCC Article 5 revision, and, when the USCIB expressed its dissatisfaction with the process and product, five of them participated in drafting the USCIB's June 29, 1993 critique of the March 31, 1993 draft of revised UCC Article 5.²² That critique urged greater recognition of international practice and, in particular, of incorporated rules, such as UCP 500.

III. UCC RECOGNITION OF UCP 500

By mid-1993, UCP 500 was completed and about to be published. Among other things, it hardened the letter of credit obligations of issuers and confirmers. Under the UCP 500, letters of credit:(1) must be issued if “pre-advised” and are established when sent (Article 11); (2) are presumed to be irrevocable (Article 6(c)); (3) must be performed in accordance with international standard banking practice as reflected in the UCP (Article 13(a)); (4) must be performed if the stipulated documents are presented, even if non-documentary conditions have not been satisfied (Article 13(c)); (5) are not discharged until payment at maturity after a time draft is accepted or a deferred payment undertaking is incurred (Articles 9(a) and (b)); and (6) must be honored or dishonored (giving a statement of discrepancies) within a reasonable time not exceeding seven banking days (Article 14(d)),

²¹ The Drafting Committee members include: Carlyle C. Ring, Jr., Chair, Professor Marion W. Benfield, John P. Burton, Bruce A. Coggeshall, William C. Hillman, Edwin E. Huddleson, III, Jeremiah Marsh, Richard L. Morningstar, Edwin E. Smith, Sandra S. Stern, Richard C. Hite, Neal Ossen, Professor Fred H. Miller, and Professor James J. White, Reporter.

²² See USCIB Study of Fundamental Problems with the Seventh Draft (March 31, 1993) Revision of UCC Article 5, *reprinted in* 9 LETTER OF CREDIT UPDATE 15 (July 1993) (signed by USCIB chairman Dennis L. Noah and president Dan Taylor). Its principal drafters were Messrs. Barnes, Bloodgood, Byrne, Kozolchyk, and Maulella, as well as Messrs. Noah and Taylor who forwarded it under their cover letter to the Drafting Committee.

failing which the bank's defenses are "precluded," i.e., forfeited (Article 14(e)).

UCP 500 also redefined "negotiation" to mean "giving of value," but did not extend the penalty of preclusion to banks that are nominated, but not obligated, to negotiate or to honor complying presentations.²³ UCP 500 set a ceiling on the "reasonable time" period of seven banking days (as a compromise between suggestions of five and ten days), but it did not set a floor, in part because many financial standby letters of credit call for same or next day response to a demand.²⁴

On most of the above issues UCP 500 would ultimately serve as precedent for Revised UCC Article 5. The Drafting Committee's March 31, 1993 draft restated the UCP's provisions of strict performance by beneficiaries when presenting documents and by issuers when dishonoring them. It did not, however, embrace the UCP's reliance on observance of international standard banking practice. Indeed, the March 31, 1993 draft imposed generalized "reasonableness" requirements as a separate overlay on the strict performance requirements.

A similar issue arose in drafting the UNCITRAL Convention on independent guarantees incorporating the URDG and standby letters of credit incorporating UCP 500. The UNCITRAL Convention provides that in interpreting the undertaking and in settling questions not addressed by the undertaking or by the Convention, "regard shall be had to generally accepted international rules and usages of independent guarantee or standby letter of credit practice."²⁵ To the extent that the UNCITRAL Convention provides for reasonableness and good faith performance, it simultaneously provides for "due regard to generally accepted standards of international practice of independent guarantees or standby letters of credit."²⁶ It also allows for disclaimer of liability for ordinary negligence.²⁷ Accordingly, the UNCITRAL Convention expressly refers to and relies on international practice even though it also restates various substantive provisions of UCP 500.²⁸

²³ See ICC Publication No. 511 commentary on UCP 500 Articles 14(e) and 10(b)(ii).

²⁴ See ICC Publication No. 511 commentary on UCP 500 Article 13(b).

²⁵ UNCITRAL Convention art. 13(2).

²⁶ See UNCITRAL Convention arts. 14(1), 16(1).

²⁷ See UNCITRAL Convention art. 14(2).

²⁸ The UNCITRAL Convention restates the substance of UCP 500 in providing for establishment of an undertaking when it is sent (Article 7(1)), presuming irrevocability (Article 7(4)), allowing a reasonable time up to seven business days to give notice of dishonor (Article 16(2)), limiting undertakings of indefinite duration (Article 12(c)), and giving the issuer discretion to reject/limit purported transfers of the beneficiary's drawing rights (Article 9). It also allows

Letter of credit bankers look to international practice as reflected in the UCP for answers to specific questions and for a general framework for analyzing and developing answers to any issue that may come up, excluding only extraordinary issues, such as applicant injunction remedies to counter beneficiary fraud. They expect the applicant to bear by express agreement or otherwise substantially all risks of providing a letter of credit. They expect to be judged in the marketplace and in the courts on the basis of adherence to standard practice and express agreement. There are, of course, courts that recognize that the letter of credit is a mercantile specialty and defer appropriately to practice.²⁹ However, in many reported cases challenging a bank's response to a demand, the courts fail to recognize that the UCP provides the answer or, at least, the framework for analyzing the question.³⁰ Accordingly, it was critical to the success of the UCC Article 5 revision that the message be sent to lawyers and judges that the question is "what is the practice?," not "what is reasonable, fair, or equitable?" That same message needed to be sent also to banks and non-banks, especially those outside the U.S., who see the UCP and international practice as protection against U.S. law and court practice, not vice-versa.

That the UCC should clearly recognize international practice rules such as the UCP was not the view merely of the USCIB bankers. It was also the view of the Task Force.³¹ As noted above, the banker and lawyer members of the Task Force shaped and were shaped by each other's views, and those that survived and achieved consensus acquired considerable momentum. Those consensus views were advocated and generally prevailed in the drafting of UCP 500, the UNCI-TRAL Convention and Revised UCC Article 5.

The influence of international practice became much clearer in the provisions of revised Article 5 following the March 31, 1993 draft in the redrafts that emerged from the several Drafting Committee meetings held in late 1993 and 1994. The Official Text (1) expressly refers to the UCP and recognizes the effectiveness of incorporating the UCP into an undertaking,³² (2) requires observance of "standard practice of financial institutions that regularly issue letters of credit,"³³

freedom to choose applicable law and, absent choice, applies the law of the place of issuance (Articles 21 and 22).

²⁹ See, e.g., *Alaska Textile Co. v. Chase Manhattan Bank*, 982 F.2d 913 (2d Cir. 1992).

³⁰ See, e.g., *Philadelphia Gear Corp. v. Central Bank*, 717 F.2d 239 (5th Cir. 1983).

³¹ Task Force on the Study of U.C.C. Article 5, *supra* note 18, at 1558.

³² See U.C.C. REVISED § 5-116(c). See also U.C.C. REVISED § 5-103(c).

³³ See U.C.C. REVISED § 5-108(a), (e).

(3) eliminates generalized "reasonable care" obligations, (4) retains the "honesty in fact" definition of "good faith,"³⁴ and (5) adopts many of the approaches and much of the language of the UCP.³⁵

IV. CONCLUSION.

Letter of credit law is part of the law merchant, which is derived from practice in the marketplace. The letter of credit marketplace is essentially international and heavily populated by internationally active banks that regularly assume all roles in letter of credit transactions, including those of applicant and beneficiary. The task of the law is to support the marketplace and the overall interests of the participants in speed, predictability, finality, efficiency, and universality. In dealing with the inevitable disputes, the law should recognize the rules of the international marketplace designed to dispose of disputes summarily (e.g., the "strict compliance" and "preclusion" rules), review the conduct of the parties against those rules, and not circumvent those rules by application of common law principles applicable to general contracts. On the whole, Revised UCC Article 5 recognizes its place within international law merchant and appropriately limits the application of general contract law and principles of equity. For this it should be applauded.

³⁴ See U.C.C. REVISED § 5-102(a)(7). See generally James G. Barnes, *Defining Good Faith Letter of Credit Practices*, 28 LOY. L.A. L. REV. 101 (1994); Donald J. Rapson, *Who is Looking Out for the Public Interest? Thoughts About the U.C.C. Revision Process in the Light (and Shadows) of Professor Rubin's Observations*, 28 LOY. L.A. L. REV. 249 (1994). The treatment in U.C.C. Article 5 revision of "reasonableness," "good faith," and the like is beyond the scope of this article. Although somewhat pertinent to internationalization, these matters are more pertinent to a separate concern that Revised U.C.C. Article 5 (including its provisions governing wrongful dishonor claims, defenses, and remedies) facilitate summary disposition.

³⁵ For an overall description of revised Article 5 and comparison with the current U.C.C. and UCP 500, see James G. Barnes & James E. Byrne, *Revision of UCC Article 5*, 50 BUS. LAW. 1449 (1995).