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Notification of documentary discrepancies in letter of credit transactions

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NOTIFICATION OF DOCUMENTARY DISCREPANCIES IN LETTER OF CREDIT TRANSACTIONS

by

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Chapter I

INTRODUCTION

"Letter of credit" or "credit", as defined in Article 5 of the Uniform Commercial Code (hereinafter as U.C.C.), is an engagement by an issuer made at the request of a customer that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit.[1] There are three basic parties involved in a letter of credit transaction: a customer or an account party, an issuer, and a beneficiary.[2] Therefore three kinds of separate and distinct relationships emerge among the parties involved: (1) an underlying contract between a customer and a beneficiary, (2) a reimbursement agreement between a customer and an issuer

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[1]U.C.C. Section 5-103(1)(a).

[2]U.C.C. Section 5-103(1)(c), (1)(d), and (1)(g) defines, respectively, an "issuer" as a bank or other person issuing a credit; a "beneficiary" of a credit as a person who is entitled under its terms to draw or demand payment; a "customer" as a buyer or other person who causes an issuer to issue a credit, including a bank which procures issuance or confirmation on behalf of that bank's customer.

The corresponding definitions are spelled out in Article 2 of the Uniform Customs and Practices for Documentary Credits (hereinafter as U.C.P.), International Chamber of Commerce (hereinafter as I.C.C.) Pub. No. 500 (1993 Revision) and Article 2 of the U.C.P., I.C.C. Pub. No. 400 (1983 Revision). The U.C.P. uses the term of "applicant for the credit" more often than, as well as, customer. In the United States, the buyer in a letter of credit is generally referred to as an account party. The U.C.P. uses "issuing bank," instead of "issuer" in contrast to the U.C.C., because the U.C.P. applies only to letters of credit issued by a bank. *See* Byron V. McCullough, LETTERS OF CREDIT (1994), §1.05[1][b], at 1-28 to 1-29.

(which may be a loan agreement when the issuer is financing the customer), and (3) a letter of credit between a beneficiary and an issuer.[3]

The letter of credit law spells out the legal relations between the issuer and the beneficiary and between the issuer and the customer.[4] In the United States, there are four sources of law that govern the rights and obligations of all parties to the letter of credit transactions, which are Article 5 of the U.C.C., the agreement of the parties including the U.C.P., general principles of law, and case law.[5] Article 5 of the U.C.C. is the applicable domestic letter of credit law in the fifty states and the District of Columbia. Section 1-102(3) of the U.C.C. permits the parties not only the freedom to contract regarding matters not covered by Article 5, but also the freedom to vary the effect of many of the provisions contained in Article 5.[6] In fact, the U.C.P. generally governs letter of credit transactions because a great majority of letters of credit are

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[3]*See* McCullough, *id.* §1.05[1], at 1-27 to 1-32. *See also* H. Harfield, BANK CREDITS AND ACCEPTANCES, 31-32 (5th ed. 1974); John F. Dolan, THE LAW OF LETTERS OF CREDIT (2d ed. 1991), ¶2.01, at 2-2. *See, e.g.*, Ocean Bank of Miami v. La Esquina Presidential, Inc., 623 So.2d 520, 20 UCC Rep.Serv.2d 1050 (Fla.Dist.Ct.App. 1993); Alaska Textile Co. v. Chase Manhattan Bank, N.A., 982 F.2d 813, 815, 19 UCC Rep.Serv.2d 540 (2d Cir. 1992).

[4]U.C.C. Section 5-103, Official Comment 3. *See also* Harfield, *id.* at 32.

[5]*See generally* McCullough, *supra* note 2, §2.05, at 2-23 to 2-66. *See also* L. Sarna, LETTERS OF CREDIT: THE LAW AND CURRENT PRACTICE (3d ed. 1989), at 1-7 to 1-8; Dolan, *supra* note 3, ¶4.01, at 4-2 to 4-5; N. J. Rubenstein, *The Issuer's Right and Obligations under a Letter of Credit*, 17 UCC L.J. 129, 136-41 (1984).

[6]U.C.C. Section 1-102(3) states: The effect of this Act (U.C.C.) may be varied by agreement, except as otherwise provided ... and except that the obligation of good faith, diligence, reasonableness and care prescribed by this act may not be disclaimed by agreement. *See also* McCullough, *supra* note 2, §2.05[2], at 2-32 to 2-34.

issued subject to it.[7] Article 5 of the U.C.C. and the U.C.P. do not treat credits comprehensively, therefore, courts must often supplement the special statutory rules considerably by references to other general principles of law (e.g., contract law, equity and estoppel, surety law, and tort law) and the body of letter of credit case law.[8]

The objective of the thesis is to examine only one aspect of the legal relation between an issuer and a beneficiary, i.e., an issuer's duties regarding notifying a beneficiary of documentary discrepancies in letter of credit transactions. To lay down a theoretical foundation, the basic principles of the letter of credit law and policy considerations for this legal obligation will be explored in this chapter. In Chapter II, the relevant provisions of the U.C.C. and U.C.P. will be examined and compared. Chapter III will focus on how the courts interpret and apply the U.C.C. and U.C.P. in the cases regarding an issuer's duties to notify the beneficiary of documentary discrepancies.

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[7]U.C.P. 500 Article 1 provides that it "shall apply to all Documentary Credits (including to the extent to which they may be applicable, Standby Letter(s) of Credit) where they are incorporated into the text of the Credit." *See also* U.C.P. 400 Art. 1 (the U.C.P. applies to all documentary credits and is binding on all parties unless otherwise expressly agreed).

Since it was first drafted by the I.C.C. in 1933, the U.C.P. has been revised in 1951, 1962, 1974, 1983, and 1993 to reflect the changes in the letter of credit over time. The U.C.P. 400 (1983 Revision) has been adopted by banking institutions in more than 160 countries (for a list of nations recognizing the U.C.P. *see* I.C.C. Pub. No. 470/399). The U.C.P. 500 (1993 Revision) has taken effect on January 1, 1994. *See* McCullough, *supra* note 2, §1.05[1], at 1-28 n.4, and §2.05[2], at 2-35.

[8]*See* U.C.C. Section 5-102, Official Comment 2 (Article 5 is a codification of "the fundamental theories underlying letters of credit" rather than codifying all the possible rules of letter of credit). *See also* McCullough, *supra* note 2, §2.05[3], at 2-47 to 2-48; Dolan, *supra* note 3, ¶4.01[1], at 4-4.

It is a well established principle that a letter of credit, essentially a contract between the issuer and the beneficiary, is independent of the underlying transaction between the customer and the beneficiary.[9] The rationale of the independence principle is to assure the beneficiary of payment under the letter of credit no matter what transpires between the buyer and the seller in a commercial letter of credit context.[10] It is this independence principle of the letters of credit law that assures the commercial vitality of the letters of credit as an efficient, swift, and assured payment and guaranty mechanisms.[11] Courts throughout the country have consistently applied this "independence principle" to letter of credit transactions.[12]

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[9]The independence principle is codified in U.C.C. Sections 5-109, 5-114(1) and Official Comment 1, U.C.P. 500 Arts. 3, 4, and U.C.P. 400 Arts. 3, 4. *See* Dolan, *supra* note 3, ¶2.01, at 2-3. Article 3(a) of the U.C.P. 500 provides: "Credits by their nature, are transactions separate from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the Credit."

[10]*See* Centennial Industries, Inc. v. Union Trust Co. of Maryland, 75 Md.App. 202, 540 A.2d 1169, 6 UCC Rep.Serv.2d (Callaghan) 810 (Md. 1988).

[11]Letters of credit may be classified by their intended use into two types: commercial and standby letter of credit. "A commercial letter of credit" functions as a payment device when a bank issues it to enable a customer to purchase goods or services. Commercial letters of credit are used extensively in international trade transactions. "A standby letter of credit" functions as a guaranty of payment when a bank promise to make payment on the beneficiary's certification that the customer has defaulted on the underlying contract. *See* K.S. Dighe, *Mercantile Specialty: A Theory by Which to Enforce Letters of Credit under the Common Law*, 69 U. DET. MERCY L. REV. 211 (1992). *See also* Harfield, *supra* note 3, at 32-33.

[12]*See, e.g.*, Pringle Associated Mortgage Corp. v. Southern National Bank of Hattiesburg, Mississippi, 571 F.2d 871, 874 (5th Cir. 1978) (the key to the uniqueness of a letter of credit and to its commercial vitality is that the promise by the issuer is independent of any underlying contracts); Chase Manhattan Bank v. Equibank, 350 F.2d 882, 886 (3d Cir. 1977) (the beneficiary bases his claim on the letter of credit, not on the agreement between the customer and the issuing bank, nor upon the

Generally, letters of credit are documentary forms of transaction.[13] A documentary letter of credit, in contrast with a clean letter of credit, is one the honor of which is conditioned upon the presentation of a document or documents.[14] The application of independence principle to documentary credits means that "all parties concerned deal with documents, and not with goods, services and/or other performances to which the documents may relate."[15] Put differently, an issuing bank's duty to honor or dishonor the drafts or demands for payment pursuant to a letter of credit is triggered by the presentment of the documents, not by the factual performance of the underlying contract.[16]

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underlying arrangement between customer and beneficiary); Allied Fidelity Insurance Co. v. Peoples Bank & Trust Co. of St. Bernard, No. 86-1330, 1986 WL 12691, at *2 (E.D.La. Oct. 30, 1986) (the Bank's obligation under its letter of credit is unaffected by the correspondence from the customer to the beneficiary); Philip Brothers v. Oil Country Specialists, 787 S.W.2d 38, 40 (Tex. 1990) (per curiam) (the viability of a letter of credit as a payment device depends upon its independence from the transaction of which it is a part).

[13]*See* Armac Industries, Ltd. v. Citytrust, 203 Conn. 394, 525 A.2d 77, 80, 3 UCC Rep.Serv.2d (Callaghan) 1512 (Conn. 1987).

[14]U.C.C. Section 5-103(1)(b). *See also* Harfield, *supra* note 3, at 32 (a "clean letter of credit" is one the payment of which is not conditioned upon the presentment of any documents other than a draft with or without an accompanying written representation as to the right to draw or demand payment).

[15]U.C.P. 500 Art. 4. *See also* U.C.P. 400 Art. 4; U.C.C. Sections 5-103(1)(a), 5-109(2), and 5-114(1).

[16]*See* U.C.C. Official Comment 1 to Section 5-114. *See also* Robert M. Rosenblith, *Seeking a Waiver of Documentary Discrepancies from the Account Party: Unexplored Legal Problems*, 56 BROOK. L. REV. 81, 82 (1990).

Under the documentary nature of the letter of credit, the duties of the issuer of the credit are "limited and straightforward."[17] The issuing bank must honor the drafts or demands for payment if they appear on their face to be in compliance with the terms and conditions set forth in the letters of credit agreement.[18] An issuing bank's grounds for refusing to honor the credit are severely restricted since the payment under a letter of credit is solely conditioned upon the terms set forth in the credit, which assures the reliability of letters of credit as a payment mechanism.[19]

If the issuing bank determines that the documents on their face fail to meet the terms and conditions of the credit, it may refuse the documents.[20] However, under the U.C.P., the issuer has the legal obligation upon refusing the documents to notify the

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[17]*See* Ward Petroleum Corp. v. FDIC, 903 F.2d 1297, 1299 (10th Cir. 1990) ("the very object of a letter of credit is to provide a near foolproof method of placing money in its beneficiary's hands when he complies with the terms contained in the letter itself").

[18]U.C.P. 500 Art. 14(a), U.C.P. 400 Art. 15, and U.C.C. Section 5-114(1). *See, e.g.*, Five Star Parking v. Philadelphia Parking Authority, 703 F.Supp. 20, 8 UCC Rep.Serv.2d 144 (E.D.Pa. 1989) (the bank's duty is simply to honor the draft or payment when the beneficiary submits all required documents and it is under no duty, implied or otherwise, to notify the customer of a draw before paying on a letter of credit); AmSouth Bank, N.A. v. Martin, 559 So.2d 1058, 11 UCC Rep.Serv.2d 1223 (Ala. 1990) (the issuer is obligated to pay beneficiary upon his presentation of documents which complied fully with terms of credit despite the verbal assertions by customer to issuer that they were not in arrears); Sea Management Service, Ltd. v. Club Sea, Inc., 512 So.2d 1025, 5 UCC Rep.Serv.2d 424 (Fla.Dist.Ct.App. 1987) (the bank had no option but to honor letter of credit once beneficiary presented requisite documents); Phibro Distributors Corp. v. Fidelity Int'l Bank, 175 A.D.2d 777, 779, 573 N.Y.S.2d 617, 618 (App.Div. 1991) (all the bank need be concerned with is compliance of presented documents with the terms of the letter of credit).

[19]*See* Crossroads Bank of Georgia v. State Bank of Springfield, 474 N.W.2d 14, 17, 15 UCC Rep.Serv.2d 1285 (Minn.Ct.App. 1991).

[20]U.C.P. 500 Art. 14(b); U.C.P. 400 Art. 16(b).

beneficiary of the documentary discrepancies in order to assert successfully the discrepancy as the basis for dishonor if challenged by the beneficiary in a wrongful dishonor action.[21]

There are several policy considerations for this legal requirement. First, the timeliness of presenting documents is crucial for the beneficiary of letters of credit to obtain payment. The U.C.P. requires that all letters of credit specify an expiry date for presentation of documents for payment, acceptance, or negotiation.[22] The expiry date is the last date when the beneficiary can present conforming documents.[23] The need for an expiration date is particularly acute in a standby letter of credit context.[24] The rationale for the term of expiry is to place a limitation upon the obligation of the

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[21]U.C.P. 500 Arts. 14(d), 14(e); U.C.P. 400 Arts. 16(d), 16(e). There are no analogous provisions in Article 5 of the present U.C.C. However, the proposed revision of Article 5 aligns with the U.C.P. approach in this regard. *See* The American Law Institute and National Conference of Commissioners on Uniform State Laws, the Proposed Final Draft (April 6, 1995) of the Revision of Article 5, Sections 5-108(b)(iii), 108(c), and Comment 3 to Section 5-108.

[22]U.C.P. 500 Art. 42; U.C.P. 400 Art. 46.

[23]U.C.P. 500 Art. 45 and U.C.P. 400 Art. 49 provide that presentation of documents to issuers outside normal banking hours need not be honored. U.C.P. 500 Art. 43(a) and U.C.P. 400 Art. 47(a) require documents to be presented within 21 days of issuance of the transport documents. *See* McCullough, *supra* note 2, §4.05[1][c], at 4-46.

[24]*See* Exxon Co., U.S.A. v. Banque de Paris et des Pays-Bas, 828 F.2d 1121, 1125, 4 UCC Rep.Serv.2d 1134 (5th Cir. 1987) (the issuer, absent evidence of fraud and bad faith, rightfully dishonor a standby letter of credit which terminated prior to the beneficiary's demand for payment pursuant to its own express expiry date).

issuing bank and provide incentive to the customer and beneficiary to perform their reciprocal duties on time.[25]

"In any event, documents must be presented not later than the expiry date of the credit (emphasis added)."[26] If the documents are presented after the expiry date, they are too late to be honored and the beneficiary will not obtain payment, no matter how proper and conforming they are to the letter of credit.[27] Under the proposed revision of Article 5, if presentation is made after the expiration of a credit, the issuer is not required to give notice of discrepancies and is permitted to raise late presentation as a defense despite their failure to give that notice.[28] On the other hand, if the first presentation is defective, the beneficiary may correct or cure the defect in a second presentation, if within the expiry date, and still obtain payment.[29]

Once the beneficiary timely presents the requisite documents, the issuer is obligated, under both the present Article 5 of the U.C.C. and the U.C.P., to make a timely decision as to whether to honor or reject the presentation.[30] Under the U.C.P., an issuing bank is also obligated to notify the beneficiary without delay of any

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[25]*See* Sarna, *supra* note 5, at 7-1 (1993 - Rel.1).

[26]U.C.P. 500 Art. 43(a); U.C.P. 400 Art. 47(a).

[27]*See* McCullough, *supra* note 2, §4.05[1], at 4-48. *See, e.g.*, *Exxon*, 828 F.2d at 1125.

[28]The Proposed Final Draft of the Revision of Article 5, *supra* note 21, Section 5-108(d) and Comment 3.

[29]*See* McCullough, *supra* note 2, §4.05[1], at 4-48.

[30]U.C.C. Section 5-112(1); U.C.P. 500 Art. 13(b); U.C.P. 400 Arts. 16(c), 16(e).

documentary discrepancies for which it refuses the payment.[31] The true purpose served by the various notice provisions of the U.C.P., as articulated by some courts, is to allow the beneficiary an opportunity to cure the defects and receive payment prior to the expiration of the letter of credit and to penalize the issuer for not providing that opportunity.[32] Upon prompt notice of the documentary defects, the beneficiary may also have a chance to persuade the customer to waive the discrepancies before the expiration of the credit and obtain payment, which is particularly acute when the defects are not curable at all or not curable within the expiry date of the credit.[33] The beneficiary's opportunity to seek a waiver of discrepancies provides support for the view that the duty to notify should not limited to curable defects.

The courts are currently divided on justifying the notice requirements on the basis of curing a defect. Some courts hold that "[a] bank's duty to notify is in no way contingent upon its evaluation of the usefulness of the notice" in light of the overall

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[31]U.C.P. 500 Arts. 14(d), 14(e); U.C.P. 400 Arts. 16(d), 16(e).

[32]*See, e.g.*, Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank of Boston, 569 F.2d 699, 703 (1st Cir. 1978); Banque De L'Union Haitienne v. Manufacturer Hanover Int'l Banking Corp., 787 F.Supp. 1416, 18 UCC Rep.Serv.2d. 856 (S.D.Fla. 1991); Offshore Trading Co. v. Citizens Nat'l Bank, 650 F.Supp. 1487, 1491, 3 UCC Rep.Serv.2d (Callaghan) 194, 200 (D.Kan. 1987) (Clearly the reasons for such rules (the U.C.P. automatic preclusion rule) is to give the beneficiary notice of the discrepancies in order to allow it to correct the documentation); Armac Industries, Ltd. v. Citytrust, 203 Conn. 394, 525 A.2d 77, 3 UCC Rep.Serv.2d (Callaghan) 1512 (Conn. 1987); Waidmann v. Mercantile Trust Co. Nat'l Ass'n, 711 S.W.2d 907, 916, 2 UCC Rep.Serv.2d 252 (Mo.Ct.App. 1986).

[33]*See, e.g.*, Stewart Hall Chemical Corp. v. Ideal Trucking Co., 551 F.Supp. 289, 292 (S.D.N.Y. 1982) (when the letter of credit was dishonored at presentation due to a technical defect, the beneficiary contacted the customer directly to seek waiver the defect).

purpose of the U.C.P. and the relevant case law.[34] While other courts excuse an issuing bank's failure to comply with the notice requirements for the defects are not curable.[35]

"Curing a defect" is surely not the only purpose under Article 16 of the U.C.P. 400 where the banking institution is the presenter in contrast with the beneficiary as the presenter.[36] Another reason for imposing the duty of prompt notification of the specification of defects upon the issuer is to allow the presenter (if a negotiating, confirming or paying bank) as much opportunity as possible to recapture its payment, since any delay can prejudice the ability to mitigate loss.[37]

The general obligation of an issuing bank under letters of credit law is, absent strong countervailing policy reasons, to honor the drafts or other demand for payment upon the beneficiary's presentation of documents which comply on their face with the terms of the letter of credit.[38] A bank should be able to deny payment only when the

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[34]*See* Banque De L'Union Haitienne, 787 F.Supp. at 1423-24. *See also* Pro-Fab, Inc. v. Vipa, Inc., 772 F.2d 847, 854 (11th Cir. 1985); Voest-Alpine Int'l Corp. v. Chase Manhattan Bank, N.A., 707 F.2d 680, 684-85 (2d Cir. 1983).

[35]*See, e.g.*, Lennox Industries, Inc. v. Mid-American Nat'l Bank & Trust Co., 49 Ohio App.3d 117, 550 N.E.2d 971, 10 UCC Rep.Serv.2d 1344 (Ohio Ct.App. 1988); Leaseamerica Corp. v. Norwest Bank of Duluth, N.A., 940 F.2d 345, 16 UCC Rep.Serv.2d 738 (8th Cir. 1991); Colorado Nat'l Bank v. Board of County Commissioners, 634 P.2d 32 (Colo. 1981).

[36]*See Banque De L'Union Haitienne*, 787 F.Supp. at 1423.

[37]*See* Rosenblith, *supra* note 16, at 90.

[38]U.C.P. 500 Art. 14(a); U.C.P. 400 Art. 16(a); U.C.C. Section 5-114(1). *See also* Rubenstein, *supra* note 5, at 142-43; Cemar Tekstill Ithalat Ihracat San. Ve Tic v. Joinpac, Inc., No. 91 Civ. 8408, 1992 WL 116370, at *1 (S.D.N.Y. May 24, 1992) (under New York law, a bank has an absolute duty to pay the amount of the credit

beneficiary has committed a wrong, such as fraud, or when the required documents are not tendered.[39] Fairness is a strong policy consideration for obligating banks to honor credits because the beneficiary relies on a bank's promise to pay.[40] In the context of commercial credits, enforcing a letter of credit protects the beneficiary's expectation of prompt payment whenever it can come up with the required documents before the expiry date.[41]

Neither the U.C.C. nor the U.C.P. specifies how precisely the documents must match their description in the letter of credit.[42] The test used by most courts is strict compliance but with excuse for defects that are obviously trivial as a result of a compromise between perfect tender and substantial compliance.[43]

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provided the beneficiary strictly complies with the terms of the credit) (emphasis added).

[39]*See, e.g.*, Sztejn v. J. Henry Schroder Banking Corp., 31 N.Y.S.2d 631 (N.Y.Sup.Ct. 1941).

[40]*See* Dighe, *supra* note 11, at 211. Banks also have a financial interest in enforcing letters of credit for they generally charge one to one and a half percent for issuing a letter of credit. *Id.* n.13.

[41]*See generally* Dighe, *id.*

[42]*See* Bank of Cochin Ltd. v. Manufacturers Hanover Trust Co., 612 F.Supp. 1533, 1537, 41 UCC Rep.Serv. (Callaghan) 920 (S.D.N.Y. 1985), *aff'd*, 808 F.2d 209 (2d Cir. 1986). *See* The Task Force on the Study of UCC Article 5, *An Examination of U.C.C. Article 5 (Letters of Credit)*, 45 BUS. LAW. 1521, 1608 (1990). *But see* the Proposed October 1994 Council Draft of the Revision of Article 5, *supra* note 21, Section 5-108(a) and Comment 1 (the standard of strict compliance governs the issuer's obligation to the beneficiary and to the applicant) .

[43]*See* P.F. Coogan et al., Bender's Uniform Commercial Code Service, Vol. 1D: SECURED TRANSACTIONS UNDER THE UCC, §31.04[1], at 31-42 to 31-43. The "strict compliance" rule, in contrast with the "substantial or reasonable compliance" rule, is best expressed and often cited by the court in Lord Sumner' words that "[t]here

The strict compliance standard reflects banking practice.[44] Those who favor the strict compliance rule argue that it recognizes the unique nature of credits and the ministerial role of the issuer in its obligation to the beneficiary.[45] The strict compliance rule would facilitate the purpose of requiring the beneficiary (seller) to present certain documentation to the issuing bank before collecting payment on the letter, i.e., to give the buyer some assurance that he will receive the goods he bargained for and therefore be protected from fraudulent acts on the seller's part; while substantial or reasonable compliance rule would frustrate this purpose and deprive the protection from the buyer.[46]

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is no room for documents which are almost the same, or which will do just as well ... " *See* Equitable Trust Co. of New York v. Dawson Partners, Ltd., 27 Lloyd's List L.R. 49, 52 (1927).

[44]The Task Force on the Study of the UCC Article 5, *supra* note 42, at 1609. Strict compliance means what a knowledgeable (reasonable) diligent document checker would have accepted as being in facial compliance with the terms of the credit. *See* Boris Kozolchyk, *Is Present Letter of Credit Law up to its Task?*, 8 GEO. MASON U. L. REV. 285, 333-349 (1986).

[45]*See* Ocean Bank of Miami v. La Esquina Presidential, Inc., 623 So.2d 520, 522, 20 UCC Rep.Serv.2d 1050 (Fla.Dist.Ct.App. 1993). *See also* Voest-Alpine Int'l Corp. v. Chase Manhattan Bank, N.A., 707 F.2d 680, 683 (2d Cir. 1983) (strict compliance is generally essential so as not to impose an obligation upon the bank that it did not undertake and so as not to jeopardize the bank's right to indemnity from its customer); Cemar Tekstill Ithalat Ihracat San. Ve Tic v. Joinpac, Inc., No. 91 Civ. 8408, 1992 WL 116370, at *1 (S.D.N.Y. May 24, 1992) (the rationale for requiring strict compliance is that the bank relies totally on the terms of the letter of credit in deciding whether to pay pursuant to the independence principle of the letter of credit law); H. Harfield, LETTERS OF CREDIT, 57-59 (1979).

[46]*See* Davidcraft Corp. v. First National Bank of Maryland, No. 83 C 5481, 1986 WL 1030, at *2 (N.D.Ill. Jan. 3, 1986) (citation omitted).

The affirmative obligation to notify the beneficiary of a letter of credit imposed on an issuing bank by the U.C.P. and the proposed revision of Article 5 of the U.C.C. is a "fitting balance" to the strict compliance rule.[47] On one hand, the "strict compliance" rule forces the beneficiary to present documents that comply with the terms of the credit. On the other hand, an issuing bank must examine the documents and notify the beneficiary of its decision of dishonor promptly so that the beneficiary would have a chance to rectify timely any errors in the documentation supporting a letter of credit or persuade the applicant to waive those discrepancies. "[I]t would be fundamentally unfair," as stated by a court, "to exact strict compliance from the beneficiary without affording an opportunity to correct documentary defects before harm has been suffered by any party to the transaction."[48]

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[47]*See* J.F. Dolan, THE LAW OF LETTERS OF CREDIT (2d ed. 1991), 1994 Cumulative Supplement No. 1, at S4-10. *See also* J.E. Byrne, *Letters of Credit*, 43 BUS. LAW. 1353, at 1371 (1988) (the automatic preclusion rule balanced and provided symmetry to the strict compliance rule); J.D. Thier, *Letters of Credit: A Solution to the Problem of Documentary Compliance*, 50 FORDHAM L. REV. 848 (1982) ("[a]n equitable approach to a strict compliance standard demands that the issuer promptly communicate all documentary defects to the beneficiary [or confirming bank], when time exists under the letter to remedy the nonconformity.")

[48]Paramont Export Co. v. Asia Trust Bank, Ltd., 238 Cal.Rptr. 920, 925, 193 Cal.App.3d 1474, 1482, 5 UCC Rep.Serv.2d 149 (1987).

Chapter II

COMPARISON OF ARTICLE 5 AND UCP PROVISIONS

This chapter will first examine the present provisions of Article 5 of the U.C.C. and the U.C.P. 400 (1983 Revision) on the notification of the documentary discrepancies in the letter of credit transactions. It then examines the proposed revision of Article 5 and the U.C.P. 500.

2.1. Present Article 5 of the U.C.C. The Article 5 does not directly nor completely address the issue of notification of documentary discrepancies.[49] Recognizing the documentary nature of the letter of credit transactions and the examination duties of the issuer, Section 5-112(1) allows the issuer three banking days (which is a longer period than in the case of ordinary drafts under Section 3-506) to examine the documents and determine whether to honor or reject the letters of credit.[50]

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[49]*See* Rosenblith, *supra* note 16, at 89 n.8 (the U.C.C. contains no provision analogous to U.C.P. 500 Art. 14 and U.C.P. 400 Art. 16).

[50]U.C.C. Section 5-112 (1) and Official Comment 1. Section 5-112(1) provides: A bank to which a documentary draft or demand for payment is presented under a credit may without dishonor of the draft, demand or credit (a) defer honor until the close of the third banking day following the receipt of the documents; and (b) further defer honor if the presenter has expressly or impliedly consented thereto. Failure to honor within the time here specified constitutes dishonor of the draft or demand and of the credit.

Under Section 5-112(1), an issuer's failure to act timely in examining documents "constitutes dishonor of ... the credit."[51] If subsequently challenged for wrongful dishonor by the beneficiary, the issuer who fails to honor within three banking days may raise nonconformity as a defense.[52] The affirmative defense of waiver or estoppel is available to the beneficiary regarding the issuer's delay in examining the documents under the U.C.C.[53] Even though the text of the present Article 5 does not impose a duty on the issuer of notification of the reasons for dishonor, the cases under the U.C.C. generally recognize this duty based on general good faith obligation or common law or equitable doctrines of waiver or estoppel.[54] A

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[51]U.C.C. Section 5-112(1).

[52]*See* James G. Barnes, *Nonconforming Presentations under Letters of Credit: Preclusion and Final Payment*, 56 BROOK. L. REV. 103, 104 (1990).

[53]*See* The Task Force on the Study of UCC Article 5, *supra* note 42, at 1601.

[54]*See* Barnes, *supra* note 52, at 104, 109 n.7. *See also* U.C.C. Sections 1-103 and Official Comment 1, 5-102(3), and Official Comment 1 to 5-104(1) ("questions of mistake, waiver or estoppel are left to supplemental principles of law"). *See, e.g.*, Dibrell Brothers Int'l S.A. v. Banca Nazionale Del Lavoro, -- F.3d --, No. 93-8452, at *7 (11th Cir. Dec. 2, 1994) (the equitable doctrine of waiver and estoppel apply in a letter of credit case, although not specifically provided for in Article 5 [of the U.C.C.]); Occidental Fire & Casualty Co. of North Carolina v. Continental Bank, N.A., 918 F.2d 1312, 1318 (7th Cir. 1990) (although neither the Illinois UCC nor the UCP 290 specifically states that a bank must give unambiguous reasons for dishonor of a sight draft, we think such a rule comports with the general good faith requirement); Barclays Bank D.C.O. v. Mercantile Nat'l Bank, 481 F.2d 1224 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139, 94 S.Ct. 888, 39 L.Ed.2d 96 (1974) (absent Article 5's provision to the contrary, the court had a duty to apply equitable doctrines of waiver or estoppel to letter of credit transaction).

showing of detrimental reliance on the part of the beneficiary is generally required by courts before they estop the issuer from raising defects that it had not raised.[55]

Under U.C.C. Section 5-112(2), the issuer has a duty to either return the documents or hold them at the disposal of the presenter, and send an advice to that effect.[56] However, no statutory penalty is provided if the issuer fails to fulfill this duty. In other words, the presenter, under the U.C.C., will have no cause of action against the issuer for wrongful dishonor as long as the drawing is defective; on the contrary, the presenter will have breached a presentment warranty under U.C.C. Section 5-111(1). The presenter may, however, have a conversion action arising from the issuer's failure to fulfill its 5-112(2) duty.[57] The beneficiary or a remitting bank is and remains the owner of the documents and the goods which the documents represent unless and until the issuer finds the presented documents conforming and makes a

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[55] *See* J.F. Dolan, *Establishing and Amending the Credit and Relationships between Issuer and other Parties*, 399 PLI/Comm 67, at 85 (1986) (citing Pro-Fab, Inc. v. Vipa, Inc., 772 F.2d 847 (11th Cir. 1985) (dictum); Banco Nacional De Desarrollo v. Mellon Bank, N.A., 726 F.2d 87 (3d Cir. 1984); United Commodities-Greece v. Fidelity Int'l Bank, 64 N.Y.2d 449, 478 N.E.2d 172, 489 N.Y.S.2d 31 (1985)). *See also* Offshore Trading Co. v. Citizens Nat'l Bank, 650 F.Supp. 1487, 3 UCC Rep.Serv.2d (Callaghan) 194 (D.Kan. 1987); Armac Industries v. Citytrust, 203 Conn. 394, 525 A.2d 77 (1987); Security State Bank of Basin v. Basin Petroleum Services, 713 P.2d 1170 (Wyo. 1986).

[56]The assumption under this U.C.C. provision is that the documents tendered by the beneficiary are valuable, e.g., the documents control title or right to possession of the goods. This may not be true in a standby letter of credit case, where the documents presented (e.g., the beneficiary's statement of default by the account party) have no independent value. *See* Barnes, *supra* note 52, at 109 n.6.

[57]*See* Rosenblith, *supra* note 16, at 89 n.8.

payment under the letter of credit.[58] If the issuer decides to reject the demand for payment, it cannot dispose the documents without the authority or consent of the owner of the documents (beneficiary or the remitting bank); otherwise, it will be subject to liability for conversion, i.e., the unauthorized exercise of dominion or control over property of another.[59]

2.2. U.C.P. 400 (1983 Revision). Under U.C.P. 400 Article 16(c), the bank has a dual obligation of examination and determination, "the issuing bank shall have a reasonable time in which to examine the documents and to determine ... whether to take up or to refuse the documents (emphasis added)."

Article 16(d) delineates an issuing bank's duties to notify the presenter of the nonconforming documents presented for payment under the letters of credit:

> "If the issuing bank decides to refuse the documents, it must give notice to that effect without delay by telecommunication or, if that is not possible, by other expeditious means, to the bank from which it received the documents (the remitting bank), or to the beneficiary, if it received the documents directly from him. Such notice must state the discrepancies in respect of which the issuing bank refuses the documents and must also state whether it is holding the documents at the disposal of, or is returning them to, the presenter (remitting bank or the beneficiary, as the case may be). The issuing bank shall then be entitled to claim from the

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[58]It is noteworthy to mention that the advise as to the fate of the documents should be to those who would have a real interest in the documents presented. In practice, the presenter may be either a "courier bank" who has no interest in the documents presented but only transmits the documents or a bank who provides a preliminary check of the documents (sometimes for a fee) and forwards them to the issuer or confirmer. *See* The Task Force on the Study of UCC Article 5, *supra* note 42, at 1607.

[59]*See* Rosenblith, *supra* note 16, at 83 n.5.

> remitting bank refund of any reimbursement which may have been made to that bank."[60]

Therefore U.C.P. 400 expressly imposes on the issuing bank an affirmative obligation of notification of the documentary discrepancies to the presenter of the documents. To comply with the U.C.P. 400 Article 16(d) requirements, the notice of dishonor must be sent 1) promptly; 2) by telecommunication or other expeditious means; 3) stating the discrepancies in particular; 4) advising the disposition of the nonconforming documents; and 5) to the right party who presents the documents. The notice of dishonor that fails to meet any of the above requirements is a defective one under the U.C.P. 400 and results in a preclusion against the issuing bank.

Under Article 16(e), "[i]f the issuing bank fails to act in accordance with the provisions of [Article 16(c) and 16(d)] and/or fails to hold the documents at the disposal of, or to return them to, the presenter, the issuing bank shall be precluded from claiming that the documents are not in accordance with the terms and conditions of the credit." Therefore failure of the issuer to examine the documents within a reasonable time or to promptly give adequate notice of documentary defects to the

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[60]Article 8 of U.C.P. 290 (1974 Revision) is the predecessor of Article 16 of U.C.P. 400. An essential difference between them is that the former did not require a specification of the defects claimed for rejection of the documents while the later does. A notice of simply stating that "your documents do not comply" will satisfy the Article 8(e) of U.C.P. 290 notice requirement. *See* Rosenblith, *supra* note 16, at 99. *See also* Banco Do Brasil, S.A. v. City Nat'l Bank of Miami, 609 So.2d 689, 696, 19 UCC Rep.Serv.2d 831 (Fla.Dist.Ct.App. 1992) (dissenting) (it was the U.C.P. 400 which required the issuer to specify the grounds for dishonor; while U.C.P. 290 only obligated an issuing bank to notify of discrepancies in the documents). *But see* Kuntal, S.A. v. Bank of New York, 703 F.Supp. 312, 313, 9 UCC Rep.Serv.2d 1033 (S.D.N.Y. 1989) (it is undisputed that Articles 16(c) and 16(d) from the 1983 revision are virtually identical to Articles 8(d) and 8(e)).

person who presented the documents to the issuer for payment triggers an preclusion and renders the issuer liable for the face amount of the beneficiary's draft or demand (i.e., the issuer has to pay for the documents regardless of their nonconformity).[61] Accordingly, under U.C.P. 400, the consequence of inaction within a reasonable time is absolute preclusion from raising any objection of non-compliance, and the consequence of lack of a notice of dishonor or a defective notice is absolute preclusion from either raising any objection of nonconformity, or raising any objection other than those stated in the notice of dishonor which is to be given without delay.[62]

Preclusion under U.C.P. 400 Article 16(e) is based on mere noncompliance with the Article 16(c) or Article 16(d) notice requirements by the issuer, rather than on detrimental reliance by the beneficiary or intentional abandonment of nonconformity defenses by the issuer.[63] The U.C.P. preclusion is often characterized as "strict," or "automatic," or "absolute" preclusion rule.[64] One commentator describes Article 16(e) as a "strict estoppel" or "strict preclusion" rule.[65] The so-called "strict estoppel" rule under the U.C.P. 400 is different from that of common-law estoppel which requires the beneficiary to prove three traditional elements: issuer's conduct that leads the beneficiary to believe that nonconforming documents do conform, reasonable reliance

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[61]*See* Dolan, *supra* note 3, ¶4.06[2][c], at 4-30.

[62]*See* The Task Force on the Study of UCC Article 5, *supra* note 42, at 1601.

[63]*See* Barnes, *supra* note 52, at 103.

[64]*See* The Task Force on the Study of UCC Article 5, *supra* note 42, at 1601-03.

[65]*See* J.F. Dolan, *Strict Compliance with Letters of Credit: Striking a Fair Balance*, 102 BANKING L.J. 18, 31 (1985).

by the beneficiary, and the beneficiary's detriment from that reliance.[66] Therefore, it is reasonable to expect that estoppel will be applied more to hold the issuer accountable in the letter of credit that incorporates the U.C.P. The court, in the credits that are not governed by the U.C.P., tends to weight the strict compliance rule over the strict estoppel and likely to rule in an issuer's favor.[67]

There are obvious conflicts between present Article 5 of the U.C.C. and Article 16 of the U.C.P. 400. The present U.C.C. employs a rigid time period (three-banking-days) for an issuer's determination on honor or dishonor of the documents presented for payment under the letter of credit; while the U.C.P. 400 uses a more flexible "reasonable time standard" in this regard.[68] Since the U.C.P. provision differs from that of the Article 5 regarding the time allowed for honor, a letter of credit which is subject to both Article 5 and the U.C.P. could create a dispute which requires court resolution. A logical resolution of the dispute would be to consider the three-banking-day period under the U.C.C. Section 5-112(1)(a) a reasonable time under the U.C.P.

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[66]*See* Dolan, *supra* note 3, ¶6.06[1][a], at 6-52. For the cases that required a showing of detrimental reliance for estoppel to apply, *see, e.g.*, Pro-Fab, Inc. v. Vipa, Inc., 772 F.2d 847 (11th Cir. 1985) (dictum); Banco Nacional De Desarrollo v. Mellon Bank, N.A., 726 F.2d 87 (3d Cir. 1984); United Commodities-Greece v. Fidelity Int'l Bank, 64 N.Y.2d 449, 478 N.E.2d 172, 489 N.Y.S.2d 31 (1985); Offshore Trading Co. v. Citizens Nat'l Bank, 650 F.Supp. 1487, 3 UCC Rep.Serv.2d (Callaghan) 194 (D.Kan. 1987); Armac Industries v. Citytrust, 203 Conn. 394, 525 A.2d 77 (1987); Security State Bank of Basin v. Basin Petroleum Services, 713 P.2d 1170 (Wyo. 1986).

[67]*See* Byrne, *supra* note 47, at 1371. *See, e.g.*, Mercantile-Safe Deposit & Trust Co. v. Baltimore County, 309 Md. 668, 670-71, 526 A.2d 591, 592, 3 UCC Rep.Serv.2d (Callaghan) 1500, 1501-02 (1987) (noted discrepancies in addition to those stated in the notice of dishonor).

[68]*See* U.C.C. Section 5-112(1), and U.C.P. 400 Art. 16(c).

unless the issuer and presenter had agreed to a longer period, an agreement which is permitted by the U.C.C. Section 5-112(1)(b).[69] Unless the courts are inclined to hold that three banking days, and three banking days only, constitute a reasonable time period for a bank under U.C.P. Article 16(c), the duties of banks will differ under the U.C.C. from their duties under the U.C.P. 400.[70]

As to the effect of a failure to act within the time allowed, the U.C.C. and U.C.P. adopted different approaches. In contrast with the automatic dishonor rule under the U.C.C., the U.C.P. uses a strict preclusion rule, i.e., the issuing bank is liable to the beneficiary for the delay and accuracy in giving notice of defects in the documents without showing of any detrimental effect on the part of the beneficiary.[71]

The U.C.P. and U.C.C. approaches have their own merits. One commentator argued that the U.C.P. is superior to the U.C.C. in providing quick and certain answers to facial nonconformity issues and wrongful dishonor issues but it lacks

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[69]*See* W.D. Hawkland & T.L. Holland, Uniform Commercial Code Series §5-112:01 (Article 5) (Main Volume) (1984).

[70]*See* Dolan, *supra* note 3, ¶4.06[2][b], at 4-28 to 4-29. *See, e.g.*, Peoples State Bank v. Gulf Oil Corp., 446 N.E.2d 1358 (Ind.Ct.App. 1983) (the issuer of a credit subject to the U.C.P. had three days to decide whether to honor the beneficiary's drafts). *But see* Alaska Textile Co. v. Chase Manhattan Bank, N.A., 982 F.2d 813, 19 UCC Rep.Serv.2d 540 (2d Cir. 1992) (the reasonable time allowed by the U.C.P. is not to be equated with the three banking day period allowed by Section 5-112(1) under the U.C.C.).

[71]*See* Pro-Fab, Inc. v. Vipa, Inc., 772 F.2d 847 (11th Cir. 1985) (instead of holding that the issuer has dishonored the credit by failure to act within three days provided by U.C.C. Section 5-112, the issuer was estopped from raising defects in the beneficiary's documents without the beneficiary's proving of detrimental reliance). *See also* Dolan, *supra* note 3, ¶4.06[2][b], at 4-29.

equity.[72] The result of enforcing U.C.P. 400 Article 16 in some cases may not seem to be fair, but the enforcement of legal rights and liabilities does not necessarily have to have an equitable result.[73] The effectiveness of the letter of credit as a commercial device is diminished under the current U.C.C. provision because the present Section 5-112 provides a certain incentive to dishonor and the beneficiary will be forced to litigate for wrongful dishonor with the burden of proof of conformity, estoppel or waiver.[74] The U.C.C. approach combined with section 5-111(1)[75] warranty and the section 5-115(1)[76] limitations on dishonor remedies generally provide too much equity and too little certainty, clarity and finality to use in practice. Furthermore, the introduction of fact-intensive matters would impede summary judgement in the letters of credit litigation context.[77]

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[72]*See* Barnes, *supra* note 52, at 108 (the inclusion of those nonconformities which appear facially to be incurable into the preclusion rule is less equitable).

[73]*See* Rosenblith, *supra* note 16, at 89.

[74]*See* The Task Force on the Study of UCC Article 5, *supra* note 42, at 1602.

[75]Under U.C.C. Section 5-111(1), the beneficiary warrants compliance with the credit to all interested parties, including the issuer.

[76]Under U.C.C. Section 5-115(1), the beneficiary of a wrongfully dishonored credit is not entitled automatically to specific performance. The beneficiary's damages are to be reduced by "any amount realized by resale or other use or disposition of the subject matter of the transaction."

[77]*See* Barnes, *supra* note 52, at 108-09. *See* Banque Worms v. Banque Commercial Privee, 679 F.Supp. 1173, 1178 (S.D.N.Y.), *aff'd*, 849 F.2d 787 (2d Cir. 1988) (actions pertaining to letters of credit are particularly "well suited to determination by motion for summary judgement because they normally present solely legal issues relating to an exchange of documents.")

2.3. The Proposed Revision of Article 5 and U.C.P. 500 (1993 Revision). One commentator has argued that both the present Article 5 of the U.C.C. and U.C.P. 400 are not up to its task and it is time to bridge the gap between Article 5 of the U.C.C., the U.C.P. and banking practice.[78]

Section 5-108 of the Proposed Final Draft of the Revision of Article 5 provides that "[a]n issuer has a reasonable time after presentation, but not beyond the end of the seventh business day of the issuer after the day of its receipt of documents: (1) to honor, (2) if the letter of credit provides for honor to be completed more than seven business days after presentation, to accept a draft or incur a deferred obligation, or (3) to give notice to the presenter of discrepancies in the presentation."[79] The incorporation of a "reasonable time" standard for dishonor into the U.C.C. would eliminate a conflict in a area in which the U.C.P. will almost certainly never move towards the U.C.C. three days rule.[80] In contrast with the present Article 5, the issuer has an affirmative obligation, under the proposed revision of Article 5, to notify the beneficiary of the documentary discrepancies after the issuer makes the decision to dishonor. Notification of discrepancies is expressly dealt with for the first time in the U.C.C.[81]

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[78]*See* Kozolchyk, *supra* note 44, at 348.

[79]The Proposed Final Draft of the Revision of Article 5, *supra* note 21, Section 5-108(b) and Comment 3.

[80]*See* The Task Force on the Study of UCC Article 5, *supra* note 42, at 1601-03.

[81]*See* Coogan et al., *supra* note 43, §31.04[5], at 31-63 (1994).

The virtue of the preclusion obligation is that it forecloses litigation about reliance and detriment. Thus, the proposed revision of Article 5 "substitutes a strict preclusion principle for the doctrines of waiver and estoppel that might otherwise apply under Section 1-103."[82] In contrast with the present Article 5 which treats the inaction within the time allowed as dishonor, Section 5-108(c) provides that failure to give timely notice precludes the issuer from asserting dishonor on the basis of any discrepancies in the presented documents against the terms and conditions of the letters of credit; even if a timely notice is given, an issuer is precluded from asserting as a basis of dishonor any discrepancies not stated in the notice.[83] Therefore the content of the notification will circumscribe an issuer's legal defenses against the wrongful dishonor charges. The issuer must specify any discrepancy that it may later rely on to justify the dishonor in the notification. The proposed revision of Article 5 is in harmony with the U.C.P. with regard to an issuer's duty of notification of documentary discrepancies in letter of credit transactions.

The widely-used 1983 revision of the U.C.P. has also undergone some significant changes. The 1993 revision, U.C.P. 500, took effect January 1, 1994.[84] The U.C.P. 500 preserves much of the features of Article 16 of the U.C.P. 400. The

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[82]The Proposed Final Draft of the Revision of Article 5, *supra* note 21, Comment 3 to Section 5-108.

[83]*Id.* Section 5-108(c).

[84]Michael E. Avidon, *Counsel's Corner: Letters of Credit -- New UCP 500 to Take Effect January 1, 1994*, 111 BANKING L.J. 83 (1994).

following discussion will highlight briefly the changes regarding notification requirements under the U.C.P. 500.

The U.C.P. 400 provided banks "a reasonable time" in which to examine the documents and determine whether to take up or refuse the documents.[85] U.C.P. 500 changes the length of time as Article 13(b) provides banks "a reasonable time, not to exceed seven banking days following the day of receipt of the documents, to examine the documents and determine whether to take up or refuse the documents and to inform the party from which it received the documents accordingly (emphasis added)."

The conflict between the present Article 5 and the U.C.P. 400 as to what constitutes timely examination and determination will be completely eliminated with the introduction of "a reasonable time subject to a maximum of seven business (banking) days" standard into the Proposed Revision of Article 5 and the U.C.P. 500.[86] It should be pointed out that the timing standard is not a fixed period, but an uncertain "reasonable time," whether one hour or several days depending on the individual transaction, subject to a maximum of seven banking days for extraordinary occurrences following the day of receipt of the documents.[87]

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[85]U.C.P. 400 Art. 16(c).

[86]The difference between "banking days" under the U.C.P. and the "business days" under the U.C.C. is rarely significant. *See* the Proposed Final Draft of the Revision of Article 5, *supra* note 21, Comment 2 to Section 5-108.

[87]*See, e.g.*, Full-Bright Industries Co. v. Lerner Stores, Inc., 818 F.Supp. 619 (S.D.N.Y. 1993) (whether time is reasonable must be determined from all facts and circumstances). *See also* the Proposed Final Draft of the Revision of Article 5, *id.* Comment 2 to Section 5-108 (what is a "reasonable time" is to be determined by examining the behavior of those -- mostly banks -- in the business of examining documents ... the nonpayment by the applicant or the insufficient fund on the

The U.C.P. 400 included in the same article (Article 16) both the duty to examine documents within a reasonable time and the duty to give notice without delay. Failure of performing these two duties activates the rule of preclusion.[88] The duty of examination and determination and the duty of notification are dealt with in two different articles under the U.C.P. 500. An issuer's duty of examination and determination is set forth in Article 13 of the U.C.P. 500 whereas the duty of notification is stipulated in Article 14, which reads:

> "d.i. If the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf, decides to refuse the documents, it must give notice to that effect by telecommunications or, if that is not possible, by other expeditious means, without delay but no later than the close of the seventh banking day following the day of receipt of the documents. Such notice shall be given to the bank from which it received the documents or to the Beneficiary, if it received the documents directly from him.
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> ii. Such notice must state all discrepancies in respect of which the bank refuses the documents and must also state whether it is holding the documents at the disposal of, or is returning them to, the presenter."

The duty of notification under U.C.P. 500 is virtually identical to that under U.C.P. 400 except that there is a change in the time limit. Under U.C.P. 500, the notice of dishonor must be sent without delay and in no event exceeding seven banking days following the day of receipt of the documents.

The preclusion rule is stated in Article 14(e): "[i]f the Issuing Bank and/or Confirming Bank, if any, fails to act in accordance with the provisions of this Article

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applicant's account to cover the credit is not a basis for extension of the time period).

[88]*See* U.C.P. 400 Arts. 16(c), 16(d), and 16(e).

and/or fails to hold the documents at the disposal of, or return them to the presenter, the Issuing Bank and/or Confirming bank, if any, shall be precluded from claiming that the documents are not in compliance with the terms and conditions of the Credit." As a result, the preclusion rule in the document examination article is now deleted from the U.C.P. 500, and banks only face a preclusion rule if they fail to give notice of documentary defects without delay after they decide to refuse the documents or more than seven days after the beneficiary presents his documents.[89] In other words, under the U.C.P. 500, issuing banks still must examine documents within a reasonable time, but there are no consequences for their violation of that duty.[90] Thus, the issuing bank that delays examining the documents for more than a reasonable time will escape the preclusion under the U.C.P. 500 as long as it notifies the beneficiary promptly after it finally decides not to accept the documents.[91] The protection under the U.C.P. 400 Article 16(e) is diminished by the change in the preclusion rule because the beneficiary may run serious risks of detriment when the bank delays examining the documents.[92]

Some perceived that seven banking days outer limit to the time within which the bank must give the notice of defects under U.C.P. 500 is far too long to protect the beneficiary in most cases in contrast with the "without delay" rule of the U.C.P.'s

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[89]*See* Dolan, *supra* note 47, ¶4.06[2][c], at S4-10.

[90]*See* U.C.P. 500 Arts. 13(a) and 13(b).

[91]*See* Dolan, *supra* note 47, ¶4.06[2][c], at S4-10.

[92]*See* Dolan, *id.* ¶4.06[2][c], at S4-11. Seven banking days for the bank to examine the documents may include two weekends, i.e., eleven days, while the expiry date of a credit continues to approach on weekends (except when the expiry date itself falls on a nonbanking day. *See* U.C.P. 500 Art. 44(a). *See* Dolan, *id.* ¶4.06[2][b], at S4-9.

prior versions.[93] However, the language of U.C.P. 500 Article 14 does not support any relaxing of the vigor "without delay" rule.[94] Seven-day period is not a safe harbor for an issuer to honor or give notice under both U.C.P. 500 and the proposed revision of Article 5, "[t]he time within which the issuer must give notice is the lesser of a reasonable time or seven business days."[95] To give notice within a reasonable time, an issuer is normally obligated to communicate promptly with the presenter shortly after making a decision to dishonor, perhaps on the same business day.[96]

The U.C.P. 500 Article 14(c) expressly permits issuers to seek waivers from applicants of documentary discrepancies prior to giving notice of dishonor, however, seeking waiver does not extend the time limit under Article 13(b). The U.C.P. 400 Article 16 is silent in this regard.[97] Under the proposed revision of Article 5 Section

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[93]*See* Dolan, *id.* ¶4.06[2][c], at S4-10, S4-11 (it is difficult to conceive of circumstances under which a bank might need seven days to give the notice after it has determined not to accept the beneficiary's documents).

[94]*See* Dolan, *id.* ¶4.06[2][c], at S4-10.

[95]*See* the Proposed Final Draft of the Revision of Article 5, *supra* note 21, Comment 2 to Section 5-108.

[96]*See* the Proposed Final Draft of the Revision of Article 5, *id.* Comment 4 to Section 5-108.

[97]U.C.P. 500 Art. 14(c) states: "If the Issuing Bank determines that the documents on their face are not in compliance with the terms and conditions of the Credit, it may in its sole judgement approach the Applicant for a waiver of the discrepancies. This does not, however, extend the period mentioned in Article 13(b) (i.e., a reasonable time, not to exceed seven banking days)."

5-108, the issuer has no duty to seek a waiver from the applicant, neither is the issuer precluded from doing so.[98]

In summary, the present Article 5 of the U.C.C. conflicts with U.C.P. 400 regarding the time limit for an issuer to examine the documents and determine whether to take them up or refuse them. Upon refusing the documents, an issuer is obligated to notify the presenter of the documentary discrepancies. Failure to observe the U.C.P. notification requirements on the part of the issuer will trigger the preclusion rule. Absent analogous provisions of notification and preclusion in the U.C.C., courts that rely solely on Article 5 will require a showing of detrimental reliance from the beneficiary in order to estop the issuer from claiming nonconformity. The proposed revision of Article 5 is in harmony with U.C.P. 500 regarding an issuer's duty to examine the documents and to notify the presenter of the discrepancies. As a result of the enforcement of U.C.P. 500 and the adoption of the revision of Article 5, it is reasonable to expect that the outcome of the litigations arising from the letter of credit transactions in the United States will move towards greater certainty, uniformity, and predictability.

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[98]*See* the Proposed Final Draft of the Revision of Article 5, *supra* note 21, Comment 2 to Section 5-108.

Chapter III

PROBLEMS WITH NOTIFICATION REQUIREMENTS

Regarding the performance of letters of credit, the largest number of cases are actions by the beneficiary against the issuer, arising out of the beneficiary's allegation that the issuer has wrongfully dishonored the credit.[99] Under both the U.C.C. and the U.C.P., the issuer is obligated to pay the complying drafts or demand for payment and may dishonor the nonconforming ones. As a matter of fact, a substantial percentage of all presentations made under letters of credit, particularly commercial letters of credit, are nonconforming.[100] Although the issuer will be able to obtain waivers from the account party in most cases, there is still a substantial amount of wrongful dishonor litigation. This Chapter will focus on how the courts interpret and apply the U.C.C. and U.C.P. provisions that govern an issuer's duty to notify the beneficiary of the documentary discrepancies when confronting the issue of the necessity and adequacy of the notice of dishonor.

3.1. Timing issues. It is an issuer's basic duties to examine the documents and determine whether to honor or reject them and notify the presenter of the dishonor in a

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[99]*See* Harfield, *supra* note 3, at 35.

[100]*See* 1 Letter of Credit Update 5 (Aug. 1985); 3 Letter of Credit Update 13 (July 1987). *See also* Alaska Textile Co. v. Chase Manhattan Bank, N.A., 982 F.2d 813, 824, 19 UCC Rep.Serv.2d 540 (2d Cir. 1992); Western Int'l Forest Products, Inc. v. Shinhan Bank, 860 F.Supp. 151, 155, 24 UCC Rep.Serv.2d 998 (S.D.N.Y. 1994).

timely fashion. Timely examination and timely notification are two separate and yet related issues. The time limit for examination and determination is relevant in deciding when and whether the cause of action for wrongful dishonor has accrued.[101] The duty to notify under the U.C.P. and the proposed revision of Article 5 is triggered by the decision of dishonor after a timely examination. As discussed in Chapter II, the consequences of failure to fulfill the timely examination and timely notification duties are also different.

The cases examined in this paper are decided under the U.C.P. 400 or its predecessor and U.C.C. Article 5 which set forth different time limits for evaluation of documents and notification of discrepancies. The present U.C.C. allows an issuer three banking days to review the draw documents and make a decision but is silent on the issue of notification. Under the U.C.P. 400, an issuing bank has "a reasonable time" to examine the documents and make a determination, while the notice of dishonor should be sent "without delay." Since the languages of "reasonable time" and "without delay" are ambiguous, the courts have been called to construe the meaning. The interplay between the U.C.P. time limit and the present U.C.C. three-day rule is another question that the courts need to answer. The following discussions attempt to explore how the courts define a timely notice of discrepancies.

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[101]*See* The Task Force on the Study of UCC Article 5, *supra* note 42, at 1602.

Bank of Cochin Ltd. v. Manufacturers Hanover Trust Co.[102] is a leading case on how to interpret the languages of "reasonable time" and "without delay" under the U.C.P. The issuer of the letter of credit brought an action against the confirming bank for wrongful honor because the confirming bank had paid the letter despite two discrepancies in the documents. However, the issuing bank did not specify the defects nor advise the fate of the documents until twelve or thirteen days after the receipt of the documents from the confirming bank.

The credit was subject to U.C.P. 290 (1974 Revision) by its express terms. Since the U.C.P. were silent as to what constitutes a "reasonable time" to determine if the documents are defective or notice "without delay", the United States District Court for the Southern District of New York referred to the three banking day rule under Section 5-112(1)(a) of the New York U.C.C. as long as it is consistent with the U.C.P.[103] The district court contended that the three-day period is a reasonable and the maximum time allowable for the issuer to meet the "without delay" notification requirement.[104] The district court further found that the U.C.P. implicitly invites cure of any documentary discrepancies apparent before the expiration of the credit by issuer's notification to the beneficiary.[105] The district court held that the issuing bank's twelve or thirteen days' unjustifiably delay violated the explicit notice requirements of

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[102]612 F.Supp. 1533, 41 UCC Rep.Serv. 920 (S.D.N.Y. 1985), *aff'd*, 808 F.2d 209 (2d Cir. 1986).

[103]612 F.Supp. at 1542.

[104]*Id.* at 1543.

[105]*Id.* at 1542.

the U.C.P., and thus precluded it, under Article 8(f) of U.C.P. 290, from asserting the nonconformity of the documents against the confirming bank.[106]

The issue on appeal is the interpretation of key undefined terms in Article 8 of the U.C.P. 290, i.e., "a reasonable time," "without delay," and "by "expeditious" means.[107] The Second Circuit did not address whether it should read the U.C.C.'s three-day rule into the U.C.P.'s time requirement. Instead, construing "giving notice without delay" language under Article 8(e) of the U.C.P. 290 as "connot[ing] a sense of urgent action within the shortest interval of time possible", the Second Circuit found that the issuer's twelve to thirteen days delay did not satisfy the U.C.P.'s "without delay" requirement in light of the near instantaneous international communication and affirmed the district court's decision in favor of the confirming bank.[108] The Circuit court further justified its decision by stating that had the issuing bank informed the confirming bank promptly of the defects, some part or all of the funds might have been recovered before they were removed from the beneficiary's bank account.[109]

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[106]*Id.*

[107]808 F.2d at 211-12.

[108]*Id.* at 213. For the disapproval of the *Bank of Cochin* decision, *see generally* David L. Tank, *Bank of Cochin Ltd. v. Manufacturers Hanover Trust: "Quasi-Strict" Compliance of Documents, Issuer's "Supervisory Cure," and "Reasonably delay" under Letters of Credit*, 18 U. MIAMI INTER-AM. L. REV. 535 (1987) ("what is reasonable time" and "what is without delay" should be treated as a matter of fact, rather than a question of law, to be decided on a factual basis; In order to apply estoppel, New York requires the party prove detrimental reliance. Both the district court and Second Circuit ignored the analysis of the elements of estoppel).

[109]*Id.*

The courts in *Bank of Cochin* reached the same decision but relied on different grounds. The district court interpreted the time limit for notice of defects under the U.C.P. by referring to the U.C.P. three-day rule, although the U.C.C. rule appears to set out only the time limit for honor or rejection of a draft or demand for payment. A notice of defects within three days after the presentation of the documents will satisfy the U.C.P. "without delay" requirements according to the district court's reasoning. The Second Circuit turned to the literal meaning of the language of "without delay" and construed a timely notice as one which is sent "within the shortest interval of time possible." The "without delay" rule set in the *Bank of Cochin* has been followed by other cases.[110]

In *Kuntal, S.A. v. Bank of New York,*[111] the issuing bank examined the documents on February 23, 1987, two business days after the receipt of the documents. The issuing bank did not determine whether to accept or refuse the documents nor give notice of its refusal of the documents until the Fourth of March, nine business days after its receipt of the documents. The bank argued that the delay was for the purpose of allowing its customer to decide whether or not to waive the discrepancies. It is not a convincing justification to the court because (1) nine full days are to long for the customer to decide whether or not to accept the deal, and (2) the bank's consultation

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[110]Although *Bank of Cochin* case addressed Articles 8(d) and 8(e) of the U.C.P. 290 (1974 Revision), it is still controlling in the case subject to the U.C.P. 400 (1983 Revision) because it is undisputed that Articles 16(c) and 16(d) from the 1983 revision are virtually identical to Articles 8(d) and 8(e). *See Kuntal, S.A. v. Bank of New York,* 703 F.Supp. 312, 313 n.2.

[111]703 F.Supp. 312, 9 UCC Rep.Serv.2d 1033 (S.D.N.Y. 1989).

with the customer is at odds with the basic letter of credit tenet that banks deal solely with documents, not in goods.[112] Pursuant to Articles 16(d) and 16(e) of U.C.P. 400 and referring to the definition of "without delay" as articulated in the *Bank of Cochin* case, the court held that the nine-day delay by the issuer in giving notice of its refusal of shipping documents waived its right to object to discrepancies absent any persuasive and reasonable justification.[113]

In *Occidental Fire & Casualty Co. of North Carolina v. Continental Bank N.A.*,[114] the beneficiary brought action against the issuing bank for wrongful dishonor. Pursuant to the letters of credit at issue, the Illinois U.C.C. Article 5 and the U.C.P. 290 (1974 Revision) governed the case. The issuing bank made a decision to reject the draw on the end of the second banking day (Friday) following the submission of the draw documents.[115] Since the decision was made after 5:00 EST, which is normally recognized as the close of business in the East, the issuing bank did not attempt to contact the beneficiaries regarding the dishonor and the reasons for it until the next business day (Monday), one day before the letters were to expire.[116] The court was called upon to decide whether the bank has a duty to communicate its notice of dishonor sooner.

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[112]*Id.* at 313.

[113]*Id.* at 314.

[114]918 F.2d 1312, 13 UCC Rep.Serv.2d 289 (7th Cir. 1990), *aff'g* 725 F.Supp. 383, 10 UCC Rep.Serv.2d (Callaghan) 934 (N.D.Ill. 1989).

[115]*Id.* at 1317-18.

[116]*Id.* at 1317.

In the district court's view, the U.C.P. Article 8(c) recognizes that the issuing bank might notice some nonconformity appearing on the face of the documents but still require time to consider whether the nonconformity requires rejection of the draw or whether it waive the defects.[117] Under U.C.C. Section 5-112(1), a bank which has acted within three business days has acted in a timely fashion. The district court held, affirmed by the Seventh Circuit, that notice of dishonor given no later than the third business day after receipt of draw documents complied with the duty under Illinois law and U.C.P.[118] According to the court, although the beneficiaries were informed of the rejection of their draw on the day right before the letters were to expire, they could have made a further draw attempt before the expiration by means of electronic facsimile, telex or air travel, but unfortunately, they did not do so.[119] The beneficiaries had to bear the consequences of submitting a draw less than a week before the letter of credit expired.[120]

In *Banco Do Brasil, S.A. v. City National Bank of Miami*,[121] a Brazilian bank, acting as the advising bank and the paying bank for the letter of credit transactions at issue, sued the issuer for reimbursement under the credit. The issuer rejected the

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[117]*Id.* at 1318.

[118]*Id.*

[119]*Id.* at 1317.

[120]*Id.* at 1318.

[121]609 So.2d 689, 19 UCC Rep.Serv.2d 831 (Fla.Dist.Ct.App. 1992)

paying bank's request for payment without giving it any explanation for the dishonor until one year after the first refusal.[122]

Pursuant to Articles 8(d) and 8(e) of the 1974 U.C.P., which was incorporated into the letter of credit, the Florida appellate court concluded that the issuing bank had the dual obligation: (1) to examine the documents and determine, within a reasonable time, whether the request for payment was in compliance with the terms of the credit; and (2) without delay and using expeditious means to notify the presenter of the specific defects and to advise of the disposition of the documents.[123] Absent an unequivocal definition of "without delay" in Article 8 of the U.C.P. 290 or in any case law dealing with international letter of credit, the court looked into the policy considerations for the timely notification, which are to allow the documentary defects to be cured in numerous cases or to permit the party to take immediate steps to recapture the funds paid or otherwise protect its position, the court thus agreed with one commentator that "the duty in Article 8(e) to give notice without delay `connote[s] a sense of urgent action within the shortest interval of time possible.'"[124] The court held that the delay by the issuing bank in specifying the defects precluded it from asserting the nonconformity of the documents against the letters of credit.[125]

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[122]*Id.* at 690.

[123]*Id.*

[124]*Id.* at 691. *See* Dolan, *supra* note 3, ¶6.06[1][b], at 6-57 (citing *Bank of Cochin*).

[125]*Id.* at 691.

In *Banque De L'Union Haitienne v. Manufacturers Hanover Int'l Banking Corp.*,[126] the foreign issuer did not notify the domestic confirmer of the documentary nonconformity until the fifth business (and eighth calendar) day after the date the confirmer stated that it received the documents. The United States District Court for the Southern District of Florida, citing *Bank of Cochin* and construing the three-day rule set forth in the U.C.C. Section 5-112 as the maximum "reasonable time" period under the U.C.P. in which to give notice in light of today's era of near instantaneous international communications, held that the issuer was precluded from claiming reimbursement for wrongful honor from the confirmer because it did not give notice "without delay" by expeditious means of its decision to dishonor.[127]

In *Petra Int'l Banking Corp. v. First American Bank of Virginia*,[128] the confirming bank alleged that the issuing bank wrongfully dishonored the letters of credit. The issuing bank did not mention any discrepancies to the confirming bank until more than one year after receipt of the documents and it did not hold the documents at the confirming bank's disposal but transferred the documents to its customer.[129] The U.C.P. 400 was the governing law by the parties' explicit choice in this case.[130] Rejecting the issuing bank's argument, the court contended that Article 16

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[126]787 F.Supp. 1416, 18 UCC Rep.Serv.2d 856 (S.D.Fla. 1991).

[127]787 F.Supp. at 1421-22.

[128]758 F.Supp. 1120, 14 UCC Rep.Serv.2d 166 (E.D.Va. 1991).

[129]*Id.* at 1128.

[130]*Id.* at 1127.

applies to drafts passing from beneficiaries or advising banks to issuing banks and drafts from confirming banks to issuing banks.[131] The term "remitting bank" in Article 16(d) is a general term to cover any bank from which an issuing bank receives a documentary draft, including both advising and confirming banks.[132] Relying on Article 16 of the U.C.P. which reflects commercial practices and the rules developed in the preceding common law of letters of credit, and *Bank of Cochin* which presents an example of the application of Article 16 in the context of an issuing and a confirming bank, the United States District Court for the Eastern District of Virginia held that the issuing bank was precluded by Article 16(e) from asserting documentary noncompliance with the terms and conditions of letters of credit.

In *Integrated Measurement Systems, Inc. v. Int'l Commercial Bank of China*,[133] the issuing bank did not notify the beneficiary of its objections until 20 days later after the presentment and indeed five days after the credit had expired. Recognizing the issuing bank's duties under Article 16 of the U.C.P. 400 to examine the documents in a "reasonable time" period and to notify defects "without delay", citing *Bank of Cochin*, and *Kuntal*, the United States District Court for the Northern District of Illinois held in the beneficiary's favor that the issuing bank did not timely notify the defects and thus

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[131]*Id.* at 1129.

[132]*Id.* at 1130.

[133]757 F.Supp. 938, 14 UCC Rep.Serv.2d 1167 (N.D.Ill. 1991).

was expressly precluded from asserting any nonconformity as a reason for dishonoring the documents.[134]

In *Lennox Industries, Inc. v. Mid-American Nat'l Bank & Trust Co.*,[135] the beneficiary made a demand for payment on January 28, 1985, two days before the letter of credit was to expire on January 30, 1985. The beneficiary argued that the notice of dishonor should be given as soon as the defects were discovered by the issuer. It is unknown when the issuer discovered the defects in this case. The appellate court recognizes that the issuer is not obligated under the U.C.C. but has a common law duty to notify the presenter of the defects in the documents and failure to do so waives the issuer's objection to such defects.[136] Since the issuer is statutorily authorized to defer rejection for three banking days, the court finds that the issuer has no duty to inform the presenter of the defects causing dishonor before the three-day deferral period provided in U.C.C. no matter when the decision of dishonor was made.[137]

Pursuant to the above-mentioned courts's reasoning, an issuer has a reasonable time of maximum three days to evaluate the documents and notify the beneficiary of

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[134]757 F.Supp. at 948.

[135]49 Ohio App.3d 117, 550 N.E.2d 971, 10 UCC Rep.Serv.2d 1344 (Ohio Ct.App. 1988).

[136]Citing Philadelphia Gear Corp. v. Central Bank, 717 F.2d 230 (5th Cir. 1983), and Bank of Cochin Ltd. v. Manufacturers Hanover Trust Co., 612 F.Supp. 1533 (S.D.N.Y. 1985), *aff'd*, 808 F.2d 209 (2d Cir. 1986).

[137]550 N.E.2d at 974. The reasoning as to when the issuer is obligated to notify in *Lennox Industries* is rejected while those of *Datapoint* and *Esso Petroleum Canada* are expressly accepted in the Proposed Final Draft of the Revision of Article 5, *supra* note 21, Comment 4 to Section 5-108.

discrepancies; when the decision of dishonor is made is immaterial to the time limit for notice of dishonor. Some courts differentiate the time limit for notice of discrepancies from the three day rule for evaluation of the documents and hold that the notice should be relayed immediately after the decision to dishonor is made. In *Datapoint Corp. v. M & I Bank*,[138] the beneficiary presented its nonconforming draft on June 19, 1986. The credit was to expire on June 20, 1986. The bank promptly mailed the notice of dishonor, which thus did not arrive until three days after expiration of the credit. The credit was subject to the U.C.P. 400. The court applied Article 16 and held that the issuer was obligated under Article 16(d) to give notice immediately by telephone to the beneficiary of the decision and the nonconformity once it decided to dishonor on June 19, 1986, so that the beneficiary would have time to cure.[139]

In *Esso Petroleum Canada v. Security Pacific Bank*,[140] the beneficiary of an irrevocable standby letter of credit charged the issuing bank for wrongful dishonor. The undisputed fact in this case were that the bank made its decision of rejecting beneficiary's request for payment due to certain discrepancies on the day the documents were presented; the bank did not inform the beneficiary of a list of specific discrepancies until the next business day when the letter of credit was about to expire, despite the beneficiary's demand for such a list on the day of dishonor.[141]

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[138]665 F.Supp. 722, 4 UCC Rep.Serv.2d 829 (W.D.Wis. 1987).

[139]*Id.* at 727.

[140]710 F.Supp. 275, 8 UCC Rep.Serv.2d 1148 (D.Or. 1989).

[141]*Id.* at 276-77.

The letter of credit at issue incorporated the U.C.P. 400 expressly. The United States District Court for the District of Oregon faced the issue of deciding whether the bank properly notified the beneficiary of dishonor by specifying the alleged discrepancies once it made the decision to reject the documents in accordance with Article 16(d) of U.C.P. 400.[142] Relying solely on Article 16(d) of the U.C.P. 400, the district court contented that the bank was required to state the discrepancies in respect of which it refused the documents at the time it notified the beneficiary of its refusal to honor the letter of credit.[143] The court held, as a result of its failure to do so (the bank did so three days later), the issuing bank was precluded from claiming the nonconformity of the presented documents pursuant to Article 16(e) of the U.C.P. and it must honor the letter of credit at issue.[144] The issuing bank's contention that, under the U.C.C. Section 5-112, it had three days to determine whether to dishonor letter of credit was not discussed by the court.

In *Penfli Industries, Inc. v. Bank of China New York Branch*,[145] the advising bank, was charged with failure to return the relevant documents or to give notice of the discrepancies in a timely fashion under Article 16 of the U.C.P. 400 by the beneficiary. There were factual disputes regarding the speed with which the advising bank notified the beneficiary of its intention to dishonor the documents in this case,

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[142]*Id.* at 280.

[143]*Id.* at 281.

[144]*Id.*

[145]No. 90 CIV. 1115 (RLC), 1990 WL 89339 (S.D.N.Y. June 19, 1990).

which precluded summary judgement as to the promptness of the notice.[146] The court contended the Article 16(d) "without delay" requirement would be satisfied if, as claimed by the advising bank, the delay between the rejection of the documents and the notification of the rejection was one day or less.

The beneficiary demanded the return of the documents on December 28, 1988 and the advising bank returned the documents to the beneficiary on January 24, 1989. Accepting the advising bank's argument that Article 16 does not require an issuing or advising bank to return a beneficiary's documents absent a direct request, the court concluded that the return of documents was not "untimely" since the advising bank returned the documents after a request to that effect by the beneficiary who was provided an opportunity to attempt to cure the defective documents in the interim.[147]

Some courts do not take the *Bank of Cochin* approach. Instead of referring to the U.C.C. three-day rule, the courts decide "what is a reasonable time" and "what is without delay" on a factual basis and may find that more than three days allowed by the U.C.C. may be reasonable under the U.C.P. in a particular case. In *Auto Servicio San Ignacio, S.R.L. v. Compania Anonima Venezolana de Navegacion*,[148] the customer on whose behalf the credit was issued brought a wrongful honor charge against the issuing bank. One of the issues facing the court is whether one or two years is a reasonable length of time for the issuing bank to wait before asserting a documents nonconformity

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[146]*Id.* at *2.

[147]*Id.* at *1, *4.

[148]765 F.2d 1306, 41 UCC Rep.Serv. 554 (5th Cir. 1985).

claim against the confirming, advising and paying bank (hereinafter as the CAP bank).[149] Affirming the district court's summary judgement favoring the CAP bank, the Court of Appeals for the Fifth Circuit contended that the issuing bank was entitled to a "reasonable time" under Article 8(d) of the U.C.P. 290 (1974 Revision), not limited to three days under the Louisiana U.C.C. Section 5-112, to notify the advising, confirming and paying bank of documentary defects, upon which a draft under a letter of credit had been honored.[150] However, a delay of one or two years in raising the question of nonconformity after the documents submitted to procure payment was unreasonable and barred the issuing bank from making a claim against the paying bank.[151]

In *Alaska Textile Co. v. Chase Manhattan Bank, N.A.*, the beneficiary presented the documents via its collecting bank "on an approval basis," which indicated that discrepancies in the documents existed and the presenter requested the issuer waive the discrepancies and authorize payment.[152] Although the issuing bank proceeded as asked, it formally notify the beneficiary of dishonor on the fifteenth banking day after

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[149]*Id.* at 1307.

[150]The express language of U.C.C. Section 5-112 appears to set out only the time frame allowed for honor or rejection of a draft or demand for payment. However, the scope of this provision was expanded to interpret the time limit for raising the nonconformity claim in *Auto Servicio*. *See* Farmers-Merchants Bank & Trust Co. v. Travelers Indemnity Co., 791 F.Supp. 150, 153, 19 UCC Rep.Serv.2d 847 (W.D.La. 1992) (bound by *Auto Servicio*, a four year delay between the time that nonconforming documents were submitted and the time that a nonconformity claim was asserted is an unreasonable delay under either the U.C.C. or the U.C.P.).

[151]*Id.* at 1310.

[152]982 F.2d 813, 815, 19 UCC Rep.Serv.2d 540 (2d Cir. 1992).

presentment because the customer refused to waive the discrepancies which warranted dishonor.[153] The beneficiary brought the wrongful dishonor charge against the issuer and alleged that the issuing bank should be precluded from relying on the nonconforming documents pursuant to Article 16(e) of the U.C.P. 400 because it failed to act within a reasonable time.[154]

The legal implication of submitting a letter of credit to an issuing bank for payment "on an approval basis" presented the court with an issue of first impression.[155] The Second Circuit analogized the presentment of documents "on an approval basis" to the presentment of documents "on a collection basis" under a letter of credit and confirmed the U.C.P.'s applicability to this case.[156] The Second Circuit rejected the beneficiary's argument that the issuer had to dishonor within a maximum three days as expressed in U.C.C. 5-112(1). The court refused to impose a strict three-day period into Article 16 of the U.C.P. 400 for fear of bastardizing both the U.C.C. and the U.C.P. because the time limits under the U.C.P. and the U.C.C. are set forth in the contexts of two different approaches to the consequences of an issuer's untimely action on demand for payment.[157] Instead, construing the "reasonable time" as a term of art that depends on nature, purpose, and circumstances of each case, the Second Circuit

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[153]*Id.* at 817, 824.

[154]*Id.* at 815, 817-18.

[155]*Id.* at 818.

[156]*Id.* at 818-19.

[157]*Id.* at 823.

held that the issuer acted timely under the circumstance of presentations "on an approval basis."[158]

In *Full-Bright Industrial Co. v. Lerner Stores, Inc.*,[159] it was not disputed that the issuing bank held the relevant documents for ten days and seven days in between discovery of the discrepancy and notification of the defects. The United State District Court for the Southern District of New York had to decide whether seven and ten days constitutes unreasonable delay in rejecting the discrepant documents under U.C.P. Article 16 (c) and 16(d).

Absent an express definition of a "reasonable time" and "without delay" in the U.C.P., the district court referred to the case law. The courts have taken different approaches to answer the question, some trying to define "reasonable time" as a specific number of days, such as in *Bank of Cochin* and *Kuntal*; while others holding that the reasonableness of time depending upon the nature, purpose, and circumstances of each case, such as *Alaska Textile*.

The district court followed the second approach in this case and tried to decide the reasonableness of the seven and ten day periods by turning to the issue of propriety of the issuing bank's seeking waiver from its customer.[160] The issuing bank argued that the delay was necessary, as a practical matter, for it to seek waiver of the discrepancies

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[158]*Id.* at 824.

[159]818 F.Supp. 619, 21 UCC Rep.Serv.2d 1102 (S.D.N.Y. 1993).

[160]818 F.Supp. at 622.

from its customer.[161] The district court concluded that the issuer's consultation with the customer on the issue of waiver was improper because it violated a principle established in the Article 16(b) of the U.C.P. 400 that issuing bank's decision to reject or to accept documentation should be based on the documents alone.[162] Under the foremost important principle of letter of credit law, the independent principle, the issuer's duty to pay is solely conditioned upon the facial compliance of the documents and completely independent of the underlying transaction. As a result, the ten and seven days delay was unreasonable and estopped the bank from claiming the nonconformity of the documents as the ground for dishonor.

In summary, majority of the courts have held that an issuer has three days to evaluate the documents and notify the beneficiary of the discrepancies relied upon for dishonor. The courts have justified their decision on the basis of the three-day rule under the present Article 5, an issuer's limited obligation of reviewing documents on the basis of facial compliance with the letter of credit, and a chance for the beneficiary to remedy the discrepancies or for the payor to recapture the payment. In case that the decision of dishonor has been made, some courts held that the reasons for dishonor

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[161] *Id.*

[162] *But see* Western Int'l Forest Products, Inc. v. Shinhan Bank, 860 F.Supp. 151, 154-55, 24 UCC Rep.Serv.2d 998 (S.D.N.Y. 1994) (held that the issuing bank should be able to seek a waiver from the customer without being precluded from asserting nonconformity as a defense in a later suit for wrongful dishonor, whether the issuer consults the customer independently or at the beneficiary's request makes no difference). An issuing bank is expressly permitted to seek waiver from the customer upon discovery of the document discrepancies under the U.C.P. 500 Article 14(c), which rejected the reasoning of *Full-Bright Industrial*.

should be given immediately at time of dishonor, otherwise the notice of dishonor is unduly delayed under the U.C.P.; while other courts held that an issuer may defer giving notice until the close of a reasonable time, e.g., three days, no matter when the decision of dishonor has been made.

The three-day rule under the present U.C.C. has been changed. Under U.C.P. 500 and the revised Article 5, an issuer has to act within seven banking days after receipt of the documents to review the documents and to send the notice of dishonor. When confronting the timing issues, the court should differentiate the time limit for evaluation and seeking waiver from the time limit for notice of discrepancies. It is reasonable for the courts to hold the time for notice of defects to be tighter than that for evaluation of the documents. An issuer is entitled to make a decision as to whether to take up or to reject the documents within a reasonable time of maximum seven banking days. Having made a decision to dishonor, an issuing bank should be obligated to notify the beneficiary of the defects immediately, not within three or seven days, to enable the beneficiary to cure the defects or attempt to persuade the customer to waive the defects within the expiry date of the letter of credit. The proposed revision of Article 5 accepts the reasoning that an issuer is obligated to communicate shortly after having made a decision to dishonor, for example, if the decision of dishonor is made on the first day, the notice of discrepancies should be sent shortly thereafter, perhaps on the same business day.[163] To obligate an issuer to give notice immediately after its

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[163]*See* the Proposed Final Draft of the Revision of Article 5, *supra* note 21, Comment 4 to Section 5-108.

decision of dishonor prevents an issuer from simply sitting on a presentation that is made within three, or seven days of expiration, and from depriving the beneficiary of the chance to either cure the defects or persuade the customer to waive the defects before the letter of credit expired.

Upon discovering nonconformities in the documents, the issuing bank must determine whether it will reject the documents or whether it will waive the defects. In practice, issuers that receive nonconforming documents would routinely ask the account party to waive the defects rather than rush to immediate rejection of the documents.[164] Since both U.C.P. 400 and present Article 5 of the U.C.C. are not explicit on the issue of seeking waiver from the customer, the courts have been called upon to decide, and indeed are divided on, the issue of propriety of the issuing bank's consultation with its customer. The letter of credit law should explicitly permit, although not obligate, an issuer to seek waiver from the customer upon discovering nonconformities in the documents to be in harmony with a reasonable and efficient banking practice.[165]

Taking into consideration of the practice of an issuer's seeking waiver from the customer, the revisions of the letter of credit law introduce a more flexible and longer time frame into evaluation of the documents. Seeking waiver should not further extend the time limit for the issuer to review the documents and make its determination, which

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[164]*See* Rosenblith, *supra* note 16, at 85.

[165]An issuer's seeking waiver from the customer is an efficient and reasonable practice. There are some defects in at least 50 percent of the drawings on commercial credits; the defects often are insubstantial or technical; the customer does waive the defects and the beneficiary get the payment in most cases. *See* Rosenblith, *supra* note 16, at 85.

is the lesser of a reasonable time or seven business days.[166] Time limit for seeking waiver is a safeguard against the possible abuse of such permission (e.g., the customer would wait and ride the market). It is an issuer's basic duties to complete its review and make its own decision in a timely manner and to communicate its decision to the presenter without delay. Consultation with the account party has to be consistent, not interfere, with these basic obligations.

3.2. Content of notification. One of the policy considerations of imposing the timely notification duty on the issuer is to render the beneficiary a chance to cure any defects that might prevent the issuer from honoring the demand for payment before the expiration of the letter of credit so that the commercial vitality of the letter of credit is fulfilled to its greatest extent. The issuer is not only obligated to promptly notify the beneficiary of the documentary discrepancies, but the issuer must state in its notice of dishonor, under the U.C.P., (1) the discrepancies in respect of which it refuses the documents, and (2) whether it is holding the documents at the disposal of, or is returning them to the presenter (remitting bank or the beneficiary).[167] Failure to do so will preclude the issuer from either claiming any unstated discrepancies as the basis of dishonor or claiming the nonconformity of the documents at all.[168] The present Article

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[166]Under U.C.C. Section 5-112(1)(b), an issuer may seek consent from the presenter to gain additional time to obtain the customer's waiver of the documentary defects.

[167]*See* U.C.P. 500 Art. 14(d), U.C.P. 400 Art. 16(d).

[168]*See* U.C.P. 500 14(e), U.C.P. 400 Art. 16(e).

5 of the U.C.C. is silent on the particularity requirement of the notification, but expressly requires an issuer to advise the disposition of the nonconforming documents.

In *Exchange Mutual Insurance Co. v. Commerce Union Bank of Sumner County*,[169] the issuing bank dishonored drafts drawn on irrevocable letter of credit for the reason that the draft "failed to comply with conditions set forth." Under the U.C.P., an issuing bank is obligated to provide the beneficiary with a prompt and complete explanation of why it has refused to honor drafts drawn on the letter of credit. The court held that the statement in the notice of dishonor was inadequate (in addition to not prompt) and the beneficiary was entitled the payment since the beneficiary was deprived of the chance to cure the defects prior to the expiration of the letter of credit. To hold otherwise would undermine the purpose of the U.C.C. and U.C.P. to simplify and facilitate the fairness of such credit arrangements.

In *Kerr-McGee Chemical Corp. v. Federal Deposit Insurance Corp.*,[170] the United States Court of Appeals for the Eleventh Circuit faced the issue that whether a bank may subsequently dishonor a letter of credit on the basis of a different ground after initially dishonoring the credit on the basis of specified grounds. Since the U.C.P. 400 was expressly incorporated by the letter of credit at issue, the court decided this case under it. Viewing Article 16(e) of the U.C.P. 400 as a strict "estoppel" or "preclusion" rule, the court contended that a bank will be estopped from

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[169]686 S.W.2d 913, 40 UCC Rep.Serv. 1804 (Tenn.Ct.App. 1984).

[170]872 F.2d 971, 8 UCC Rep.Serv.2d 788 (11th Cir. 1989).

subsequent reliance on a ground for dishonor if it did not specify that ground in its initial dishonor.[171]

In this case, the issuing bank, of which the FDIC assumed control later, failed to assert the difference between the amount of the invoice ($1,014,590.53) and that of the credit ($1,002,000.00) as a ground for dishonor at the first presentment although it was an apparent defect.[172] When the beneficiary presented additional documentation for the second time pursuant to the notice of the dishonor, it was refused on the basis of the defect in the invoice amount which was not consistent with the letter of credit and the sight draft as required by the terms of the credit.[173] Although the issuing bank's second dishonor would have been justified under the "strict compliance" rule adopted in Florida letter of credit law, the court held that under the U.C.P. 400 the issuing bank's failure to allege defect in the invoice at its first dishonor of request for payment under letter of credit estopped it from later relying on that ground to avoid payment.[174] Therefore The United States District Court for the Middle District of Florida's judgement for the issuing bank was reversed and remanded.[175]

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[171] *Id.* at 973-74.

[172] *Id.* at 974.

[173] *Id.* at 972-73.

[174] *Id.* at 974.

[175] *Id.* at 974-75.

In *Integrated Measurement Systems, Inc. v. Int'l Commercial Bank of China*,[176] the United States District Court for the Northern District of Illinois relied upon U.C.P. 400 Article 16 and followed the doctrine established in the case law that "any grounds for dishonor not stated in the original notice are waived."[177] The district court stressed the importance of mandating the bank to adhere to its original statement of discrepancies because "that statement is critical in defining the beneficiary's opportunity to cure any identified defects" in a letter of credit situation.[178] The district court held that the bank have waived all other arguments of nonconformity that were not mentioned in the original notices.[179]

In *Agri Export Cooperative v. Universal Savings Ass'n*,[180] the issuer twice refused the beneficiary's request for payment made pursuant to the letter of credit without disclosing the reason for non-payment. The beneficiary brought action for wrongful dishonor against the issuer. The issuer counterclaimed that the presentment of the letter of credit was improper.[181] The letter of credit at issue provided that the

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[176]757 F.Supp. 938, 14 UCC Rep.Serv.2d (Callaghan) 1167 (N.D.Ill. 1991).

[177]*Id.* at 947. Citing *Occidental Fire & Casualty Co. of North Carolina*, 918 F.2d 1312, 1318 (although neither the Illinois U.C.C. nor the U.C.P. specifically states that a bank must give unambiguous reasons for dishonor of a sight draft, we think such a rule comports with the general good faith requirement); American Employers Insurance Co. v. Pioneer Bank & Trust Co., 538 F.Supp. 1354, 1357 (N.D.Ill. 1981); *Kerr-McGee Chemical*, 872 F.2d 971, 973-74.

[178]*Id.* at 947 n.14.

[179]*Id.* at 947.

[180]767 F.Supp. 824, 16 UCC Rep.Serv.2d 174 (S.D.Tex. 1991).

[181]*Id.* at 827.

U.C.P. 400 would be the controlling law in case of disputes, except when the U.C.P. conflicts with the laws of Texas or the United States.[182] Relying on the Articles 16(d) and (e), the United States District Court for the Southern District of Texas held that both of the beneficiary's presentments were proper pursuant to the letter of credit even under the strict compliance rule in Texas.[183] The district court further held that even assuming the beneficiary's presentments were improper, the issuer would be barred from complaining of any improper presentment pursuant to the terms of the letter for its failure to comply with the U.C.P. notice requirement when refusing payment.

In *Banque De L'Union Haitienne v. Manufacturers Hanover Int'l Banking Corp.*,[184] the District Court for the Southern District of Florida ruled in favor of the confirming bank in the charge brought by the issuing bank for reimbursement of improper payment. Adhering to Article 16(d) of the U.C.P. 400, to which the letter of credit at issue was subject, the court found, among other noncompliance with the Article 16 on the part of the issuing bank, that the notice given to the confirming bank claimed only two defects (which were not actually required by the letter) and it failed to state whether it was holding or returning the documents.[185]

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[182]*Id.* at 828.

[183]*Id.* at 828-29.

[184]787 F.Supp. 1416, 18 UCC Rep.Serv.2d 856 (S.D.Fla. 1991).

[185]*Id.* at 1421.

In *Fallowfield Development Corp. v. Strunk*,[186] the issuing bank refused to honor the letter of credit on the day of presentation "upon the advice of counsel." The beneficiary brought wrongful dishonor charge against the issuer for its failure to give adequate reason for the rejection pursuant to Article 16 of the U.C.P. 400. Despite the fact that the letter of credit at issue was subject to the U.C.P., the United State District Court for the Eastern District of Pennsylvania rejected the beneficiary's claim on the basis of the violation of the U.C.P. 400 particularity requirement. The review of the Pennsylvania case law suggests that "the U.C.P. is merely a reflection of `custom and practice' rather than binding substantive law."[187] The district court concluded that whether the beneficiary's alleged fraud in the underlying transaction would justify the dishonor is a question of fact for the jury to determine.

In *Full-Bright Industrial Co. v. Lerner Stores, Inc.*,[188] the issuing bank, although claiming that it was holding the documents at the beneficiary's disposal, informed the beneficiary in a cable that "documents will not be returned to you at this time."[189] The court held that it was contrary to U.C.P. 400 Articles 16(d) and 16(e) which requires the issuing bank either hold the documents at beneficiary's disposal or

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[186]19 UCC Rep.Serv.2d 572, No. 89-8644, 1992 WL 301282 (E.D.Pa. Oct. 13, 1992).

[187]*Id.* at 577. *See, e.g.*, Banco Nacional de Desarrolo v. Mellon Bank, N.A., 726 F.2d 87 (3d Cir. 1984); Intraworld Indust. Inc. v. Girard Trust Bank, 336 A.2d 316, 322 (Pa. 1975) (Pennsylvania law applied despite a clause that "the bank's obligations are subject to the U.C.P.").

[188]818 F.Supp. 619, 21 UCC Rep.Serv.2d 1102 (S.D.N.Y. 1993).

[189]*Id.* at 622.

return them to the beneficiary.[190] The bank was therefore estopped from claiming documentary discrepancies as the reason for dishonor.

Contrary to the majority precedents, the court in *Republic of Senegal v. Brown Brothers Harriman & Co.* construed the U.C.P. particularity requirement against the beneficiary.[191] In this case, the letter of credit required "a like manually signed statement from an independent and mutually acceptable source corroborative of the facts as stated" in the beneficiary's statement. The beneficiary submitted subsequently to the issuer three documents, namely, the Universal Statement, the Calrice Statement, and the USDA Statement, accompanying a sight draft. The issuer notified the beneficiary of the defects in the Universal Statement and returned the Calrice Statement and the USDA Statement, in addition to other documents presented on behalf of the beneficiary, as "not required" by the terms of the credit.[192]

The beneficiary argued that issuer's notice of dishonor was defective in not spelling out the deficiencies in the Calrice and USDA Statements and as a result the defects should be waived pursuant to Article 16(d) and 16(e) of the U.C.P. 400.[193] Recognizing that Article 16(e) authorizes waiver in the event of defective notice, however, the United State District Court for the Southern District of New York viewed a waiver claim with "a wary eye," because if courts treated waiver claims "too

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[190]*Id.*

[191]No. 88 CIV. 3154 (RPP), 1989 WL 63085 (S.D.N.Y. June 7, 1989).

[192]*Id.* at *3.

[193]*Id.* at *4.

hospitably" the letter of credit may "become less useful payment devices because of the increased risk of forfeiting the right to reimbursement from their customers which banks would soon face."[194] Article 16(d) should be construed by the court in a way that would encourage beneficiaries to submit "succinct and unambiguous documents in an orderly manner" to ensure bank's ability to act quickly and enhance the fluidity of letters of credit.[195]

In this court's view, an extensive and detailed itemization of each of the particular deficiencies of documents submitted under a letter of credit is not required to satisfy Article 16(d) particularity requirement. In the present case, the Calrice and USDA Statements were so irrelevant to the terms of the credit as to not require a long enumeration of their defects.[196] The beneficiary who submitted the documents in a disorderly manner should bear the consequences of notice problem, if there is any. The court found, as a matter of law, that the issuer's notice of deficiencies was proper and adequate.[197]

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[194]*Id.* at *5. The district court observed the distinction between "equitable waiver" and "the waiver provision of Article 16(e)", but admitted that they reflect the same policy underlying letters of credit as reliable payment devices. *Id.*

[195]*Id.*

[196]*Id.*

[197]*Id.*

Most of the litigation dealing with the content of notice concerns waiver.[198] Waiver and estoppel are often confused and sometimes used interchangeably by the courts in letter of credit cases.[199] No matter what term the court uses, an issuer will likely be held liable "where its statement or its silence induces the beneficiary to fail to cure a documentary defect that was otherwise curable."[200] The general waiver rule, as established in the case law, is that the issuer waives defects not specified in the notice of dishonor which could have been cured if the presenter had been notified of the defects. However, there is an exception to the general rule, i.e., where the letter of credit has expired prior to the issuer's omission of some defects in a specification of discrepancies, the issuer will not be precluded from asserting the omitted defects to justify dishonor because the presenter could not have made a timely cure even if they

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[198]*See* Coogan et el., *supra* note 44, §31.04[5], at 31-61. Waiver is defined as an "intentional or voluntary relinquishment of a known right" in Black's Law Dictionary (4th ed.). If the issuer accepts the nonconforming documents or rejects the documents on other grounds, its right to dishonor on the basis of nonconformity will be deemed to have been given up.

[199]*See* McCullough, *supra* note 2, §4.06[3], at 4-92 and n.33. *See also* Dolan, *supra* note 3, ¶6.06[1], at 6-51. *See, e.g.*, Northern Trust Co. v. Oxford Speaker Co., 109 Ill.App.3d 433, 65 Ill.Dec. 113, 117, 440 N.E.2d 968, 972 (Ill.App.Ct. 1982) (distinguishing waiver from estoppel in that in a waiver it is not necessary that the party claiming the waiver should have been misled to his injury by the acts of the insurer); *Bank of Cochin*, 612 F.Supp. 1533 (S.D.N.Y. 1985), *aff'd*, 808 F.2d 209 (2d Cir. 1986) (waiver is distinguished from estoppel. An issuer is deemed to have waived the additional reasons that are not specified in the initial notice of dishonor; failure to give any reasons for dishonor in the notice precludes/estops an issuer from later asserting any nonconformity). *But cf. American Employers Insurance*, 538 F.Supp. 1354 (N.D.Ill. 1981) (failure to give reasons results in waiver of all objections).

[200]*See* R.A. Hillman, J.B. McDonnell, and S.H. Nickles, COMMON LAW AND EQUITY UNDER THE UCC CODE (1985), ¶7.02[4], at 17-8.

had been included in the specification of discrepancies.[201] The result of *Republic of Senegal* is contrary to the majority precedents and is unfair because the court place the burden on the beneficiary where the issuer failed to specify the defects in the notice although the letter of credit had not expired.

It is obvious that a specific notification will facilitate the beneficiary to cure the discrepancies upon which the dishonor relies, which is a rationale behind the notice requirements. Majority of the courts, relying either on the U.C.P. particularity requirement or on the consideration of present U.C.C.'s good faith and the equitable doctrines of waiver and estoppel, have held an issuing bank liable for the amount of the letter of credit if it fails to specify the reasons for dishonor despite the apparent nonconformity of the documents presented by the beneficiary. The cases decided under the U.C.P. 400 will be controlling in the future since the U.C.P. 500 has not change the rule regarding the content of the notice. The adoption of the revised Article 5, which deals with the particularity requirement and the strict preclusion rule for the first time in the U.C.C., would provide the courts an additional statutory basis to hold the issuer accountable for its statement.

Failure to advise the disposition of the nonconforming documents on the part of an issuing bank would prevent the beneficiary from correcting the discrepancies, and

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[201] *See* Hawkland & Holland, *supra* note 74, §5-114:04 (Article 5) (Main Volume), at n.11. *But See* Northern Trust Co. v. Oxford Speaker Co., 109 Ill.App.3d 433, 65 Ill.Dec. 113, 117, 440 N.E.2d 968, 972 (Ill.App.Ct. 1982) (the application of equitable defenses, such as waiver and estoppel, was not conditioned upon a showing that the beneficiary could have cured the defective documents before the letter of credit expired).

prevent the beneficiary from regaining possession of the goods if the documents do control title or right to possession of the goods. Therefore, it is sound to hold the issuer liable for not advising the fate of the documents despite the documentary nonconformities.

3.3. Means to notify. After the decision to dishonor is made, the issuing bank has the obligation, under the U.C.P., to notify the beneficiary by telecommunication or other expeditious means.[202] The present U.C.C. Article 5 does not address how quickly notice of dishonor must be relayed; instead, a general good faith requirement that applies to all transactions subject to the U.C.C. governs the manner in which notice is effected.[203]

In *Crocker Commercial Services, Inc. v. Countryside Bank*,[204] the district court granted summary judgement in the beneficiary's favor in a wrongful dishonor action. Despite the beneficiary's request to be contacted by an urgent telephone call should any questions concerned the honor of the presented documentation arises so that the beneficiary would correct any curable defects, the issuing bank stood by silently and permitted the credit to run out and notified the beneficiary of the dishonor on the basis of hypertechnical language difficulties by a rather slow communication method, i.e., in writing.

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[202]*See* U.C.P. 290 Art. 8(e); U.C.P. 400 Art. 16(d); U.C.P. 500 Art. 14(d).

[203]*See* U.C.C. Section 1-203; *See also* Occidental Fire & Casualty Co. of North Carolina v. Continental Bank, 918 F.2d 1312, 1318 (7th Cir. 1990).

[204]538 F.Supp. 1360, 33 UCC Rep.Serv. 650 (N.D.Ill. 1981).

Under the Illinois substantive law which is applicable to the present case, the issuer had three-banking-days to determine on the payment of the draw under the credit; inaction within it results in dishonor. The beneficiary presented all the required documentation on January 16, 1981 (Friday), the letter of credit was to expire on January 21, 1981, and the issuing bank did not respond until January 30, 1981 in writing.

A party may be precluded from raising the issue of conformity on grounds of waiver or estoppel pursuant to the Illinois Code Comment to Section 5-114. Applying the waiver doctrine to the dishonor of the letter of credit, the court held that an issuer's failure to present any objections waives all objections [205]. The court did not elaborate on its estoppel analysis but only stated briefly that even if the waiver analysis were nonapplicable, an estoppel doctrine would be invoked against the bank for all the classic components of estoppel are present.[206]

In *Datapoint Corp. v. M & I Bank*,[207] the beneficiary presented the documents to the issuing bank one day before the credit was to expire. The issuing bank made a decision to dishonor and mailed the notice of dishonor along with the presented documents to the beneficiary's collection agent on the day of the presentment. The United State District Court for the Western District of Wisconsin held that a dishonor

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[205]Citing *First Arlington National Bank v. Stathis,* 90 Ill.App.3d 802, 812, 46 Ill.Dec. 175, 183, 413 N.E.2d 1288, 1296 (Ill.App.Ct. 1980) (as a fortiori that the issuer was held to have waived all objection not specifically stated in its pre-litigation refusal to honor the credit).

[206]538 F.Supp. at 1364.

[207]665 F.Supp. 722, 4 UCC Rep.Serv.2d 829 (W.D.Wis. 1987).

by mail was wrongful under Article 16(d) of the U.C.P. 400 since the issuing bank did not give notice by telecommunication or other expeditious means and therefore was precluded under Article 16(e) of the U.C.P. 400 from claiming that draft varied from the terms of the letter of credit.

In *Crist v. J. Henry Schroder Bank & Trust Co.*,[208] the receiver of the beneficiary of a letter of credit sued the issuing bank for wrongful dishonor because the bank failed to notify the dishonor in an expeditious way pursuant to Article 16(d) of U.C.P. 400. The issuing bank received the documents on December 27, 1985 and determined to dishonor the drafts on January 2, 1986. The bank sent the notice of dishonor by regular mail on January 3, 1986, one day after the decision to dishonor. The letters of credit at issue expired on December 31, 1985.

The United District Court for the Southern District of New York construed "the duty to notify expeditiously" as being triggered only after the issuing bank has decided to dishonor within a reasonable time.[209] There was an issue of material fact as to whether the bank was afforded a reasonable amount of time to examine documents for noncompliance prior to the expiration of the letter of credit. Assuming the bank was not afforded a reasonable time to review the documents because of the late presentation, the bank was entitled to make the dishonor decision after the credit expired. The district court then contended that the beneficiary suffered no prejudice

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[208]693 F.Supp. 1429 (S.D.N.Y. 1988).

[209]*Id.* at 1432 n.4.

from the bank's less than expeditious means of notification because the credit would have expired and nothing could be done to remedy the nonconformity.

In *Occidental Fire & Casualty Co. of North Carolina v. Continental Bank, N.A.*,[210] the issuing bank notified the co-beneficiaries of the dishonor and the reasons for it first by telephone and then sent written confirmation of the dishonor via Airborne Express mail on the day before the letters were to expire. The Seventh Circuit held that the bank acted with reasonable speed in advising the beneficiaries of the rejection of their draw since telephonic communication is an expeditious means of communication under the U.C.P.[211]

In *Leaseamerica Corp. v. Norwest Bank Duluth, N.A.*,[212] the letter of credit at issue was subject to the U.C.P. 400. The issuing bank telephoned the beneficiary to give notice to dishonor, even though both bank and beneficiary had facsimile machines. The Eighth Circuit, affirmed the United States District Court for the District of Minnesota's judgement for the bank, held that the bank complied with the requirement of notice by telecommunication under Article 16(d) of the U.C.P. by telephoning the beneficiary and failure to notify by facsimile machine was not a violation of the U.C.P.

In summary, notice by regular mail would be too slow to satisfy the U.C.P. requirement unless the credit would expire before an issuing bank could make a decision of dishonor within a reasonable time. Although the telephonic notice of

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[210]918 F.2d 1312, 1317-18, 13 UCC Rep.Serv.2d 289 (7th Cir. 1990).

[211]*Id.* at 1318.

[212]940 F.2d 345, 16 UCC Rep.Serv.2d 738 (8th Cir. 1991).

dishonor will likely be held by the court to meet the U.C.P. requirement as to expeditious notification, an issuing bank could later face evidentiary problems in proving the notice if the beneficiary says it did not get the call or there are disputes over what has been said on the phone regarding the discrepancies. Therefore, a written notice by today's instantaneous telecommunication, e.g., telex or facsimile, will solve the problem.

3.4. Parties to notify. There is no provision in the present Article 5 of the U.C.C. which states who must be notified in case of dishonor. Article 14(d) of the U.C.P. 500 (successor of Article 16(d) of the U.C.P. 400), on the other hand, requires that the notice be sent to the remitting bank or to the beneficiary, depending upon from which the issuing bank directly received the documents.

In an unreported New York Supreme Court case, *Price & Pierce Int'l, Inc. v. Cimex, Inc.*,[213] the issue for the court to decide was to whom the issuer was required to give notice of discrepancies. In this case, the issuer notified the beneficiary directly while the beneficiary forwarded the documents through the services of Morgan. The court held that Morgan, which presented the documents to the issuing bank, was the "remitting bank" under the U.C.P. 400 article 16(d) and therefore the notice of discrepancies must be sent to Morgan. The court's opinion was criticized for its failure to clarify precisely what interest Morgan had in the documents.[214] Whether or not

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[213]No. 21224/80 (N.Y.Sup.Ct. Dec. 12, 1986), cited in Byrne, *supra* note 49, at 1367. Court's Decision in `Price & Pierce,' 3 Letter of Credit Update 35 (July 1987).

[214]*See* Byrne, *id.* at 1367.

Morgan acted as a remitting bank rather than a mere courier for the beneficiary would depend upon the degree of its operational involvement in the credit transaction, which warrants a detailed factual analysis of the case and is not susceptible to the summary judgement.[215]

In *Occidental Fire & Casualty Company of North Carolina v. Continental Bank N.A.*,[216] the beneficiary under the letter of credit brought action against the issuing bank to recover for wrongful dishonor. Among its claims, the plaintiff argued that the issuing bank failed to impart to one of the co-beneficiaries timely notice of dishonor.[217]

Pursuant to the terms of the letter of credit, the controlling laws in this case were the Illinois U.C.C. and the 1974 version of the U.C.P.[218] Relying on Article 5-112(3) of the Illinois U.C.C. and U.C.P. 290 Article 8(e), the Eleventh Circuit affirmed the ruling of the United States District Court for the Northern District of Illinois that the issuing bank was required to inform only the "presenter" of the sight draft -- the remitting bank in the case, which typically acts as an agent for the beneficiary of the credit, of the dishonor of the draw documents.[219]

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[215]*See* Byrne, *id.*

[216]918 F.2d 1312, 13 UCC Rep.Serv.2d 289 (7th Cir. 1990).

[217]*Id.* at 1319.

[218]*Id.* at 1313.

[219]A "presenter", under Section 5-112(3) of the Illinois U.C.C., is defined as "any person presenting a draft or demand for payment for honor under a credit even though that person is a confirming bank or other correspondent which is acting under an issuer's authorization."

Article 8(e) of U.C.P. 290 (which was replaced by Article 16(d) of U.C.P. 400) states that notice of dishonor is to be communicated to the remitting bank, not directly

The letters of the credit at issue on their face required, as the court held, a joint draw by both co-beneficiaries.[220] In this case, the plaintiff had acted on its own behalf as one of the co-beneficiaries of the credit and also as an agent for the other co-beneficiary in presenting the sight draft.[221] Therefore the notice to the plaintiff -- beneficiary, as well as a remitting bank, legally constituted notice to the other beneficiary.[222] In any event, the court held that the issuing bank attempted three times to reach the other beneficiary by telephone once the decision to dishonor was made satisfied the bank's obligation, assuming it had any, to provide the other beneficiary with notice of dishonor.[223]

The examination of the case law reveals that letter of credit disputes do not often arise out of who should be notified in the case of dishonor of the demand for payment because the letter of credit law is clear in this respect. However, an issuing bank should exercise caution when the letter of credit requires a joint draw by co-beneficiaries and only one beneficiary presents the documents. It will do an issuer no harm if it notifies both beneficiaries of the defects.

3.5. When to apply the notification requirements. The cases discussed above illustrate how the court has imposed on an issuer a duty, either under the U.C.P.'s

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to the beneficiary or beneficiaries of the credit, presuming that the sight draft will ordinarily be presented to the issuer by another financial institution. *Id.* at 1320.

[220]*Id.* at 1315.

[221]*Id.* at 1320.

[222]*Id.*

[223]*Id.*

explicit notice requirements or under the U.C.C.'s equitable doctrine and good faith obligation, to promptly and adequately notify the right party its decision of dishonor of draws under a letter of credit. The following discussion will focus on whether the courts should apply the notification requirements, in light of the rationales for this obligation explored in Chapter I, to the issuer a) when the defects are not curable; b) when the defects are known to the party seeking payments.

Wing On Bank Ltd. of Hong Kong v. American Nat'l Bank & Trust Co. of Fort Lauderdale[224] is an early case that addressed the issue of the bearing of curability of the defect on notification requirements and set a precedent for conditioning the application of notice requirements upon the usefulness of the notice. With due respect to the U.C.P. notice requirements, however, the Fifth Circuit stressed the incurability of the defects in the shipping papers. As a result of the beneficiary's failure to sustain its proof of prejudice, the issuing bank was not accountable for its delay in sending notification of the defect.

In *Flagship Cruises, Ltd. v. New England Merchants Nat'l Bank of Boston*,[225] the beneficiary of the letter of credit, pursuant to Article 8 of the U.C.P. 290 to which the credit was subject, argued that the issuer's nonconformity defenses should be confined to those stated in the notice of refusal to pay.[226] The First Circuit, however, read a limitation into Article 8 and stated that the issuer was precluded from relying on

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[224]457 F.2d 328 (5th Cir. 1972).

[225]569 F.2d 699, 24 UCC Rep.Serv. 745 (1st Cir. 1978).

[226]*Id.* at 703.

reasons for nonpayment other than those stated upon initial refusal only to the extent that the statements may have misled the beneficiary, who could have remedied defects but relied on the statement of reasons to their injury.[227] The issuer was not held accountable for its inadequate notice because the statement of notice came after a time when the beneficiary or the presenting bank could have taken any effective remedial action, i.e., the defects were not curable.

In *American Employers Insurance Co. v. Pioneer Bank & Trust Co.*,[228] the issuer dishonored the draft by inaction within three banking days under Illinois Section 5-112(1), but never gave the beneficiary the statement of its reasons for dishonor. The court determined that the rationale behind the notice requirement is to enable the beneficiary to correct any curable defects.[229] If the issuer fails to provide any indication of why a demand is refused, the beneficiary is left no recourse but to file suit for wrongful dishonor. Nevertheless, the district court was against the notion that an issuer's silence to present any objection waived all objection and held that the defects not specified upon initial refusal were waived only to the extent that they were curable.[230]

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[227]*Id.*

[228]538 F.Supp. 1354 (N.D.Ill. 1981).

[229]*Id.* at 1357.

[230]*Id.* at 1357.

In *Colorado Nat'l Bank v. Board of County Commissioners*,[231] the beneficiary submitted a demand draft, instead of a 15-day sight draft as dictated in the letter of credit, on the day the letter of credit was to expire. The bank failed to state in the notice the discrepancy between the presented demand draft and the required 15-day sight draft as one of the reasons for dishonor. The beneficiary argued that the issuing bank should therefore be estopped from relying upon the discrepancy as a ground for dishonor as a result of its failure to state so at the time of dishonor.

Observing the three-banking-day rule in Colorado, the court concluded that the beneficiary could not have cured the defect since any subsequent presentment would have been untimely. As recognized by the court, the general waiver-estoppel rule in Colorado is that "[w]hen an issuer of a letter of credit formally places its refusal to pay upon specified grounds, it is held to have waived all other grounds."[232] The same court also defined the limitation to that general rule, which is "where the statements have misled the beneficiary who would have cured the defect but relied on the stated grounds to its injury."[233] The court therefore rejected the beneficiary's argument and held that the issuing bank was not estopped from relying upon the discrepancy as a defense in the wrongful dishonor charge brought by the beneficiary.

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[231]634 P.2d 32 (Colo. 1981).

[232]*Id.* at 41.

[233]*Id.*

In *American Coleman Co. v. Intrawest Bank of Southglenn, N.A.*,[234] the beneficiary brought a wrongful dishonor charge against the issuing bank. This case was decided solely on the basis of the Colorado U.C.C. and the opinion did not mention the U.C.P.[235] Affirming the United States District Court for the District of Colorado's summary judgement on behalf of the issuing bank, the Court of Appeals for the Tenth Circuit held that the issuing bank was not estopped from raising defense of nonconformity although it did not assert the defense at time of dishonor. The Tenth Circuit rejected the beneficiary's argument that the documentary nature of the letter of credit at issue was changed by being denominated as "Clean Irrevocable Letter of credit" and applied the three-banking-day-rule under Article 5 of the U.C.C. as adopted by the State of Colorado (C.R.S. Section 4-5-112(1)).[236] The beneficiary rendered the documents on November 13, 1986. The letter of credit would expire on November 15, 1986. The issuing bank, which formally dishonored the request for payment on November 17, 1986, acted timely within the three banking day limit.[237] By the time of dishonor the letter of credit had expired for two days and therefore the court deemed that the beneficiary had no time to cure any defects.

Recognizing the general waiver-estoppel rule in Colorado that statement of specified grounds for refusal to pay operates as waiver of all other grounds, the district

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[234]887 F.2d 1382, 10 UCC Rep.Serv.2d 1361 (10th Cir. 1989).

[235]887 F.2d 1382.

[236]*Id.* at 1384.

[237]*Id.* at 1383-84.

court, however, relied upon the limitation to the general rule, i.e., the estoppel rule only operates where statements have misled beneficiary who would have cured defect but relied on stated grounds to its injury.[238] The court thus required proof of the beneficiary's detrimental reliance on the issuer's failure to act timely, i.e., the beneficiary was compelled to prove that it could have cured the claimed documentary discrepancy had it been notified of the defects when notice of dishonor was first given or required to be given. Failure to meet this burden of proof on the part of the beneficiary (i.e., absent detrimental reliance) is the main reason that the court ruled in the bank's favor.

In *Lennox Industries, Inc. v. Mid-American Nat'l Bank & Trust Co.*,[239] the trial court granted summary judgement in favor of the issuing bank. Although the Appellate court found that the existence of issue of material fact precluded summary judgement, the court agreed with the lower court that the expiration of the credit during the three-day period that the U.C.C. gives the issuer to examine documents excuses any requirement of the issuer to give notice of defects, since there is no way that the beneficiary can cure the defect irrespective of the notice.[240]

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[238]*Id.* at 1387. Citing Colorado Nat'l Bank v. Board of County Commissioners, 634 P.2d 32, 41 (Colo. 1981).

[239]49 Ohio App.3d 117, 550 N.E.2d 971, 10 UCC Rep.Serv.2d 1344 (Ohio Ct.App. 1988).

[240]550 N.E.2d at 974.

In *World Houseware Producing Co. v. Mellon Bank (East), N.A.*,[241] the beneficiary sought to recover the amount of letter of credit from the issuing bank. The issuing bank failed to include, in its notice of dishonor, the discrepancies that (1) there was no original certificate of origin and (2) the beneficiary failure to provide a signature from Consumer Testing Laboratories, Ltd. as required by the original Credit. Despite the beneficiary's argument that it could have cured the first defect if it was notified at time of dishonor, the United States District Court for the Eastern District of Pennsylvania entered the judgement in favor of the issuing bank.

The court applied the Pennsylvania U.C.C. and contended that the issuing bank could have waited until the close of the third business day (on Wednesday, May 2, 1990) to review the documents, which were received on Friday, April 27, 1990, and provide notice of dishonor.[242] Then the beneficiary would have no time to cure the defects because the notice of dishonor would be received on about the expiry date of letter of credit. Furthermore, the second defect was not curable even if the issuer had the time to cure because a company by the name simply did not exist.[243] This case was therefore distinguishable from *Kerr-McGee Chemical Corp.*,[244] where the beneficiary

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[241]No. 91-5067, 1992 WL 165053 (E.D.Pa. June 5, 1992).

[242]*Id.* at *3.

[243]*Id.*

[244]872 F.2d 971 (11th Cir. 1989).

could not cure before the expiration of letter of credit only because of the issuer's delay in raising the fatal discrepancy.[245]

In *Leaseamerica Corp. v. Norwest Bank of Duluth, N.A.*,[246] it was undisputed that the issuing bank did not notify the beneficiary whether it was holding or returning the documents. The Eighth Circuit rejected the beneficiary's argument that the issuing bank should be precluded from dishonoring the draft for its violation of the requirement of Article 16(d) of the U.C.P. 400 and affirmed the judgement in the bank's favor. Construing the purpose of the U.C.P. Article 16 notice requirements as "[giving] a beneficiary a chance to cure a curable defect" upon a timely presentation, the court found that it would be appropriate to apply Article 16(e) of the U.C.P. 400 to situations involved timely presentment of documents with curable defects.[247] The Eighth Circuit justified its decision on the beneficiary's untimely presentment and incurable defects.[248]

In *Occidental Fire & Casualty Co. v. Continental Bank B.A.*,[249] among the wrongful dishonor charges against the issuing bank, the beneficiary claimed that the issuing bank was barred by waiver or estoppel from dishonoring the March 1987 draw on the basis of the language nonconformity because it failed to mention it in the notice

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[245]1992 WL 165053, at *3 n.3.

[246]940 F.2d 345, 16 UCC Rep.Serv.2d 738 (8th Cir. 1991).

[247]*Id.* at 350 (citing *Bank of Cochin*, 612 F.Supp. 1533 (S.D.N.Y. 1985), *aff'd*, 808 F.2d 209 (2d Cir. 1986), and *Offshore Trading*, 650 F.Supp. 1487 (D.Kan. 1987)).

[248]*Id.* at 349-50.

[249]918 F.2d 1312 (7th Cir. 1990), *aff'g 725 F.Supp. 383 (N.D.Ill. 1989).*

of dishonoring the previous draws. Under Illinois law, waiver is defined as "the intentional abandonment or relinquishment of a known right;" whether express or implied from a party's conduct, the evidence must show a "clear, unequivocal and decisive act of a party" demonstrating an intent to waive the known right.[250] Noticing each of the previous draws was dishonored for another apparently valid reason, the court deemed that the issuing bank did not unequivocally intend to waive the language nonconformity by failing to raise it as a reason for denying the previous draws should it ever appear in some future draw, however, the issuing bank probably waived its right to raise it for dishonor of those particular draws.[251] According to the court, the issuing bank has no general obligation, absent specific circumstances to the contrary, to provide an exhaustive list of all available grounds for rejection or be found to have waived them with respect to any subsequent draw attempt.[252]

The district court found that no attempt to cure the defects in the previous draws was made by the beneficiary in the subsequent draw and the beneficiary failed to demonstrate its detrimental reliance on the issuing bank's silence with regard to the language nonconformity in the previous draws.[253] Therefore there is no adequate basis for applying the equitable doctrine of waiver/estoppel in the beneficiary's favor.[254]

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[250]*Id.* at 1320 (citations omitted).

[251]*Id.* at 1321.

[252]*Id.*

[253]*Id.*

[254]*Id.*

There is another line of authority that opposes conditioning the notice requirement upon the curability of the defects in the presentation of the document. For example, in *Voest-Alpine Int'l Corp. v. Chase Manhattan Bank, N.A.*,[255] the beneficiary alleged that the confirming bank had waived strict compliance with terms of the credit by accepting the defective documents. The Second Circuit rejected the confirming bank's contention that incurability of defects defeats any possibility of waiver because it is totally at odds with the concept of waiver.[256] Defined as the intentional relinquishment of a known right, waiver requires showing of the knowledge of the existence of the right and an intention to relinquish it on the part of the party charged with waiver.[257] In the court's view, whether or not a defect can be cured is irrelevant to a waiver analysis.

In *Pro-Fab, Inc. v. Vipa Inc.*,[258] the Eleventh Circuit explicitly stated, without further explanation, that "[a] bank's duty to notify is in no way contingent upon its evaluation of the usefulness of the notice."[259] Therefore, failure to give timely notice of dishonor is not excused by the contention that the beneficiary could not have cured the deficiencies in the documentation no matter how much time was given.

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[255]707 F.2d 680 (2d Cir. 1983).

[256]*Id.* at 684-85.

[257]*Id.*

[258]772 F.2d 847, 41 UCC Rep.Serv. 1779 (11th Cir. 1985).

[259]*Id.* at 854.

In *Bank of Cochin Ltd. v. Manufacturers Hanover Trust Co.*,[260] the issuing bank argued that its failure to timely notify the confirming bank was not violative of the U.C.P. or letter of credit policy because the defects were in any case incurable by the time it received the documents as a result of the disappearance of the beneficiary with the letter of credit proceeds. The district court and the Second Circuit rejected the issuing bank's "usefulness of the notice" argument. The U.C.P. notice requirement was construed to be applicable to an issuing bank's obligations to a confirming bank after the latter's honor of a demand for payment. To hold the issuing bank accountable for its delay in notifying is to facilitate the expectation in the international financial community that the parties will live up to their statutory obligations. Conditioning the notice requirement upon the curability of the defects is at odds with the basic letter of credit tenet that banks deal solely with documents, not in goods.[261]

The *Bank of Cochin* factual scenario recurred in *Banque De L'Union Haitienne v. Manufacturers Hanover Int'l Banking Corp.*, where the beneficiary had disappeared with the proceeds of the letter of credit by the time the issuing bank received the fraudulent documents from the confirming bank.[262] The United States District Court for the Southern District of Florida rejected the issuing bank's argument that Article 16 of the U.C.P. 400 does not apply in light of the purpose behind it (i.e., to allow the beneficiary an opportunity to cure the discrepancies prior to the expiration of the

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[260]612 F.Supp. 1533 (S.D.N.Y. 1985), *aff'd*, 808 F.2d 209 (2d Cir. 1986).

[261]*Id.* at 1543.

[262]787 F.Supp. 1416, 1423, 18 UCC Rep.Serv.2d 856 (S.D.Fla. 1991).

credit) because the defect was incurable. The court distinguished the application of U.C.P. notice requirements to an issuing bank -- confirming bank context from an issuer -- beneficiary context. The opportunity-to-cure rationale, which is a purpose under Article 16 but not the only one, is more relevant in the issuer -- beneficiary context than in an issuer -- confirmer context since correspondent banks are hardly in the position to cure documents themselves.[263] Adherence strictly to the U.C.P. notice provisions is critical to the promotion of certainty in letter of credit transactions. "The U.C.P. provides the rules of the game and all who deal in credits must be expected to comply."[264] Under the applicable case law and the overall policy of the U.C.P., the district court ruled in the confirming bank's favor to acknowledge the expectation in the international financial community that parties will fulfil their statutory duties.[265] A decision in the issuing bank's favor would invite issuers to disregard their duties and prove in court that "their" case is excepted from Article 16 because there was nothing they could have done to cure the loss.

The courts are divided on deciding whether the notice requirement is contingent upon the curability of the defects. Some courts refused to apply the U.C.P. notice requirements when the defects are not curable either because the credit has expired or because of the nature of the defects and justified their decision on one of the rationales for the notification requirement, i.e., to allow the beneficiary a chance to cure the

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[263]*Id.* at 1424.

[264]*Id.*

[265]*Id.*

defects and obtain payment. If the defects are not curable within the expiry date of the credit or the defects are not curable no matter how much time is given, the notification requirement would not have helped the beneficiary in obtaining payment under the credit. Allowing the beneficiary a chance to cure the defects is definitely a reason for the notice requirements, but it is not the only one. As discussed in Chapter I, allowing the beneficiary a chance to persuade the customer to waive the documentary discrepancies which may not be curable before the letter of credit expires is also a rationale for the notice requirements. The courts that refuse to recognize a duty of notification on the basis of the beneficiary's inability to cure even though the credit has not expired apparently overlook this rationale.

The courts applying the U.C.C. justified their refusal to apply notice requirements on the beneficiary's failure to sustain the burden of proving detrimental reliance on an issuer's silence. The beneficiary who presents documents shortly before the expiration of a credit could not have relied on the issuer's failure to perform the notification duty to its detriment because it may never have the chance to cure any defects within the expiry date of the credit. The proposed revision of Article 5 substitutes a strict preclusion principle for the doctrines of waiver and estoppel where an issuer fail to give timely notice or fail to state discrepancies relied upon for dishonor in the notice. The court shall not, under the revised Article 5, excuse the issuer of its failure to comply with the notice requirements in cases where the beneficiary is unable to cure the defects even if it has received notice. The litigation about "detrimental reliance" will no longer be relevant in cases concerning the notice requirements.

The courts which consider the usefulness of the notice is irrelevant to the application of the notice requirements stress facilitation of the parties expectations that all parties will live up to their statutory duties. Strictly enforcement of the notice requirements is critical to the promotion of certainty and stability in the letter of credit transactions. In light of the overall purpose of the notice requirement, there is a need for a prompt and adequate notification of discrepancies in all cases when the credit has not expired.

Whether the beneficiary's knowledge of a defect has any bearing on the notice requirements is another problem that has been addressed by the courts. In *Philadelphia Gear Corp. v. Central Bank*,[266] the issuing bank dishonored the drafts drawn under a credit which was subject to the U.C.P. 290 on the basis of general noncompliance with the terms of the credit with a timely notice. The district court held that the issuing bank was precluded from raising the documents' defects, which were curable, as a defense because (1) it failed to inform the presenter (remitting bank) of the precise reasons for dishonor, and (2) it failed to advise the disposition of the documents. The Fifth Circuit reversed the district court's judgement for it did not strike the correct balance between the issuing bank's duty to pay under a credit and the beneficiary's duty to comply strictly to the terms of the credit.

It was undisputed that the beneficiary was aware of "some" of the defects at the time of presentation. A majority of the Fifth Circuit held that the dishonor was proper to the extent that the defects in the documents were known to the parties seeking

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[266]717 F.2d 230, 37 UCC Rep.Serv. (Callaghan) 226 (5th Cir. 1983).

payment, because the beneficiary breached the U.C.C. Section 5-111(1) warranty of compliance with the terms of the credit and also breached the good faith obligation under the U.C.C. Section 1-203 by knowingly tendering nonconforming drafts.[267] In other words, a knowing tender of defective drafts absolves the issuing bank of its duty to give notice of the specific defects and of its duty to return the drafts and supporting documentation. The court stated that "it would be a strange rule indeed under which a party can tender drafts containing defects of which it knew and yet obtain recovery on the ground that it was not advised of them."[268] The majority's treatment of the beneficiary's conduct as bad faith was unprecedented as applied to documents that appear on their face to be nonconforming.[269]

Recognizing that one of the rationales behind the U.C.P. notice requirements is to allow an innocent beneficiary an opportunity to cure an inadvertent error, the dissent in *Philadelphia Gear* admitted that "this motivation is less compelling when the beneficiary knew beforehand of the defects."[270] However, the dissent stressed that "strict compliance" was required of the presenter with respect to the documents presented, and that the issuer, following receipt of the documents, should also strictly adhere to the U.C.P. requirements regarding timely and specific notice of dishonor. The majority opinion would encourage issuers to withhold their reasons for dishonor in

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[267]*Id.* at 238.

[268]*Id.*

[269]*See* Barnes, *supra* note 55, at n.17.

[270]*Id.* at 241.

day-to-day practice and then to plead in subsequent litigations beneficiary's knowledge of defects, which is a complex, subjective, litigable issue. The certainty and speed in enforcing the letter of credit obligation would be diminished by excusing the issuing bank from its obligation on the basis of the beneficiary's knowledge of the defects.

In *Newvector Communications, Inc. v. American Mobile Communication*,[271] the letter of credit incorporated U.C.P. 290 (1974 Revision). The district court followed the *Philadelphia Gear* logic in stating that the issuing bank is not liable for wrongful dishonor where the beneficiary knowingly tendered the nonconforming documents.[272] However, the issue of facts existed as to the knowledge of tender of non-conforming drafts and thus precluded summary judgement.[273]

In *Pro-Fab, Inc. v. Vipa Inc.*,[274] the issuer sent a list of defects regarding the beneficiary's March 10 shipment in a letter dated March 30, 1983, two days before the expiration date of the credit. By April 1, 1983, the beneficiary had cured all but three of the listed discrepancies but the issuer continued to refuse payment.[275] The beneficiary argued that the issuer was guilty of wrongful dishonor under Section 11-5-112 of the Georgia Code because it failed to give notice of dishonor within the required

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[271]663 F.Supp. 252 (D.Utah 1987).

[272]*Id.* at 257.

[273]*Id.* at 258.

[274]772 F.2d 847, 41 UCC Rep.Serv. 1779 (11th Cir. 1985).

[275]*Id.* at 850.

time period.[276] Admitting that the notice was not timely, however, the issuer argued that (1) the notice was irrelevant due to non-curability of the defect regardless of time given to cure, and (2) the beneficiary breached Section 11-5-111 presentment warranty by knowingly presenting the nonconforming documents.[277]

Rejecting the issuer's first argument while accepting its second point, the Eleventh Circuit contended that when a beneficiary knowingly presented the nonconforming documents, he can not later recover on the ground of inadequate notice from the issuer.[278] To hold otherwise would be anomalous to penalize a party for failing to notify another party of an apparent defect already known to the other party. The *Pro-Fab* is factually distinguished from *Philadelphia Gear* (where timely but inadequate notice was given) for the timeliness of the notice and whether the beneficiary had prior knowledge of the defects remained a question of fact.[279] The summary judgement was therefore precluded and the case was remanded to the district court.

In *Paramount Export Co. v. Asia Trust Bank*,[280] the issuing bank failed to return defective bill of lading to the beneficiary or to hold it at the disposal of the advising bank. The court held that the bank lost its right to claim that documents were

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[276]*Id.* at 854.

[277]*Id.*

[278]*Id.* at 855.

[279]772 F.2d at 855.

[280]193 Cal.App.3d 1474, 238 Cal.Rptr. 920, 5 UCC Rep.Serv.2d 149 (Cal.Ct.App. 1987).

nonconforming as a result of violating Article 8 requirement of the U.C.P. 290 (1974 Revision). The court distinguished the present case from the *Philadelphia Gear* on the basis of the beneficiary's prior knowledge of the defects, which was undisputed in the latter but questionable in the former.[281] Furthermore, the court considered that *Philadelphia Gear* was wrongly decided because the rationale underlying the *Philadelphia* opinion is completely inconsistent with the plain languages of Article 8, which afforded the beneficiary some sort of protection in the event of noncompliance.[282] The issuer challenged that the opportunity-to-cure policy behind Article 8 would be undermined if the court rule in the beneficiary's favor because the beneficiary did not attempt to correct the errors after knowing of the defects.[283] However, the court justified its decision favoring the beneficiary on the general rules surrounding letter of credit transactions which require the parties to mechanically follow certain procedures, such as the strict compliance rules and U.C.P. notice requirements.[284] The Paramount decision apparently outweighs the issuer's duty to abide by the U.C.P. notice requirements over the beneficiary's duty of strict compliance.

As the foregoing discussion uncovered, the courts are divided on the application of the notice requirements to the issuing bank when the defects are known to the parties

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[281]*Id.* at 1482, 238 Cal Rptr. 920, 924.

[282]*Id.* 238 Cal.Rptr. 920, 925.

[283]*Id.* at 1483, 238 Cal.Rptr. 920, 925.

[284]*Id.* 238 Cal.Rptr. 920, 925.

seeking payment. The courts that refuse to apply the notice requirement reasoned that the opportunity-to-cure rationale behind the notice requirements under the U.C.P. is less compelling if the beneficiary has prior knowledge of the defects. As a matter of fact, almost half of the presentations do have some defects. Nonconformity of the documents do not necessarily results in a dishonor of the draw under a letter of credit. An issuing bank may determine, upon discovering any documentary discrepancies, either to reject the documents or to waive the defects. The beneficiary may present nonconforming documents "on an approval basis," as in *Alaska Textile*,[285] to request the issuing bank to seek waiver of the discrepancies from the customer, the issuer is still bound by the U.C.P. notice requirements. In case of dishonor, the notice of discrepancies would alert the beneficiary to the need to cure or seek waiver of the defects from the customer itself. Therefore, courts should be reluctant to refuse the application of notice requirements on the basis of the beneficiary's prior knowledge of the defects absent other compelling reasons to the contrary.

The *Philadelphia Gear* and the cases following it are wrongly decided. The strict enforcement of the notice requirements of the U.C.P. and revised Article 5, if adopted, is necessary to promote certainty and integrity in the international financial community. Furthermore, the strict adherence to the notice requirements enables the disputes susceptible to summary judgement which will bring a speedy judicial resolution to the disputes in letter of credit transactions. To allow the issuer to defend

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[285]Alaska Textile Co. v. Chase Manhattan Bank, N.A., 982 F.2d 813, 19 UCC Rep.Serv.2d 540 (2d Cir. 1992).

its violation of the notice requirement on the knowledge of the presenter would invite more factual inquiry into the case and preclude summary judgement.

Chapter IV

CONCLUSIONS

The case law regarding the notification of documentary discrepancies in letter of credit transactions is pretty much settled except on the timing issue and limitations to the notice requirements, which reflects the conflicts and silence in the present U.C.C. and U.C.P. 400.

The courts have recognized that the time limit for an issuer to review draw documents and seek waiver is different from the time limit for notification of discrepancies. It does take an issuing bank's time, usually three days as held by the majority of the courts under the present Article 5 and the U.C.P. 400, to examine the documents and to determine whether to take up or reject the documents. Once the decision of dishonor is made, the notice to that effect should and can be relayed immediately in light of today's near instantaneous communication means so that the discrepancies upon which the dishonor relies will be remedied or the fund paid under the letter of credit will be recaptured.

The revisions of the U.C.P. and U.C.C. Article 5 bring about the changes in the time limit for examination and notification. The issuer now have seven, instead of three banking days, to act after receiving demand for payment. An introduction of a longer time frame for the evaluation of documents is necessary because the U.C.P. 500 now explicitly permits the issuer to consult with the customer about waiver after

discovering the documentary discrepancies. As a result of the uniformity of the law, the courts will no longer face the dilemma of compromising between the U.C.C. and U.C.P.'s different time limits. The court should not relax the "without delay" rule of the prior version of the U.C.P. for notification despite the addition of a seven-day outer limit in the U.C.P. 500, which is particularly important when the issuer does not face a preclusion, under the U.C.P. 500, for an unreasonably delay of examination as long as it notifies the beneficiary of the documentary discrepancies before the seventh banking day.

The courts have applied the notice requirements in most cases in light of two of the rationales behind it, i.e., to afford the beneficiary an opportunity to cure the defects before the letter of credit expires or to allow a payor a better chance to recapture the payment. Absent any statutory exceptions to the notice requirements in the U.C.P., some courts have fashioned two exceptions to the application of the notice requirements: incurability of the defects and the presenter's prior knowledge of the defects. The courts that reject the application of the notice requirement because the beneficiary is unable to cure apparently overlook the possibility of the beneficiary's obtaining a waiver from the customer and obtain payment despite the documentary defects. Under the revised Article 5, the issuer will be excused for failure to comply with the notice requirement only when (i) forgery or material fraud is an issue, or (ii) the letter of credit expires before presentation. Strict adherence to the letter of credit law is critical to the promotion of certainty and stability in letter of credit transactions. The courts should be reluctant to read other limitations than those statutorily stated into

the notice requirements. When the letter of credit has not expired yet, the need for notification is supported by allowing the beneficiary's seeking waiver from the customer in all cases. Absent fraud, the courts should apply the notice requirements regardless of the presenter's knowledge of the discrepancies.

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