

ARTICLE

WARRANTIES BY BENEFICIARIES OF LETTERS OF CREDIT UNDER REVISED ARTICLE 5 OF THE UCC: THE TRUTH AND NOTHING BUT THE TRUTH

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WARRANTY SLIPPED BACK IN. At a special meeting of the UCC Article Drafting Committee in Chicago on Saturday, 30 July [1994] at which only a small portion of the Advisers and other participants were present, the Commissioners reinserted the highly controversial provisions on warranty into the Article 5 draft.¹

I. INTRODUCTION

This solemn warning indicates the depth of concern with statutory warranties by beneficiaries of letters of credit during the U.C.C. Article 5 revision process. The revision was completed in 1995.² Revised Article 5 subsequently has swept virtually the entire country.³ Although there have been a few other non-uniform amendments, a threat by opponents to seek deletion of

1. *USCIB Releases Study on Article 5 Revision*, 10 LETTER OF CREDIT UPDATE 3, 3 (1994). The commentary continued: "Although the version presented to the NCCUSL contained these provisions, opponents have vowed to resist adoption of this section before the other sponsoring body, the American Law Institute, and, if necessary, to urge legislatures to adopt non-conforming versions omitting this language." *Id.*

2. *See* U.C.C. §§ 5-101 to 5-117 (1995). All citations to Revised Article 5 are made to "U.C.C. section number" without special designation. All citations to the 1962 Text of Article 5 are made to "1962 U.C.C. section number." For a summary of Revised Article 5, see generally James G. Barnes & James E. Byrne, *Revision of U.C.C. Article 5*, 50 BUS. LAW. 1449 (1995).

3. Revised Article 5 has been enacted by the District of Columbia and every state except Georgia and Wisconsin. *See* Uniform Law Commissioners, UCC Article 5—Letters of Credit: State Adoptions, http://www.nccusl.org/nccusl/uniformact_factsheets/uniformacts-fs-ucca5.asp (last visited Mar. 3, 2002).

the statutory warranty provisions⁴ has proved to be toothless. No jurisdiction has done so.⁵

This Article analyzes the statutory warranty provisions in both original and Revised U.C.C. Article 5 in light of the objections that were raised during the U.C.C. revision process⁶ and developments in letter-of-credit law.⁷ These developments include the 1993 revision of the Uniform Customs and Practices for Documentary Credits (UCP 500),⁸ the formulation of the 1998 International Standby Practices (ISP 98),⁹ and the finalization of the U.N. Convention on Independent Guarantees and Stand-by Letters of Credit (U.N. Convention) by the U.N. Commission on International Trade Law (UNCITRAL).¹⁰

4. Refer to note 1 *supra*.

5. See U.C.C. § 5-110, 2B U.L.A. 183-84 (Supp. 2001) (listing jurisdictions that have adopted statutes varying the uniform text and indicating that no jurisdiction has deleted the statutory warranty provisions).

6. Refer to Part III. *infra*.

7. Refer to Parts V. & VI. *infra*.

8. See INTERNATIONAL CHAMBER OF COMMERCE, PUB. NO. 500, ICC UNIFORM CUSTOMS AND PRACTICES FOR DOCUMENTARY CREDITS (1993) [hereinafter UCP 500]. The ICC is a nongovernmental organization serving world business with members in 123 countries. *Id.* at 54. Bankers in most countries and in every major financial center rely upon the UCP. See James E. Byrne, *Fundamental Issues in the Unification and Harmonization of Letter of Credit Law*, 37 LOY. L. REV. 1, 3 n.5 (1991) (noting that the UCP has achieved virtually universal adherence).

9. See generally JAMES E. BYRNE, INST. OF INT'L BANKING LAW & PRACTICE, THE OFFICIAL COMMENTARY ON THE INTERNATIONAL STANDBY PRACTICES (James G. Barnes ed., 1998) [hereinafter OFFICIAL COMMENTARY ISP 98]. ISP 98 has been approved by the ICC. International Chamber of Commerce, Seminar on New Rules for Standby Letters of Credit (Jan. 22, 1999), http://www.iccwbo.org/home/news_archives/1999/news_rules_for_letter.asp.

Professor James E. Byrne of George Mason School of Law, the Director of the Institute of International Banking Law and Practice, Inc., was the Reporter and Chair of the Institute's Working Group for ISP 98. See OFFICIAL COMMENTARY ISP 98 *supra*. The Institute, a private institution, holds conferences and distributes materials on letters of credit. For more information on the Institute, see its Web site at <http://www.iiblp.org>. ISP 98 has its own Web site at <http://www.isp98.com>.

10. See *United Nations Convention on Independent Guarantees and Stand-by Letters of Credit*, 1995 U.N.Y.B. 1358-62, U.N. Doc. A/RES/50/48 [hereinafter *U.N. Convention*] (discussing UNCITRAL's development of the U.N. Convention and providing the final text). UNCITRAL is an inter-governmental technical organ of the U.N. General Assembly that assists the international community in modernizing and harmonizing laws dealing with international trade. *Explanatory Note by the UNCITRAL Secretariat on the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit*, Comm. on Int'l Trade Law, 13th Sess., U.N. Doc. A/CN.9/341 at 1 (1997).

For a general discussion of the U.N. Convention, see Filip De Ly, *The UN Convention on Independent Guarantees and Stand-by Letters of Credit*, 33 INT'L LAW. 831 (1999). For discussion of the pros and cons of the U.N. Convention, see John F. Dolan, *The UN Convention on International Independent Undertakings: Do States with Mature Letter-of-Credit Regimes Need It?*, 13 BANKING & FIN. L. REV. 1 (1997), and Paul S. Turner, *The United Nations Convention on International Standby Letters of Credit: How Would It Change Existing Letter of Credit Law in the United States?*, 114 BANKING L.J.

UCP 500 is a private codification of the international standard practices of financial institutions that regularly issue letters of credit.¹¹ Although not law per se,¹² courts and arbitration tribunals enforce UCP 500 as part of the undertaking of an issuer that has incorporated UCP 500 into its letter of credit.¹³

The adoption of the U.N. Convention by the U.N. General Assembly and the focus of UCP 500 upon commercial letters of credit¹⁴ led to the development of ISP 98.¹⁵ ISP 98 deals with the practices of financial institutions with respect to standby letters of credit.¹⁶ Like UCP 500, ISP 98 is intended to be incorporated into a letter of credit and enforced as part of an issuer's undertaking.¹⁷

II. THE LEGAL CONTEXT OF LETTERS OF CREDIT UNDER REVISED ARTICLE 5

Under Revised Article 5 a "letter of credit" is a definite undertaking by an "issuer"¹⁸ to pay or to deliver an item of value upon satisfaction of the documentary conditions precedent to the issuer's duty to honor.¹⁹ An issuer's undertaking is made to a

790 (1997).

11. See INT'L CHAMBER OF COMMERCE, DOCUMENTARY CREDITS: UCP 500 & 400 COMPARED (Charles del Busto ed., 1993) (presenting the justification for UCP 500).

12. See *id.* at 2 (noting that incorporation of the UCP is subject to national law and that courts and arbitration tribunals must resolve conflicts with national law).

13. See, e.g., *San Diego Gas & Elec. Co. v. Bank Leumi*, 50 Cal. Rptr. 2d 20, 24-25 (Cal. Ct. App. 1996) (stating that the UCP has "the force of law with respect to a letter of credit" incorporating the UCP). The influence of the UCP on Revised Article 5 was enormous. James J. White, *The Influence of International Practice on the Revision of Article 5 of the UCC*, 16 NW. J. INT'L L. & BUS. 189, 190 (1995).

14. Refer to notes 29-37 *infra* and accompanying text (discussing the concept of commercial letters of credit).

15. See OFFICIAL COMMENTARY ISP 98, *supra* note 9, at xvi (discussing the need for ISP 98).

16. *Id.* For the concept of a standby letter of credit, refer to notes 29-37 *infra* and accompanying text.

17. See OFFICIAL COMMENTARY ISP 98, *supra* note 9, at 16 (noting that, unless the context requires otherwise, upon incorporation into a letter of credit, the terms and conditions of ISP 98 will apply).

18. In order to prevent wily creditors from depriving individual consumers of defenses to payment by requiring a consumer to issue a letter of credit naming a creditor as beneficiary, undertakings by individuals with respect to personal, family or household debts do not qualify as letters of credit. U.C.C. § 5-102(a)(9) (providing that "issuer" does not include an individual engaged in a consumer transaction); *id.* § 5-102 cmt. 5 (noting that consumers are excluded from the definition of "issuer" in order to preserve their defenses against creditors).

19. U.C.C. § 5-102(a)(10). The definition of "letter of credit" is one of the seven Revised Article 5 provisions that cannot be varied by either a contrary agreement or an incorporation by reference. *Id.* § 5-103(c) ("With the exception of . . . Sections 5-102 (a) (9)

“beneficiary”²⁰ at the request of, or for the account of, an “applicant.”²¹ If an issuer and a beneficiary operate in different markets, additional financial institutions may be involved. In order to enable a beneficiary to obtain payment from a local financial institution, an issuer, for example, can promise to reimburse a designated “nominated person”²² in the beneficiary’s market for giving value pursuant to the issuer’s letter of credit. A nominated person that reciprocally undertakes to honor a presentation under an issuer’s letter of credit is a “confirmer”²³ with obligations to both the issuer and the beneficiary.²⁴ However, a nominated person that does not confirm an issuer’s letter of credit is free not to give value pursuant to it.²⁵ An “adviser” is another type of local intermediary. An “adviser,” at the request of an issuer, a confirmer, or another adviser, either notifies or requests another adviser to notify a beneficiary that a letter of credit has been issued, confirmed, or amended.²⁶ An adviser also can be, but need not be, a nominated person.²⁷

Letters of credit are commercial instruments. An issuer agrees to issue a letter of credit in exchange for both an

and (10), . . . the effect of this article may be varied by agreement or by a provision stated or incorporated by reference in an undertaking.”). For discussion of the nonvariable provisions, see Sandra Stern, *Varying Article 5 of the UCC by Agreement*, 114 BANKING L.J. 516, 517–21 (1997).

An attempt by the parties to vary the statutory definition of “letter of credit” by including nondocumentary conditions of honor could disqualify an instrument from treatment as a letter of credit. *See, e.g.,* Wichita Eagle & Beacon Publ’g Co. v. Pac. Nat’l Bank of S.F., 493 F.2d 1285, 1286–87 (9th Cir. 1974) (per curiam) (holding that nondocumentary conditions with respect to external facts required enforcement of an instrument as a guaranty rather than as a letter of credit); *see generally* Richard F. Dole, Jr., *The Essence of a Letter of Credit under Revised U.C.C. Article 5: Permissible and Impermissible Nondocumentary Conditions Affecting Honor*, 35 HOUS. L. REV. 1079 (1998) (examining the circumstances under which nondocumentary conditions “preclude the existence of a letter of credit”).

20. A “beneficiary” is a person who, under the terms of a letter of credit, is entitled to have a complying presentation honored. U.C.C. § 5-102(a)(3).

21. An “applicant” is a person at whose request or for whose account a letter of credit is issued. *Id.* § 5-102(a)(2).

22. *Id.* § 5-102(a)(11).

23. *Id.* § 5-102(a)(4).

24. *Id.* § 5-107(a). To the extent of its confirmation, a confirmer is obligated to the beneficiary of a confirmed letter of credit as though the confirmer was an issuer and also is obligated to the issuer of the confirmed letter of credit as though the issuer were an applicant.

25. *Id.* § 5-107(b) (“A nominated person who is not a confirmer is not obligated to honor or otherwise give value for a presentation.”).

26. *Id.* § 5-102(a)(1).

27. *See* Banco Nacional de Desarrollo v. Mellon Bank, N.A., 726 F.2d 87, 92–93 (3d Cir. 1984) (ruling that an advising bank that was not a nominated person acted at its peril in paying the beneficiary before submitting the required documents to the issuer, who dishonored).

applicant's payment of a fee and an applicant's promise to reimburse advances by the issuer.²⁸ Letters of credit conventionally are described as either "commercial letters of credit" or "standby letters of credit."²⁹ A general way of distinguishing commercial from standby letters of credit is to regard a commercial letter of credit as requiring an issuer to pay a seller upon the seller's performance of an agreed sale.³⁰ All other letters of credit should be regarded as standbys.³¹ Standby letters of credit can be used in virtually any context, including sales, and are not limited to assuring payment of obligations that are in default.³² So-called "clean" standby letters of credit are payable upon presentation of a beneficiary's demand alone.³³

Notwithstanding this rule-of-thumb, the distinction between commercial and standby letters of credit is imprecise.³⁴ Revised Article 5 deals with this by adopting a "one law for all letters of credit approach." There are no special rules for either commercial letters of credit or standbys.³⁵ UCP 500 also can be incorporated

28. See, e.g., *Am. Coleman Co. v. Intrawest Bank of Southglen, N.A.*, 887 F.2d 1382, 1383 (10th Cir. 1989) (noting that the letter of credit was issued in exchange for a fee and a reimbursement agreement secured by real estate); see U.C.C. § 5-108(i)(1) ("An issuer that has honored a presentation . . . is entitled to be reimbursed by the applicant in immediately available funds not later than the date of its payment of funds.").

29. See JOHN F. DOLAN, *THE LAW OF LETTERS OF CREDIT: COMMERCIAL AND STANDBY CREDITS* ¶ 1.01, at 1-1 (rev. ed. 2001) (discussing standard letter of credit transactions).

30. JAMES G. BARNES ET AL., *THE ABCS OF THE UCC: ARTICLE 5: LETTERS OF CREDIT 1-10* (Amelia H. Boss ed., 1998) (noting that although both standby and commercial letters of credit "provide for payment against the presentation of specified documents[,] standby letters of credit do not require "a negotiable bill of lading or other transport document and do not effect payment of the purchase price for the sale of goods").

31. See *id.* at 7-9 (noting the varied uses of standbys, including providing cash collateral upon the imminent expiration of a letter of credit that neither has been renewed nor replaced).

32. See *id.* (explaining that it is false to imply that a standby letter of credit either is payable only after a default or is not used in conjunction with sales of goods).

33. If a letter of credit does not specify the form that a demand must take, at a bare minimum a demand must be documentary. OFFICIAL COMMENTARY ISP 98, *supra* note 9, at 160 (noting that, under Rule 4.08, "[i]f a standby does not specify any required document, it will still be deemed to require a documentary demand for payment"). It is common to require a type of document known as a "draft," in which a "drawer" orders a "drawee" to pay a "payee." See Revised U.C.C. §§ 3-104(a), (e), 2 U.L.A. 25-26 (1991) (providing that a negotiable instrument that is an order to pay is a "draft"). Under Revised Article 5, unless a letter of credit so provides, a draft need not be a negotiable instrument. U.C.C. § 5-102 cmt. 11.

34. See BROOKE WUNNICKE, ET AL., *STANDBY AND COMMERCIAL LETTERS OF CREDIT* § 2.05, at 2-9, 2-10 (3d ed. 2000) ("The distinction between commercial and standby letters of credit has not been definitively codified.").

35. BARNES ET AL., *supra* note 30, at 9 ("[T]he one law for all letters of credit approach is taken in UCC Article 5." (internal quotation marks omitted)).

into any type of letter of credit.³⁶ Both ISP 98 and the U.N. Convention, which focus upon standby letters of credit, allow users of commercial letters of credit to opt-in to coverage.³⁷

For a letter of credit to be commercially acceptable, it must assure a beneficiary of prompt and certain payment.³⁸ An interrelated series of Revised Article 5 provisions provides this assurance. These provisions include: (1) codification of the traditional independence principle; (2) the test for the adequacy of a documentary presentation; and (3) the preclusion of an issuer from justifying dishonor with documentary discrepancies of which timely notice was not given.³⁹

The codification of the traditional letter-of-credit law “independence principle”⁴⁰ severs a beneficiary’s entitlement to payment from the underlying relationships between the beneficiary, the issuer, and the applicant.⁴¹ Under the statutory

36. UCP 500, *supra* note 8, art. 1, at 10 (stating that UCP 500 applies to any Documentary Credits in which it is incorporated, including, to the extent applicable, standbys).

37. OFFICIAL COMMENTARY ISP 98, *supra* note 9, at 1, 4 (noting that Rule 1.01(b) indicates that ISP 98 applies to undertakings that expressly incorporate it “however named or described”); *U.N. Convention*, *supra* note 10, art. 1(2) at 1358 (providing that the Convention applies to international letters of credit that expressly incorporate it that do not fall within the Convention’s definition of independent guarantee and stand-by letter of credit).

38. BARNES ET AL., *supra* note 30, at 10 (“[T]he basic expectations of the marketplace [are] that bank letters of credit will be paid against the bank’s receipt of the documents specified in the credit . . .”).

39. Refer to notes 41–49 *infra* and accompanying text.

40. The principle that an issuer’s obligations under a letter of credit are independent or “abstract” from other rights and obligations in other transactions is a principle of both new and old letter-of-credit law that materially enhances certainty of payment. UCP 500 expresses the independence principle by declaring that “[c]redits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based . . .”; and, “[i]n Credit operations all parties concerned deal with documents, and not with goods, services and/or other performances to which the documents may relate.” UCP 500, *supra* note 8, arts. 3, 4 at 11. ISP 98 provides:

Because a standby is independent, the enforceability of an issuer’s obligations under a standby does not depend on:

- i. the issuer’s right or ability to obtain reimbursement from the applicant;
- ii. the beneficiary’s right to obtain payment from the applicant;
- iii. a reference in the standby to any reimbursement agreement or underlying transaction; or
- iv. the issuer’s knowledge of performance or breach of any reimbursement agreement or underlying transaction.

OFFICIAL COMMENTARY ISP 98, *supra* note 9, Rule 1.06(c) at 23.

Finally, under the U.N. Convention, in order to be “independent” an undertaking cannot be “[d]ependent upon the existence or validity of any underlying transaction, or upon any other undertaking . . . or . . . [s]ubject to any term or condition not appearing in the undertaking . . .” *U.N. Convention*, *supra* note 10, arts. 3(a), (b) at 1358–59.

41. See U.C.C. § 5-103 cmt. 1 (illustrating the independence principle by example: “That the beneficiary may have breached the underlying contract . . . is no defense for the

independence principle, which the parties cannot vary by agreement without excluding an instrument from Revised Article 5,⁴² the payment obligations of an issuer to a beneficiary are independent of the performance or the nonperformance of any contract or arrangement underlying the letter of credit.⁴³ A beneficiary's entitlement to payment depends upon a presentation of required documents that "appear[] on . . . [their] face strictly to comply with terms and conditions of the letter of credit" according to the "standard practice of financial institutions that regularly issue letters of credit."⁴⁴ Absent a different agreement, an issuer must determine whether the documents presented appear to comply strictly with the terms and conditions of a letter of credit within a reasonable time, not to exceed seven business days, after the day of presentation.⁴⁵ An issuer that fails to give timely notice of dishonor stating all the documentary discrepancies upon which dishonor could be based⁴⁶ is precluded from thereafter raising additional documentary

issuer's refusal to honor").

42. *Id.* § 5-103(c) (protecting seven provisions of Revised Article 5 from variation).

43. *Id.* § 5-103(d). The principal Revised Article 5 exceptions to the independence principle are forgery and material letter-of-credit fraud. *See id.* § 5-109. In several other instances, the independence principle is qualified to allow consideration of an underlying transaction for a specific purpose: (1) breach of a statutory warranty by a beneficiary that has obtained honor, *id.* § 5-110; and (2) subrogation of an unreimbursed issuer or nominated person that has honored a presentation or an applicant that has reimbursed an issuer to the rights of another to the same extent as a secondary obligor would have been subrogated, *id.* § 5-117(a).

44. *Id.* §§ 5-108(a), (e). Proof of forgery or material fraud with respect to a document, or a material fraud by the beneficiary, could justify good faith dishonor notwithstanding the apparent facial compliance of a documentary presentation. *Id.* § 5-109(a)(2). *But see id.* § 5-109(a)(1) (listing four classes of presenters that are entitled to honor notwithstanding proof of forgery or material fraud including a holder in due course of a draft drawn under a letter of credit that had been accepted by an issuer). However, unless an applicant obtains an injunction against honor, notwithstanding the applicant's claim of forgery or material fraud, an issuer is free to honor a presentation in good faith. *Id.* § 5-109(a)(2). In fact, an issuer is more likely to honor than to dishonor. *See id.* § 5-109 cmt. 2 (observing that honor avoids the liability for wrongful dishonor that would arise if an issuer failed to prove forgery or material fraud in subsequent litigation).

45. *Id.* § 5-108(b). A provision of a letter of credit can alter the statutory deadline. *See id.* § 5-108 cmt. 1 ("[S]tandards may be established between the issuer and the applicant by agreement . . ."). Otherwise, affected persons must agree to variation of the deadline, which is not immunized from variation by agreement. *See id.* § 5-103(c). An issuer's obligation to determine whether or not facial strict compliance appears to exist is owed to both a beneficiary and an applicant. *Id.* § 5-108 cmt. 1 ("The standard of strict compliance governs the issuer's obligation to the beneficiary and to the applicant."). An issuer consequently should obtain the agreement of both a beneficiary and an applicant to a change in the statutory deadline that is not incorporated into a letter of credit.

46. *Id.* § 5-108(b)(3) (requiring an issuer "to give notice to the presenter of discrepancies in the presentation" within a reasonable time not to exceed seven business days after the day of the receipt of the documents).

discrepancies.⁴⁷ Strict statutory preclusion is involved. Principles of waiver, estoppel, and prejudicial reliance by a beneficiary upon lack of timely notice are irrelevant.⁴⁸ However, the forgery of a required document, a material fraud by a beneficiary upon either an issuer or an applicant, and a prior expiration of a letter of credit are not mere documentary discrepancies. They are not subject to preclusion.⁴⁹

The Revised Article 5 provisions enhancing speed and certainty of payment of letters of credit are affected by a beneficiary's statutory warranties, which limit the finality of payment.⁵⁰

III. A BENEFICIARY'S WARRANTY UNDER THE 1962 OFFICIAL TEXT OF ARTICLE 5

A. *Perceptions of the 1962 Official Text Warranty During the Revision Process*

The 1962 Official Text of U.C.C. Article 5 contained the following statutory warranty by a beneficiary: "Unless otherwise agreed the beneficiary by transferring or presenting a documentary draft or demand for payment warrants to all interested parties that the necessary conditions of the credit have been complied with."⁵¹ The Official Comment to this cryptic provision delphicly added that "The purpose of this section is to state the peculiar warranty of performance made by a beneficiary."⁵²

47. *Id.* § 5-108(c). Failure to give any notice of documentary discrepancies within the applicable deadline makes a subsequent dishonor wrongful per se. Because this type of dishonor arises from failure to give notice of discrepancies within the applicable deadline, it is referred to as "silent dishonor." *Id.* § 5-108 cmt. 2.

48. *Id.* § 5-108 cmt. 3 (emphasizing that the statutory preclusion supersedes principles of waiver and estoppel).

49. *See id.* §§ 5-108(c), (d) (providing that failure to give notice or to mention "fraud, forgery or expiration in the notice does not preclude the issuer" from basing dishonor on these elements); *see also id.* § 5-108 cmt. 3. Forgery or material fraud by anyone affecting required documents and material fraud by a beneficiary that does not involve the required documents are excluded from preclusion. *Id.* §§ 5-108(c), (d), 5-109(a), cmt. 1. An example of material fraud by a beneficiary on an applicant that is distinct from the required documents would be the substitution of containers of chaff for containers of properly-invoiced oatmeal after the beneficiary's invoice for the oatmeal had been issued.

50. *See, e.g.,* James G. Barnes, *Barnes Sees 'Mellon Bank' Case Stirring L/C Warranty Controversy*, 6 LETTER OF CREDIT UPDATE 13, 14 (1990) [hereinafter Barnes, *Barnes Sees 'Mellon Bank' Case*] (asserting that there is a "need in letter of credit practice for a final payment rule with only limited exceptions").

51. 1962 U.C.C. § 5-111(1).

52. *Id.* § 5-111 cmt.

In 1989, a Joint Task Force composed of lawyers from the American Bar Association and bankers from the United States Council on International Banking (USCIB), a trade association representing more than 350 banks engaged in international transactions,⁵³ completed an in-depth analysis of the inadequacies of the 1962 version of Article 5.⁵⁴ The Joint Task Force's conclusion that the 1962 Official Text was "wanting in major respects both as to predictability and certainty"⁵⁵ led to commencement of the revision process.⁵⁶ Two of the problems discussed by the Task Force involved a beneficiary's statutory warranty.⁵⁷ Nevertheless, a majority of the Task Force favored retention of a beneficiary's warranty provision.⁵⁸ Professor James J. White, the Reporter appointed by the Uniform Commissioners⁵⁹ to assist the revision effort, initially assumed there was a consensus that Revised Article 5 should contain beneficiary's warranties.⁶⁰ However, the USCIB opposed any statutory warranties that were unique to a presentation under a letter of credit, including a warranty that the documents

53. See James G. Barnes, *Internationalization of Revised UCC Article 5 (Letters of Credit)*, 16 NW. J. INT'L L. & BUS. 215, 217, 218 n.8 (1995) [hereinafter Barnes, *Internationalization*] (listing the ABA and USCIB members); see also White, *supra* note 13, at 190 n.5 (describing the USCIB and its membership). The USCIB subsequently has been renamed the International Financial Services Organization (IFSA). *About IFSA: History*, at <http://www.ifsaonline.org> (last visited Jan. 28, 2002).

54. The Joint Task Force's report, published in 1990, identified forty-nine significant problems with the 1962 Text of Article 5. Task Force on the Study of U.C.C. Article 5, *An Examination of U.C.C. Article 5 (Letters of Credit)*, 45 BUS. LAW. 1527, 1531-32, 1641 (1990) [hereinafter Task Force Report]. The Joint Task Force began its work in 1986. Albert J. Givray et al., *Letters of Credit*, 46 BUS. LAW. 1579, 1583-84 (1991). Members of the former Joint Task Force have been actively involved in subsequent revision and harmonization efforts. See Barnes, *Internationalization*, *supra* note 53, at 218-20 (noting that Task Force members worked on the 1993 UCP revision, the U.N. Convention, and the Article 5 revision).

55. Task Force Report, *supra* note 54, at 1535 (declaring that the mix of Article 5 statutory and case law was deficient in "areas which are vital to any system of commercial law").

56. See White, *supra* note 13, at 192 (observing that the Task Force study was the "stimulus" for revision).

57. Task Force Report, *supra* note 54, at 1590-95 (debating the issues of whether the warranty applied to both patent and latent defects in the documents presented and whether an issuer, a confirmer, or a negotiating bank (nominated person) that either dishonored a presentation of documents by inaction or honored a presentation of documents by mistake should be able to bring a warranty action).

58. *Id.* at 1594 ("[A] majority of the Task Force members favor retention of the . . . warranty . . .").

59. The National Conference of Commissioners on Uniform State Laws (NCCUSL) is an organization composed of more than 300 lawyers, judges, and law professors appointed by states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands to draft proposals for uniform and model state laws. *About NCCUSL*, at <http://www.nccusl.org> (last visited Feb. 16, 2002).

60. White, *supra* note 13, at 205-06 (observing that the Task Force Report suggested only that the warranties were unsatisfactory in their existing form).

presented were truthful.⁶¹ A USCIB study⁶² described the 1962 Official Text beneficiary's warranty provision as "discredited" and unworthy of continuation.⁶³ A post-honor action by an issuer for restitution from a beneficiary was preferred as "less disruptive."⁶⁴ The Uniform Commissioners' Drafting Committee reacted by dropping beneficiary's warranties from the next several drafts of the proposed Revision.⁶⁵ But, the day before the final text of the Revision was adopted, the USCIB accepted the reformulated beneficiary's warranties that appear in Revised Article 5.⁶⁶

Judicial disarray with respect to the 1962 Official Text beneficiary's warranty provision developed during the revision process and influenced the Revision's approach.⁶⁷

B. Judicial Development of the 1962 Official Text Beneficiary's Warranty Provision During and After the Revision Process

In 1986, Professor John Dolan published a groundbreaking article observing that the 1962 Official Text beneficiary's warranty provision was "important" but had been "largely overlooked."⁶⁸ Professor Dolan observed that an applicant's claims of forgery and fraud were used to justify an injunction against honor.⁶⁹ However, this type of injunction defeated the assurance of prompt and certain payment that is the *raison d'être* for letters of credit.⁷⁰ Professor Dolan argued that the 1962 Official Text beneficiary's warranty of compliance with the

61. *Id.* at 190 & n.5, 206–07 (explaining that the USCIB argued that the warranties were unnecessary and would place American banks at a competitive disadvantage).

62. *See USCIB Study of Fundamental Problems with the Seventh Draft (March 31, 1993) Revision of UCC Article 5*, 9 LETTER OF CREDIT UPDATE 15 (1993) (identifying problems with the March 31, 1993 draft).

63. *Id.* at 20 ("There should be no warranties that are peculiar to presentation under a letter of credit.").

64. *Id.* at 20–21 (captioning one point: "Insufficient Use of Restitution Principles").

65. *See White, supra* note 13, at 206–07 (noting that the warranty section was omitted from two drafts).

66. *Compare id.* at 207 (explaining that the USCIB agreed to the warranty provision in Revised Article 5 on the day before the final vote), *with* note 1 *supra* and accompanying text (contending that the warranty was "slipped back in" at a poorly attended special meeting).

67. *White, supra* note 13, at 205–06 (noting that differing interpretations of the § 5-111(1) warranty in various cases and in academic debate drove the need for its revision).

68. John F. Dolan, *Letters of Credit, Article 5 Warranties, Fraud, and the Beneficiary's Certificate*, 41 BUS. LAW. 347, 347 (1986) (asserting that the "largely overlooked" warranty should "play an important role" in letter of credit disputes involving alleged fraud by a beneficiary).

69. *Id.* at 355.

70. *Id.*

necessary conditions of a letter of credit provided an adequate post-honor remedy at law for forgery and fraud.⁷¹ Pre-honor injunctive relief was unnecessary.⁷² Professor Dolan also considered that the beneficiary's certificate, commonly required to draw upon standby letters of credit, primarily added to a beneficiary's warranties and that a warranty cause of action would circumvent difficult-to-satisfy elements of an action for common-law fraud.⁷³

Notwithstanding Professor Dolan's observations, the beneficiary's warranty provision had been the subject of few reported cases when the Joint Task Force reviewed experience under the 1962 Official Text.⁷⁴ But, in October 1989, after the Task Force Report had been finalized, in *Mellon Bank, N.A. v. General Electric Credit Corp.*,⁷⁵ a federal district court ruled that a beneficiary warranted both to an issuing bank and to an applicant "the truth of the statements necessary to draw on the credit."⁷⁶ The *Mellon Bank* decision heralded a spate of conflicting decisions under the 1962 Official Text that heightened concern with the scope of the proposed beneficiary's warranties in the Revision.⁷⁷ The December 8, 1992 Draft of the Revision, for example, provided that a beneficiary warranted to an issuer, to any other person to whom presentment was made, and to an applicant that "there is no fraud, the documents are what they purport to be, and the statements and representations in the documents are true in all material respects."⁷⁸

Under the 1962 Official Text, the principal issue was what it meant for a beneficiary to warrant "to all interested parties" that "the necessary conditions of the credit [had] been complied with."⁷⁹ A second important issue was whether an issuer could assert breach of warranty as a justification for dishonor.⁸⁰

71. *Id.* at 347, 356–58.

72. *Id.* at 347, 355–56.

73. *Id.* at 357–58.

74. See Task Force Report, *supra* note 54, at 1591–93 (citing and categorizing these few cases). Professor White, the Reporter for Revised Article 5, described the 1962 Official Text beneficiary's warranty as "ungerminated" for thirty years before becoming subject to conflicting court decisions. White, *supra* note 13, at 205.

75. 724 F. Supp. 360 (W.D. Pa. 1989).

76. *Id.* at 363.

77. See James G. Barnes, *Critique of Irwin Post-Honor "Warranty" Opinion*, 8 LETTER OF CREDIT UPDATE 15, 16 (1992) (discussing beneficiary's warranty decisions affecting the Article 5 revision process).

78. White, *supra* note 13, at 206 n.31.

79. 1962 U.C.C. § 5-111(1).

80. Refer to Part III.B.2 *infra*.

1. *Substantive Scope of the 1962 Official Text Warranty Provision.* There was general consensus that “interested parties” included a range of the participants in letter-of-credit transactions, including issuers, confirmers, applicants, and nominated persons.⁸¹ The disagreement involved the substantive scope of the warranty.

The literal view was that a beneficiary warranted the absence of an issuer’s principal 1962 Official Text defenses to liability for wrongful dishonor:⁸² facially noncomplying documents, forgery, and fraud.⁸³ For a duty to honor to exist, facially complying documents literally were required by statute;⁸⁴ whereas, the necessity of the absence of forgery and fraud derived from letter-of-credit law’s traditional deference to the social policy against fraud. The cases taking the literal view involved both commercial and standby letters of credit.⁸⁵

A policy-oriented view considered that a beneficiary warranted that the documents presented contained truthful statements.⁸⁶ All of the cases adopting this view involved the truthfulness of statements required to draw upon standby letters of credit.⁸⁷

81. See, e.g., *Mellon Bank*, 724 F. Supp. at 365 (reasoning that an issuer that has not been reimbursed by an applicant, and an applicant that has reimbursed an issuer, have standing to assert breach of warranty); *Mfrs. Hanover Int’l Banking Corp. v. Spring Tree Corp.*, 752 F. Supp. 522, 523 (D. Mass. 1990) (holding that a “negotiating bank,” an older term for a Revised Article 5 “nominated person,” has standing to recover payment from a beneficiary after an issuer dishonors); *Delta Brands, Inc. v. MBank Dallas, N.A.*, 719 S.W.2d 355, 358–59 (Tex. App.—Dallas 1986, writ ref’d n.r.e.) (holding that an unreimbursed confirmer has standing to assert breach of warranty).

82. See, e.g., *First Arlington Nat’l Bank v. Stathis*, 450 N.E.2d 833, 839 (Ill. App. Ct. 1983) (concluding that the § 5-111(1) warranty is at least as broad as the § 5-114 defenses); *Barnes, Barnes Sees ‘Mellon Bank’ Case*, *supra* note 50, at 13 (stating that a beneficiary is generally understood to warrant two matters: (1) a beneficiary’s documents facially comply with the terms of a letter of credit; and (2) there is no forgery or fraud).

83. See 1962 U.C.C. § 5-114(1), (2)(b) (requiring honor only if the documents presented facially comply with the terms of a letter of credit and permitting dishonor in certain cases of forgery and fraud).

84. 1962 § 5-114(1).

85. See, e.g., *Stathis*, 450 N.E.2d at 839–40 (holding that documents complying on their face satisfy the § 5-111(1) beneficiary’s warranty); *Banco del Estado v. Navistar Int’l Transp. Corp.*, 942 F. Supp. 1176, 1178–79 (N.D. Ill. 1996) (deciding a case involving a false description of goods being sold, with the dispute between issuer and beneficiary of a commercial letter of credit); see also *Barnes, Barnes Sees ‘Mellon Bank’ Case*, *supra* note 50, at 13 (reasoning that a beneficiary warrants that the documents facially comply with no forgery or fraud).

86. See, e.g., *Sun Marine Terminals, Inc. v. Artoc Bank & Trust, Ltd.*, 797 S.W.2d 7, 11 (Tex. 1990) (“[A] beneficiary warrants that all statements made in documents presented to obtain payment are true.”).

87. See, e.g., *Pubali Bank v. City Nat’l Bank*, 676 F.2d 1326, 1327–29 (9th Cir. 1982) (deciding dispute between an applicant, a beneficiary, and a secured party assignee of proceeds of standby letters of credit), *adhered to*, 777 F.2d 1340, 1343–44 (9th Cir. 1985)

A commonly-stated rationale for the literal view was that requiring a beneficiary to warrant the truthfulness of statements about underlying transactions would conflict with the independence principle. This traditional letter-of-credit law principle requires the independence of obligations created by letters of credit from the underlying transactions that gave rise to them.⁸⁸ However, after an issuer has paid a beneficiary, letter-of-credit rules intended to facilitate speedy and certain payment, like the independence principle, substantially have achieved their purpose and have far less relevance.⁸⁹ At bottom, the literal view was justified by the plain words of Section 5-111(1): the warranty was that “the necessary conditions of the credit have been complied with.”⁹⁰ Under traditional letter-of-credit principles, the truthfulness of representations of external facts is neither a necessary nor an appropriate condition of a letter of credit.⁹¹

(holding that there was no evidence to counter previous decision), *clarified*, *Cenlin Taiwan Ltd. v. Centon, Ltd.*, 5 F.3d 354, 356 (9th Cir. 1993) (positing that an advising bank that merely assists a beneficiary in obtaining payment does not make a beneficiary’s warranty, and that the *Pubali* advising bank’s liability would have been more properly based upon its fraudulent conduct); *Phillips Coll., Inc. v. Riley*, 844 F. Supp. 808, 810, 814–16 (D.D.C. 1994), *aff’d mem.* 50 F.3d 1096 (D.C. Cir. 1995) (deciding a case that involved an applicant versus a beneficiary of a standby letter of credit); *Mellon Bank, N.A. v. Gen. Elec. Credit Corp*, 724 F. Supp. 360, 362–66 (W.D. Pa. 1989) (deciding a dispute involving an issuer that also had been assigned applicant’s rights versus a beneficiary of a standby letter of credit); *Sun Marine Terminals*, 797 S.W.2d at 8–11 (resolving a case between an applicant versus a beneficiary of a standby letter of credit); *Brown v. U.S. Nat’l Bank of Omaha*, 371 N.W.2d 692, 695–697, 700–01 (Neb. 1985) (deciding a case involving applicants seeking to enjoin honor of standby letters of credit by an issuer).

88. See, e.g., *Amwest Surety Ins. Co. v. Republic Nat’l Bank*, 977 F.2d 122, 128–29 (4th Cir. 1992) (asserting that a warranty of the truthfulness of statements would allow an issuer to recover because of nonperformance of an underlying transaction). Refer to notes 40–43 *supra* and accompanying text for discussion of the independence principle.

89. See, e.g., *Sun Marine Terminals*, 797 S.W.2d at 11 (“Payment in this case has already been made; the letter of credit has served its purpose.”); *DOLAN*, *supra* note 29, at 2-63 & n.287 (“Nor does it violate the independence principle to look to the underlying contract extensively to determine whether draws under the credit are wrongful.”); see also *In re Papio Keno Club, Inc.*, 262 F.3d 725, 731 (8th Cir. 2001) (holding, in a nonwarranty case, that the independence principle did not apply to an applicant’s action to recover a draw from a beneficiary that exceeded the amount to which the beneficiary was entitled under the underlying contract); 3 JAMES J. WHITE & ROBERT S. SUMMERS, *UNIFORM COMMERCIAL CODE* 165 (4th ed. 1995) (“Once the beneficiary has left the bank with money in his pocket that [the independence] principle has been served . . .”).

90. 1962 U.C.C. § 5-111(1).

91. Refer to notes 95–101 *infra* and accompanying text (discussing the erroneous view that a letter of credit could require the documents to be truthful). 1962 U.C.C. § 5-103(1)(a) (defining a “letter of credit” as an “engagement . . . that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit.”).

The decisions rejecting the literal view typically treated their analysis as self-evident and provided little rationale.⁹² But Professor Dolan supplied a policy-oriented rationale. He dismissed as “next to frivolous” the view that a beneficiary warranted the facial conformity of the presented documents.⁹³ According to Professor Dolan, a beneficiary’s warranty must cover the absence of “latent defects,” like forgery, fraud, and untruthfulness or an issuer’s and a nominated person’s duty to examine documents would be undercut.⁹⁴

A few cases taking the literal view contained an ill-considered dictum that, if the parties had so desired, a letter of credit could have required the statements in the presented documents to be truthful.⁹⁵ However, a condition of a letter of credit requiring an issuer to conduct an external investigation to ascertain the truthfulness of representations would make prompt payment unlikely and, from the standpoint of an issuer charged with investigating, unwise. In the well-known case of *Wichita Eagle and Beacon Publishing Co. v. Pacific National Bank of San Francisco*,⁹⁶ the Ninth Circuit Court of Appeals refused to recognize an instrument with this type of condition as a letter of credit, explaining that: “The instrument involved here strays too far from the basic purpose of letters of credit, namely, providing a means of assuring payment cheaply by eliminating the need for the issuer to police the underlying contract.”⁹⁷ The Joint Task Force had described letter-of-credit conditions requiring an issuer to conduct a factual investigation as “non-documentary

92. See, e.g., *Brown*, 371 N.W.2d at 701 (holding that “the beneficiary warrants that a documented fact has occurred” without stating a rationale).

93. DOLAN, *supra* note 29, at 6-98 to 6-99.

94. See *id.* at 6-99, 6-101 (criticizing the *Delta Brands* decision). Notwithstanding Professor Dolan’s position, a majority of the Task Force had supported application of the 1962 Official Text warranty to patent defects, provided that a warranty claim by an issuer that had dishonored through inaction was precluded automatically, and that a warranty claim by an issuer that mistakenly had honored was limited by principles of waiver and estoppel with respect to curable documentary defects. Task Force Report, *supra* note 54, at 1594–95.

95. See, e.g., *PNC Bank, N.A. v. Liberty Mut. Ins. Co.*, 912 F. Supp. 169, 173–76 (W.D. Pa.), *aff’d mem.*, 101 F.3d 691 (3d Cir. 1996) (noting that “in the absence of language expressly making veracity a condition of the credit”, there is no warranty of truth); *Amwest Surety Ins. Co. v. Republic Nat’l Bank*, 977 F.2d 122, 128–31 (4th Cir. 1992) (“[O]nly if the list of conditions in a letter of credit includes one of veracity can one say that a condition has not been complied with when an assertion by the beneficiary that is required by the letter of credit turns out to be false.”).

96. 493 F.2d 1285 (9th Cir. 1974).

97. *Id.* at 1286; see generally *Dole*, *supra* note 19, at 1079 (“[C]alling a pumpkin a ‘letter of credit’ will not make it one.” (quoting *Transparent Prods. Corp. v. Paysaver Credit Union*, 864 F.2d 60, 62 (7th Cir. 1988))).

conditions.”⁹⁸ The Task Force’s report had denounced these conditions as “essentially repugnant to letter of credit law and practice.”⁹⁹

Revised Article 5 deals with nondocumentary conditions involving external facts in two ways. Issues are required to ignore them.¹⁰⁰ But, in rare cases, the conditions can be enforced by the courts. In order to qualify for judicial enforcement, a nondocumentary condition must appear on its face to be so fundamental as to leave an issuer without any obligation if the condition is ignored. Also, an applicant must prove that he or she reasonably, materially, and prejudicially has relied upon the enforceability of the nondocumentary condition. However, the enforceability of a fundamental nondocumentary condition precludes an undertaking from functioning as a letter of credit. The undertaking will be enforced, if at all, as an ordinary contractual obligation providing significantly less certainty of payment to the promisee.¹⁰¹

Because issuers and nominated persons are required to disregard all nondocumentary conditions involving external facts that do not preclude the existence of a letter of credit,¹⁰² an Official Comment explicitly rejects a warranty of truthfulness.¹⁰³ An issuer or a nominated person should not be able to assert a breach of warranty upon the basis of facts that were irrelevant when payment was made.

2. *Breach of Warranty as a Defense to Dishonor.* Another important 1962 Official Text warranty issue was whether an issuer could defend a wrongful dishonor action by simply claiming that a beneficiary had breached a warranty. *Philadelphia Gear Corp. v. Central Bank*¹⁰⁴ held “yes.” The opinion stated: “Section 10:5-111 of the Code provides that a beneficiary warrants, in presentation, that its drafts conform to

98. Task Force Report, *supra* note 54, at 1547 (noting that frequently a “nondocumentary condition” requires a bank “to determine questions of fact or law at issue between the account party and the beneficiary”).

99. *Id.* at 1550.

100. U.C.C. § 5-108(g) cmt. 9 (“[A]n issuer shall disregard the nondocumentary conditions and treat them as if they were not stated.”).

101. See § 5-102 cmt. 6 (commenting that a “fundamental” nondocumentary condition can exclude an undertaking from Revised Article 5); see also Dole, *supra* note 19, at 1109–17 (discussing the distinction between fundamental and nonfundamental nondocumentary conditions).

102. Refer to notes 100–01 *supra* and accompanying text (discussing how Revised Article 5 handles nondocumentary conditions involving external facts in two ways).

103. U.C.C. § 5-110 cmt. 2 (“It is not a warranty that the statements made on the presentation of the documents presented are truthful . . .”).

104. 717 F.2d 230 (5th Cir. 1983).

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the conditions of the credit. By knowingly tendering nonconforming drafts, Philadelphia breached . . . these provisions."¹⁰⁵

If it had been widely followed, *Philadelphia Gear* would have transformed the 1962 Official Text beneficiary's warranty provision into a major impediment to the payment of letters of credit. As the dissent observed, issuers that dishonored could have used the warranty provision to require beneficiaries to prove their entitlement to payment by establishing either that they had submitted conforming documents or that any discrepancies did not matter.¹⁰⁶ These fact issues would have precluded beneficiaries from obtaining summary judgment, and, in *Philadelphia Gear* itself, were held to have made it unnecessary for the issuer to justify its dishonor.¹⁰⁷ But *Philadelphia Gear* was not widely followed.¹⁰⁸ The case also quickly was outdated with respect to letters of credit that incorporated the 1983 changes in the UCP. These changes precluded an issuer from justifying dishonor with documentary discrepancies of which a presenter had not been given prompt notice.¹⁰⁹ Revised Article 5 explicitly rejects the *Philadelphia Gear* rationale by providing that a beneficiary's warranties do not arise until a presentation of documents has been honored.¹¹⁰

105. *Id.* at 238 (footnote omitted).

106. *Id.* at 241-42 (Goldberg, J., dissenting) (predicting that the majority's ruling, which was premised on a beneficiary's knowing submission of nonconforming documents, would result in issuers claiming that a knowing breach of warranty existed when they had failed to give the proper notice of a defective submission).

107. *Id.* at 238 (concluding that a beneficiary's knowledge of documentary nonconformities made it unnecessary for the issuer to specify its reasons for dishonor).

108. The leading case accepting the *Philadelphia Gear* analysis was *Pro-Fab, Inc. v. Vipa, Inc.*, 772 F.2d 84 (11th Cir. 1985). *Pro-Fab* also illustrated the fact issues generated by the *Philadelphia Gear* analysis by remanding for a factual finding as to whether the beneficiary had actual knowledge that any documentary discrepancies were material. *Id.* at 855. See also *Newvector Communications, Inc. v. Union Bank*, 663 F. Supp. 252, 257 (D. Utah 1987) (explaining that an issuing bank is not liable for wrongful dishonor where the beneficiary knowingly has not performed in accordance with a letter of credit). The court in *Newvector* denied cross motions for summary judgment due to the existence of myriad fact issues. *Id.* at 258.

109. *Kerr-McGee Chem. Corp. v. FDIC*, 872 F.2d 971, 974 (11th Cir. 1989) (explaining that the *Philadelphia Gear* requirement that a beneficiary prove lack of knowledge of documentary discrepancies is superseded by the preclusive rule in the 1983 version of the UCP). *Philadelphia Gear* involved a prior version of the UCP. James G. Barnes, *Nonconforming Presentations Under Letters of Credit: Preclusion and Final Payment*, 56 BROOK. L. REV. 103, 106 (1990) (reporting that the letter of credit at issue incorporated the version of the UCP in effect prior to the 1983 revision).

110. U.C.C. § 5-110(a) ("If its presentation is honored, the beneficiary warrants . . .") (emphasis added). An Official Comment adds: "Since the warranties in subsection (a) are not given unless a letter of credit has been honored, no breach of warranty under this subsection can be a defense to dishonor by the issuer." *Id.* § 5-110 cmt. 1.

IV. A BENEFICIARY'S WARRANTIES UNDER REVISED ARTICLE 5

A. *Scope of the Warranties*

There are two beneficiary's warranties. After a presentation has been honored, a beneficiary warrants: (1) to an applicant, an issuer, and any other person to whom presentation had been made¹¹¹ that there was no forgery or material fraud; and (2) to an applicant alone, that a drawing did not "violate" either an agreement between the applicant and the beneficiary, or any other agreement intended by both the applicant and the beneficiary to be "augmented by the letter of credit."¹¹²

Neither of the beneficiary's warranties is breached by mere facial blemishes in the documents presented.¹¹³ In order to establish breach of the warranty against forgery and material fraud, whether or not the documents presented are perfect facially, an applicant, issuer, or nominated person must prove that forgery or material fraud exists.¹¹⁴ A beneficiary's special warranty to applicants that a draw does not violate underlying agreements similarly has nothing to do with the facial conformity of the documents presented.¹¹⁵ Revised Article 5 implicitly rejects the 1962 Official Text warranty of the facial compliance of the documents presented.¹¹⁶

1. *The Warranty Against Forgery and Material Fraud.* This warranty is limited to forgery and material letter-of-credit fraud as outlined by Revised Article 5, elaborated by an Official Comment, and developed in consistent case law under the 1962 Official Text.¹¹⁷ Forgery and material fraud also justify an

111. "Other persons" to whom presentation is made include confirmers and other nominated persons. *See id.* § 5-102(a)(12) (defining "presentation" as being made to issuers and nominated persons); § 5-102(a)(4) (defining a "confirmer" as a nominated person).

112. *Id.* § 5-110(a).

113. *See id.* § 5-110 cmt. 2 (explaining that the special warranty to applicants is not "a warranty that the documents strictly comply").

114. *See id.* § 5-110(a)(1) (specifying that the warranty is breached by forgery or fraud of the kind described in § 5-109(a)).

115. Refer to Part IV.A.2 *infra*.

116. Refer to notes 82-85 *supra* and accompanying text (discussing the literal view of the 1962 Official Text beneficiary's warranty).

117. *Id.* § 5-109(a)(1); *see also id.* § 5-109 cmt. 1 (containing a series of statements about forgery and material fraud that are likely to influence courts); *see, e.g.*, *Emery-Waterhouse Co. v. R.I. Hosp. Trust Nat'l Bank*, 757 F.2d 399, 404-07 (1st Cir. 1985) (noting that the elements of common-law fraud were "significantly different" from letter-of-credit fraud under the 1962 Official Text).

injunction against honor.¹¹⁸ Both the warranty and the justification for injunctive relief involve essentially the same misconduct.¹¹⁹ However, the availability of injunctive relief is subject to special statutory safeguards that do not apply to the warranty.¹²⁰ A judicial safeguard that developed under the 1962 Official Text also is noted with approval by an Official Comment. The Comment states that material fraud does not exist unless a “beneficiary has no colorable right to expect honor and . . . there is no basis in fact to support such a right to honor.”¹²¹

As a substantive matter, forgery *must* involve a required document, while material fraud *can* involve a required document.¹²² The involvement of a required document is evidence that forgery or fraud is material but is not conclusive. In order to be material, the forged or fraudulent aspect of a required document must be important either to a purchaser of a document with intrinsic value or to the parties in the underlying transaction.¹²³ An Official Comment, for example, notes that a required invoice overstating by two the number of barrels of salad oil that had been shipped in a thousand-barrel shipment would be immaterial; whereas overstating by 995 the number of barrels in the shipment would be highly material.¹²⁴ Forgery or material fraud with respect to a required document need not have been committed by a beneficiary¹²⁵ and subjects a beneficiary to injunctive relief whether or not the beneficiary was

118. U.C.C. § 5-109(b) (declaring that, in order to forestall forgery or material fraud, a court may temporarily or permanently enjoin honor or grant similar relief).

119. *See id.* § 5-109(a), § 5-109 cmt. 1, § 5-110(a)(1) (indicating the same substantive standard for injunctive relief and the warranty against forgery and fraud).

120. The special safeguards are: (1) no prohibition upon injunctive relief by the law applicable to an accepted draft or a deferred obligation; (2) providing adequate protection against loss to an adversely affected beneficiary, issuer, or nominated person; (3) satisfying the general state prerequisites to injunctive relief, like the inadequacy of a remedy at law; and (4) findings that an applicant is more likely than not to prove forgery or material fraud and that a person demanding honor is not protected from injunctive relief by Revised Article 5. For example, a holder in due course of a draft that has been accepted by either an issuer or a nominated person under a letter of credit cannot be enjoined. *See id.* §§ 5-109(a)(1), (b).

121. *Id.* § 5-109 cmt. 1.

122. *See id.* § 5-109(a) (indicating that forgery or material fraud can involve either a required document or another type of material fraud by a beneficiary upon an issuer or an applicant).

123. *Id.* § 5-109 cmt. 1 (“[T]he fraudulent aspect of a document [must] be material to a purchaser of that document or . . . the fraudulent act [must] be significant to the participants in the underlying transaction.”).

124. *Id.*

125. *See id.* § 5-109(a) (“[A] required document is forged or materially fraudulent or honor of the presentation would facilitate a material fraud by the beneficiary. . . .”) (emphasis added); *id.* § 5-109 cmt. 1 (“[F]raud must be found either in the documents or must have been committed by the beneficiary on the issuer or applicant.”).

aware of it.¹²⁶ However, a beneficiary must have actual fraudulent intent with respect to material fraud that does not involve a required document.¹²⁷

2. *The Warranty Against Violation of Underlying Agreements.* This special warranty clarifies that the independence principle does not prevent an applicant, after reimbursing an issuer, from enforcing the applicant's rights under other law against the beneficiary and others in the underlying transaction. The special warranty applies in two contexts: (1) where the underlying agreements are not between an applicant and a beneficiary; and (2) where the underlying agreements are between an applicant and a beneficiary.¹²⁸ The first context is illustrated by facts of the 1962 Official Text case of *Sun Marine Terminals, Inc. v. Artoc Bank & Trust, Ltd.*¹²⁹ In that case, Sun Marine Terminals Inc. (Sun) had agreed to construct and to operate a gasoline storage terminal for Uni Oil, Inc. (Uni).¹³⁰ The agreement required Uni to obtain a standby letter of credit from a U.S. bank designating Sun as the beneficiary.¹³¹ Uni instructed Artoc Bank & Trust, Ltd. (Artoc), Uni's bank in the Bahamas, to obtain a suitable letter of credit, which Artoc did—from Southeast First National Bank of Miami.¹³² In the letter of credit transaction, Artoc, which had applied to the Miami bank for issue of the letter of credit, was the applicant but had no underlying contract with Sun.¹³³ Under Revised Article 5, Sun nonetheless would warrant to Artoc that any draw did "not violate" the underlying contract between Sun and Uni, which gave rise to Artoc's application for the letter of credit.¹³⁴

126. See *id.* § 5-109(b) ("If an applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary . . . a court . . . may . . . enjoin the issuer from honoring . . ."). Forgery or material fraud with respect to a required document of which a beneficiary was unaware could have been committed by a supplier of goods who provided the beneficiary a required invoice that was fraudulent.

127. See *id.* § 5-109(b); see also WUNNICKE ET AL., *supra* note 34, § 8.04[D], at 8–45 (stating that the general rule in the United States is that a beneficiary must be the perpetrator of fraud that does not involve a required document).

128. See *id.* § 5-110(a) ("[T]he beneficiary warrants . . . to the applicant that the drawing does not violate [1] any agreement between the applicant and the beneficiary or [2] any agreement intended by them to be augmented by the letter of credit.").

129. 797 S.W.2d 7 (Tex. 1990).

130. *Id.* at 8–9.

131. *Id.* at 9.

132. *Id.*

133. *Id.* at 10.

134. With respect to an applicant that has not participated in an underlying transaction with a beneficiary, the special warranty requires that both the applicant and

The second context in which the special warranty applies is illustrated by the facts of the 1962 Official Text case of *Mellon Bank, N.A. v. General Electric Credit Corp.*¹³⁵ In *Mellon Bank, General Electric Credit Corp.* (GECC) had entered into a sale/leaseback of a valuable machine with Woodings Consolidated Industries (Woodings).¹³⁶ In conjunction with the sale/leaseback, Woodings was required to obtain a standby letter of credit designating GECC as the beneficiary.¹³⁷ In the second context, a letter of credit supports an underlying agreement between the applicant and the beneficiary, like the underlying agreements between Woodings and GECC.¹³⁸

Both the *Sun Marine Terminals* and the *Mellon Bank* cases recognized a warranty of truthfulness under the 1962 Official Text.¹³⁹ But an Official Comment emphasizes that the Revised Article 5 special warranty to applicants is not a warranty of truthfulness: "It is not a warranty that the statements made on the presentation of the documents presented are truthful It is a warranty that the beneficiary has performed all of the acts expressly and implicitly necessary under any underlying agreement to entitle the beneficiary to honor."¹⁴⁰

The rejection of a warranty of truthfulness by Revised Article 5 is reasonable. The truthfulness of the statements in the required documents is immaterial to the existence of an obligation to honor a letter of credit.¹⁴¹ Issuers and nominated persons should not be allowed to impair the finality of payment based on circumstances that they were required to ignore in making payment. An issuer and a nominated person also have no stake in the accuracy of documents pertaining to an underlying transaction.

the beneficiary must have intended the letter of credit "to augment" another agreement. U.C.C. § 5-110(a)(2) ("The beneficiary warrants [to the applicant that] the drawing does not violate any agreement between the applicant and the beneficiary or any other agreement intended by them to be augmented by the letter of credit.").

135. 724 F. Supp. 360 (W.D. Pa. 1989). The *Mellon Bank* case held that General Electric Credit Corp. (GECC), the beneficiary, had breached the 1962 Official Text warranty to both the issuer and the applicant. *Id.* at 366. Under Revised Article 5, only the special warranty to applicants would have been involved.

136. *Id.* at 362.

137. *Id.*

138. *Id.*

139. Refer to note 87 *supra* and accompanying text.

140. U.C.C. § 5-110 cmt. 2.

141. See U.C.C. § 5-108(a) (providing that, unless an issuer can prove forgery or material fraud, "an issuer shall honor a presentation that, as determined by . . . standard practice . . . appears on its face strictly to comply with the terms and conditions of the letter of credit"). If the truthfulness of external facts is made an express nondocumentary condition of a letter of credit, under Revised Article 5, either an issuer is required to ignore this, or, in rare cases, an instrument will not be recognized as a letter of credit. Refer to notes 100–01 *supra* and accompanying text.

It is instructive to consider how the special warranty to applicants would apply to the rights of Woodings, the applicant in the *Mellon Bank* case.¹⁴² The standby letter of credit required GECC, the beneficiary, to present a signed, typewritten statement that “the amount of the accompanying draft is due and owing by Customer to GECC”¹⁴³ The agreement between Woodings and GECC permitted a draw only after Woodings’s default upon the sale/leaseback, but default was not a condition of the letter of credit.¹⁴⁴ Nevertheless, the court described GECC’s statement that the \$600,000 amount of its draft was “due and owing” as “erroneous” and a breach of warranty.¹⁴⁵ Woodings had missed a \$15,011 lease payment, but, because GECC had not declared a default and accelerated the applicant’s unmatured obligations, the entire \$600,000 drawn was not due and owing.¹⁴⁶

Under Revised Article 5, the question would be whether GECC’s draw had “violated” the underlying Letter of Credit Agreement between GECC and Woodings.¹⁴⁷ In discussing this, both an Official Comment and Professor James White’s treatise equate “violation” with “lack of authorization” of a draw by underlying agreements.¹⁴⁸ Based upon this reasoning, Professor White’s treatise contends that a violation of the underlying agreement existed on the facts of the *Mellon Bank* case and that the special warranty to applicants would have been breached.¹⁴⁹ In order to preclude any doubt that an unauthorized draw violates an underlying agreement, the treatise also recommends that applicants’ lawyers describe an unauthorized draw as a

142. The case involved the rights of Mellon Bank, the issuer, both as an issuer and as an assignee of Woodings’s rights as applicant. 724 F. Supp. at 363, 365.

143. *Id.* at 362–63.

144. *Id.* at 363.

145. *Id.* at 364.

146. *Id.*

147. *See* U.C.C. § 5-110(a)(2).

148. “[I]f the underlying sales contract *authorized* the beneficiary to draw only upon actual default or upon its or a third party’s determination of default by the applicant and if the beneficiary drew *in violation of its authorization*, then upon honor of its draw the warranty would be breached.” *Id.* cmt. 2 (emphasis added).

Professor White’s treatise echoes this theme. WHITE & SUMMERS, *supra* note 89, at 164 (“We believe that most beneficiaries, who draw under standby letters of credit when they are not authorized to draw . . . would have broken their section 5-110(a)(2) warranty by ‘violating an agreement intended to be secured’ by the letter of credit.”). The 1962 Official Text warranty-of-truth standby cases similarly equated “truth” with authorization. *See, e.g.,* Sun Marine Terminals, Inc. v. Artoc Bank & Trust, Ltd., 797 S.W.2d 7, 12 (Tex. 1990) (“[T]he express language of the agreement . . . authorized Sun to draw upon the letter of credit in such circumstances.”).

149. WHITE & SUMMERS, *supra* note 89, at 164 (contending that the “same result” as *Mellon Bank* “would follow under 5-110(a)(2)”).

“violation” of any agreement imposing restrictions upon a draw.¹⁵⁰ But this recommended precaution is not a prerequisite to breach of the special warranty to applicants.¹⁵¹

The position taken by the Official Comment and Professor White’s treatise demonstrates that the special warranty to applicants applies in the same context as the 1962 Official Text warranty-of-truth standby letter of credit cases. However, it remains an open question whether the mere lack of authorization for a draw by an underlying agreement is sufficient to breach the special warranty to applicants. By analogy from the warranty of the absence of forgery and material fraud, a material breach should be necessary to “violate” an underlying agreement.¹⁵² Moreover, the breach of the underlying contract in the *Mellon Bank* case could have been immaterial. In order to correct its lack of authorization to demand \$600,000, all GECC would have had to do was to declare a default and to accelerate the unmatured balance of Woodings’s debt prior to making a new demand.¹⁵³ A corrective declaration of default and acceleration could have taken place immediately.¹⁵⁴ If GECC had taken immediate corrective action, Woodings’s damages from the unauthorized draw would have been limited to the interest that Woodings would have owed under its reimbursement agreement with Mellon Bank due to GECC’s premature demand—a trivial breach of the underlying contract that should not have been significant enough to breach the special warranty to applicants.

With respect to a “clean” standby letter of credit, which merely requires presentation of a demand,¹⁵⁵ an issuer is required to honor any demand that is in proper form. The special warranty to applicants nevertheless would be breached by a demand that did not comply with the restrictions placed upon a draw in an underlying agreement.¹⁵⁶

150. *Id.*

151. *See* U.C.C. § 5-110(a)(2).

152. Refer to Part IV.A.1 *supra*. It would be inaccurate to describe an immaterial breach as a contract “violation.”

153. *See* *Mellon Bank, N.A. v. Gen. Elec. Credit Corp.*, 724 F. Supp. 360, 364 (W.D. Pa. 1989) (noting that, although Woodings was in default, Mellon Bank had neglected to declare a default and accelerate the maturity of the unpaid balance of Woodings’s debt).

154. In the *Mellon Bank* case, GECC drew the \$600,000 on February 12, 1987 and never corrected its failure to declare default and to accelerate the maturity of the unpaid balance. *Id.* at 363–64. The long-term failure to correct lack of acceleration turned an initial immaterial breach into a material breach.

155. Refer to note 33 *supra* and accompanying text (noting that “clean” standby letters of credit require only a documentary demand).

156. *See* *Irwin v. First Nat’l Bank of LaFayette*, 587 So. 2d 203, 203–05 (La. Ct. App. 1991) (involving breach of the 1962 Official Text warranty by a transferee of the beneficiary of a clean standby letter of credit who drew with respect to a debt not covered

3. *Subrogation to an Applicant's Special Warranty Rights.*

Even though the facts of the *Mellon Bank* case can be used to illustrate a breach of the special warranty to applicants, the special warranty to applicants is a change in the law. Under the 1962 Official Text,¹⁵⁷ the *Mellon Bank* decision determined that GECC had breached a beneficiary's warranty to the issuer as well as to the applicant;¹⁵⁸ whereas, under Revised Article 5, only the special warranty to applicants would have been involved.¹⁵⁹ However, principles of equitable subrogation could entitle other participants in a letter of credit transaction to enforce an applicant's special warranty rights.

Under the 1962 Official Text, a majority of courts would not subrogate an unreimbursed issuer that had honored a letter of credit to the rights of an applicant whose obligation the issuer had satisfied.¹⁶⁰ Two rationales predominated: (1) in honoring, an issuer was satisfying its own primary obligation under letter-of-credit law, and only secondary obligors qualified for equitable subrogation; and (2) allowing equitable subrogation would be inconsistent with the independence principle.¹⁶¹ Revised Article 5, on the other hand, rejects automatic denial of equitable subrogation to an issuer, an applicant, or a nominated person

by the letter of credit). It would be more difficult to prove a breach of the warranty against material fraud with respect to a draw upon a clean letter of credit. See U.C.C. § 5-109 cmt. 3.

157. There is a question under Revised Article 5 as to whether "violation" of an underlying contract requires a material breach of the underlying contract. Refer to notes 147-52 *supra* and accompanying text (discussing whether an underlying agreement's lack of authorization for a draw is sufficient to breach the special warranty to applicants). Because GECC never corrected its failure to declare a default and to accelerate the unmatured balance of Woodings's debt, the facts of the *Mellon Bank* case can be used to illustrate both a material and an immaterial breach of contract. Refer to notes 152-54 *supra* and accompanying text (demonstrating that GECC could have taken measures to ensure that the consequences of the breach of the underlying contract were immaterial).

158. *Mellon Bank*, 724 F. Supp. at 364-65 (finding that both unreimbursed issuers and applicants that had reimbursed an issuer had standing to enforce the 1962 Official Text warranty).

159. See U.C.C. § 5-110(a)(2) (providing that the warranty that a draw is not a violation of an underlying agreement is made only to applicants).

160. See, e.g., *Tudor Dev. Group, Inc. v. U.S. Fid. & Guar. Co.*, 968 F.2d 357, 361-62 (3d Cir. 1992) (noting that a majority of courts denied an issuer equitable subrogation rights). The court described the "classic explanation of the doctrine of equitable subrogation as follows: Where property of one person is used in discharging an obligation owed by another . . . under such circumstances that the other would be unjustly enriched by the retention of the benefit thus conferred, the former is entitled to be subrogated to the position of the obligee or lien-holder." *Id.* at 361.

161. See *id.* at 362-63 (accepting the primary obligation rationale but rejecting the independence principle rationale); see also Amelia H. Boss, *Suretyship and Letters of Credit: Subrogation Revisited*, 34 WM. & MARY L. REV. 1087 (1993) (arguing that allowing subrogation does not compromise the independence principle).

following honor of a letter of credit.¹⁶² Following honor, a request for equitable subrogation by an issuer, an applicant, or a nominated person must be evaluated as though the requestor were a secondary obligor, but subrogation otherwise is left to the discretion of a court.¹⁶³ The Revised Article 5 requirement that honor precede subrogation safeguards the independence principle¹⁶⁴ and cannot be waived by a contrary agreement.¹⁶⁵

Equitable subrogation is always discretionary and decided upon a case-by-case basis.¹⁶⁶ Nevertheless, Professor White believes that, given the right facts, an unreimbursed issuer could justify equitable subrogation to an applicant's special warranty rights against a beneficiary.¹⁶⁷

The breach of a beneficiary's warranty, and the equitable subrogation of an issuer, an applicant, or a nominated person to another's rights, are the principal qualifications to finality of payment under Revised Article 5.¹⁶⁸ On the other hand, forgery and material fraud are a general exception to finality of payment.¹⁶⁹

B. Remedies for Breach of Warranty

Revised Article 5, like the 1962 Official Text, does not contain a statutory measure of damages for breach of a

162. U.C.C. § 5-117 cmt. 1 ("By itself this section does not grant any right of subrogation."). The provision adopts the position of dissenting Judge Becker in the *Tudor Development Group* case. See *id.* § 5-117 cmt. 1; see also *Tudor Dev.*, 968 F.2d at 369 (Becker, J., dissenting).

163. See *id.* § 5-117(a)-(c).

164. The requirement prevents an issuer from using a claim to equitable subrogation to justify dishonor. See *id.* § 5-117 cmt. 2 (noting that the prerequisite of honor ensures that subrogation will "not be used as an offensive weapon by an issuer or others").

165. *Id.* §§ 5-103(c), 5-117(d) ("Notwithstanding any agreement or term to the contrary . . .").

166. See *Tudor Dev. Group*, 968 F.2d at 369 (Becker, J., dissenting) ("In short the issuer's ability to protect itself may be a strong equity against it, as is the fact that it receives a fee for its services, but countervailing equities may outweigh these considerations in certain cases."). Under Revised Article 5, an issuer could protect itself by taking an assignment of an applicant's entitlement to the special warranty in the agreement in which the applicant promises to reimburse advances by the issuer.

167. James J. White, *Rights of Subrogation in Letters of Credit Transactions*, 41 ST. LOUIS U. L.J. 47, 55-56, 61-64 (1996) (reasoning that it could be fair to allow an issuer to assert an applicant's warranty rights against a beneficiary).

168. The finality rules also provide that an issuer that has honored takes the presented documents free from claims of the beneficiary or the presenter and is precluded from asserting a right of recourse on a Revised Article 3 draft. U.C.C. § 5-108(i)(2)-(3). *But see id.* § 5-108(i)(4) (precluding restitution with respect to mistakes concerning apparent discrepancies in documents or a presentation). It is an open question whether restitution would be permissible in other circumstances.

169. Refer to note 43 *supra*.

beneficiary's warranty.¹⁷⁰ An Official Comment suggests that courts should consider the analogous remedies for breach of warranty in U.C.C. Article 2 on sales of goods, Revised U.C.C. Article 3 on negotiable instruments, and U.C.C. Article 4 on bank collections.¹⁷¹ The Official Comment adds that "the damages for breach of warranty will often be much less than the amount of a draw, sometimes zero."¹⁷² Two illustrations are given:

Assume a seller entitled to draw only on proper performance of its sales contract.

Assume it breaches the sales contract in a way that gives the buyer a right to damages but no right to reject. The applicant's damages for breach of the warranty in subsection (a)(2) are limited to the damages it could recover for breach of the contract for sale. Alternatively assume an underlying agreement that authorizes a beneficiary to draw only the "amount in default." Assume a default of \$200,000 and a draw of \$500,000. The damages for breach of warranty would be no more than \$300,000.¹⁷³

Both examples involve the special warranty to applicants. The example involving a commercial letter of credit is limited to breaches of a contract for sale by a seller that do not give a buyer a right either to reject or to revoke acceptance of the contract goods.¹⁷⁴ A total breach of a contract of sale could entitle a buyer to recover so much of the price as had been paid through draws on a letter of credit.¹⁷⁵ Damages in the amount of a draw also would occur with respect to a standby letter of credit whenever a draw was totally unjustified.¹⁷⁶ Moreover, in the event of breach of the warranty against forgery and material fraud, an applicant's recoverable damages could exceed the amount of a draw. *Emery-Waterhouse Co. v. Rhode Island Hospital Trust*

170. Compare U.C.C. § 5-110 cmt. 3 ("The damages . . . are not specified . . ."), with 1962 U.C.C. §§ 5-111, 5-115.

171. U.C.C. § 5-110 cmt. 3 (stating that "[c]ourts may find damage analogies" in these other provisions).

172. *Id.*

173. *Id.*

174. *Id.* ("Assume it breaches the sales contract in a way that gives the buyer a right to damages *but no right to reject.*" (emphasis added)).

175. *Id.* § 2-711(1) ("[I]f the breach goes to the whole contract . . ., the buyer may cancel and whether or not he has done so may . . . [recover] so much of the price as has been paid . . .").

176. Compare note 173 *supra* and accompanying text (quoting illustrations from § 5-110 cmt. 3), with *Pubali Bank v. City Nat'l Bank*, 777 F.2d 1340, 1342-44 (9th Cir. 1985) (granting applicant's motion for partial summary judgment in an action to recover the total amount drawn on behalf of a beneficiary of two standby letters of credit).

National Bank,¹⁷⁷ a decision under the 1962 Official Text, is illustrative.

Emery-Waterhouse affirmed a jury verdict that required the assignee of a standby letter of credit to return the entire \$139,700 drawn and also to pay the applicant \$1,397,000 in punitive damages.¹⁷⁸ The evidence presented to the jury indicated that the assignee had made three fraudulent certifications to the issuer that the amounts of draws previously had been demanded from the applicant, one fraudulent certification that the amount drawn was due and two reckless certifications that the amount drawn was due.¹⁷⁹

The theory of liability in *Emery-Waterhouse* is noteworthy. A beneficiary's warranty was not discussed, and the jury found that the assignee had not committed common-law fraud.¹⁸⁰ Instead, the court based its affirmance upon the existence of the type of fraud that would justify an injunction against honor under the 1962 Official Text—special letter-of-credit fraud upon an applicant that did not require proof of reasonable reliance upon fraudulent statements.¹⁸¹

It is an open question whether the recovery in the *Emery-Waterhouse* case would be possible under Revised Article 5. With respect to issuers, nominated persons, and advisers, consequential damages are expressly prohibited,¹⁸² and punitive damages are implicitly prohibited.¹⁸³ This was done “out of fear that imposing consequential [and punitive] damages on issuers would raise the cost of a letter of credit to a level that might render it uneconomic.”¹⁸⁴ However, imposing punitive damages upon beneficiaries with actual fraudulent intent¹⁸⁵ would not

177. 757 F.2d 399 (1st Cir. 1985).

178. *Id.* at 401.

179. *Id.* at 403-08.

180. *Id.* at 404-07.

181. *Id.* at 405 (suggesting that letter-of-credit fraud does not require proof of reliance).

182. U.C.C. § 5-111(a), (b) (stating that issuers are liable for incidental damages “but not consequential damages”); *id.* § 5-111(c) (asserting that advisers and nominated persons other than confirmers are liable for incidental “but not consequential damages”). For most purposes, confirmers are treated as issuers. *See id.* § 5-107 cmt. 1 (“[U]nless the context otherwise requires, the terms ‘confirmer’ and ‘confirmation’ should be read into this article wherever the terms ‘issuer’ and ‘letter of credit’ appear.”).

183. *Id.* § 5-111 cmt. 4 (“*A fortiori* punitive and exemplary damages are excluded . . .”).

184. *See id.*

185. A beneficiary's breach of the warranty against forgery and material fraud through unknowing use of a required document that had been forged or fraudulently altered by a supplier should not give rise to damage liability. Refer to notes 125–27 *supra* and accompanying text.

affect the cost of letters of credit. Indeed, the possibility of punitive damages would deter beneficiary fraud and reduce the need for injunctions against honor. Revised Article 5 is silent with respect to the remedies for breach of a beneficiary's warranties.¹⁸⁶ An award of punitive damages for a beneficiary's intentional breach of the warranty against forgery and material fraud would be consistent with the text as well as the policy of the statute.¹⁸⁷

V. THE EFFECT OF UCP 500 AND ISP 98 ON A BENEFICIARY'S WARRANTIES UNDER REVISED ARTICLE 5

If a letter of credit expressly incorporates rules of "custom or practice, such as the Uniform Customs and Practices for Documentary Credits," the expressly incorporated rules supercede conflicting statutory provisions that are variable.¹⁸⁸ The provisions that cannot be varied are: (1) the definitions of "issuer" and "letter of credit";¹⁸⁹ (2) the provision deeming letters of credit stating that they are "perpetual" to expire in five years;¹⁹⁰ (3) the provision declaring that an issuer or a nominated person cannot unreasonably withhold its consent to an assignment of proceeds to an assignee in possession of a letter of credit that must be presented in order to obtain honor;¹⁹¹ and (4) the requirement that honor must take place for equitable subrogation to be possible.¹⁹² Beneficiary's warranties are not protected from variation, and thus can be superceded.¹⁹³

186. U.C.C. § 5-110 cmt. 3 (failing to specify damages for breach of warranty).

187. Refer to notes 177-81 *supra* and accompanying text (analyzing the 1962 Official Text *Emery-Waterhouse* case). Principles of common-law fraud also supplement Revised Article 5. See *Union Pac. R.R. Co. v. Vill. of S. Barrington*, 958 F. Supp. 1285, 1297-98 (N.D. Ill. 1997) (reviewing common-law fraud claim under the 1962 Official Text in which a developer alleged that the village intentionally and falsely represented to a bank that the developer had not complied with a subdivision ordinance in order to draw upon a standby letter of credit). In view of both the differences in the substantive elements of common-law fraud and the routine availability of compensatory and punitive damages for common-law fraud, the fact that Revised Article 5 treats a special type of fraud as a basis for injunctive relief as well as a breach of warranty should not preempt an action for common-law fraud. See *Banco Del Estado v. Navistar Int'l Transp. Corp.*, 954 F. Supp. 1275, 1286-87 (N.D. Ill. 1997) (rejecting the contention that dismissal of a 1962 Official Text breach of warranty claim precluded assertion of a common-law fraud claim based upon a beneficiary's conduct prior to the issue of a letter of credit).

188. U.C.C. § 5-116(c) (confirming that the incorporated rules "govern except to the extent of any conflict with the nonvariable provisions specified in section 5-103(c)").

189. *Id.* §§ 5-102(a)(9)-(10), 5-103(c).

190. *Id.* §§ 5-103(c), 5-106(d).

191. *Id.* §§ 5-103(c), 5-114(d).

192. *Id.* §§ 5-103(c), 5-117(d).

193. See *id.* §§ 5-103(c), 5-110(a).

Both the text and comments of Revised Article 5 refer to the UCP as an example of expressly incorporated rules of custom or practice that can alter variable statutory provisions.¹⁹⁴ Although ISP 98 was finalized subsequent to the completion of the revision process, the ISP 98 rules likewise can alter variable statutory provisions.¹⁹⁵

Both UCP 500¹⁹⁶ and ISP 98¹⁹⁷ are silent with respect to a beneficiary's warranties. If there is no conflict between a rule of practice and the statute, Revised Article 5 provides that both apply.¹⁹⁸ It also is generally-recognized that the UCP is subordinate to national law with respect to fraud, and ISP 98 expressly disclaims coverage of fraud.¹⁹⁹ In sum, despite the fact that statutory beneficiary's warranties are not protected from variation, incorporation of either UCP 500 or ISP 98 into a letter of credit should not affect the warranties.

VI. THE EFFECT OF THE U.N. CONVENTION ON A BENEFICIARY'S WARRANTIES UNDER REVISED ARTICLE 5

The U.N. Convention deals with "independent guarantee[s]" and "stand-by letter[s] of credit."²⁰⁰ A European "independent

194. *Id.* § 5-116(c) & cmt. 3.

195. ISP 98 rules may not always reflect current practice. *See* DOLAN, *supra* note 29, at 4-117 to 4-120 (demonstrating that a number of ISP 98 rules do not reflect current usage). But express incorporation of ISP 98 contractually would waive variable Revised Article 5 rules.

196. *See* UCP 500, *supra* note 8, art. 19-23, at 23-28 (omitting mention of the beneficiary's warranties in the articles dealing with liabilities and responsibilities); *Nasser v. Fl. Fleet Sales, Inc.*, 79 F. Supp. 2d 284, 294 (S.D.N.Y. 1999) (recognizing that the UCP does not contain any beneficiary's warranties).

197. *See* OFFICIAL COMMENTARY ISP 98, *supra* note 9, at 90-139 (omitting mention of beneficiary's warranties in the ISP 98 rules dealing with presentation).

198. U.C.C. § 5-116(c) (stating that only conflicting rules of practice displace the variable provisions of Revised Article 5); *id.* § 5-116 cmt. 3 ("[W]here there is no conflict between Article 5 and the relevant provision of the UCP or other practice, both apply.").

199. With respect to UCP 500, *see* *Rockwell Int'l Syst., Inc. v. Citibank, N.A.*, 719 F.2d 583, 588 (2d Cir. 1983) (recognizing that a New York "fraud-in-the-transaction" defense controls even though the UCP fails to provide such a defense); *Prutscher v. Fid. Int'l Bank*, 502 F. Supp. 535, 536-37 (S.D.N.Y. 1980) (finding that "[no] provision of the UCP" requires a confirmer to make payment over fraudulent documents). *See* John F. Dolan, *Letters of Credit: A Comparison of UCP 500 and the New U.S. Article 5*, 1999 J. BUS. L. 521, 536 ("Credits incorporating Revised Article 5 or issued by a bank in a jurisdiction that has adopted the article should be subject to the warranty rule even if they incorporate UCP 500."). With respect to ISP 98, *see* OFFICIAL COMMENTARY ISP 98, *supra* note 9, at 19 ("These Rules do not define or otherwise provide for . . . defenses to honour based on fraud, abuse, or similar matters. These matters are left to applicable law.").

200. *See* U.N. Convention, *supra* note 10, art. (2)(1) ("[A]n undertaking is an independent commitment, known in international practice as an independent guarantee or as a stand-by letter of credit . . .").

guarantee” is a functional equivalent of an American standby letter of credit.²⁰¹ However, the European terminology sometimes differs from that of Revised Article 5, and the U.N. Convention blends the two. Under the U.N. Convention, an issuer is a “guarantor/issuer” and an applicant is a “principal/applicant.”²⁰² Novel terms include an “instructing party,” another person acting on behalf of a principal/applicant, and a “counter-guarantor,” an instructing party that gives a “counter-guarantee” to a guarantor/issuer.²⁰³ On the other hand, the U.N. Convention uses both “confirmer” and “beneficiary” in the Revised Article 5 sense.²⁰⁴

The U.N. Convention became effective on January 1, 2000, one year after five countries had ratified it.²⁰⁵ For the U.N. Convention to apply to a transaction, any one of the following three circumstances must be present: (1) the place of business where an instrument was issued must be in a ratifying country in which the U.N. Convention is in force;²⁰⁶ (2) the rules of private international law must require application of the law of a ratifying country in which the U.N. Convention is in force;²⁰⁷ or (3) an independent guarantee or stand-by letter of credit must

201. *Am. Nat'l Bank & Trust Co. of Chi. v. Hamilton Indus. Int'l, Inc.*, 583 F. Supp. 164, 169–70 (N.D. Ill. 1984), *rev'd on other grounds sub nom.*, *Banque Paribas v. Hamilton Indus. Int'l, Inc.*, 767 F.2d 380 (7th Cir. 1985) (finding that an instrument designated as an unconditional guarantee was in substance a letter of credit under the 1962 Official Text); U.C.C. § 5-102 cmt. 6 (“[C]ertain documents labelled [sic] ‘guarantees’ in accordance with European (and occasionally, American) practice are [Revised Article 5] letters of credit.”); DOLAN, *supra* note 29, at 1-31 (“First-demand guarantees, performance guarantees, and simple-demand guarantees are the foreign bank equivalents of the standby.” (internal quotation marks and footnotes omitted)).

202. *See U.N. Convention, supra* note 10, arts. 2(1), 2(2)(a).

203. *See id.* arts. 2(2)(b), 6(b)-(d). In the *Sun Marine Terminals* case, Artoc Bank & Trust, Ltd. acted as an “instructing party.” Refer to notes 129–33 *supra* and accompanying text.

204. *See U.N. Convention, supra* note 10, art. 2(1), 6(e)-(f).

205. *See id.* art. 28(1) (stating that the U.N. Convention became effective on the first day of the month following the expiration of one year from the deposit of the fifth instrument of ratification, acceptance, approval, or accession). The original ratifying states were: Ecuador, El Salvador, Kuwait, Panama, and Tunisia. The United States has signed the Convention but not ratified it. *See* <http://untreaty.un.org/ENGLISH/bible/englishinternetbible/partI/chapterX/treaty23.asp> (last visited Feb. 4, 2002).

206. *U.N. Convention, supra* note 10, art. 1(1)(a) (“This Convention applies to an international undertaking . . . [i]f the place of business of the guarantor/issuer at which the undertaking is issued is in a Contracting state . . .”).

207. *Id.* art. 1(1)(b). With respect to states that adopt the Convention after the date of deposit of the fifth instrument of ratification, December 8, 1998, the Convention becomes effective on the first day of the month following the expiration of one year from the date of deposit of the state’s ratification. *Id.* art. 28(2). Belarus is the only state to ratify subsequent to the initial five ratifying states. Belarus ratified on January 23, 2002. *See* <http://untreaty.un.org/ENGLISH/bible/englishinternetbible/partI/chapterX/treaty23.asp> (last visited Feb. 4, 2002).

incorporate the U.N. Convention.²⁰⁸ With respect to ratifying countries in which the U.N. Convention is in force, the U.N. Convention as a whole²⁰⁹ automatically applies only to international independent undertakings known in international practice as either independent guarantees or stand-by letters of credit.²¹⁰ International status is established by the listing in an undertaking of places of business in different countries for two or more of the participants in a letter-of-credit transaction.²¹¹ An international commercial letter of credit is not covered automatically. It is necessary to add an express clause opting-in to U.N. Convention coverage.²¹² By the same token, an international independent guarantee or stand-by letter of credit can include express language opting-out of U.N. Convention coverage.²¹³ To the extent that it is unclear whether a particular international instrument is a commercial or a stand-by letter of credit, the parties should make their intentions clear by either expressly opting-in or expressly opting-out.²¹⁴ However, if an international independent guarantee or stand-by letter of credit does not specify

208. The parties could incorporate the U.N. Convention either by expressly subjecting an independent guarantee or stand-by letter of credit to it, or by choosing the law of a jurisdiction in which the U.N. Convention is in force. *See U.N. Convention, supra* note 10, art. 1(2).

209. In a form of "mini-convention," the Convention's choice-of-law rules apply to an international undertaking that is involved in litigation in an adopting country in which the Convention is in force even though the undertaking otherwise is not subject to the Convention. *See id.* art. 1(3) (stating that the U.N. Convention choice of law provisions operate independently of the U.N. Convention's scope provisions); James E. Byrne & Harold Burman, *UN Convention on Independent Guarantees and Stand-by Letters of Credit: Introductory Note*, 35 INT'L LEGAL MATERIALS TREATIES & AGREEMENTS 735, 738 (1996) (noting that the choice-of-law rules have the effect of a "mini-convention").

210. *U.N. Convention, supra* note 10, art. (1)(1), (2)(1).

211. *Id.* art. 4(1). The relevant categories of participants are: guarantor/issuer, beneficiary, principal/applicant, instructing party, counter-guarantor, and confirmer. *Id.* arts. 4(1), 6(b).

212. *See id.* art. 1(2) ("This Convention applies also to an international letter of credit not falling within article 2 if it expressly states that it is subject to this Convention."); *Report of the United Nations Commission on International Trade Law*, U.N. GAOR, 50th Sess., Supp. No. 17, ¶¶ 26-30 at 7-8, U.N. Doc. A/50/17 (1995) [hereinafter U.N. Doc. A/50/17] (discussing the reasons for deleting a provision expressly authorizing parties to opt-in the Convention, while noting that such a right generally would be recognized).

213. *U.N. Convention, supra* note 10, art. 1(1) ("This Convention applies to an international undertaking referred to in article 2 . . . unless the undertaking excludes the application of the Convention."); U.N. Doc. A/50/17, *supra* note 212, ¶ 175 at 35-36 ("[P]arties to an undertaking would remain free to opt out of the draft Convention in its entirety, or to exclude or modify many of its individual provisions."). Conversely, the parties to international letters of credit that are not automatically covered by the Convention can opt-in to coverage. *See* note 212 *supra* and accompanying text (noting that article 1(2) allows parties expressly to opt-in to the Convention).

214. The distinction between a commercial and a standby letter of credit is imprecise. Refer to notes 29-34 *supra* and accompanying text.

the governing law, and then becomes involved in litigation in an adopting country in which the U.N. Convention is in force, an express clause opting-out of the U.N. Convention will not cancel the U.N. Convention's default choice-of-law rule.²¹⁵ Without regard to the applicability of the remainder of the U.N. Convention, this default choice-of-law rule selects the law of the location of an issuer's place of business where an independent guarantee or stand-by letter of credit was issued.²¹⁶ A choice-of-law clause choosing the law of another country is necessary to cancel the default choice-of-law rule.²¹⁷

A failure to cancel the U.N. Convention's default choice-of-law rule could frustrate a decision by the parties to an international commercial letter-of-credit transaction to opt-in to U.N. Convention coverage.²¹⁸ If the U.N. Convention is not in force in the country in which the commercial letter of credit was issued, the provision opting-in to U.N. Convention coverage could be regarded as ineffective.

Under the U.N. Convention, a beneficiary must demand payment, and four negatively-phrased "certifications" are deemed to arise from a demand.²¹⁹ In affirmative terms, a beneficiary is deemed to certify that: (1) the demand is made in good faith; (2) all documents are genuine and have not been falsified; (3) payment is due upon the basis asserted in the demand and supporting documents; and (4) the demand has a conceivable basis.²²⁰ Because

215. See Turner, *supra* note 10, at 796-97 (reasoning that the drafters could have been more clear about how article 1(1) applies to articles 21 and 22 in respect to opting out provisions).

216. *U.N. Convention, supra* note 10, art. 22.

217. *Id.* arts. 1(3), 21 (stating that an undertaking is governed by the law either stipulated in it or agreed elsewhere by the guarantor/issuer and the beneficiary or as otherwise provided by the U.N. Convention). The Revised Article 5 default choice-of-law rule similarly provides that an issuer's liability is governed by the law of the jurisdiction in which the issuer is located, or if there are multiple addresses, the one at which a letter of credit was issued. U.C.C. § 5-116(b).

The Convention, like Revised Article 5, allows unrestricted freedom of contract in choosing the applicable law. *U.N. Convention, supra* note 10, art. 21 ("The undertaking is governed by the law . . . [of] choice . . ."); U.C.C. § 5-116(a) ("The jurisdiction whose law is chosen need not bear any relation to the transaction.").

218. It is not assured that the law of a jurisdiction in which the U.N. Convention was not in force would enforce a letter of credit provision expressly stating that the letter of credit was subject to the U.N. Convention.

219. See *U.N. Convention, supra* note 10, art. 2(1) (stating that the undertakings covered by the Convention require a demand for payment by a beneficiary). *Id.* art. 15(3) ("The beneficiary, when demanding payment, is deemed to certify . . ."); *id.* arts. 19(1)(a)-(c) (stating the exception to a payment obligation).

220. See *id.* arts. 15(3), 19(1)(a)-(c). There are five statutory illustrations of situations in which a demand has no conceivable basis: (1) the contingency or risk that the undertaking secured undoubtedly has not materialized; (2) unless the risk was covered by the undertaking, the underlying obligation of the principal/applicant has been declared

these certifications are implied from a beneficiary's demand for payment,²²¹ the certifications clearly are deemed to be made to a guarantor/issuer, a category that includes a counter-guarantor and a confirmer.²²² Article 20 of the U.N. Convention authorizes a principal/applicant and an instructing party to obtain provisional relief based upon circumstances that breach the certifications,²²³ which indicates that the certifications also are deemed to be made to them.

There are no express remedies for breach of these certifications. On the other hand, if the second through fourth certifications are manifestly and clearly false, a guarantor/issuer has a right to refuse to honor and a principal/applicant and an instructing party can be entitled to provisional remedies, including a court order either forbidding honor or freezing a beneficiary's use of drawn funds.²²⁴

The sparse drafting history of the U.N. Convention indicates that these "certifications" are not warranties and do not give rise to an independent cause of action.²²⁵ Incorrect certifications primarily

invalid by a court or arbitral tribunal; (3) the underlying obligation undoubtedly has been fulfilled to the satisfaction of the beneficiary; (4) fulfillment of the underlying obligation clearly has been prevented by the willful misconduct of the beneficiary; and (5), in the case of a demand under a counter-guarantee, the beneficiary of the counter-guarantee has made payment in bad faith. *Id.* art. 19(2).

221. Refer to note 219 *supra* and accompanying text.

222. *U.N. Convention, supra* note 10, art. 6(b).

223. *Id.* art. 20(1).

224. *See id.* art. 19(1) ("[T]he guarantor/issuer, acting in good faith, has a right, as against the beneficiary, to withhold payment."); *id.* art. 19(3) (granting a principal/applicant provisional court measures in circumstances in which a guarantor/issuer has a right to withhold payment); *id.* art. 20 (stating that if there is a "high probability" shown by "immediately available strong evidence" that a circumstance that would give a guarantor/issuer a right to withhold payment exists, on the application of a principal/applicant or an instructing party, a court can issue a provisional order that the guarantor/issuer "hold the amount of the undertaking" or "to the effect that the proceeds of the undertaking paid to the beneficiary are blocked").

225. *See* 1993 U.N. Comm'n Int'l Trade L. Y.B. 24, U.N. Doc. A/CN.9/SER.A/1993, at 185 ¶¶ 83-84 [hereinafter U.N. Doc. A/CN.9/SER.A/1993] ("[T]he sentence . . . had been introduced for clarification purposes and was not intended to create any separate cause of action for the principal or the issuer."). This discussion took place when the only certification was that "payment is due" upon a clean standby letter of credit. *Id.* at 184 ¶ 78. However, when UNCITRAL changed this to a certification that a demand was "not in bad faith or otherwise improper," later added three more certifications, and made all four certifications applicable to all stand-by letters of credit, there was no indication that the function of the certifications had changed. *See id.* at 185 ¶ 85 (noting that certification that a demand was "not in bad faith or otherwise improper" linked the certification more closely with Article 19 improper demands); U.N. Doc. A/50/17, *supra* note 212, at 23 ¶¶ 104-105 (inferring an even closer link to Article 19 improper demands and advocating extension of the four certifications to stand-by letters of credit requiring documentary presentations. Prior to the 1995 extension, a certification was made only by the beneficiary of a "clean" letter of credit who otherwise was not required to certify or to present a document. *Id.* at 23 ¶ 102.

affect whether a demand is improper and whether a guarantor/issuer has a right to dishonor.²²⁶ Because the certifications are not actionable warranties,²²⁷ the inaccuracy of one or more of the certifications does not give a guarantor/issuer a defense to liability for wrongful dishonor. However, the certifications could be mistaken for actionable warranties by American judges and lawyers who are familiar with the actionable warranties in both the 1962 Official Text and Revised Article 5.²²⁸ This misreading of the U.N. Convention appears to create a *Philadelphia Gear* issue that in fact does not exist.²²⁹

The U.N. Convention leaves the definition of “good faith” to international practices.²³⁰ To the extent that national law shapes those practices, Revised Article 5 retains the traditional U.C.C. good faith standard of “honesty in fact.”²³¹ If this becomes what a certification of good faith is understood to mean under the U.N. Convention, the substance of the certification would not be disruptive. Moreover, whatever good faith ultimately is determined to mean, the U.N. Convention neither excuses a guarantor/issuer from honor nor authorizes a principal/applicant to seek provisional judicial relief because of a bad faith demand. The meaning of “good faith” consequently will be determined in post-honor litigation that will not impair payment of an international independent guarantee or stand-by letter of credit. On the other hand, the subject matter of the other three certifications both constitutes an exception to a

226. See *U.N. Convention*, *supra* note 10, arts. 15(3), 19(1)(c) (stating that an issuer has a right to withhold payment to a beneficiary if any one of the certifications added in 1995 is breached); see also *U.N. Doc A/CN.9/SER.A/1993*, *supra* note 225 at 185 ¶ 83 (noting that a certification is relevant in determining whether a demand is improper under Article 19).

227. Refer to note 225 *supra* and accompanying text.

228. See, e.g., *Turner*, *supra* note 10, at 803 (“Article 15(3), like Section 5110(a)(1), seems designed to give the issuer a cause of action against the beneficiary for fraud.”). One of the reasons that the USCIB initially resisted including a beneficiary’s warranties in Revised Article 5 was that letter-of-credit warranties did not exist in the law of other countries. See *White*, *supra* note 13, at 205 (“There are no warranties in the UCP nor, apparently, in the European law . . .”).

229. The *Philadelphia Gear* case held that an issuer could assert breach of warranty as a justification for dishonor. Refer to Part III.B.2. *supra* (discussing the warranty issues in the *Philadelphia Gear* case).

230. See *U.N. Convention*, *supra* note 10, art. 5 (stating that the U.N. Convention is to be interpreted to promote good faith international practices); *id.* art. 6 (declining to define “good faith”); *id.* art. 14(1) (stating that a guarantor/issuer shall act in “good faith” having “due regard for generally accepted standards of international practice”).

231. U.C.C. § 5-102(a)(7) (“Good faith means honesty in fact . . .”). An extensive Official Comment explains that adding compliance with “standards of fair dealing” to the definition of “good faith” was rejected as inconsistent with basic aspects of letter-of-credit law and practice. *Id.* § 5-102 cmt. 3. The Official Comment adds that the narrower definition of good faith would help U.S. letters of credit maintain “continuing vitality and competitiveness in international transactions.” *Id.*

guarantor/issuer's obligation to pay a beneficiary and can entitle a principal/applicant and instructing party to provisional remedies.²³²

If it is manifest and clear that any one of the second through fourth certifications²³³ is incorrect, the U.N. Convention allows a guarantor/issuer, acting in good faith, to withhold payment from a beneficiary.²³⁴ If these certifications were warranties, this authorization clearly would conflict with the Revised Article 5 position that warranties do not arise until after payment of a beneficiary.²³⁵ The resulting conflict would raise the prospect of a reprising of the American *Philadelphia Gear* case under the U.N. Convention.²³⁶ Payment of international independent guarantees and stand-by letters of credit subject to the U.N. Convention could be delayed until after a trial on whether a breach of warranty excused a guarantor/issuer's payment obligation! However, because the certifications are not actionable warranties,²³⁷ the U.N. Convention in fact does not permit a guarantor/issuer to use breach of warranty as a justification for dishonor.

Unlike Revised Article 5, which contains core unvariable provisions,²³⁸ the U.N. Convention allows unlimited freedom of contract. For example, during UNCITRAL's²³⁹ final deliberations on the U.N. Convention, a concern was raised that the text was inconsistent with UCP 500. The response was that conflict could be avoided through the exercise of freedom of contract:

The Commission noted that evidence of the deference of the draft Convention to the contractual autonomy of the parties was found in the fact that the text was replete with references to such freedom to diverge from various of its provisions, and that, were there any inconsistencies to be

232. Refer to note 224 *supra* and accompanying text (discussing the remedies for breach of the other certifications).

233. The three certifications state that all of the documents are genuine and have not been falsified, payment is due upon the basis asserted in the demand and accompanying documents, and the demand has a conceivable basis. Refer to notes 219–20 *supra* and accompanying text.

234. *U.N. Convention, supra* note 10, art. 19(1).

235. Compare U.C.C. § 5-110(a) (declaring that warranties arise upon honor of presentation), with *U.N. Convention, supra* note 10, art. 15(3) (stating that a beneficiary is deemed to certify when demanding payment). *Contra, Turner, supra* note 10, at 801–04 (contending that the certifications are warranties but that the U.N. Convention warranty rules do not clearly conflict with Revised Article 5).

236. Refer to Part III.B.2 *supra*. *Contra Turner, supra* note 10, at 803–04 (contending that there is no clear conflict and that the U.N. Convention warranty rules can be harmonized with Revised Article 5).

237. Refer to note 225 *supra* and accompanying text.

238. Refer to notes 188–92 *supra* and accompanying text.

239. Refer to note 10 *supra* and accompanying text.

perceived, they could easily be overcome in that manner should the parties be so inclined.²⁴⁰

In view of the ease with which the significance of the certifications can be misread, the parties to a transaction involving a letter of credit to be issued under the U.N. Convention should exercise their freedom to contract by having the letter of credit expressly waive the actionability of the certifications. It is clear that incorporation of either UCP 500 or ISP 98 would not suffice as a waiver. Both UCP 500 and ISP 98 impose an obligation upon an issuer to pay a letter of credit.²⁴¹ But UCP 500 implicitly, and ISP 98 explicitly, both subordinate this obligation to a country's laws on fraud and abuse of rights, including the U.N. Convention where it is in force.²⁴² The Official Commentary on ISP 98 treats the subject matter of two of the U.N. Convention's certifications as illustrations of the national law to which ISP 98 is subject.²⁴³

VII. CONCLUSION

Statutory beneficiary's warranties can be an efficient method of redressing the unjust enrichment of a beneficiary that otherwise would result from an improper demand upon an issuer.²⁴⁴ But, for letters of credit to retain their commercial significance, finality of payment must be respected. The Revised Article 5 beneficiary's warranties strike a reasonable balance. The basic warranty is limited to the absence of forgery and material fraud.²⁴⁵ The problem of nonfraudulent but erroneous standby certifications is addressed by a special warranty, to applicants alone, that a draw does not violate underlying agreements.²⁴⁶ A warranty of the truthfulness of

240. U.N. Doc. A/50/17, *supra* note 212, at 8 ¶ 28.

241. See UCP 500, *supra* note 8, art. 9, at 13-16; OFFICIAL COMMENTARY ISP 98, *supra* note 9, at 62 (citing Rule 2.01).

242. With respect to the UCP 500, refer to note 199 *supra* (citing authority indicating that it is generally recognized that the UCP is subordinate to national law). With respect to ISP 98, see OFFICIAL COMMENTARY ISP 98, *supra* note 9, at 19 (stating, in Rule 1.05: "These rules do not define or otherwise provide for . . . defenses to honour based on fraud, abuse, or similar matters. These matters are left to applicable law."). Comment 5(a) to Rule 1.05 adds that the applicable law includes Article 19 of the U.N. Convention and its rules permitting the withholding of payment by an issuer "if '[a]ny document is not genuine or has been falsified' or if 'the demand has no conceivable basis' judging by its type and purpose." *Id.* at 20 (alteration in original).

243. OFFICIAL COMMENTARY ISP 98, *supra* note 9, at 19 (discussing ISP 98 treatment of fraud, abuse, and similar matters).

244. See James J. White, *Comments on the March 31, 1993 Draft of Article 5*, 9 LETTER OF CREDIT UPDATE 22, 29 (1993) (commenting that statutory warranty rights are not fundamentally different but an improvement upon rights of restitution; statutory warranty rights have the advantage of "uniformity, findability and clarity").

245. Refer to Section IV.A.1 *supra*.

246. Refer to Section IV.A.2 *supra*.

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the representations made in the drawing documents properly was rejected. Issuers and nominated persons are not allowed to consider the truthfulness of the documents presented in deciding whether to make payment. It would be unreasonable to allow recovery of a payment upon the basis of facts that were irrelevant in making it.²⁴⁷

The Revised Article 5 warranty rules are consistent with UCP 500, ISP 98, and the U.N. Convention.²⁴⁸ They are a giant step forward from the “ungerminated” warranty rules²⁴⁹ in the 1962 Official Text of Article 5.

247. Refer to notes 95–101 *supra* and accompanying text (stating that issuers are not obligated to make factual investigations to ascertain the truthfulness of representations).

248. Refer to sections V and VI *supra*.

249. Refer to note 74 *supra* and accompanying text (noting that the 1962 Official Text’s beneficiary warranty received little attention from the judiciary for thirty years before becoming subject to conflicting court decisions).