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## Applicant Ad Hoc Waiver of Discrepancies in the Documents Presented under Letters of Credit

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# APPLICANT AD HOC WAIVER OF DISCREPANCIES IN THE DOCUMENTS PRESENTED UNDER LETTERS OF CREDIT

*Richard F. Dole, Jr.\**

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## I. INTRODUCTION

A documentary letter of credit is supposed to provide an effective assurance of payment by a financially responsible third-party issuer, typically a bank.<sup>1</sup> But, under Uniform Commercial Code (“U.C.C.”) Article 5,<sup>2</sup> the American law governing letters of credit, the issuer is obligated to the beneficiary to honor only a documentary presentation that appears on its face strictly to comply with the letter of credit’s terms and conditions.<sup>3</sup> Unless otherwise agreed, the issuer also has a statutory duty to the applicant to dishonor a documentary presentation that does not appear on its face strictly to comply with the letter of credit’s terms and conditions.<sup>4</sup> With respect to commercial letters of

1. Ronald J. Mann, *The Role of Letters of Credit in Payment Transactions*, 98 MICH. L. REV. 2494, 2495 (2000) [hereinafter Mann, *The Role of Letters of Credit*] (“The classic explanation claims that the letter of credit provides an effective assurance of payment from a financially responsible third party.”).

2. The Official Text of Article 5’s 1995 revision will be cited as “U.C.C. section number” without special designation. The Official Text of the prior 1962 version will be cited as “1962 U.C.C. section number.” The 1995 revision of Article 5 has been enacted by every state except Wisconsin. See <http://www.nccusl.org/Update/uniformact-factsheets/uniformacts-fs-ucca5.asp> (last visited Dec. 5, 2004).

3. U.C.C. § 5-108(a) (providing that the issuer shall honor a presentation that appears on its face strictly to comply with the terms and conditions of the letter of credit). The issuer’s breach of this statutory obligation to the beneficiary is “wrongful dishonor.” See *id.* § 5-111(a) (imposing liability “[i]f an issuer wrongfully dishonors . . .”).

4. *Id.* § 5-108(a) & cmt. 7 (explaining that, unless otherwise provided or agreed, the issuer has an obligation to the applicant to dishonor a presentation of documents that does not apparently facially strictly comply with the letter of credit’s terms and conditions); *id.* § 5-108 cmt. 1 (providing examples of permissible contractual variations of the issuer’s obligation to the applicant). The issuer’s violation of this duty to the applicant is “wrongful honor.” See James G. Barnes & James E. Byrne, *Letters of Credit: 1998 Cases*, 54 BUS. LAW. 1885, 1903-04 (1999) [hereinafter Barnes & Byrne, *1998 Cases*] (“Most post-honor reimbursement cases involve applicant claims that the issuer wrongfully honored the beneficiary’s presentation . . .”).

The documentary conditions in a letter of credit typically are the documents required by the application-reimbursement agreement between the applicant and the issuer. Gerald T. McLaughlin, *Exploring Boundaries: A Legal and Structural Analysis of the Independence Principle of Letter of Credit Law*, 119 BANKING L.J. 501, 507 (2002) [hereinafter McLaughlin, *The Independence Principle*] (explaining that the issuer “incorporates in the text of the credit the documents specified in . . . [the] application . . .”). The issuer’s breach of its statutory obligation to the applicant to dishonor a presentation of documents that does not on its face apparently strictly comply consequently also can breach the application-reimbursement agreement. In both cases, at most direct and incidental damages are recover-

credit,<sup>5</sup> there is ample evidence that documentary presentations are likely to contain discrepancies.<sup>6</sup> Nevertheless, the beneficiary usually is able to obtain honor through the applicant's ad hoc waiver of documentary defects following an inquiry by the issuer.<sup>7</sup> As the Second Circuit observed in *Alaska Textile Co. v. Chase Manhattan Bank, N.A.*,<sup>8</sup> "This process is efficient, and the law should encourage it . . . ."<sup>9</sup>

The process can be abused. In *E & H Partners v. Broadway National Bank*,<sup>10</sup> the issuer supplied the applicant with copies of all the documents presented.<sup>11</sup> The applicant's attorney wrote a letter to the issuer identify-

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able. See U.C.C. §5-111(b) (providing that the applicant's recoverable damages for wrongful honor do not include either consequential damages or amounts saved as a result of breach); *id.* § 5-111(b) cmt. 2 (explaining that improper honor may or may not damage the applicant).

5. See *infra* notes 21 and 25 and accompanying text for the distinction between commercial and standby letters of credit.

6. See Mann, *The Role of Letters of Credit*, *supra* note 1, at 2495 (stating that banker and lawyer interviewees "uniformly claimed that sellers ordinarily do not present documents that conform to the requirements of the letter of credit"); see INTERNATIONAL CHAMBER OF COMMERCE, PUB. NO. 500, UNIFORM CUSTOMS AND PRACTICES FOR DOCUMENTARY CREDITS 4 (1993) [hereinafter UCP 500] ("Some surveys indicate that approximately fifty percent of the documents presented under the Documentary Credit are rejected because of discrepancies or apparent discrepancies."). In Professor Mann's sample, the waiver rate was substantially in excess of 50 percent. See *infra* note 7 and accompanying text.

The International Chamber of Commerce ("ICC") is a nongovernmental organization serving world business with members in 123 countries. See UCP 500, *supra*, 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). The operative version of the UCP is revised and renumbered periodically. The version immediately preceding UCP 500 was UCP 400. See INTERNATIONAL CHAMBER OF COMMERCE, PUB. NO. 511, DOCUMENTARY CREDITS: UCP 500 & 400 COMPARED III (Charles del Busto ed., 1993) [hereinafter UCP 500 & 400 COMPARED] (comparing UCP 400 and UCP 500).

In 2003, the ICC published a compilation of international standard-banking practice under UCP 500. INTERNATIONAL CHAMBER OF COMMERCE, PUB. NO. 645, INTERNATIONAL STANDARD BANKING PRACTICE (2003) [hereinafter ISBP]. The ISBP does not amend UCP 500 and should not be separately incorporated into a letter of credit. Its function is to clarify the significance of incorporation of UCP 500 into a letter of credit. *Id.* at 8-9 (stating that the ISBP explains rather than amends UCP 500 and its incorporation into a letter of credit is discouraged).

7. See Mann, *The Role of Letters of Credit*, *supra* note 1, at 2513-14 ("[E]ven when the documents suggest a default on the underlying contract, applicants almost always waive the discrepancies and permit full payment. . . . [A]pplicants generally waived promptly."). See Margaret L. Moses, *The Irony of International Letters of Credit: They Aren't Secure, But They (Usually) Work*, 120 BANKING L.J. 479, 484-89 (2003) (discussing of the function of a negotiable bill of lading consigned to the issuing or confirming bank in motivating applicants to waive documentary discrepancies with respect to commercial letters of credit). Refer to notes 21-24 *infra* and accompanying text for the concept of a commercial letter of credit. *But see* *Suntex Indus. Corp. v. The CIT Group/BBC, Inc.*, 2001 WL 34401367, at \*2 (D. Del. 2001), *aff'd*, 2002 WL 1012964 (3d Cir. 2002) (holding that the guarantor of the applicant's obligation to reimburse the issuer was entitled to exercise a contractual right to veto the applicant's waiver of discrepancies).

8. 982 F.2d 813 (2d Cir. 1992).

9. *Id.* at 824.

10. 39 F. Supp. 2d 275 (S.D.N.Y. 1998). *E & H Partners* was decided properly.

11. *Id.* at 278-79.

ing discrepancies, and the issuer's notice of dishonor and discrepancies with respect to the first presentation of documents mirrored the attorney's letter.<sup>12</sup> The court held that the applicant also played an undue role in the issuer's decision to dishonor the second presentation of documents.<sup>13</sup> In the beneficiary's action for wrongful dishonor, the issuer was estopped from asserting that the second presentation had been discrepant.<sup>14</sup> Other problems include legal and practice rules that unnecessarily hamper the issuer's good faith inquiry about the applicant's willingness to waive discrepancies.<sup>15</sup>

This article discusses the extent to which nonabusive intentional applicant ad hoc waiver of known documentary discrepancies<sup>16</sup> is facilitated by the three regimes<sup>17</sup> of contemporary American letter-of-credit law: U.C.C. Article 5,<sup>18</sup> the 1993 Revision of the Uniform Customs and Practices for Documentary Credits (UCP 500),<sup>19</sup> and the 1998 International Standby Practices (ISP 98).<sup>20</sup>

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12. *Id.*

13. *Id.* at 284-85.

14. *Id.* at 284-85 (alternative holding). The other holding was that the beneficiary's second presentation had conformed to the letter of credit. *Id.* at 281-84.

Issuers must protect themselves against *E & H Partners* estoppel by insulating their evaluation of the documents presented from undue intrusion by the applicant. See *infra* notes 147-48 and accompanying text.

15. See *infra* notes 165-76, 276-83 and accompanying text.

16. Waiver is an intentional relinquishment of a known right. *E.g.*, *Oei v. Citibank*, N.A., 957 F. Supp. 492, 509-11 (S.D.N.Y. 1997) (holding that the applicant could not have waived documentary discrepancies of which he was unaware).

17. The 1995 U.N. Convention on Independent Guarantees and Stand-by Letters of Credit (the U.N. Convention), a potential fourth regime, has not been ratified by the United States Senate and is not discussed. For the text of the U.N. Convention, 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 (1995). The U.N. Convention was formulated by the U.N. Commission on International Trade Law ("UNCITRAL"). 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'n on Int'l Trade Law, 30th Sess., U.N. Doc. A/CN.9/431, at 1 (1996). The U.N. Convention became effective on January 1, 2000, 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 adopting states are Belarus, Ecuador, El Salvador, Kuwait, Panama, and Tunisia. Belarus is the only country to adopt the Convention after it became effective. The United States has signed the Convention but not ratified it. See United Nations Treaty Collection, <http://untreaty.un.org/ENGLISH/bible/englishinternetbible/part1/chapterX/treaty27.asp> (last visited Oct. 21, 2005).

18. See *supra* note 2.

19. See *supra* note 6. UCP 500 can be incorporated into domestic as well as international letters of credit. See UCP 500, *supra* note 6, art. 1 (noting UCP 500 applies to all letters of credit into which it is incorporated).

20. ISP 98 can be incorporated into domestic as well as international letters of credit. See JAMES E. BYRNE, THE OFFICIAL COMMENTARY ON THE INTERNATIONAL STANDBY PRACTICES R. 1.01(b) (Institute for Int'l Banking L. & Practice 1998) [hereinafter OFFICIAL COMMENTARY ISP 98] ("A standby letter of credit or other similar undertaking, however named or described, whether for domestic or international use, may be made subject to these Rules by express reference to them."); *infra* notes 21-26 and accompanying text for the concept of a standby letter of credit.

## II. OVERVIEW OF LETTER-OF-CREDIT LAW

### A. THE DISTINCTION BETWEEN COMMERCIAL AND STANDBY LETTERS OF CREDIT

#### 1. U.C.C. Article 5

Letters of credit conventionally are classified as either commercial letters of credit or standby letters of credit.<sup>21</sup> A commercial letter of credit requires the issuer to pay the seller of goods upon the seller's timely presentation of the documents specified in the letter of credit.<sup>22</sup> The specified documents represent the seller's performance of the agreed sale and, in addition to the seller's draft or demand for payment, typically include at least the seller's invoice and transportation documents indicating that the goods have been shipped.<sup>23</sup> Additional documents that can be required include a packing list, an insurance policy, an inspection certificate by an independent testing agency, a certificate of origin, and a certificate of shipment.<sup>24</sup>

All other letters of credit can be regarded as standbys.<sup>25</sup> Standby letters of credit can be used in any context, including sales, and are not

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The development of ISP 98 was coordinated by the nonprofit Institute for International Banking Law and Practice and the International Financial Services Association, an association of the major banks issuing letters of credit. See OFFICIAL COMMENTARY ISP 98, *supra*, at xvi. ISP 98 has been endorsed by the ICC. See *id.* at v (Preface by Dieter Kiefer). Professor James E. Byrne of George Mason School of Law, the Director of the Institute of International Banking Law and Practice, was Reporter and Chair of the Working Group for ISP 98. See *id.* at 354. For more information on the Institute, see its website <http://www.iiblp.org>.

21. See 1 JOHN F. DOLAN, *THE LAW OF LETTERS OF CREDIT: COMMERCIAL AND STANDBY CREDITS 1-1* (rev. ed. 2003) [hereinafter DOLAN] (discussing standard letter-of-credit transactions).

22. *Id.* at 1-2 to 1-3.

23. See, e.g., *S.B. Int'l, Inc. v. Union Bank of India*, 783 S.W.2d 225, 226 (Tex. App.—Dallas 1989, no writ) (commercial letter of credit requiring presentation of drafts, invoices, and bills of lading). In order to be timely, presentation must be made before both the expiration date and any earlier presentation deadline imposed by the letter of credit. See *Banco Gen. Runinahui, S.A. v. Citibank Int'l*, 97 F.3d 480, 483 (11th Cir. 1996) (letter of credit requiring documents to be presented “no later than 15 days after shipment, but within the validity of the credit.”).

24. See, e.g., *Bank of Cochin, Ltd. v. Mfrs. Hanover Trust Co.*, 612 F. Supp. 1533, 1535 (S.D.N.Y. 1985), *aff'd*, 808 F.2d 209 (2d Cir. 1986) (commercial letter of credit requiring presentation of a certification by the beneficiary that it had performed the conditions of the letter of credit, a certification by Lloyd's of London or the shipping company that the ship was a first class or approved non-Pakistani vessel, a certificate of West European origin, a certificate of analysis by Lloyd's of London or another international testing agency, a marine insurance policy, and a packing list in addition to drafts, invoices, and bills of lading).

25. JAMES G. BARNES ET AL., *THE ABCS OF THE UCC ARTICLE 5: LETTERS OF CREDIT 1-10* (Boss ed. 1998) [hereinafter BARNES ET AL.] (noting that, although both standby and commercial letters of credit “provide for payment against the presentation of specified documents,” standbys do not require “a negotiable bill of lading or other transport document;” also 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).

limited to assuring payment upon the applicant's default.<sup>26</sup> Notwithstanding these rules-of-thumb, distinguishing between commercial and standby letters of credit can be difficult,<sup>27</sup> but it also can be unnecessary. Article 5, for example, adopts a "one law for all letters of credit approach."<sup>28</sup> There are no special Article 5 rules for either commercial letters of credit or standbys.<sup>29</sup> Although the other letter-of-credit regimes focus on either commercial or standby letters of credit,<sup>30</sup> they do not contain precise definitions.<sup>31</sup>

## 2. *The Other Letter-of-Credit Regimes*

UCP 500 is a codification by the International Chamber of Commerce (ICC) of the international standard practice of financial institutions that regularly issue commercial letters of credit.<sup>32</sup> UCP 500 is not law per se<sup>33</sup> but is enforced by courts and arbitration tribunals as part of the undertaking of an issuer that has incorporated UCP 500 into its letter of credit.<sup>34</sup> Although most appropriate for commercial letters of credit,<sup>35</sup> with modifications, UCP 500 can be incorporated into standbys.<sup>36</sup>

26. See *id.* at 7-9 (explaining that it is false to imply that a standby letter of credit is payable only after a default or is not used in sales of goods). Nevertheless, standby letters of credit are used frequently to assure payment in the event of the applicant's default. See, e.g., *Interfirst Bank Greenspoint v. First Fed. Sav. & Loan Ass'n*, 747 P.2d 129, 131-32 (Kan. 1987) (standby letter of credit requiring presentation of sight draft, signed certificate that named individuals that had not performed satisfactorily under the terms of a contract or other obligation to Interfirst Bank Greenspoint or its transferee, plus the original letter of credit).

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

28. BARNES, ET AL., *supra* note 25, at 9 ("[T]he one law for all letters of credit approach [is] taken in UCC Article 5.") (internal quotation marks omitted).

29. *Id.*

30. See *infra* notes 32-40 and accompanying text.

31. See UCP 500, *supra* note 6, arts. 1-2 (UCP 500 applies to all "documentary credits," including standby letters of credit, in which it is incorporated; documentary credits and standby letters of credit generally defined the same way); OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 1.01 cmt. 3 ("no definition of a standby letter of credit is provided"); see also *id.* R. 1.01 cmt. 9 (the phrase "documentary letter of credit" is avoided because it is ambiguous).

32. See UCP 500 & 400 COMPARED, *supra* note 6, at III (discussing the role of the ICC and presenting a justification for UCP 500); *supra* note 6 for discussion of the ICC.

33. See UCP 500 & 400 COMPARED, *supra* note 6, 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).

34. 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 it).

35. See OFFICIAL COMMENTARY ISP 98, *supra* note 20, at vii ("To accurately reflect the . . . requirements of a standby, one would need to exclude, amend or adapt the majority of the articles in the UCP.") (Preface by Gary Collyer).

36. UCP 500, *supra* note 6, art. 1 (stating that UCP 500 applies to any Documentary Credits in which it is incorporated, including, to the extent applicable, standbys). See, e.g., *E & H Partners v. Broadway Nat'l Bank*, 39 F. Supp. 2d 275, 277-78 (S.D.N.Y. 1998) (standby letter of credit incorporating UCP 500). However, careful lawyers exclude inappropriate UCP 500 articles from incorporation into a standby. See James E. Byrne, *The International Standby Practices (ISP98): New Rules for Standby Letters of Credit*, 32 UCC

UCP 500's focus on commercial letters of credit<sup>37</sup> led to ICC endorsement of ISP 98 for standby letters of credit.<sup>38</sup> Like UCP 500, ISP 98 is incorporated into a letter of credit and enforced as part of the issuer's undertaking.<sup>39</sup> ISP 98 is not designed for commercial letters of credit.<sup>40</sup>

### 3. *The Greater Significance of Applicant Ad Hoc Waiver for Commercial Letters of Credit*

Applicant ad hoc waiver of known documentary discrepancies occurs most frequently with respect to commercial letters of credit. Commercial letters of credit typically require the presentation of both a greater number of documents and more complex documents than standbys, affording a greater opportunity for discrepancies.<sup>41</sup> An applicant for a commercial letter of credit who wants the goods also has an economic incentive to waive discrepancies,<sup>42</sup> whereas an applicant for a standby letter of credit may gain nothing from waiver except the obligation to reimburse the issuer.<sup>43</sup> On the other hand, standby letters of credit can require the presentation of complex documentation,<sup>44</sup> and the applicant for a standby can

L.J. 149, 155-58 (1999) (identifying UCP 500 articles that are "problematic" for standbys). Byrne also considers other provisions that would be appropriate for standbys to be either "imprecise" or to have been omitted from UCP 500. *Id.* at 158-62.

37. See *supra* notes 21-26 and accompanying text for the concept of a commercial letter of credit.

38. See OFFICIAL COMMENTARY ISP 98, *supra* note 20, at xvi (discussing the need for ISP 98); see also *supra* note 20 for the endorsement of ISP 98 by the ICC and *supra* notes 21-26 and accompanying text for the concept of a standby letter of credit.

39. See OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 1.04(i) (explaining that, unless the context requires otherwise or ISP 98 expressly is modified or excluded, upon incorporation into a letter of credit, the terms and conditions of ISP 98 are part of the issuer's agreement).

40. See *id.* R. 1.01(b), R. 1.01 cmt. 8 (noting that Rule 1.01(b) states that ISP 98 applies to undertakings that expressly incorporate it "however named or described"). But see JAMES E. BYRNE, *ISP 98 & UCP 500 COMPARED* R. 1.01 cmt. 5 (Institute for Int'l Banking L. & Practice 2000) [hereinafter *ISP 98 & UCP 500 COMPARED*] (ISP 98 "was not designed for commercial letters of credit.").

If the issuer of a letter of credit mistakenly incorporated both UCP 500 and ISP 98, the result could be surprising. UCP 500 has no rule dealing with conflicting incorporations but ISP 98 does. See OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 1.02(b) (ISP 98 supersedes conflicting rules of practice to which a standby letter of credit is subject). This carefully phrased statement means that incorporation of both UCP 500 and ISP 98 into a commercial letter of credit would not result in ISP 98 superseding UCP 500. See *id.* R. 1.02 cmt. 6 (Rule 1.02(b) does not apply to conflicting rules applicable to a commercial letter of credit).

41. See *supra* notes 21-26 and accompanying text for discussion of the documentation commonly required by commercial and standby letters of credit.

42. See Mann, *The Role of Letters of Credit*, *supra* note 1, at 2515 (noting that even if the documents suggest a default on the underlying contract, applicants for commercial letters of credit "almost universally" waive documentary defects).

43. See OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 5.05 cmt. 1 (implying that some standbys are default undertakings that the applicant does not want to pay and therefore would refuse to waive discrepancies).

44. *E.g.*, *E & H Partners v. Broadway Nat'l Bank*, 39 F. Supp. 2d 275, 278 (S.D.N.Y. 1998) (a standby letter of credit obtained by a wholesaler for a domestic supplier required the presentation of sight drafts upon the issuer accompanied by copies of commercial invoices, signed bills of lading, packing lists, signed purchase orders, a notification to the applicant that the supplier was thirty days past due upon the invoices thirty days prior to a



have an economic incentive to waive discrepancies. In *Havoco of America, Ltd. v. Sumitomo Corp.*,<sup>45</sup> for example, Sumitomo, a sales agent for Havoco, a buyer/reseller of coal, agreed to finance Havoco's contract to supply coal to the TVA.<sup>46</sup> Sumitomo obtained standby letters of credit designating Havoco as beneficiary that required presentation of coal invoices and barge bills of lading.<sup>47</sup> In its role as sales agent, Sumitomo had an economic incentive to waive documentary discrepancies that did not imperil the coal supply contract on which it earned commissions. Because applicant waivers can occur, ISP 98 deals with ad hoc waivers by applicants for standby letters of credit.<sup>48</sup>

### B. U.C.C. ARTICLE 5: KEY DEFINITIONS

Under U.C.C. Article 5, which measures time in "business days,"<sup>49</sup> a "letter of credit" is a definite undertaking by the "issuer"<sup>50</sup> either to pay or to deliver an item of value upon satisfaction of the *documentary conditions* precedent to the issuer's duty to honor.<sup>51</sup> The issuer's undertaking

draw, a signed statement by an authorized officer of the beneficiary that the commercial invoices remained unpaid at the time of the draw, and the original standby letter of credit).

45. 971 F.2d 1332 (7th Cir. 1992).

46. *Id.* at 1334.

47. *See id.* at 1334, 1337 (Sumitomo financed Havoco's contract to supply coal to the TVA with monthly nonrevolving letters of credit that named Havoco as beneficiary). The letters of credit provided for payment of Havoco upon its presentation of coal invoices and barge bills. *Havoco of America, Ltd. v. Hilco, Inc.*, 750 F. Supp. 946, 953-54 (N.D. Ill. 1990) (the sales agency agreement required the letters of credit to provide for payment to Havoco within seven days after presentation of coal invoices and barge bills of lading), *aff'd*, 971 F.2d 1332 (7th Cir. 1992). These were standby letters of credit because the beneficiary was the buyer rather than the seller of the coal. A commercial letter of credit requires the issuer to pay the seller upon the seller's presentation of required documents representing performance of the agreed sale. *See supra* note 23 and accompanying text. The documents required to be presented by the *Havoco* letter of credit were far fewer than is common with respect to commercial letters of credit. *See supra* notes 23-26 and accompanying text.

48. *E.g.*, OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 5.05 (Issuer Request for Applicant Waiver without Request by Presenter). Official Comment 1 explains: "This Rule permits the issuer to seek waiver from the applicant on its own initiative similar to UCP 500 Art. 14(c). It does not assume that all standbys are default undertakings in which the applicant does not want to pay and will always refuse to waive discrepancies." *Id.* R. 5.05 cmt. 1.

49. *See* U.C.C. § 5-108(b) (providing that the issuer either must honor or give notice of dishonor by the end of the "seventh business day" after the business day of receipt of the documents).

50. *Id.* § 5-102(a)(9) (the "issuer" is the person that issues the letter of credit). In order to prevent a wily creditor from depriving an individual consumer of defenses to payment by requiring the consumer to issue a letter of credit naming the creditor as beneficiary, undertakings by individuals with respect to personal, family or household debts do not qualify as letters of credit. *See id.* § 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).

51. *See id.* § 5-102(a)(10) (emphasis supplied). The definition of letter of credit is one of seven Article 5 provisions that cannot be varied by either a contrary agreement or an incorporation by reference. *See id.* § 5-103(c) ("With the exception of . . . , the effect of this Article may be varied by agreement or by a provision stated or incorporated by reference

is made to the “beneficiary”<sup>52</sup> at the request of, or for the account of, the “applicant.”<sup>53</sup> The beneficiary or a person, typically a bank, acting for the beneficiary that presents required documents to the issuer for honor is the “presenter.”<sup>54</sup>

If the issuer and the beneficiary operate in different markets, the beneficiary may want to obtain payment from a local financial institution. To make this possible, the issuer can undertake to reimburse a designated “nominated person”<sup>55</sup> in the beneficiary’s market for giving value pursuant to the issuer’s letter of credit. A nominated person per se is not obligated to give value pursuant to the issuer’s letter of credit.<sup>56</sup> But a nominated person can become a “confirmer”<sup>57</sup> by undertaking to honor a presentation under the issuer’s letter of credit and assuming obligations to both the issuer and the beneficiary.<sup>58</sup> An “adviser” is another local intermediary. At the request of the issuer, the confirmer, or another adviser, an adviser either notifies or requests another adviser to notify the

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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 the undertaking from treatment as a letter of credit. *E.g.*, *Wichita Eagle & Beacon Publ’g Co. v. Pac. Nat’l Bank*, 493 F.2d 1285, 1286-87 (9th Cir. 1974) (per curiam) (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).

52. Under the terms of the letter of credit, the “beneficiary” is the person who is entitled to have a complying presentation of documents honored. See U.C.C. § 5-102(a)(3) (definition of “beneficiary”).

53. The “applicant” is the person at whose request or for whose account the letter of credit is issued. See *id.* § 5-102(a)(2) (definition of “applicant”).

54. See *id.* § 5-102(a)(13) (definition of “presenter”). In *DBJJJ, Inc. v. Nat’l City Bank*, 19 Cal. Rptr. 3d 904, 907-08 (Cal. Ct. App. 2004), for example, a bank presented the documents to the issuer on the beneficiary’s behalf. A nominated person that has given value for the required documents or a person acting for the nominated person also can be the presenter. See U.C.C. § 5-102(a)(13) (a nominated person that has given value or a person acting for the nominated person can be the presenter). See *infra* note 55 and accompanying text for the concept of a nominated person.

55. See *id.* § 5-102(a)(11) (the issuer undertakes to reimburse a nominated person for giving value under the letter of credit).

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

57. See *id.* § 5-102(a)(4) (a “confirmer” is a nominated person who undertakes to honor a letter of credit issued by another). A confirmer must have been designated or authorized by the issuer to give value under the issuer’s letter of credit. See *id.* § 5-102(a)(4) cmt. 1 (a person that agrees to confirm without the designation or authorization of the issuer is not an Article 5 confirmer). See *id.* § 5-102(a)(11) (definition of “nominated person”). An unauthorized confirmer is referred to as a “silent confirmer.” *Dibrell Bros. Int’l S.A. v. Banca Nazionale del Lavoro*, 38 F.3d 1571, 1575-76 n.4 (11th Cir. 1994) (per curiam) (silent confirmation occurs when the beneficiary rather than the issuer requests confirmation). A silent confirmer can have the Article 5 liability of the issuer of a letter of credit for its own account, or, if its undertaking does not qualify as a letter of credit, contractual liability to the beneficiary. See U.C.C. § 5-102 cmt. 1 (a silent confirmer can be liable under either Article 5 or contract law).

58. See *id.* § 5-107(a) (to the extent of its confirmation, the confirmer is obligated directly on the confirmed letter of credit as though it was the issuer and also is obligated to the issuer of the confirmed letter of credit as though the issuer were an applicant).

beneficiary that the letter of credit has been issued, confirmed, or amended.<sup>59</sup> An adviser also can be, but need not be, a nominated person and a confirmer.<sup>60</sup>

The confirmation of the issuer's letter of credit by a nominated person at the issuer's request is deemed to make the issuer an "applicant" for the letter of credit issued by the confirmer.<sup>61</sup> The issuer-confirmer relationship accordingly is a special context in which applicant ad hoc waiver of known documentary discrepancies could occur. In this special context, there are two applicants that theoretically could make waivers: (1) the applicant for the issuer's letter of credit,<sup>62</sup> and (2) the issuer whose letter of credit has been confirmed by the confirmer.<sup>63</sup> However, if the applicant for the issuer's letter of credit does not join the issuer in waiving documentary discrepancies, the issuer's entitlement to reimbursement for paying the confirmer could be jeopardized.<sup>64</sup> With respect to confirmed letters of credit, the waiver of the applicant for the issuer's letter of credit is central.<sup>65</sup>

### C. THE OTHER LETTER-OF-CREDIT REGIMES: KEY DEFINITIONS

The UCP 500 terms for "letter of credit" are "Documentary Credit" and "Credit," which include both commercial and standby letters of credit.<sup>66</sup> UCP 500 generally uses Article 5 terminology.<sup>67</sup> But the roles of adviser, issuer, nominated person, and confirmer are restricted to "banks,"<sup>68</sup> and time is measured in "banking days."<sup>69</sup> Rule 1.01(a) states that ISP 98 applies to performance, financial, and direct pay standbys

59. *See id.* § 5-102(a)(1) (definition of "adviser").

60. *See Banco Nacional de Desarrollo v. Mellon Bank, N.A.*, 726 F.2d 87, 89-92 (3d Cir. 1984) (advising bank acted at its peril in paying the beneficiary before presenting documents to the issuer, which justifiably dishonored).

61. *See supra* note 58 and accompanying text.

62. *See, e.g., Robalen, Inc. v. Generale de Banque, S.A.*, 1999 WL 688301, at \*4 (S.D.N.Y. 1999) (the issuer had waived discrepancies with respect to the first two presentations to the confirmer but not with respect to the third presentation under UCP 500).

63. *See, e.g., Marino Indus. Corp. v. Chase Manhattan Bank, N.A.*, 686 F.2d 112, 116-18 (2d Cir. 1982) (the issuer had refused to waive late presentation, but there was a question of fact whether the confirmer had waived it under UCP 290).

64. *See U.C.C. § 5-111 cmt. 2* (improper honor may or may not damage the applicant); *Chase Manhattan Bank v. Equibank*, 550 F.2d 882, 886-87 (3d Cir. 1977) (under 1962 Article 5, the issuer could waive the expiry date of the letter of credit without the consent of the applicant even if this jeopardized the issuer's right of reimbursement).

65. *See Chase Manhattan Bank*, 550 F.2d at 886-87.

66. *See UCP 500, supra* note 6, art. 2 (a "Documentary Credit" or a "Credit," which can include a standby, obligates the "Issuing Bank" to pay or to accept and to pay drafts against stipulated documents). Article 4 provides that credit operations deal with documents and not with the goods, services, or other performances to which the documents relate. *Id.* art. 4.

67. *See id.* art. 2 (applicant & beneficiary).

68. *Id.* arts. 2 (issuing bank), 9(a) (nominated bank and confirming bank), & 11(a) (advising bank).

69. *Id.* art. 14(d)(i) (notice of dishonor must be given no later than the "seventh banking day" following the day of receipt of the documents).

without defining standby.<sup>70</sup> ISP 98 follows the Article 5 approach. Issuers, advisers, nominated persons, and confirmers are not confined to banks,<sup>71</sup> and time is measured in “business days.”<sup>72</sup>

### III. AMENDING A LETTER OF CREDIT, APPLICANT PRECLUSION TO OBJECT TO HONOR, AND PRESENTER PRECLUSION TO OBJECT TO DISHONOR DISTINGUISHED FROM APPLICANT AD HOC WAIVER

Applicant ad hoc waiver of known documentary discrepancies should be distinguished from the applicant’s and the beneficiary’s agreement to amend the documentary conditions of an issued letter of credit. Intentional applicant ad hoc waiver of known documentary discrepancies occurs, if it does, either before or after the issuer has given notice of dishonor and discrepancies to the presenter<sup>73</sup> and is limited to the single presentation of documents.<sup>74</sup> The applicant’s and the beneficiary’s agreement to amend the documentary conditions of an issued letter of credit can occur at any time and, upon becoming effective, applies to all subsequent documentary presentations under the letter of credit.<sup>75</sup> Under all three regimes, an agreement between the applicant and the beneficiary amending the documentary conditions of an issued letter of credit does not bind the issuer until the issuer assents.<sup>76</sup>

Applicant ad hoc waiver of known documentary discrepancies also should be distinguished from applicant preclusion to object to honor. Intentional applicant ad hoc waiver of known documentary discrepancies is voluntary on the applicant’s part and occurs, if it does, either before or after the issuer has given notice of dishonor and discrepancies to the presenter.<sup>77</sup> Applicant preclusion to object to honor is involuntary on the applicant’s part, and occurs, if it does, after the issuer has honored a doc-

70. OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 1.01(a); *id.* R. 1.01 cmt. 3 (stating that standby letter of credit is not defined).

71. *See id.* Rs. 1.09(a) (confirmer), 2.01(a) (issuer), 2.04 (nominated person), & 2.05 (advisor). ISP 98 also refers to “applicants” and “beneficiaries.” *Id.* R. 1.09(a).

72. *See id.* R. 5.01(a)(i) (notice of dishonor that is given within three business days after the business day of presentation is not unreasonable).

73. *See infra* notes 165-91, 213 and accompanying text.

74. *See* U.C.C. § 5-108 cmt. 7 (“Waiver of discrepancies by . . . an applicant in one or more presentations does not waive similar discrepancies in a future presentation.”).

75. *See, e.g.,* Sanders-Langsam Tobacco Co. v. Chem. Bank, 224 Bankr. 1, 3-4 (Bankr. E.D.N.Y. 1998) (letter of credit amended prior to any presentation to require presentation of a “[p]urchase order evidencing quantities and prices of merchandise in above invoices”).

76. *Id.* at 9-12 (the applicant’s and the beneficiary’s agreement to operate without purchase orders two weeks after amending the first letter of credit to require presentation of purchase orders was not binding upon the issuer under UCP 400). Article 5 has the same rule. *See* U.C.C. § 5-106(b) (the issuer is not bound by an amendment to the issued irrevocable letter of credit to which it has not consented). ISP 98 refers to an issuer’s expression of consent by issue of an amendment. *See* OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 2.06(b)(i) (“an amendment binds the issuer when it leaves the issuer’s control”).

77. *See infra* notes 165-91, 213 and accompanying text.

umentary presentation and either has sought or obtained reimbursement from the applicant.<sup>78</sup> If the applicant receives the presented documents and remains silent for more than an agreed period of time or, absent of an agreement, for an unreasonable period of time, the applicant can be precluded from asserting that honor was improper due to documentary discrepancies.<sup>79</sup> Applicant preclusion to object to honor can result from the expiration of a deadline for objection in a reimbursement agreement,<sup>80</sup> from estoppel,<sup>81</sup> from incorporation into a standby letter of credit of the ISP 98 provision requiring an applicant that has been forwarded honored documents to give notice of apparent discrepancies,<sup>82</sup> and from expiration of the one-year Article 5 statute of limitations on an issuer's liability for wrongful honor.<sup>83</sup>

Finally, ISP 98 has a special-presenter-preclusion provision that bars litigation for wrongful dishonor. If a "presenter"<sup>84</sup> that has been given notice of dishonor and discrepancies requests the issuer to ask the applicant to waive the discrepancies without expressly excluding preclusion and the issuer complies, the presenter is precluded thereafter from challenging the identified discrepancies.<sup>85</sup> This special-preclusion provision

78. James G. Barnes & James E. Byrne, *Letters of Credit*, 49 BUS. LAW. 1907, 1915 n.6 (1994).

79. *Id.*

80. *Id.* at 1915 n.56 ("Reimbursement agreements frequently state that the applicant is precluded from defending a claim for reimbursement unless the applicant promptly specifies the discrepancies in the presentation and returns the documents to the issuer.").

81. See, e.g., *Petra Int'l Banking Corp. v. First Am. Bank*, 758 F. Supp. 1120, 1136-37 (E.D. Va. 1991), *aff'd per curiam sub nom. Petra Int'l Banking Corp. v. Dameron Int'l, Inc.*, 953 F.2d 1383 (4th Cir. 1992) (applicant precluded from asserting documentary discrepancies after obtaining the goods with the documents, entering into a secret settlement with the seller with respect to the inferior quality of the goods, and not challenging the issuer's right to reimbursement until more than a year later).

82. See OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 5.09 (an applicant that has been forwarded honored documents must object to honor of a noncomplying presentation by prompt notice of facially apparent discrepancies within a time after receipt of the documents that is not unreasonable). Comment 3 suggests that notice of objection that was given more than seven business days after the applicant received the honored documents would be unreasonable. *Id.* R. 5.09 cmt. 3.

For pros and cons with respect to applicant preclusion to object to honor, compare *DOLAN*, *supra* note 21, at 4-120, 4-121 ("Preclusion rules should probably not apply in the issuer/applicant setting."), with Barnes & Byrne, *1998 Cases*, *supra* note 4, at 1903-06 (stating that ISP 98 reflects general letter-of-credit principles in precluding applicants from asserting discrepancies apparent upon the face of documents that have been provided to them).

83. U.C.C. §§ 5-111(b) (the issuer is liable to the applicant for direct and incidental damages, but not consequential damages, caused by wrongful honor), 5-115 (an action must be commenced either within one year after the expiration of the letter of credit or within one year after the claim accrued, whichever is later, and a claim accrues upon breach regardless of the aggrieved party's lack of knowledge of the breach). Wrongful honor is the issuer's honor of discrepant documents. See *supra* note 4.

84. See OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 1.09(a) (a "presenter" is either the beneficiary, a nominated person that has given value under the letter of credit, or a person acting for the beneficiary or the nominated person). The Article 5 definition of "presenter" is similar. See U.C.C. § 5-102(a)(13).

85. See OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 5.06 (presenter request that the issuer ask the applicant for a waiver). The preclusion is imposed by Rule 5.06(c)(1). *Id.* R. 5.06(c)(1).

could trap uninformed presenters and discourage offers of settlement by wary presenters.<sup>86</sup> ISP 98 is the only letter-of-credit regime to provide for presenter preclusion.<sup>87</sup>

In sum, intentional applicant ad hoc waiver of known documentary discrepancies differs from amending a letter of credit in that it is effective with respect to the applicant without the consent of the other parties to the letter-of-credit transaction<sup>88</sup> and leaves the terms of the letter of credit unaltered. On the other hand, applicant preclusion to object to honor occurs only if the applicant has not made a prior ad hoc waiver of discrepancies, and presenter preclusion to object to dishonor arises between the issuer and the presenter without the applicant's involvement.

#### IV. THE EFFECT OF LETTER-OF-CREDIT RULES ASSURING PROMPT AND CERTAIN PAYMENT UPON THE SIGNIFICANCE OF APPLICANT AD HOC WAIVER

For a letter of credit to be commercially acceptable, the beneficiary must be assured of prompt and certain payment.<sup>89</sup> Several interrelated rules, which have slightly different formulations in the three regimes, provide this assurance. These rules include: (1) the Independence Principle; (2) the apparent facial compliance test for the adequacy of a documentary presentation; and (3) the preclusion of the issuer from justifying dishonor with documentary discrepancies of which timely notice has not been given.<sup>90</sup> The first two rules increase the necessity for applicant ad hoc waiver. On the other hand, issuer preclusion to assert documentary discrepancies makes applicant ad hoc waiver unnecessary.

##### A. U.C.C. ARTICLE 5

As expressed in Article 5, the Independence Principle, which cannot be varied by agreement,<sup>91</sup> severs the beneficiary's entitlement to payment by the issuer from underlying relationships between the beneficiary, the issuer, and the applicant.<sup>92</sup> The payment obligation of the issuer to the beneficiary is independent of the performance or the nonperformance of

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86. See *infra* notes 308-13 and accompanying text.

87. See OFFICIAL COMMENTARY ISP 98, *supra* note 20, at 220-21 (identifying no equivalent rule in other letter-of-credit regimes).

88. However, the issuer has the right to refuse to waive discrepancies that the applicant has waived. See *infra* notes 214-23 and accompanying text.

89. BARNES ET AL., *supra* note 25, 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 . . .").

90. See *infra* notes 91-100 and accompanying text (Article 5); see also *infra* notes 101-28 and accompanying text (UCP 500 & ISP 98).

91. See U.C.C. § 5-103(c)-(d) (stating that the Independence Principle is protected from variation).

92. See *id.* § 5-103 cmt. 1 (illustrating the Independence Principle by example: "That the beneficiary may have breached the underlying contract . . . is no defense for the issuer's refusal to honor.").

any contract or arrangement underlying the letter of credit, including the reimbursement agreement between the applicant and the issuer.<sup>93</sup> The beneficiary's entitlement to payment depends on the presentation of required documents that appear "on . . . [their] face strictly to comply with the terms and conditions of the letter of credit" according to the "standard practice of financial institutions that regularly issue letters of credit."<sup>94</sup> Absent a different agreement, the issuer must determine whether the documents presented appear to comply strictly with the terms and conditions of the letter of credit within a reasonable time, not to exceed seven business days, following the business day of receipt of the documents.<sup>95</sup> An issuer that fails to give timely notice to a presenter<sup>96</sup> of a documentary discrepancy is precluded from asserting it.<sup>97</sup> Failure to give notice of either honor or dishonor by the deadline is wrongful "silent dishonor."<sup>98</sup> Statutory strict preclusion is involved. Waiver, estoppel, and prejudicial reliance on the lack of timely notice are irrelevant.<sup>99</sup>

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93. See *id.* § 5-103(d). The principal Article 5 exception to the Independence Principle is material letter-of-credit fraud. See *id.* § 5-109. In two 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, see *id.* § 5-110(a); and (2) subrogation of an unreimbursed issuer that has honored a presentation, of an applicant that has reimbursed an issuer, and of a nominated person that has given value under a letter of credit to the rights of another to the same extent as a secondary obligor would have been subrogated, see *id.* § 5-117.

94. See *id.* § 5-108(a), (e). Proof of material fraud or forgery with respect to a required document can justify good-faith dishonor notwithstanding the apparent facial compliance of a documentary presentation. See *id.* § 5-109(a)(2). But see *id.* § 5-109(a)(1) (four classes of presenters are entitled to honor notwithstanding proof of material fraud or forgery, e.g., a holder in due course of a draft drawn under the letter of credit that had been accepted by the issuer). However, unless the applicant obtains an injunction against honor, notwithstanding the applicant's claim of material fraud or forgery with respect to a required document, the issuer is free to honor a presentation in good faith, *id.* § 5-109(a)(2), and in fact is more likely to honor than to dishonor. See *id.* § 5-109 cmt. 2 (honor avoids the liability for wrongful dishonor that would arise if the issuer could not prove material fraud or forgery of a required document in subsequent litigation).

95. See *id.* § 5-108(b). The seven-business-day maximum begins on the business day following the business day of presentation and could allow eight business days overall.

Documents must be received at the place specified for presentation to activate the statutory deadline. See *id.* cmt. 2, ¶ 6 (documents are considered received only at the place specified for presentation).

96. See *supra* note 54 and accompanying text for the definition of presenter.

97. See U.C.C. § 5-108(c). On the other hand, failure to give prompt notice to the presenter whether the required documents will be held at the presenter's disposal or returned, which also is required, does not create preclusion. See *id.* § 5-108(b)-(c), (h) (an issuer that has dishonored a presentation shall advise the presenter whether the documents will be held at the disposal of the presenter or returned but failure to give this notice does not give rise to preclusion). However, an issuer's failure to acknowledge the presenter's right to dishonored documents with significant value could constitute conversion of the documents under supplementary principles of tort law. See *Amwest Sur. Co. v. Concord Bank*, 248 F. Supp. 2d 867, 881-83 (E.D. Mo. 2003) (granting beneficiary summary judgment that issuer had converted sight draft and accompanying written certification by retaining the documents without notifying the beneficiary that the documents either would be returned or held for it).

98. See U.C.C. § 5-108 cmt. 2 ("failure of the issuer to act" is "silent dishonor").

99. See *id.* § 5-108 cmt. 3 (emphasizing that the statutory preclusion is not dependent upon principles of waiver and estoppel).

However, there is no preclusion with respect to the forgery of a required document, a material fraud by the beneficiary upon either the issuer or the applicant, or the prior letter of credit expiration.<sup>100</sup> These are not mere documentary discrepancies.

## B. THE OTHER LETTER-OF-CREDIT REGIMES

UCP 500 and ISP 98 take the same general approach as Article 5. Both recognize the Independence Principle.<sup>101</sup> The UCP 500 and ISP 98 test for compliance is whether or not the presented documents appear on their face to be in compliance with the letter of credit's terms and conditions.<sup>102</sup> Under both UCP 500 and ISP 98, the substantive test for apparent facial compliance is the practice of issuers.<sup>103</sup> However, UCP 500 has one unique per se discrepancy rule. Required documents that appear on their face to be inconsistent with one another are deemed to be not in compliance with the letter of credit.<sup>104</sup> Under ISP 98, required documents are to be examined for inconsistency with each other only to the extent required by the standby.<sup>105</sup> If there is no agreed consistency requirement, it suffices that every required document complies with the letter of credit's terms and conditions.<sup>106</sup> Article 5 leaves the significance of

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100. 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"); see also *id.* §5-108 cmt. 3. Material fraud by the beneficiary requires that the beneficiary have no colorable right to expect honor and no basis in fact to support a right to honor. See *id.* §5-109 cmt. 1 (explaining that the test is derived from decisions under the 1962 text of Article 5).

101. 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 that "[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 6, arts. 3(a), 4. 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 20, R. 1.06(c).

102. UCP 500, *supra* note 6, art. 13(a) (providing that required documents must appear on their face to comply with the terms and conditions of the Credit); OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 4.01(a)-(b) (explaining that apparent compliance is determined by examining the presentation on its face against the terms and conditions of the standby).

103. UCP 500, *supra* note 6, art. 13(a) ("international standard banking practice"); OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 4.01(b) ("standard standby practice").

104. UCP 500, *supra* note 6, art. 13(a) ("Documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to be in compliance . . ."). But mere differences in data content do not make documents inconsistent. See ISBP, *supra* note 6, at 15.

105. OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 4.03.

106. *Id.* R. 4.03 cmt. 3 ("[T]he test is whether each document relates to the standby."). In the context of a standby letter of credit, there is not necessarily a single underlying obligation from which an examiner can determine consistency. *Id.* In the relatively rare situation in which a standby requires consistency, the standby should indicate which documents must be consistent and how consistency is to be ascertained. *Id.* R. 4.03 cmt. 4.



the inconsistency of required documents to the letter of credit's terms and the practice of issuers.<sup>107</sup>

Absent a special agreement, both UCP 500 and ISP 98 impose a seven-day outside deadline for giving notice of dishonor and discrepancies by telecommunication, if available, or by other prompt and expeditious means.<sup>108</sup> An issuer is precluded from asserting a documentary discrepancy that has not been the subject of timely notice.<sup>109</sup> Like Article 5, UCP 500 sub-Article 13(b) states that a reasonable time for examination and a decision with respect to honor can be less than seven days.<sup>110</sup> Although the sub-Article 14(e) preclusion provision literally applies only to obligations imposed by Article 14,<sup>111</sup> *DBJJJ, Inc. v. National City Bank*,<sup>112</sup> a California intermediate-appellate-court decision, reads sub-Article 14(d) as incorporating sub-Article 13(b)'s reasonable time requirement<sup>113</sup> and making violation of sub-Article 13(b) a basis for sub-Article 14(e) preclusion.<sup>114</sup>

107. See *id.* at 148 (Article 5 has no rule comparable to ISP 98 Rule 4.03).

108. UCP 500, *supra* note 6, arts. 13(b) (providing that a reasonable time to examine the documents in order to determine whether or not to refuse them, and to inform the party from whom the documents had been received cannot exceed seven banking days after the day of receipt of the documents), 14(d) (providing that notice of refusal of the documents must be given by telecommunication or other expeditious means no later than the seventh banking day after the day of receipt of the documents); OFFICIAL COMMENTARY ISP 98, *supra* note 20, Rs. 5.01(a)(i) (explaining that notice of dishonor that is given more than seven business days after the business day of receipt of the documents is deemed to be unreasonable), 5.01(b)(i) (providing that notice of dishonor is to be given by telecommunication or another available prompt means).

109. UCP 500, *supra* note 6, art. 14(d)(ii), (e) (providing that all discrepancies must be included in timely notice or the issuer "shall be precluded"); OFFICIAL COMMENTARY ISP 98, *supra* note 20, Rs. 5.02, 5.03(a) (all discrepancies must be included in timely notice and failure to do so "precludes assertion of that discrepancy" with respect to the presentation involved); see also *DBJJJ, Inc. v. Nat'l City Bank*, 19 Cal. Rptr. 3d 904, 912, 915-16 (Cal. Ct. App. 2004) (stating that, if, on remand, the beneficiary proved that the issuer had exceeded a reasonable time in deciding to dishonor, the issuer would be precluded from claiming that the documents were discrepant under UCP 500).

110. See U.C.C. § 5-108(b) ("a reasonable time after presentation, but not beyond the end of the seventh business day"); UCP 500, *supra* note 6, art. 13(b) ("a reasonable time, not to exceed seven banking days . . .").

111. See DOLAN, *supra* note 21, at 6-76 to 6-77 (stating that preclusion literally applies only to the duties in Article 14).

112. 19 Cal. Rptr. 3d at 904.

113. See *id.* at 912-13 ("If the issuing bank does not examine the documents within a 'reasonable time not to exceed seven banking days' it cannot notify the beneficiary 'without delay' as required by Article 14(d)(1).").

114. See *id.* The court acknowledged that UCP 500 in fact was ambiguous as to whether a violation of Article 13(b) gave rise to Article 14(e) preclusion. Its conclusion was influenced by UCP 400's clear application of preclusion and the lack of evidence that UCP 500 was intended to alter the prior-preclusion rule. See *id.* Before the *DBJJJ, Inc.* decision, some commentators had recommended that beneficiaries insert provisions in letters of credit making violation of Article 13(b) a basis for Article 14 preclusion. See, e.g., WUNNICKE, *supra* note 27, at 5-36 ("[A] provision of the letter of credit might [so] state . . .").

Article 14's incorporation of the Article 13 reasonable time requirement into its preclusion rule does not alter the sequential relationship of the two articles. The issuer has no obligation to give notice until a reasonable time for the examination of presented documents has passed. See *Banco Gen. Runinahui, S.A. v. Citibank Int'l*, 97 F.3d 480, 486 (11th Cir. 1996) (holding that the examination and notice obligations are "sequential" under UCP 400).

ISP 98 gives greater deference to an issuer's judgment by focusing on whether notice of dishonor and discrepancies was unreasonable. Notice that is given within three business days after the day of presentation is deemed to be not unreasonable, and notice that is given after the expiration of seven business days is deemed to be unreasonable.<sup>115</sup> Whether notice that is given between four and seven business days is unreasonable depends on the circumstances and banking practice.<sup>116</sup>

UCP 500 does not explicitly exclude material fraud, forgery of a required document, or the prior expiration of the letter of credit from its strict-preclusion rule. However, UCP 500 Article 14 is captioned "Discrepant Documents" and emphasizes discrepancies "in" presented documents.<sup>117</sup> Material fraud, forgery of a required document, and the letter of credit's expiration are not dealt with by Article 14 or any other aspect of UCP 500, which does not displace their exclusion from Article 5 preclusion.<sup>118</sup> ISP 98 expressly excludes only notice of expiry from preclusion.<sup>119</sup> But ISP 98 does not deal with fraud and forgery<sup>120</sup> and likewise does not displace their exclusion from Article 5 preclusion.<sup>121</sup>

UCP 500 preclusion has a broader scope than Article 5 and ISP 98 preclusion. UCP 500 requires that timely notice of dishonor and discrepancies also advise a presenter whether the dishonored documents will be held at the presenter's disposal or returned.<sup>122</sup> An otherwise timely and complete notice of dishonor and discrepancies is vitiated by omitting this additional notice.<sup>123</sup> Both Article 5 and ISP 98 require this notice but do not make the failure to provide it in a timely fashion a basis for preclu-

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115. OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 5.01(a)(i). ISP 98 adopted an "unreasonable notice" test in lieu of a "reasonable notice" test in order to allow issuers the latitude permitted by standard correspondent banking practice. *See id.* R. 5.01 cmt. 4 ("This Rule reverses the formulation because it has been misunderstood as an invitation to determine what is reasonable rather than, as intended, its outer limit.").

116. *Id.* R. 5.01 cmts. 4, 6 (unreasonableness should be determined by standard correspondent banking practice and the circumstances).

117. *See* UCP 500, *supra* note 6, arts. 14(b) ("documents" on their face must comply), 14(c) ("documents appear on their face not to be in compliance"), 14(f) ("discrepancies in the document(s)").

118. *See* *Mid-America Tire, Inc. v. PTZ Trading Ltd.*, 768 N.E.2d 619, 634-37 (Ohio 2002) (holding that UCP 500 does not displace the Article 5 fraud provisions that it does not cover). *Boston Hides & Furs, Ltd. v. Sumitomo Bank, Ltd.*, 870 F. Supp. 1153, 1162-64 (D. Mass. 1994), limited the exclusion from preclusion to latent fraud. But *Boston Hides* was decided under the 1962 version of Article 5, which contained neither an express-preclusion rule nor express-exceptions from preclusion. *See* ABA Task Force on the Study of Article 5, *An Examination of U.C.C. Article 5 (Letters of Credit)*, 45 BUS. LAW. 1521, 1601 (1990) ("The cases under the U.C.C. do not preclude the raising of objections in addition to those originally raised unless the beneficiary can establish the affirmative defense of waiver or estoppel . . .").

119. OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 5.04 ("Failure to give notice that a presentation had been made after expiration does not preclude dishonor for that reason.").

120. *Id.* R. 1.05(c) (defenses to honor based upon fraud, abuse, or similar matters are left to applicable law).

121. *See id.*

122. UCP 500, *supra* note 6, art. 14(d)(ii).

123. *See id.*

sion.<sup>124</sup> UCP 500 also requires that notice of a decision to dishonor be given by telecommunication, if possible, or other expeditious means, "without delay,"<sup>125</sup> which suggests that even notice by telecommunication could be deficient. ISP 98, on the other hand, states that notice by available telecommunication or another means of prompt notice is permissible,<sup>126</sup> which is intended to create a presumption that notice by telecommunication is prompt.<sup>127</sup> Article 5 does not address the telecommunication issue, simply requiring that notice be given within the deadline for a decision to dishonor.<sup>128</sup>

Under all three regimes, issuer preclusion to assert documentary discrepancies makes applicant ad hoc waiver unnecessary.

## V. EXPLICIT TREATMENT OF APPLICANT AD HOC WAIVER

### A. U.C.C. ARTICLE 5

Article 5 authorizes the applicant to waive the statutory right to dishonor of a presentation of nonconforming documents through either a prior agreement<sup>129</sup> or an ad hoc waiver.<sup>130</sup> Official Comment 1 to Section 5-108 contains examples of permissible prior agreements, including total waiver of the statutory right to dishonor with respect to presentations below a certain dollar amount and authorization of examination of documents exclusively by electronic or electro-optical means.<sup>131</sup>

The text of Article 5 otherwise does not address applicant ad hoc waiver, but several Official Comments do. One Official Comment states, "This section does not preclude the issuer from contacting the applicant

124. See U.C.C. § 5-108(b)-(c), (h) (an issuer that has dishonored shall advise the presenter whether the presented documents will be held or returned but failure to give this notice does not give rise to preclusion); OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 5.07 (explaining that dishonored documents must be returned, held, or disposed of as reasonably instructed by the presenter but failure to include notice of disposition of the documents in notice of dishonor does not preclude the issuer from asserting defenses). Comment 1 to Rule 5.07 explains that the documents presented under a standby typically are not inherently valuable. *Id.* R. 5.07 cmt. 1. However, under tort principles supplementing all three regimes, an issuer's retention of dishonored documents without giving the required notice can constitute conversion. See *supra* note 97.

125. UCP 500, *supra* note 6, art. 14(d)(i) ("notice . . . by telecommunication or, if that is not possible, by other expeditious means, without delay . . .").

126. ISP 98, *supra* note 20, R. 5.01(b)(i) ("notice . . . is to be given . . . by telecommunication, if available . . .").

127. See ISP 98 & UCP 500 COMPARED, *supra* note 40, R. 5.01 & cmt. 14 (ISP 98 "establishes a presumption that notice by telecommunication is prompt.")

128. See U.C.C. § 5-108(b)(3) (providing that notice of dishonor must be given within a reasonable time after presentation).

129. *Id.* § 5-108(a) (providing for a contrary agreement).

130. See *e.g.* Robalen, Inc. v. Generale de Banque, S.A., 1999 WL 688301, at \*2, \*4 (S.D.N.Y. 1999) (under UCP 500, the applicant's ad hoc waiver of failure to present a dated On-Board bill of lading with respect to two shipments did not prevent the applicant from refusing to waive this discrepancy with respect to the third shipment).

131. U.C.C. § 5-108 cmt. 1. The Official Comment adds that the illustrated agreements do not violate the prohibition in § 5-103(c) against agreements "generally excusing liability or generally limiting remedies for failure to perform obligations." *Id.*

during its examination.”<sup>132</sup> This is an inadequate response to decisions like *Full-Bright Industrial Co. v. Lerner Stores, Inc.*,<sup>133</sup> which held that it was improper under UCP 400, the predecessor of UCP 500, for the issuer to contact the applicant for a waiver of discrepancies before deciding to reject the documents.<sup>134</sup> Another Official Comment says that contacting the applicant about waiver does not affect what is a “reasonable time” for honor or dishonor.<sup>135</sup> This Comment reasonably rejects the holding under UCP 400 in *Alaska Textile Co. v. Chase Manhattan Bank, N.A.*<sup>136</sup> that the issuer’s inquiry whether the applicant would waive documentary discrepancies at the request of the beneficiary could extend the issuer’s outside deadline.<sup>137</sup> However, the Comment goes too far in apparently precluding an issuer from waiting for an applicant’s response to a request for a waiver within the issuer’s seven-day outside deadline.<sup>138</sup> Another Official Comment addresses a conflict of authority under former Article 5,<sup>139</sup> providing that neither the applicant’s nor the issuer’s ad hoc waiver of defects in one or more presentations entitles the beneficiary to count on waiver of the same documentary defects in later presentations.<sup>140</sup> Finally, an Official Comment states that, notwithstanding the applicant’s ad hoc waiver of documentary discrepancies, the issuer can dishonor a non-complying presentation.<sup>141</sup> This Comment rejects the alternative holding in *Bombay Industries, Inc. v. Bank of New York*<sup>142</sup> that the issuer wrongfully had refused to honor a letter of credit following the applicant’s waiver of documentary discrepancies.<sup>143</sup>

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132. *Id.* § 5-108 cmt. 2.

133. 1994 WL 97361 (S.D.N.Y. 1994). For discussion of the inadequacy of this Official Comment see *infra* notes 144-57 and accompanying text.

134. *Id.* at \*3 (“It is contrary to the underlying purpose of letters of credit to tie acceptance of the documents to the satisfaction of the buyer with the seller’s performance.”); see also *Kuntal, S.A. v. Bank of New York*, 703 F. Supp. 312, 313 (S.D.N.Y. 1989) (noting that the issuer’s waiting for the applicant to decide whether to waive discrepancies is “at odds with the basic letter of credit tenet that banks deal solely in documents, not in goods” (citing *Bank of Cochin Ltd. v. Mfrs. Hanover Trust*, 612 F. Supp. 1533, 1543 (S.D.N.Y. 1985))).

135. “What is a ‘reasonable time’ is not extended to accommodate an issuer’s procuring a waiver from the applicant.” U.C.C. § 5-108 cmt. 2.

136. 982 F.2d 813 (2d Cir. 1992).

137. *Id.* at 822-24 (Under UCP 400 article 16(c) and (e), the issuer’s contacting the applicant for waiver of a patent, incurable discrepancy at the request of the beneficiary could postpone a decision with respect to dishonor until the applicant had responded or the beneficiary had renewed its demand for honor). UCP 500 also rejects the holding. See UCP 500, *supra* note 6, art. 14(c) (providing that the issuer’s contacting the applicant with respect to waiver of documentary discrepancies does not extend the issuer’s deadline for deciding whether or not to honor).

138. For discussion of the issuer’s waiting for the applicant’s response within the maximum seven-day deadline, see *infra* notes 184-91 and accompanying text.

139. U.C.C. § 5-108 cmt. 7.

140. See *id.* (citing conflicting cases).

141. See *id.* § 5-108 cmt. 7.

142. 1995 WL 808811 (N.Y. Sup. Ct. 1995), *rev’d*, 649 N.Y.S.2d 784 (N.Y. App. Div. 1996).

143. *Id.* at \*2-\*3. The issuer’s waiver of the same discrepancies in prior presentations and the issuer’s subsequent application of the value of the beneficiary’s goods to the issuer’s secured debt even though the beneficiary had not been paid for them also influenced

### 1. *Contacting the Applicant and Treating Different Presentations Differently*

The Official Comment stating that an issuer can contact the applicant while presented documents are being examined<sup>144</sup> is vague and does not signal clearly<sup>145</sup> that an issuer must be careful how it contacts the applicant and what it tells the presenter about the contact. The issuer has no need to seek the applicant's waiver with respect to presented documents that appear on their face to comply strictly with the letter of credit.<sup>146</sup> If the documents do not appear to comply, the issuer should identify the apparent discrepancies before contacting the applicant and limit the inquiry to the identified discrepancies.<sup>147</sup> The documents themselves should be retained. Neither the originals nor copies of all the originals should be forwarded to the applicant.<sup>148</sup> Premature contact or surrender of either the original documents or copies of all the originals to the applicant, coupled with the applicant's aggressively campaigning for dishonor, could result in a factual finding that the issuer had abrogated its obligation to make an independent decision with respect to the conformity of the documents presented.<sup>149</sup>

The issuer has no Article 5 duty to contact the applicant about waiver<sup>150</sup> and need not notify the presenter that the issuer will or has done so.<sup>151</sup> If the issuer does notify the presenter of an inquiry to the applicant about waiver, the issuer must make clear that the issuer is not waiving its own privilege of dishonor upon the basis of the documentary discrepancies. In *Bank of Seoul v. Norwest Bank Minnesota, N.A.*,<sup>152</sup> the issuer's informing the beneficiary that "we are contacting L/C applicant . . . for approval" was held to have created a fact issue as to whether the issuer had intended to waive its own privilege to require strictly com-

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the court. *Id.* Although the trial court decision was reversed on appeal, see *supra* note 142, the trial judge eventually had his way. In *Bombay Indus., Inc. v. Bank of New York*, 1997 WL 860671, at \*1-4 (N.Y. Sup. Ct. 1997), the trial judge held that the issuer had failed to give timely notice of dishonor and discrepancies and was precluded by UCP 500 from dishonoring.

144. See *supra* note 132 and accompanying text.

145. The Official Comment adds without elaboration, "however, the decision to honor rests with the issuer." U.C.C. § 5-108 cmt. 2.

146. See *supra* note 3 and accompanying text.

147. See Gerald T. McLaughlin & Neil B. Cohen, *Banks and Letters of Credit*, NAT'L L.J., Jan. 31, 2000, B4, col. 1 (in approaching the applicant for a waiver of documentary discrepancies, the issuer should inform the applicant in writing of the discrepancies that have been identified and retain the documents).

148. See *id.*

149. Compare *E & H Partners v. Broadway Nat'l Bank*, 39 F. Supp. 2d 275, 284-85 (S.D.N.Y. 1998) (alternative holding) (issuer estopped to assert documentary discrepancies for allowing the applicant to play an active part in the issuer's decision to dishonor), with *Western Int'l Forest Prods., Inc. v. Shinhan Bank*, 860 F. Supp. 151, 154-55 (S.D.N.Y. 1994) (after determining that a documentary presentation is nonconforming, the issuer can consult the applicant with or without the beneficiary's request to do so).

150. U.C.C. § 5-108 cmt. 2 (stating that the issuer has no duty to seek a waiver from the applicant).

151. See *id.*

152. 630 N.Y.S.2d 520 (N.Y. App. Div. 1995).

plying documents.<sup>153</sup> The issuer can avoid waiver of its privilege to dishonor either by not notifying the presenter of contact with the applicant about waiver or by coupling notice to the presenter with explicit notice that the issuer will make an independent decision about waiver.<sup>154</sup> However, reservation of the insurer's rights is not notice of dishonor, and the issuer will be precluded from asserting documentary discrepancies if timely notice of dishonor and discrepancies is not given.<sup>155</sup> Indeed, the Fifth Circuit decision in *Voest-Alpine Trading USA Corp. v. Bank of China*<sup>156</sup> indicates that including notice that the applicant is being contacted in what otherwise purports to be a notice of dishonor can create ambiguity that renders the notice of dishonor ineffective. In affirming the district court's conclusion that the issuer had not given timely notice of dishonor, the Fifth Circuit panel commented:

We find ample evidence supporting the district court's decision. The court's determination that the August 11 telex did not reject the letter of credit [*sic*] is based primarily on the Bank of China's offer to obtain waiver from [the purchaser]. The offer to solicit waiver, the district court reasoned, suggests that the documents had not in fact been refused but might be accepted after consultation with [the purchaser].<sup>157</sup>

The Official Comment stating that the applicant's or the issuer's ad hoc waiver of defects in one or more presentations does not entitle the beneficiary to the same waiver in later presentations<sup>158</sup> derives from the uniqueness of each presentation—each presentation involves different documents, different goods, a different timeline, and, frequently, a different document checker.<sup>159</sup> If a single letter of credit provides for multiple presentations of documents, the applicant's willingness to waive the same

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153. *Id.* at 521-22 (trial court properly denied issuer's motion for summary judgment due to fact question with respect to waiver).

154. See James G. Barnes & James E. Byrne, *Letters of Credit: 1995 Cases*, 51 BUS. LAW. 1417, 1420 (1996) (summarizing the *Bank of Seoul* case and observing that cautious banks either may want to disclaim waiver in notifying beneficiaries or simply cease notifying beneficiaries).

155. See *Voest-Alpine Trading USA Corp. v. Bank of China*, 288 F.3d 262, 265-66 (5th Cir. 2002) (issuer's telex to presenting bank listing seven documentary discrepancies and stating, "We are contacting the applicant for acceptance of the relative discrepancy [*sic*]" was not notice of dishonor under UCP 500).

156. *Id.*

157. *Id.* at 266; see Paul S. Turner, *Notices of Discrepancy and Requests for Waiver Under UCP 500*, 10 DCINSIGHT 5, 6 (ICC July/September 2004) [hereinafter Turner, *Notices of Discrepancy*] ("It is not possible to word the notice in a manner that contemplates the waiver and does not thereby, as the court in *Voest Alpine* stated, leave open the possibility that the allegedly discrepant documents might have been accepted at a future date.").

158. U.C.C. § 5-108 cmt. 7.

159. This result has been referred to as an application of the Independence Principle. See McLaughlin, *The Independence Principle*, *supra* note 4, at 546-48 (stating that the irrelevancy of applicant and issuer waivers under prior letters of credit is an application of the Independence Principle). However, the traditional Independence Principle makes irrelevant transactions underlying the letter of credit. See U.C.C. § 5-103(d) (providing that the obligations of the issuer to the beneficiary and a nominated person are independent of underlying arrangements). The uniqueness of each presentation is a more accurate explanation.

discrepancy with respect to the initial presentations does not obligate the applicant to continue making the waiver.<sup>160</sup> In *Robalen v. Generale de Banque, S.A.*,<sup>161</sup> for example, the applicant's and the issuer's waiver of the failure to date "On Board" stamps on bills of lading with respect to two shipments did not preclude the issuer from refusing to waive the required dated "On Board" stamp for the third shipment.<sup>162</sup> *A fortiori*, a waiver of a documentary discrepancy in a presentation under one letter of credit gives the beneficiary no reason to rely on waiver of the same discrepancy under another letter of credit involving the same parties.<sup>163</sup> Nevertheless, in honoring a presentation of documents notwithstanding identified discrepancies, the careful issuer notifies the presenter that the discrepancies may not be waived in the future.<sup>164</sup>

## 2. *A Reasonable Time for Honor or Dishonor*

In 1998, the International Financial Services Association (IFSA), an association of banks and other financial institutions that process international transactions,<sup>165</sup> approved a Statement of Practice under UCP 500 concerning a reasonable time for examination and notice of dishonor.<sup>166</sup> The Statement of Practice states that issuing banks consider three banking days a "safe harbor" period for examining presented documents, preparing and reviewing a notice of dishonor, and giving expeditious notice of dishonor and discrepancies.<sup>167</sup> Moreover, if the applicant has been

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160. *Robalen v. Generale de Banque, S.A.*, No. 97 Civ. 0887 (TPG), 1999 WL 688301, at \*4 (S.D.N.Y. 1999).

161. *Id.*

162. *Id.* at \*3-4 (granting issuer summary judgment in beneficiary's action for wrongful dishonor under UCP 500).

163. *See N. Am. Foreign Trading Corp. v. Chiao Tung Bank*, No. 95 Civ. 5189 (LBS), 1997 WL 193197 (S.D.N.Y. 1997). A nominated person that had made a discrepant presentation sued the applicant for unjust enrichment asserting that the same documentary discrepancy had existed in forty prior transactions and either had been waived or cured. The court responded that the sophisticated parties to letter-of-credit transactions are aware of the rule of strict compliance and should not be allowed to recover without either apparent strict compliance or a waiver with respect to the specific presentation. *See id.* at \*1, \*6-7.

164. *See, e.g., Pro-Fab, Inc. v. Vipa, Inc.*, 772 F.2d 847, 850, 852 (11th Cir. 1985) (holding that, although the applicant had waived discrepancies with respect to three shipments, the issuer had accompanied its checks with the statement that payment was being made notwithstanding the listed documentary discrepancies; and was not precluded from dishonoring with respect to a fourth shipment after the applicant refused to waive discrepancies with respect to the fourth shipment).

165. About IFSA, [http://www.ifsaonline.org/03\\_content/0305\\_about/030500\\_about\\_main.html](http://www.ifsaonline.org/03_content/0305_about/030500_about_main.html) (last visited Oct. 21, 2005) (explaining that the IFSA is the only organization in the world dedicated to the international processing areas of banks and other financial institutions). The IFSA participated in the development of ISP 98. *See supra* note 20.

166. IFSA, *Reasonable Time for Examination & Notice of Dishonor*, Statement of Practice, LC Rules & Laws Critical Texts 91 (2d ed. Institute for Int'l Banking L. & Practice 2002) [hereinafter Statement of Practice, LC Rules & Laws] (the Statement of Practice was approved by the IFSA Board of Directors on March 20, 1998).

167. *See id.* at 93-94 (Statement of Practice 2 and 3). ISP 98 explicitly adopts this three-day safe harbor. *See OFFICIAL COMMENTARY ISP 98*, *supra* note 20, R. 5.01(a)(i) (explaining that notice given within three business days is deemed to be not unreasonable), which also existed under the 1962 version of Article 5. *See James G. Barnes, Nonconforming*

contacted for a waiver, the deadline for giving notice of dishonor is extended to the seventh banking day after the presentation of the documents, unless the applicant communicates its refusal to waive more quickly or the issuer decides to dishonor irrespective of the applicant's decision.<sup>168</sup> The Statement of Practice has not been endorsed by the ICC.<sup>169</sup>

*DBJJJ, Inc. v. National City Bank*<sup>170</sup> involved two commercial letters of credit that incorporated UCP 500 and were payable to the same beneficiary. The issuer had inquired whether the applicant would waive discrepancies in the presentations under both letters of credit. Presentation had been made upon one letter of credit's expiration date and three days before the other's expiration date.<sup>171</sup> On the seventh banking day after the banking day of presentation, after both letters of credit had expired, the applicant had refused to waive the discrepancies.<sup>172</sup> The issuer had given same-day notice of dishonor and discrepancies.<sup>173</sup>

A California intermediate-appellate court reversed the trial court's grant of summary judgment to the issuer for acting in accordance with the Statement of Practice.<sup>174</sup> To the extent that the Statement of Practice<sup>175</sup> indicated that it always was reasonable to take seven banking days to dishonor when the applicant had been approached for a waiver, the intermediate-appellate court considered the Statement of Practice to be invalid under both UCP 500 and Article 5.<sup>176</sup> On the other hand, denial of summary judgment to the beneficiary was affirmed.<sup>177</sup> The beneficiary had made conclusory arguments rather than presenting uncontested facts establishing that the issuer's notices of dishonor and discrepancies had

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*Presentations Under Letters of Credit: Preclusion and Final Payment*, 56 BROOK. L. REV. 103, 104 (1990) (noting that under 1962 Article 5, dishonor is deemed to occur after three banking days).

168. Statement of Practice, LC Rules & Laws, *supra* note 166, at 92.

169. See ISBP, *supra* note 6. The ISBP, a compilation of international standard banking practice under UCP 500 approved by the ICC and published in 2003, does not deal with the deadline for notice of dishonor and discrepancies. See *id.*

170. 19 Cal. Rptr. 3d 904 (Cal. Ct. App. 2004).

171. See *id.* at 907-08 (the expiration date of letter of credit No. 091 was December 14, 2001 and the issuer acknowledged receiving the presented documents on December 11, 2001). Presentation shortly before the letter of credit's expiration date is not best practice but occurs with some frequency.

172. *Id.*

173. *Id.* at 907-08.

174. The trial court had concluded that "[d]efendant [Bank] had until the close of business on the seventh banking day following its receipt of Plaintiff's claim and supporting documents . . . to send its Advice of Rejection . . ." *Id.* at 908.

175. The Statement of Practice considered by the court had been two pages of the Statement adopted by the U.S. Council on International Banking. *Id.* at 911 ("Bank cites a two-page excerpt from an article by the U.S. Council on International Banking . . ."). The U.S. Council on International Banking is the former name of the IFSA. Statement of Practice, LC Rules & Laws, *supra* note 166, at 91 (the IFSA was formerly the USCIB).

176. *DBJJJ, Inc.*, 19 Cal. Rptr. 3d at 912 ("Bank's claim was that seven banking days is always reasonable where a bank seeks a waiver from an applicant, an incorrect argument.").

177. *Id.* at 912-14.



been too late.<sup>178</sup> The case was remanded for a trial on the timeliness of the issuer's notices.<sup>179</sup> The *DBJJJ, Inc.* case raises several questions, including: (1) is the Statement of Practice in fact inconsistent with UCP 500 and Article 5, and (2) what is likely to happen on remand of the case?

The Statement of Practice does not say that it always is reasonable to take seven banking days to dishonor when the applicant has been approached for a waiver. There are two express exceptions: (1) the applicant's prompt communication of a refusal to waive and (2) the issuer's decision to dishonor without regard to what the applicant does.<sup>180</sup> But both of these express exceptions were irrelevant in *DBJJJ, Inc.* The applicant did not waive promptly, and the issuer waited for the applicant's decision.<sup>181</sup> Because the express exceptions were not applicable, the issuer in *DBJJJ, Inc.* complied with the Statement of Practice in giving the applicant a "refusal date" that was the seventh banking day after the banking day of presentment.<sup>182</sup> But the issuer's using the latest possible refusal date as provided by the Statement of Practice in and of itself could have delayed the applicant's response and, for that reason, was inconsistent with the UCP 500 sub-Article 13(b) requirement that the issuer decide about dishonor within a "reasonable time."<sup>183</sup> The Statement of Practice is not consistent with sub-Article 13(b). But Article 5 is a different story.

There is no Article 5 provision on point. The alleged inconsistency was based on the Article 5 Official Comment stating that a reasonable time for deciding about honor or dishonor "is not extended to accommodate an issuer's procuring a waiver from the applicant."<sup>184</sup> This Official Comment makes sense with respect to the seven-day outside deadline for a decision. The 1995 revision of Article 5 extended the issuer's outside stat-

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178. *Id.* ("There are no facts in Seller's separate statement in support of its motion for summary judgment relevant to this issue . . . . A mere description of the rule of preclusion is insufficient.").

179. *Id.* at 915-16 ("If, upon remand, Seller establishes that Bank violated Article 13(b), Bank would be precluded from claiming that the documents are not in compliance with the terms of the credit.").

180. Statement of Practice, LC Rules & Laws, *supra* note 166, at 92 (noting that the time for giving notice is earlier than the seventh banking day if the applicant refuses to waive promptly or the issuer decides to dishonor at an earlier date, even if the applicant waives). The express exception for the issuer's decision to dishonor, even if the applicant waives, covers both situations in which the applicant waives promptly but the issuer refuses to waive and situations in which the issuer refuses to waive without waiting for the applicant's decision. *See id.*

181. *See supra* notes 172-73 and accompanying text.

182. *See* Statement of Practice, LC Rules & Laws, *supra* note 166, at 92 ("the time for giving notice to the presenter runs to the close of the seventh banking day after presentation, unless . . . [the exceptions apply] . . .").

183. *See DBJJJ, Inc.*, 19 Cal. Rptr. 3d at 910 ("By giving no meaning to the phrase 'reasonable time,' Bank's argument is inconsistent with the plain language of Article 13(b).").

184. The court stated, "Bank's argument also ignores the comment to the California Uniform Commercial Code section 5108 . . . ." *Id.* at 911.

utory deadline from three to seven business days.<sup>185</sup> An additional open-ended extension is unnecessary.<sup>186</sup> However, the Official Comment should not be read to preclude the issuer's delaying a final decision while the applicant is considering waiver before the expiration of the seven-business-day outside deadline.<sup>187</sup>

The Official Comment refers to UCP 500 sub-Article 14(c) for the proposition that "[w]hat is a 'reasonable time' is not extended to accommodate an issuer's procuring a waiver from the applicant."<sup>188</sup> However, sub-Article 14(c) merely states that approaching the applicant for a waiver "does not . . . extend the period mentioned in sub-Article 13(b)."<sup>189</sup> The period mentioned in sub-Article 13(b) is "a reasonable time, not to exceed seven banking days following the day of receipt of the documents, to examine the documents and determine whether to take up or refuse the documents and to inform the party from which it received the documents accordingly."<sup>190</sup> Sub-Article 13(b) does not state, as the Article 5 Official Comment implies, that the issuer's having approached the applicant for a waiver cannot be a factor in what is a reasonable time for notice of dishonor within the seven-day outside deadline. Indeed, the Statement of Practice's existence indicates that issuers consider that a request to the applicant for a waiver can extend the time for deciding upon dishonor within this period.<sup>191</sup>

The *DBJJ, Inc.* case was remanded for a factual determination as to whether the issuer had taken too long to dishonor.<sup>192</sup> In contacting the applicant about both letters of credit, the issuer had designated the seventh banking day following presentation as the "refusal date," adding, "[p]lease contact us immediately with your waiver of discrepancies or other instructions."<sup>193</sup> The justification for denying summary judgment to the issuer with respect to both letters of credit was that, by responding on the designated "refusal date," the applicant appeared to have interpreted the issuer's request for a waiver as not asking for a response before the "refusal date."<sup>194</sup> If, on remand, it is determined that the is-

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185. Compare U.C.C. § 5-108(b) ("not beyond the end of the seventh business day of the issuer after the day of its receipt of the documents"), with 1962 U.C.C. § 5-112(1)(a) (issuer can "defer honor until the close of the third banking day following receipt of the documents").

186. See *Kuntal, S.A. v. Bank of N.Y.*, 703 F. Supp. 312, 313-14 (S.D.N.Y. 1989) (the issuer failed to justify the applicant's taking nine full days to reject a waiver under UCP 400).

187. See *infra* notes 188-91 and accompanying text.

188. U.C.C. § 5-108 cmt. 2.

189. UCP 500, *supra* note 6, art. 14(c).

190. *Id.* art. 13(b).

191. See *supra* note 166 and accompanying text. However, the Statement of Practice presently does not conform to UCP 500. See *supra* notes 180-83 and *infra* notes 196-203 and accompanying text.

192. *DBJJ, Inc. v. Nat'l City Bank*, 19 Cal. Rptr. 3d 904, 915-16 (Cal. Ct. App. 2004) ("If, upon remand, Seller establishes that Bank violated Article 13(b), Bank would be precluded from claiming the documents are not in compliance with the terms of the credit.").

193. *Id.* at 907-08.

194. *Id.* at 910-12.

suer's designated "refusal date" had caused the applicant to delay its response, the issuer could not justify its own delay with delay by the applicant that the issuer had caused. Preclusion would be imposed with respect to both letters of credit.<sup>195</sup>

How should the Statement of Practice be reconciled with sub-Article 13(b)? If the Statement of Practice had directed the issuer in the *DBJJJ, Inc.* case to urge the applicant to respond as soon as possible without designating a "refusal date,"<sup>196</sup> the issuer's notice itself could not have been the cause of delay. But the Statement of Practice also should deal with the issuer's awareness that a presentation has been made shortly before the letter of credit's expiration date. All well-drafted letters of credit have expiration dates.<sup>197</sup> The problem is recurrent.

A presenter's cure of a defective documentary presentation makes applicant waiver unnecessary. By requiring the issuer to decide whether to dishonor within a reasonable time and to list all the justifications in the notice of dishonor,<sup>198</sup> the UCP 500 preclusion rule facilitates cure by presenters.<sup>199</sup> For presentations shortly before a letter of credit's expiration date, the time for cure is short. The issuer's awareness of an imminent expiration date does not require the issuer to rush the examination of presented documents,<sup>200</sup> and the issuer is free to contact the applicant

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195. UCP preclusion is automatic and absolute. A presenter's lacked prejudicial reliance upon unreasonably delayed dishonor is irrelevant. See James E. Byrne, *Letters of Credit*, 43 BUS. LAW. 1353, 1370-71 (1988) (discussing the preclusion rule of UCP 400). It consequently is irrelevant that the presenter would have been unable to cure the defective presentation made on the expiration date of one letter of credit if timely notice had been given. See *id.* (stating that it is a misunderstanding to consider that UCP preclusion is dependent upon the ability to cure documentary defects).

196. If the references to the "refusal date" had been deleted, the notices in *DBJJJ, Inc.* would have sufficed. The issuer had urged, "Please contact us immediately with your waiver of discrepancies or other instructions." See *supra* note 193 and accompanying text.

197. See 12 CFR § 7.1016(b)(iii) (2005) (explaining that, as a safe and sound banking practice, the Comptroller of the Currency considers that letters of credit issued by national banks either should have a limited duration, permit termination by the issuer, or entitle the issuer to cash collateral from the applicant upon demand); see also U.C.C. § 5-106(c) (providing that a letter of credit without a stated expiration date expires either one year after the stated date of issue, or, if there is no stated date of issue, one year after the date of issue). If a letter of credit requires that documents be presented before its expiration date, a presentation shortly before the document presentation date is the functional equivalent of a presentation shortly before the expiration date. See, e.g., *Banco Gen. Runinahui, S.A. v. Citibank Int'l*, 97 F.3d 480, 483 (11th Cir. 1996) (letter of credit requiring documents to be presented "no later than 15 days after shipment, but within the validity of the credit.").

198. See UCP 500, *supra* note 6, arts. 13(b) (providing that a decision about dishonor must be made in a "reasonable time, not to exceed seven banking days . . ."), 14(d)(ii) ("notice must state all discrepancies in respect of which the bank refuses the documents . . .").

199. See, e.g., *Offshore Trading Co. v. Citizens Nat'l Bank of Fort Scott*, 650 F. Supp. 1487, 1491 (D. Kan. 1987) (in discussing the UCP 400 preclusion rule the court commented, "Without notice of the discrepancies, the beneficiary may be unable to present conforming documents.").

200. See *Banco Gen. Runinahui, S.A.*, 97 F.3d at 487 (holding that the presentation of documents the day before the document presentation deadline imposed by the letter of credit did not compel any conclusion as to whether the issuer had completed examination of the documents within a reasonable time).

about waiver of identified discrepancies.<sup>201</sup> But, in view of the issuer's awareness of the impending expiration date, it is not reasonable under UCP 500 sub-Article 13(b) for the inquiry to the applicant to justify delay in notice of dishonor.<sup>202</sup> Prompt notice of dishonor should be given.<sup>203</sup> In order to conform to UCP 500, the Statement of Practice should have an additional express exception for discrepancies that are identified in a normal examination when the issuer is aware that the letter of credit is about to expire.

The *DBJJJ, Inc.* court explained<sup>204</sup> that its interpretation of sub-Article 13(b) had relied upon an ICC 1993 Publication entitled *UCP 500 & 400 Compared*.<sup>205</sup> But sub-Article 13(b) requires a decision with respect to honor and dishonor within a "reasonable time."<sup>206</sup> Sub-Article 13(b)'s plain wording indicates that the issuer may have acted unreasonably by not requesting that the applicant respond before the last possible day.<sup>207</sup> Moreover, the ICC publication does not explore the effect of the issuer's contacting the applicant upon the duration of the issuer's reasonable time to respond to presented documents, merely cryptically observing that: "Still, this sequence [contacting the applicant for a waiver] requires the Issuing Bank to exercise a reasonable time not to exceed the seven banking days allowed by UCP 500 Article 13(b), for taking up or refusing the document(s)."<sup>208</sup>

The ICC publication also flatly asserts that the issuer cannot approach the applicant for a waiver until the issuer has decided to refuse the dis-

201. See UCP 500, *supra* note 6, art. 14(c) (the issuer has discretion with respect to contacting the applicant about discrepancies).

202. See *Hellenic Republic v. Standard Chartered Bank*, 631 N.Y.S.2d 320, 321-22 (N.Y. App. Div. 1995) (under UCP 400, the court commented, "the expiration date of a letter of credit is a relevant factor in determining whether there was unreasonable delay in providing notice of dishonor . . ."); see also *Datapoint Corp. v. M & I Bank of Hilldale*, 665 F. Supp. 722, 727 (W.D. Wis. 1987) (holding that mailing notice of dishonor and the presented documents in the afternoon preceding the last day for presentation was unreasonable as a matter of law under UCP 400). In the *DBJJJ, Inc.* case, the court rejected the beneficiary's contention that UCP 500 always requires the issuer to give notice of dishonor to the beneficiary at the same time that the applicant is approached for a waiver. *DBJJJ, Inc. v. Nat'l City Bank*, 19 Cal. Rptr. 3d 904, 913-14 (Cal. Ct. App. 2004) ("That argument is better addressed to the International Chamber of Commerce."). However, the beneficiary had argued for a nonexistent general issuer obligation to notify the beneficiary and the applicant at the same time. Sub-Article 13(b) imposes that obligation only when documentary discrepancies are identified by a normal examination shortly before the expiration date of the letter of credit, and the issuer is aware of the imminent expiration date. See *id.* On the other hand, if the issuer is unaware of the impending expiration date, sub-Article 13(b) would not require prompt notice of dishonor. See OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 5.01 cmt. 7 (noting reasons that an issuer that is not advised of impending expiration by the presenter could be unaware of it).

203. Whether or not the identified discrepancies could be cured is irrelevant. See *Toyota Tsusho Corp. v. Comerica Bank*, 929 F. Supp. 1065, 1073-74 (E.D. Mich. 1996) (UCP 400 preclusion is not dependent upon the beneficiary's proof of either detrimental reliance or an ability to cure defects); see also *supra* note 195.

204. *DBJJJ, Inc.*, 19 Cal. Rptr. 3d at 911 n.5 ("We rely heavily on the publication . . .").

205. See *supra* note 6.

206. UCP 500, *supra* note 6, art. 13(b).

207. See *supra* note 183 and accompanying text.

208. See UCP 500 & 400 COMPARED, *supra* note 6, at 47.

crepant documents.<sup>209</sup> If a decision to refuse the documents was a prerequisite to asking the applicant about waiver, the issuer would be obligated by UCP 500 sub-Article 14(d)(i) to give immediate notice of dishonor and discrepancies to the presenter in conjunction with the request to the applicant.<sup>210</sup> But the ICC publication misstates the sub-Article 14(c) prerequisite to contacting the applicant, which is that “the documents appear on their face not to be in compliance with the terms and conditions of the Credit.”<sup>211</sup> Under UCP 500, identifying discrepancies and refusing to accept documents are distinct actions, and the former does not trigger an obligation to give immediate notice of dishonor and discrepancies.<sup>212</sup>

Nevertheless, the issuer cannot control when the applicant will respond to a waiver request. To avoid preclusion, the issuer must dishonor before a reasonable time to do so has expired. But the including special provisions in the issuer’s letter of credit can revive the transaction after the notice of dishonor. If the applicant belatedly waives and the issuer retains the presented documents and also is willing to waive, special letter-of-credit provisions can authorize the issuer to revoke both timely notice of dishonor and discrepancies and timely notice that the presented documents are being held for the presenter.<sup>213</sup>

### 3. *The Issuer’s Not Being Bound by the Applicant’s Waiver of Discrepancies*

#### a. General Principles

The Official Comment stating that the issuer can dishonor on the basis of documentary discrepancies that the applicant has waived<sup>214</sup> reflects the Independence Principle. The issuer’s rights and obligations to the beneficiary are independent of both arrangements between the issuer and the applicant and arrangements between the applicant and the beneficiary.<sup>215</sup> A waiver of documentary discrepancies by the applicant does not bind an issuer that has not agreed to be bound by the applicant’s waiver.<sup>216</sup>

209. *See id.* (“The approach to the Applicant must be made solely to obtain his waiver once the Issuing Bank decides to refuse the discrepant documents.”).

210. *See* UCP 500, *supra* note 6, art. 14(d)(i) (“If the Issuing Bank . . . decides to refuse the documents, it must give notice . . . without delay . . .”).

211. *See id.* art. 14(c).

212. *See* DBJJJ, Inc. v. Nat’l City Bank, 19 Cal. Rptr. 3d 904, 914-15 (“[T]he identification of discrepancies is separate from the refusal to take up the documents.”).

213. *See* Turner, *Notices of Discrepancy*, *supra* note 157, at 6 (stating that letter of credit provisions should be effective to authorize revocation of both notice of dishonor and notice that the presented documents are being held for the presenter).

214. *See supra* note 141 and accompanying text.

215. U.C.C. § 5-103(d) (“Rights and obligations of an issuer to a beneficiary . . . are independent of . . . arrangements between the issuer and the applicant and between the applicant and the beneficiary.”).

216. *See* Mueller Co. v. S. Shore Bank, 991 F.2d 14, 17 n.5 (1st Cir. 1993) (holding that, under UCP 400, it was not bad faith for the issuer to dishonor discrepant documents even though the applicant had expressed an initial willingness to waive the discrepancies); *see also* Win Spark Trading Co. v. Century Bus. Credit Corp., 2002 WL 1343763, at \*1 (S.D.N.Y. 2002) (mem.), *aff’d sub. nom.* Win Spark Trading Co. v. Periscope Sportswear,

The issuer is liable to the applicant for damage caused by the honor of discrepant documents.<sup>217</sup> The applicant's ad hoc waiver of documentary discrepancies confirms the issuer's entitlement to reimbursement for honoring discrepant documents but not necessarily the issuer's ability to obtain actual reimbursement. The applicant's weak financial condition could make the issuer's unsecured right to reimbursement meaningless.<sup>218</sup> Moreover, even a fully secured right of reimbursement would not compel the issuer to waive discrepancies that the applicant has waived. Secured transaction paperwork typically describes the secured obligation as everything that the debtor owes to the secured party.<sup>219</sup> If this type of security agreement is used for collateral fully securing the issuer's right of reimbursement, the collateral also is available to satisfy the applicant's other mature obligations to the issuer.

A financial institution typically issues a letter of credit at the request of an applicant with whom the financial institution has an ongoing financial relationship.<sup>220</sup> The applicant's waiver of documentary discrepancies with respect to a substantial letter of credit with a fully secured right of reimbursement could lead the issuer to review its overall relationship with the applicant.<sup>221</sup> If the issuer elected to terminate that overall relationship by calling its loans, the issuer would be free to refuse to waive the documentary discrepancies that the applicant had waived and to apply the collateral securing the issuer's right of reimbursement to the applicant's other mature secured obligations.

It violates the Independence Principle for the issuer to consider the applicant's financial strength and viability in evaluating the apparent facial conformity of presented documents.<sup>222</sup> But it is consistent with the Independence Principle for the issuer to consider the applicant's financial

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Inc., No. 2-7810, 2003 WL 21024943 (2d Cir. 2003) (holding that, unless the applicant had actual or apparent authority to act for the issuer, the applicant's telling the beneficiary that strict compliance would be waived would not bind the issuer). *But see* Marsala Int'l Trading Co. v. Comerica Bank, Inc., 976 P.2d 275, 279-80 (Colo. Ct. App. 1998) (holding that, under UCP 500, after the applicant has waived documentary discrepancies, the issuer must make payment). The *Marsala* case failed to consider the Independence Principle and is incorrect. *See* McLaughlin & Cohen, *supra* note 147 (noting that *Marsala* "seems" to overlook the Independence Principle and "seems incorrect").

217. *See* U.C.C. § 5-111 cmt. 2 (explaining that wrongful honor may or may not damage the applicant); DOLAN, *supra* note 21, & 9.03[1][a] (stating that the credit application is an ordinary contract that is not subject to the strict compliance test). *See supra* note 4 for a discussion of the damages that the applicant can recover from the issuer.

218. *See* Lectrodryer v. SeoulBank, 91 Cal. Rptr. 2d 881, 882 (Cal. Ct. App. 2000) (applicant went into bankruptcy after waiving documentary discrepancies).

219. *See* 2004 Official Text of the U.C.C. with Comments, Selected Commercial Statutes § 9-204(c) (West Abridged ed. 2004) (collateral can secure "future advances or other value, whether or not the advances or value are given pursuant to commitment").

220. *See, e.g.,* Lectrodryer, 91 Cal. Rptr. 2d at 882 (the applicant was one of the issuer's largest customers).

221. *See* Barnes & Byrne, 1998 Cases, *supra* note 4, at 1890 ("Discretionary waiver by the issuer depends on the issuer assuring itself of reimbursement. Typically, this will involve a new credit assessment . . .").

222. *See* U.C.C. § 5-103(d) ("Rights and obligations of an issuer to a beneficiary . . . are independent of . . . contracts or arrangements between the issuer and the applicant. . ."); McLaughlin, *The Independence Principle*, *supra* note 4, at 509 (under the Independence

strength and viability in deciding whether to waive documentary discrepancies.<sup>223</sup> The Independence Principle has fulfilled its function after the presented documents have been reviewed on their face and found wanting. The beneficiary only can benefit from the issuer's consideration of extrinsic facts in deciding whether the beneficiary should be allowed better rights than justified by the documents presented.

b. The California *Lectrodryer* Case

The California case of *Lectrodryer v. SeoulBank*<sup>224</sup> may appear to be inconsistent with this analysis. Lectrodryer, a Kentucky company, sold a molecular sieve dryer used in refining oil into gasoline for \$493,000 to JDP, a California exporter of industrial equipment.<sup>225</sup> Lectrodryer shipped the machinery to JDP without requiring prepayment.<sup>226</sup> JDP resold the sieve dryer for \$601,701 and delivered it to Dae Ahn, a South Korean oil refinery.<sup>227</sup>

JDP had been one of the largest customers of SeoulBank's Los Angeles office.<sup>228</sup> By late 1995, SeoulBank extended a \$2,000,000 credit line and made an additional \$380,000 loan to JDP, and JDP agreed to have SeoulBank issue its letters of credit.<sup>229</sup> When JDP applied for a \$493,000 letter of credit to pay Lectrodryer, SeoulBank conditioned issue of the letter of credit upon JDP's making a \$493,000 payment to the bank.<sup>230</sup> JDP wrote three corporate checks to SeoulBank, totaling approximately \$494,000, and SeoulBank had issued the \$493,000 letter of credit designating Lectrodryer as beneficiary.<sup>231</sup> When two of JDP's checks totaling \$492,983 were dishonored, JDP replaced the dishonored checks with \$492,983 in cashier's checks purchased with a payment for the sieve dryer by Dae Ahn.<sup>232</sup>

Notwithstanding JDP's ad hoc waiver of the discrepancies, SeoulBank rejected Lectrodryer's discrepant presentation, which contained a bill of

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Principle, an issuer can not dishonor "simply because" the applicant is insolvent or otherwise unable to reimburse the issuer).

223. See Gerald T. McLaughlin & Neil B. Cohen, *Letter-of-Credit Disputes*, NAT'L L.J., June 26, 2000, B6, col. 1 (noting that, if the applicant is about to file bankruptcy, the issuer might insist upon strict documentary compliance despite the applicant's waiver).

224. 91 Cal. Rptr. 2d 881.

225. *Id.* at 882.

226. See Appellant's Opening Brief at 5, *Lectrodryer v. SeoulBank*, 91 Cal. Rptr. 2d 881 (Cal. Ct. App. 2000) (No. B125737) [hereinafter Appellant's Opening Brief] (the equipment had been delivered to JDP prior to Lectrodryer's making a presentation under SeoulBank's letter of credit).

227. See *Lectrodryer*, 91 Cal. Rptr. 2d at 882; see Respondent's Brief and Opening Brief in Cross-Appeal at \*8, *Lectrodryer v. SeoulBank*, 91 Cal. Rptr. 2d 881 (Cal. Ct. App. 2000) (No. B125737) [hereinafter Respondent's Brief] (Lectrodryer personnel had traveled to South Korea to supervise installation of the equipment).

228. See Respondent's Brief, *supra* note 227, at 1 (JDP was one of the largest customers of the Los Angeles office).

229. See *id.* at 8-9.

230. See *id.* at 10-11.

231. See *id.* at 11.

232. See *id.* at 12 (detailing financial transactions).

lading showing shipment of the sieve dryer from Kentucky to New York rather than the required combined bills of lading for shipment from Kentucky to New York and then to Korea.<sup>233</sup> The letter of credit expired without having been honored.<sup>234</sup> SeoulBank used JDP's payment on the letter of credit to reduce JDP's outstanding loans.<sup>235</sup> JDP eventually entered bankruptcy, leaving Lectrodryer unpaid.<sup>236</sup>

Lectrodryer sued SeoulBank for unjust enrichment<sup>237</sup> and obtained a \$493,000 general jury verdict that was affirmed on appeal.<sup>238</sup> The California intermediate-appellate court held that the jury reasonably could have found that JDP had prepaid the letter of credit and that SeoulBank had been unjustly enriched by retention of this prepayment after the letter of credit had expired without having been honored.<sup>239</sup> The court alternatively held that the jury reasonably could have found either that SeoulBank wrongfully had dishonored after waiving the documentary discrepancies or that SeoulBank had misled JDP into believing that the February 21, 1996 expiration date letter of credit would be extended until JDP's credit line had expired on February 28, 1996 and no longer could be used to pay Lectrodryer.<sup>240</sup>

These holdings were derived from an unnecessary concession and failures of proof by SeoulBank. SeoulBank denied that the letter of credit had been prepaid but had not disputed that a prepaid letter of credit's expiration would obligate the issuer to refund the prepayment.<sup>241</sup> In view of the jury's determination that the letter of credit had been prepaid, this concession had foreclosed a setoff defense by SeoulBank<sup>242</sup> and also could have been construed as a tacit admission that expiration of the prepaid letter of credit without having been honored had unjustly enriched the bank. SeoulBank likewise had not refuted Lectrodryer's expert testimony that, in seeking a waiver of "any discrepancies" from JDP, SeoulBank had signaled its willingness to abide by JDP's decision.<sup>243</sup> Nor had the bank disproved Lectrodryer's claim that SeoulBank had dissuaded JDP from using its credit line to pay Lectrodryer by feigning willingness to extend the letter of credit until the credit line had expired.<sup>244</sup>

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233. See *Lectrodryer*, 91 Cal. Rptr. at 882 & n.1.

234. *Id.* at 882.

235. *Id.*

236. See *id.* at 882.

237. See *id.* ("The trial court sustained SeoulBank's demurrer to [Lectrodryer's counts] for fraud and intentional interference with contractual relations.").

238. *Id.* at 882, 884.

239. *Id.* at 883 (alternative holding).

240. *Id.* at 883 n.2 (alternative holding).

241. *Id.* at 882-83 ("SeoulBank does not dispute that it could not retain funds used to purchase a pre-paid letter of credit if the letter of credit was closed after never having been paid.").

242. Setoff would preclude unjust enrichment. See *infra* notes 261-65 and accompanying text.

243. *Lectrodryer*, 91 Cal. Rptr. 2d at 884 (the expert testified that there would have been "no reason" for SeoulBank to seek a general waiver of documentary discrepancies from JDP without previously having determined to waive the discrepancies).

244. See *id.* at 883 n.2.



*Lectrodryer* involved a commercial letter of credit that did not incorporate the UCP. The intermediate-appellate court's principal error was accepting Lectrodryer's assertion that, due to the letter of credit's expiration, letter-of-credit law was irrelevant to the case.<sup>245</sup> In *North American Foreign Trading Corp. v. Chiao Tung Bank*,<sup>246</sup> for example, NAFTA, a New York importer, obtained commercial letters of credit issued by Barclays Bank of Zurich and payable to Huston Electronics, a Taiwanese manufacturer.<sup>247</sup> Chiao Tung, a nominated bank, paid Huston \$1.8 million for the documents and presented them to Barclays for reimbursement.<sup>248</sup> However, the purchased documents had not included required inspection certificates, and Barclays dishonored after NAFTA refused to waive the discrepancies.<sup>249</sup> Although Chiao Tung had not forwarded the original bills of lading for the goods, NAFTA subsequently obtained possession of the goods by providing letters of indemnity to the carriers.<sup>250</sup>

Chiao Tung sued NAFTA for unjust enrichment under both New York and California law, alleging that its 1.8 million dollar payment to Huston enriched NAFTA unjustly by enabling NAFTA to obtain possession of the goods without paying for them.<sup>251</sup> However, the court ruled that:

There is simply no "injustice" which was perpetrated on Chiao Tung, a sophisticated commercial entity which made a large payment to Huston knowing that the proper documentation for collection under the letters of credit had not been provided.<sup>252</sup>

There likewise had been no injustice to Lectrodryer in SeoulBank's dishonor of Lectrodryer's discrepant presentation even if the letter of credit had been prepaid.<sup>253</sup> Under California law, the jury finding that SeoulBank was obligated to refund JDP's prepayment<sup>254</sup> would not have entitled either JDP or Lectrodryer to recover the refund. Lectrodryer had not claimed that SeoulBank had held the prepaid funds in trust.<sup>255</sup> Although it was undisputed that the prepayment had been made with the

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245. See *id.* at 883 ("The focus of Lectrodryer's case was on what happened to the proceeds of the sale of the sieve dryer *after* the letter of credit expired.").

246. No. 95 Civ. 5189 (LBS), 1997 WL 193197 (S.D.N.Y. 1997).

247. *Id.* at \*1.

248. *Id.*

249. *Id.*

250. *Id.* at \*2.

251. *Id.* at \*2-3 (noting that both New York and California unjust enrichment law provide that justice must require restitution).

252. *Id.* at \*9.

253. See *supra* note 233 and accompanying text with respect to Lectrodryer's presentation of the wrong transportation documents.

254. If a prepayment had been made, SeoulBank had not disputed that it was obligated to refund the prepayment upon expiration of the letter of credit. See *supra* note 241 and accompanying text.

255. See Respondent's Brief, *supra* note 227, at 24-33 (emphasizing that SeoulBank had been unjustly enriched by retaining the proceeds of JDP's resale of the dryer). Moreover, a claim that the prepayment involved a trust would have been rejected. No special circumstances had transformed SeoulBank's refund obligation into a trust obligation. See *Weststeyn Dairy 2 v. Eades Commodities Co.*, 280 F. Supp. 2d 1044, 1075-86 (E.D. Cal. 2003)

proceeds of JDP's resale of the sieve dryer,<sup>256</sup> this had not been planned. JDP initially wrote checks on its own account and used Dae Ahn's payment to buy replacement cashier's checks only upon dishonor of its own checks.<sup>257</sup> SeoulBank also denied knowing that the cashier's checks had been purchased with Dae Ahn's funds.<sup>258</sup>

Moreover, whether or not there were grounds for imposing a constructive trust upon SeoulBank's refund obligation, a constructive trust had not been imposed in the trial court.<sup>259</sup> The refund obligation was an ordinary debt of SeoulBank that was subject to setoff against JDP's ordinary mature obligations to the bank:<sup>260</sup>

Setoff . . . [is] that right which exists between two parties each of whom under an independent contract owes an ascertained amount to the other to set-off his respective debts by way of mutual deduction so that in any action brought for the larger debt, the residue only, after such deduction, shall be recovered.<sup>261</sup>

The justification for setoff is efficiency. "[A] man should not be compelled to pay one moment what he will be entitled to recover back the next."<sup>262</sup> For setoff to be permissible, the debt collected through setoff must be mature, and there must be mutuality of obligation between the debts setoff in the sense that the parties must owe them to each other in the same legal capacities.<sup>263</sup>

The facts of the *Lectrodryer* case indicated that SeoulBank had satisfied the prerequisites for setting off its refund obligation to JDP against JDP's mature loans and in fact had done so.<sup>264</sup> This setoff precluded un-

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(\$1.1 million in prepayments by dairies to feed merchant did not involve express, constructive, or resulting trusts).

256. See *supra* note 232 and accompanying text.

257. *Id.*

258. See Respondent's Brief, *supra* note 227, at 12 n.9 (arguing that the jury would have been justified in rejecting SeoulBank's claim of lack of knowledge of the source of the funds).

259. See *supra* notes 237-40 and accompanying text.

260. If the prepayment had involved known trust funds, this would have precluded its mutuality with JDP's debts to SeoulBank and prevented SeoulBank's setoff of its refund obligation. See, e.g., *Dockendorf v. Dakota County State Bank*, 673 F.2d 961, 965 (8th Cir. 1981) (stating that, under Nebraska law, a bank that knows of a trust deposit can not satisfy a claim against the depositor by setting off the trust deposit). This is the general rule. A bank customer's trust obligation is held in a different legal capacity than the bank customer's ordinary debts. See *infra* note 263 and accompanying text.

261. *John Wills, Inc. v. Citizens Nat'l Bank of Nebraska*, 16 A.2d 804, 806 (N.J. 1940) (quoting 24 R.C.L. 792).

262. William H. Loyd, *The Development of Set-Off*, 64 U. PA. L. REV. 541, 541 (1916).

263. See, e.g., *All Am. Auto Salvage v. Camp's Auto Wreckers*, 679 A.2d 627, 632 (N.J. 1996) (stating that the indebtedness that gives rise to setoff must be due and owing and that mutuality of obligation must exist). With respect to setoffs involving bank accounts, *All American Auto Salvage* also requires that the funds setoff be the property of the bank and that the bank account be unrestricted. *Id.*

264. There had been mutuality of obligation and JDP's loan obligations had been in default. Because JDP had not deposited Dae Ahn's payment with SeoulBank, the additional requirements necessary to setoff the balance in a deposit account were not applicable. See *Lectrodryer v. SeoulBank*, 91 Cal. Rptr. 2d 881, 882 (Cal. Ct. App. 2000). ("JDP paid SeoulBank \$492,000 with two cashier's checks."). In point of fact, JDP did not have a

just enrichment of SeoulBank from the prepaid letter of credit's expiration.<sup>265</sup>

The *Lectrodryer* court alternatively held that the jury could have believed the testimony of Lectrodryer's expert that SeoulBank waived the documentary discrepancies.<sup>266</sup> Although the reported case does not state this clearly, SeoulBank apparently had forwarded the presented documents to JDP without identifying discrepancies, inquiring whether JDP would waive "any discrepancies" that existed.<sup>267</sup> According to Lectrodryer's expert, there would have been no reason for SeoulBank to seek JDP's general waiver unless the bank previously had determined to comply with JDP's instructions.<sup>268</sup> However, the expert was wrong. It is efficient for an issuer to postpone a decision about waiver until the applicant has waived. If the applicant refuses to waive the documentary discrepancies, the issuer is obligated to the applicant to dishonor.<sup>269</sup> At most SeoulBank's conduct had been ambiguous.<sup>270</sup> SeoulBank should have made its intention explicit by retaining the presented documents and by coupling a request to JDP for waiver of specific discrepancies with an express reservation of the independent privilege to decide whether to waive.<sup>271</sup> This alternative holding of the *Lectrodryer* case is belied by SeoulBank's dishonor notwithstanding JDP's waiver. The alternative holding relied on questionable expert testimony to attribute an intention to SeoulBank that the bank did not have.<sup>272</sup>

In sum, two of the legal theories advanced by the appellate court in *Lectrodryer* are unpersuasive. On the other hand, the appellate court's third theory is consistent with the principle that the issuer is not bound by

deposit account with SeoulBank. See Respondent's Brief, *supra* note 227, at 7 (SeoulBank's agency office was not authorized to accept deposits from California corporations like JDP).

265. See RESTATEMENT OF RESTITUTION § 60 (1937) (the existence of an enforceable duty to a transferee precludes restitution). Comment (a) adds, "If a person does an act which it is his legal duty to do, whether such duty is enforceable at law or in equity, he is not entitled to restitution, irrespective of the cause of the act." *Id.* § 60 cmt. (a); cf. *Nationwide Merchant Bank Ltd. v. Star Fire Int'l*, 889 F. Supp. 124, 125-27 (S.D.N.Y. 1995) (allowing a party unjustly enriched by an unauthorized wire transfer to set off a payment to the plaintiff on account of the unjust enrichment by the third party that had instigated the transfer).

266. *Lectrodryer*, 91 Cal. Rptr. 2d at 883-84 (alternative holding).

267. See Respondent's Brief, *supra* note 227, at 21 (SeoulBank's "general inquiry" to JDP was "highly irregular"); *id.* at 34 (SeoulBank had JDP "review Lectrodryer's documentation").

268. *Lectrodryer*, 91 Cal. Rptr. 2d at 883-84 (alternative holding).

269. See U.C.C. § 5-108(a) (unless otherwise provided or agreed with the applicant, the issuer shall dishonor a presentation that does not appear on its face to comply); *Barnes & Byrne, 1998 Cases, supra* note 4, at 1890 (the issuer may postpone a decision about waiver until the issuer hears from the applicant).

270. See *supra* notes 152-54 and accompanying text.

271. See *supra* notes 147-51 and accompanying text for a discussion of the manner in which waiver should be requested.

272. See *DOLAN, supra* note 21, at 6-69 to 6-70 (the position of the expert in *Lectrodryer* was "questionable").

the applicant's waiver<sup>273</sup> and justifies the case's result. The jury could have found that SeoulBank deliberately had misled JDP about the bank's willingness to extend the letter of credit's expiration date until JDP's credit line had expired.<sup>274</sup> This intentional deception would have justified estopping SeoulBank from precluding unjust enrichment by setting off its refund obligation.<sup>275</sup>

#### 4. Overview of the U.C.C. Article 5 Approach to Applicant Ad Hoc Waiver

The Official Comments to Article 5 frequently elaborate points either merely touched on or omitted from the statutory text. The preambles to Section 5-109(a)&(b),<sup>276</sup> for example, refer to "material fraud," but it is Official Comment 1<sup>277</sup> that explains that the existence of fraud is determined under general state law and the materiality of the fraud to the enforceability of a letter of credit is determined under Article 5.<sup>278</sup> Applicant ad hoc waiver of known documentary defects is treated almost exclusively by Official Comments.<sup>279</sup> Official Comments 1, 2, and 7 to Section 5-108 deal with the subject, with Official Comments 1 and 2 also referring to other matters.<sup>280</sup> The substance of the Official Comments dealing with applicant ad hoc waiver is reasonable with three exceptions: (1) the Official Comment permitting contact with the applicant during the examination process does not allude to the care with which this must be done and could mislead the incautious;<sup>281</sup> (2) the Official Comment dealing with the effect of contacting the applicant for a waiver of discrepancies gives the erroneous impression that both Article 5 and UCP 500 per se forbid allowing the applicant time to respond before expiration of the seven-day outside deadline for notice of dishonor and discrepancies;<sup>282</sup> and (3) the Official Comment fails to emphasize the distinctness of applicant and issuer ad hoc waiver of known discrepancies, which could have undermined the credibility of the expert testimony in the *Lectrodryer* case that the applicant's waiver had been determinative.<sup>283</sup>

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273. See *supra* notes 214-23 and accompanying text for discussion of the issuer's not being bound by the applicant's waiver of discrepancies.

274. See *supra* note 240 and accompanying text.

275. See *Lines v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 743 F. Supp. 176, 182-83 (S.D.N.Y. 1990) (alternative holding) (setoff would be inequitable and impermissible with respect to the beneficiary's liability for wrongfully drawing upon letters of credit); cf. *E & H Partners v. Broadway Nat'l Bank*, 39 F. Supp. 2d 275, 284-85 (S.D.N.Y. 1998) (alternative holding) (issuer estopped to claim that the presented documents were discrepant by its "improper consultations" with the applicant).

276. U.C.C. § 5-109(a)-(b).

277. *Id.* § 5-109 cmt. 1.

278. *Id.* § 5-109 cmt. 1 ("Material fraud by the beneficiary occurs only when the beneficiary has no colorable right to expect honor and where there is no basis in fact to support such a right to honor.")

279. See *supra* notes 129-43 and accompanying text.

280. U.C.C. § 5-108 cmts. 1, 2, 7.

281. See *supra* notes 144-51 and accompanying text.

282. See *supra* notes 188-91 and accompanying text.

283. See *supra* notes 266-72 and accompanying text.

B. THE EFFECT OF UCP 500 AND ISP 98 UPON APPLICANT  
AD HOC WAIVER

If a letter of credit expressly incorporates rules of "custom or practice, such as the Uniform Customs and Practices for Documentary Credits," the formal name of UCP 500, the expressly incorporated rules supersede conflicting Article 5 provisions that are variable.<sup>284</sup> The Article 5 treatment of applicant ad hoc waiver is variable.<sup>285</sup> The treatment of issuer preclusion to assert documentary discrepancies, which can make applicant ad hoc waiver unnecessary, also is variable.<sup>286</sup>

Both the text and comments of Article 5 refer to the UCP as rules of custom or practice that, upon incorporation into a letter of credit, can alter variable statutory provisions.<sup>287</sup> Although ISP 98 was finalized after the 1995 revision of Article 5, incorporated ISP 98 rules also can alter variable Article 5 provisions.<sup>288</sup>

The limited UCP 500 treatment of applicant ad hoc waiver has been discussed.<sup>289</sup> ISP 98 has two substantial rules on the subject. One rule deals with the issuer's unsolicited request for the applicant's waiver, and the other deals with the issuer's request for the applicant's waiver at the behest of a presenter that has received notice of dishonor.<sup>290</sup>

Rule 5.05 dealing with the issuer's unsolicited request for waiver by the applicant is consistent with UCP 500 but not with the Article 5 Official Comment stating that the issuer's contacting the applicant about waiver cannot extend the reasonable time for a decision with respect to honor:

If the issuer decides that a presentation does not comply and if the presenter does not otherwise instruct, the issuer may, in its sole discretion, request the applicant to waive non-compliance or otherwise to authorize honor within the time available for giving notice of dis-

284. U.C.C. § 5-116(c) (the incorporated rules "govern except to the extent of any conflict with the nonvariable provisions"). The nonvariable provisions are listed in section 5-103(c) and consist of (1) the definitions of "issuer" and "letter of credit," *id.* § 5-102(a)(9)-(10); (2) the provision deeming letters of credit stating that they are "perpetual" to expire in five years, *id.* § 5-106(d); (3) the provision declaring that the issuer and a nominated person can not unreasonably withhold consent to the assignment of proceeds to an assignee in possession of a letter of credit that must be presented, *id.* § 5-114(d); and (4) the provision requiring honor for equitable subrogation to be possible, *id.* § 5-117(d).

285. *See id.* § 5-103(c) (protecting only selected statutory provisions from variation).

286. *Id.* § 5-108(c)-(d) (dealing with issuer preclusion are not listed as unvariable in section 5-103(c)).

287. *Id.* §§ 5-116(c), 5-116 cmt. 3.

288. Whether or not the ISP 98 rules reflect mercantile usage, *see* DOLAN, *supra* note 21, at 4-112 to 4-114 (stating that a number of ISP 98 rules do not reflect mercantile usage), express incorporation of ISP 98 contractually waives inconsistent Article 5 rules that are variable. *See id.* at 4-114 to 4-115 (incorporation of ISP 98 into a letter of credit makes it a contract term).

289. *See supra* notes 188-91 and accompanying text. The sole provision dealing with applicant waiver is Sub-Article 14(c), which authorizes issuer discretion. *See* UCP 500, *supra* note 6, art. 14(c) (stating that the Issuing Bank "may in its sole judgment approach the Applicant for a waiver of the discrepancy(ies)").

290. OFFICIAL COMMENTARY ISP 98, *supra* note 20, Rs. 5.05 (the issuer's unsolicited request for the applicant's waiver), 5.06 (the issuer's asking the applicant for waiver at the request of the presenter).

honor but without extending it. Obtaining the applicant's waiver does not obligate the issuer to waive non-compliance.<sup>291</sup>

Official Comment 1 describes Rule 5.05 as "similar" to UCP 500 sub-Article 14(c).<sup>292</sup> Official Comment 3 emphasizes the "rather obvious proposition" that neither the issuer's seeking nor the issuer's receiving a waiver from the applicant obligates the issuer to waive discrepancies.<sup>293</sup> Most importantly, Rule 5.05 states that a request for a waiver by the applicant can be made "within the time available for giving notice of dishonor without extending it."<sup>294</sup> Rule 5.01 makes determinative whether notice of dishonor was given at a time that was not unreasonable.<sup>295</sup> Notice given within three business days is deemed to be not unreasonable, and notice given after seven business days is deemed to be unreasonable.<sup>296</sup> As to whether notice given between four and seven business days is unreasonable, Professor James E. Byrne, the Chair and Reporter of the Working Group that drafted ISP 98,<sup>297</sup> has endorsed the previously-discussed IFSA Statement of Practice under UCP 500.<sup>298</sup> Under the Statement of Practice, a request for applicant waiver extends the reasonable time for honor or dishonor until the seven-day outside deadline for notice of dishonor and discrepancies.<sup>299</sup> The Statement of Practice contains two express exceptions.<sup>300</sup> A requirement that the issuer ask for a prompt response and an exception for the issuer's awareness of the imminent expiration of the letter of credit are necessary to conform the Statement of Practice to UCP 500.<sup>301</sup> Although ISP 98 provides that an imminent expiration date does not require the issuer to rush the examination of documents,<sup>302</sup> this is consistent with awareness of an imminent expiration date precluding the issuer from further delaying a decision with respect to dishonor in order to obtain the applicant's response to a request for waiver.<sup>303</sup> ISP 98 poses no impediment to the issuer's insertion of special provisions in the letter of credit allowing retraction of both timely notice

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291. *See id.* R. 5.05.

292. *See id.* R. 5.05 cmt. 1.

293. *See id.* R. 5.05 cmt. 3.

294. *See id.* R. 5.05.

295. *See id.* R. 5.01(a).

296. *See id.* R. 5.01(a)(i).

297. *See supra* note 20.

298. ISP 98 & UCP 500 COMPARED, *supra* note 40, R. 5.01 cmt. 4. See the discussion of the IFSA Statement of Practice at *supra* notes 165-203 and accompanying text.

299. Statement of Practice, LC Rules & Laws, *supra* note 166, at 2.

300. The two express exceptions are an earlier refusal by the applicant and the issuer's decision to dishonor whatever the applicant says. *See supra* note 168 and accompanying text.

301. *See supra* notes 196-203 and accompanying text for a discussion of the need to conform the Statement of Practice to UCP 500.

302. "Whether the time within which notice is given is unreasonable does not depend upon an imminent deadline for presentation . . . . Unless a standby otherwise expressly states a shortened time within which notice of dishonour must be given, the issuer has no obligation to accelerate its examination of a presentation." OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 5.01(a)(ii), (iv).

303. *See supra* notes 196-203 and accompanying text.

of dishonor and discrepancies and timely notice that the presented documents are being held for the presenter upon receiving a belated applicant waiver in which an issuer that still has possession of the documents is willing to join.<sup>304</sup>

Rule 5.06 deals with the issuer's request for a waiver by the applicant at the request of the presenter.<sup>305</sup> The Rule provides in pertinent part:

- If, after receipt of notice of dishonour, a presenter requests . . . that the issuer seek the applicant's waiver:
- a. no person is obligated to . . . seek the applicant's waiver;
  - b. the presentation to the issuer remains subject to these Rules unless departure from them is expressly consented to by the presenter; and
  - c. if . . . a waiver is sought:
    - i. the presenter is precluded from objecting to the discrepancies notified to it by the issuer;
    - ii. the issuer is not relieved from examining the presentation under these Rules;
    - iii. the issuer is not obligated to waive the discrepancy even if the applicant waives it; and
    - iv. the issuer must hold the documents until it receives a response from the applicant or is requested by the presenter to return the documents, and if the issuer receives no such response or request within ten business days of its notice of dishonour, it may return the documents to the presenter.<sup>306</sup>

The Official Comments emphasize that, as under UCP 500, the issuer is not required to seek a waiver at the presenter's request, that the presenter's request for a waiver does not affect the issuer's deadline for timely notice of dishonor and discrepancies, and that the applicant's waiver of documentary discrepancies does not obligate the issuer to waive.<sup>307</sup>

A novel aspect of Rule 5.06 provides that the issuer's seeking a waiver of discrepancies from the applicant at the request of a presenter that has received notice of dishonor bars the presenter from thereafter objecting to the identified discrepancies.<sup>308</sup> Official Comment 4 states:

304. See *supra* note 213 and accompanying text.

305. OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 1.09(a) (defining "presenter" as a person making a presentation of required documents as or on behalf of the beneficiary or a nominated person that has given value under the letter of credit). This is also the Article 5 definition. See U.C.C. § 5-102(a)(13).

306. OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 5.06.

307. See *id.* Rs. 5.06 cmts. 2 (no person is obligated to seek waiver), 5 (a request that the issuer seek waiver does not excuse the issuer from its deadlines), 6 (the issuer's seeking and receiving the applicant's waiver does not obligate the issuer to waive).

308. See *id.* R. 5.06(c)(i) ("the presenter is precluded from objecting to the discrepancies notified to it by the issuer"). A more justifiable judge-made waiver rule had been rejected in *Alaska Textile Co. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813, 819-20 (2d Cir. 1992) (holding that the beneficiary's concurrent submission of documents with discrepancies to the issuer "on an approval basis" and urging the applicant to waive the discrepancies did not waive the beneficiary's rights under UCP 400). The trial court had held that, by concurrently asking the issuer to request a waiver and directly asking the applicant to

Unless this Rule is expressly excluded . . . , the presenter and the beneficiary are deemed to accept the determination that the documents are discrepant and cannot later assert them. This Rule requires the beneficiary to take a position when it seeks waiver and permits the . . . issuer to take the beneficiary's position into account . . . .<sup>309</sup>

As Official Comment 4 notes, after notice of dishonor has been given, sub-Rule 5.06(c)(i) requires a presenter that had not expressly excluded its applicability to abandon the contention that the documents are not discrepant as the price for asking the issuer to request a waiver.<sup>310</sup> But the Comment does not explain why this price is exacted.

The preclusion rule is confined to presenters that have received timely notice of dishonor from the issuer. The common situation in which the presenter requests that the applicant be contacted before being given notice of dishonor is not covered. The rule consequently does not protect issuers from expiration of the deadline for timely notice of dishonor and discrepancies while the issuer is responding to the presenter's request that a waiver be sought.<sup>311</sup> The preclusion rule apparently is intended to produce finality with respect to a presentation of documents that has been dishonored in timely fashion. However, a presenter that is aware of the preclusion rule either would make clear to the issuer that its request that the applicant be contacted expressly excludes the applicability of

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waive discrepancies, the beneficiary had waived its own right to preclude the issuer for not giving notice of dishonor within a reasonable time. *Alaska Textile Co. v. Lloyd Williams Fashions, Inc.*, 777 F. Supp. 1139, 1141-42 (S.D.N.Y. 1991). Because of the possibility of issuer preclusion arising from the applicant's delay in responding to the issuer's request for a waiver, *Alaska Textile* involved a more appealing context for presenter preclusion than Rule 5.06, which imposes preclusion solely upon presenters who have received notice of dishonor.

Rule 5.06 also deals with a second situation; namely, following dishonor by an examiner other than the issuer, the presenter requests that the documents be forwarded to the issuer so that the issuer can seek the applicant's waiver. See OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 5.06 cmt. 1 (describing the two situations in which the rule applies). This second situation is more comparable to the fact situation in *Alaska Textile* in that the issuer is being asked both to suspend its judgment about discrepancies and to contact the applicant. This is a more appropriate situation for presenter preclusion than a situation in which the issuer has made a prior decision to dishonor and has given notice of dishonor and discrepancies. It should be noted that the second situation covered by Rule 5.06 authorizes an examiner to forward the presented documents to the issuer, not the issuer to forward the presented documents to the applicant. The issuer's forwarding the presented documents to the applicant can be considered to impair the issuer's independence. See *supra* notes 147-49 and accompanying text.

309. OFFICIAL COMMENTARY ISP 98, *supra* note 20, R. 5.06 cmt. 4.

310. *Id.*

311. See *id.* R. 5.06 ("If, after receipt of notice of dishonour, a presenter requests that . . . the issuer seek the applicant's waiver . . ."). Failure to give timely notice of dishonor with respect to a discrepancy precludes the issuer from thereafter asserting the discrepancy with respect to the same presentation of documents. See *id.* R. 5.03(a) (providing that the preclusion applies to any document that is retained or re-presented but not to a different presentation under the same or a different standby). If the issuer had failed to give timely notice of dishonor and discrepancies and was precluded from asserting documentary discrepancies, the presenter would have no need to request that the applicant be contacted for a waiver.



sub-Rule 5.06(c)(1)<sup>312</sup> or would refrain from making a request that could forestall an action for wrongful dishonor. On the other hand, a presenter that was not aware of sub-Rule 5.06(c)(1) inadvertently could be precluded by a well-meaning effort to head off litigation.<sup>313</sup>

## VI. CONCLUSION

The Independence Principle, the cornerstone of letter-of-credit law,<sup>314</sup> dictates the treatment of applicant ad hoc waiver of known documentary discrepancies. The Independence Principle requires that the issuer make an independent determination as to the apparent facial conformity of the documents presented with the letter of credit's terms and conditions.<sup>315</sup> Whether or not the presenter requests that the applicant be approached for a waiver, the approach should not be made until the issuer has identified apparent documentary discrepancies. This identification is not a decision to dishonor and does not require prompt notice of dishonor.<sup>316</sup> The issuer should retain the actual documents presented, not provide copies of all the originals, and limit its inquiry to the identified apparent documentary discrepancies.<sup>317</sup> The issuer also should make clear that, in the event of the applicant's waiver, the issuer will make an independent decision with respect to waiver.<sup>318</sup> The presenter need not be informed. If the presenter is informed, the presenter should be told that the issuer will make an independent determination about waiver if the applicant waives.<sup>319</sup>

If documentary discrepancies are identified in a normal examination before an impending expiration date of which the issuer is aware, if the applicant communicates a refusal to waive promptly, or if the issuer decides not to waive even if the applicant does, the issuer must give prompt

312. The presenter can notify the issuer that the request to contact the applicant excludes the applicability of the preclusion provision. *See id.* R. 5.06(b) (providing that departure from ISP 98 can be expressly consented to by the presenter); *id.* R. 5.06 cmt. 4 (explaining that the request to seek a waiver can exclude the preclusion provision expressly).

313. *See* John F. Dolan, *Analyzing Bank Drafted Standby Letter of Credit Rules, The International Standby Practice (ISP98)*, 45 WAYNE L. REV. 1865, 1896-1897 (2000) (Rule 5.06 is doubly inefficient in putting upon beneficiaries a burden that they would not reasonably expect and in discouraging beneficiaries with a reasonable expectation of waiver from asking issuers to contact applicants).

314. *See* McLaughlin, *The Independence Principle*, *supra* note 4, at 503 ("without the independence principle, the letter of credit would cease to be a useful payment mechanism").

315. *See* E & H Partners v. Broadway Nat'l Bank, 39 F. Supp. 2d 275, 284-85 (S.D.N.Y. 1998) (alternative holding) (holding that the issuer, which had allowed the applicant unduly to influence the decision to dishonor, was estopped to dishonor).

316. *See supra* notes 209-12 and accompanying text.

317. The expert testimony in *Lectrodryer* that the issuer had left the ultimate decision upon discrepancies to the applicant was influenced by the issuer's failing to limit contact with the applicant to previously identified discrepancies and providing the applicant with the documents presented. *See supra* notes 266-72 and accompanying text.

318. *SeoulBank in Lectrodryer* had failed to state this explicitly. *See supra* notes 266-72 and accompanying text.

319. *See supra* notes 150-57 and accompanying text.

notice of dishonor and discrepancies.<sup>320</sup> Otherwise, the issuer must urge the applicant to respond as soon as possible, but a decision can be delayed until the seven-day outside deadline for notice of dishonor and discrepancies.<sup>321</sup> Moreover, if the applicant makes a belated waiver in which the issuer concurs, special letter-of-credit provisions can authorize an issuer that has retained possession of the documents to revoke both timely notice of dishonor and discrepancies and timely notice that the presented documents are being held for the presenter.<sup>322</sup>

UCP 500 is more accommodating to clear requests for applicant waiver that respect the Independence Principle than the Official Comments to Article 5.<sup>323</sup> With the exception of its presenter-preclusion rule,<sup>324</sup> so is ISP 98.<sup>325</sup>

Two Article 5 Official Comments pose potential obstacles to effective applicant waiver. The vague Official Comment permitting issuer contact with the applicant during the examination process does not signal the nuanced way in which this must be done.<sup>326</sup> Most importantly, the Official Comment indicating that a request for applicant waiver never can affect the reasonable time for deciding whether to honor or to dishonor unnecessarily could hamper the waiver process.<sup>327</sup> The Official Comment should be understood to mean that a request for applicant waiver can not extend the seven-day outside deadline for notice of dishonor and discrepancies.<sup>328</sup> In any event, the Official Comment's relevance to issuer delay within the seven-day outside deadline is variable and waived by the incorporation of UCP 500 or ISP 98 into a letter of credit.<sup>329</sup>

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320. See *supra* notes 180, 197-203 and accompanying text.

321. See *supra* notes 188-203 and accompanying text.

322. See *supra* note 213 and accompanying text.

323. See *supra* notes 281-83 and accompanying text for criticism of the Official Comments. However, the IFSA Statement of Practice under UCP 500 should be harmonized with UCP 500. See *supra* notes 196-203 and accompanying text.

324. See *supra* notes 308-13 and accompanying text.

325. See *supra* notes 291-95 and accompanying text.

326. See *supra* notes 144-57 and accompanying text.

327. See *supra* notes 188-91 and accompanying text.

328. See *supra* notes 184-87 and accompanying text.

329. The court in *DBJJJ, Inc. v. Nat'l City Bank*, regrettably failed to appreciate this and used the Article 5 Official Comment to misinterpret sub-Article 13(b) as never permitting an issuer to wait for an applicant's response prior to expiration of the seven-day outside deadline. See *DBJJJ, Inc. v. Nat'l City Bank*, 19 Cal. Rptr. 3d 904, 911 (Cal. Ct. App. 2004) ("This comment to the California Uniform Commercial Code is consistent with the plain language of Article 13(b) . . .").



# **Comments**

