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Letters of Credit--A Concise Codification

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Unlike the other articles of the Uniform Commercial Code, article 5\(^1\) enters into an area of business practices heretofore not regulated by statute in Ohio or elsewhere. With no case law or statute\(^2\) to provide guideposts for the use of letters of credit, custom and trade practices have been of major importance. The purpose of article 5 is not to interfere with these practices but rather to provide a statutory framework which sets forth the fundamental rules relating to letters of credit and which will serve to promote the wider use of this convenient method of financing sales transactions.

In order to better understand article 5, it is necessary to examine the role of the letter of credit in international and domestic trade.

Letters of credit may be broken down into two categories, clean credits and documentary letters of credit. The first of these includes the well known traveler’s letter of credit. A person traveling abroad may find it difficult to obtain credit or cash on his own personal security and so obtains a letter of credit from his bank. The letter of credit is in effect the promise of his bank to reimburse its correspondents or others who make advances to the traveler. The bank’s well known name and financial status are in effect substituted for the unknown personal credit standing of the wayfaring stranger.\(^3\)

The documentary letter of credit with which we are primarily concerned is of a different nature. It is designed to facilitate sales transactions particularly where the buyer and seller operate in different markets. If, for example, a buyer in Cincinnati seeks to purchase cuckoo clocks from a seller in West Germany, there are a number of ways in which the seller can be paid for the clocks but none is so satisfactory or economical as the documentary letter of credit. The buyer could send cash or a bank draft with his order. Although this

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\(^1\) Article 5 of the Uniform Commercial Code has become Ohio Rev. Code §§ 1305.01-16 (Supp. 1961).

\(^2\) The only Ohio statute referring to letters of credit is Ohio Rev. Code § 1105.29 (1953) which authorizes commercial banks to issue letters of credit. This power is restricted generally to situations where the bank is secured by a contract to ship goods, by documents of title or by cash. See, Ohio Legislative Service Commission, Ohio Annotations to Uniform Commercial Code; Information Bulletin No. 1958-1, 52 (1958).

\(^3\) State of New Jersey, Study of the Uniform Commercial Code 441 (1960). The New Jersey study prepared primarily by Professor William Hawkland is a useful tool in studying the Code in Ohio as well as in New Jersey.
is fine from the standpoint of the seller, there are obvious disadvantages for the buyer. The seller could pocket the proceeds or inferior goods could be sent. Even if the goods are conforming and are sent, the buyer will be out of pocket until the goods arrive and are sold in Cincinnati. If on the other hand, the seller ships on receipt of the order without anything more, he may have trouble collecting the full purchase price from the buyer. The documentary letter of credit solves these problems. The buyer wends his way to his bank and makes arrangements for the issuance of a letter of credit in favor of the seller. This means that the bank agrees to honor drafts drawn upon it by the seller providing that certain documents such as bills of lading, invoices, and insurance papers accompany the draft when it is presented. The bank sends the letter of credit to its correspondent bank in West Germany who then notifies the seller of the terms of the credit. The seller now is assured that if he complies with the letter, he will be paid by the buyer's bank. The seller if he so desires may discount the draft in West Germany for virtually the face amount of the draft because of the support of the letter. The buyer meanwhile promises to reimburse his bank and to pay it a small commission. The cost as represented by the commission may be as low as one-tenth of one per cent and is usually about one-eighth of one per cent. The buyer may also arrange with his bank for financing whereby the bank obtains a security interest and releases the necessary documents to the buyer for his use. This enables the buyer to pay for the clocks after they are sold at retail in Cincinnati.

Article 5 follows accepted banking terminology in referring to the seller in the above situation as a "beneficiary" and the buyer as the "customer." The beneficiary is a person who is entitled under the terms of the letter of credit to draw or demand payment, while the customer is the person who causes the issuer to issue a credit. The issuer is usually although not necessarily a bank. The bank in the seller-beneficiary's region who notifies him of the terms of the credit is designated an "advising bank." In some cases, the advising bank will also engage that it will honor the drafts drawn by the seller, in which case it is known as the "confirming bank." The

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^5 Ohio Rev. Code § 1305.01(A)(4) (UCC § 5-103(1)(d)).

^6 Ohio Rev. Code § 1305.01(A)(7) (UCC § 5-103(1)(g)).

^7 Ohio Rev. Code § 1305.01(A)(3) (UCC § 5-103(1)(c)).

^8 Ohio Rev. Code § 1305.01(A)(3) (UCC § 5-103(1)(e)).

^9 Ohio Rev. Code § 1305.01(A)(6) (UCC § 5-103(1)(f)).
confirming bank will of course be promptly reimbursed by the issuing bank. The cost of confirming, a device which gives the seller the added promise of a bank in his own region, is a little as one twentieth of one per cent.

This then is the letter of credit. It is a low cost and convenient device to meet the credit needs of both the buyer and the seller. It has been estimated that about ninety per cent of the financing of international sales is done by means of letters of credit. In domestic trade, its use is also increasing substantially.

Any examination of the letter of credit area must take into account the work of the International Chamber of Commerce in setting forth the practices in this field. This work is embodied in a document known as the "Uniform Customs and Practice for Commercial Documentary Credits" which was last revised in 1951 and which has received the adherence of bankers' associations throughout the world including the United States. Although the Uniform Customs and Practices do not have the force of law, they do represent the customs in the light of which such transactions proceed, and in addition, its provisions are often incorporated into letter of credit agreements by reference. The provisions of article 5 recognize the role of these customs. Division (C) of Revised Code section 1305.02 provides that this chapter covers some but not all of the rules or concepts of letters of credit as they have developed prior to the effective date of the Uniform Commercial Code. As pointed out in the official comment to this section, article 5 is not designed to stultify the further development of letters of credit. Article 5 does not go into detail on some of the matters covered by the Uniform Customs and Practices although in many areas there is a considerable overlap between the two.

Article 5 covers three categories of letters of credits. The first of these is a letter issued by a bank and requiring the presentation of certain documents in the manner described above. The second

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10 State of New Jersey, op. cit. supra note 3, at 444.
11 Note, supra note 4, at 227, 233.
12 Hoxter, International Rules on Letters of Credit (ECA memo 1950); State of New Jersey, op. cit. supra note 3, at 441.
13 International Chamber of Commerce, Uniform Customs and Practice for Commercial Documentary Credits, Brochure No. 151 (1951) (hereinafter cited as "Uniform Customs and Practice").
14 State of New Jersey, op. cit. supra note 3, at 447.
16 Ohio Rev. Code § 1305.02(C) (UCC § 5-102(3)).
18 Ohio Rev. Code § 1305.02(A)(1) (UCC § 5-102(1)(a)).
covers credits issued by persons or organizations other than banks
where the presentation of documents is also required. The letters
of credit are occasionally issued by financial institutions other than
banks, and there is no reason why letters issued by firms with strong
credit reputations should not be covered. The third category covers
"clean" credits—those in which there is no such documentary pre-
sentation requirement. In order for this third category to fall under
the scope of article 5, it is necessary that the credit either be labeled as,
or state that it is, a letter of credit.

Insofar as formal requirements are concerned, Revised Code
section 1305.03 provides that no particular form of phrasing is
required for a credit. The credit, however, must be in writing and
signed by the issuer. The Uniform Customs and Practice do not
contain this writing requirement although this would probably be
the result reached by the courts in the absence of the Code. A
telegram may be a sufficient signed writing provided that the issuer
is identified by an authorized identification which may be in code.

This requirement is new as a matter of law but follows accepted
banking practices.

A non-bank issuer should keep in mind that a credit which does
not require presentation must be conspicuously designated as a credit.

Section 1305.04 provides that consideration is not necessary for
the establishment, enlargement or modification of a credit. This
eliminates the possibility that the venerable doctrine of considera-
tion might be employed by some courts to impair letter of credit financing
by requiring the presenter of the draft to demonstrate that there is
valid consideration for the promise of the bank to honor his drafts.

This approach is consistent with that taken in article 2 in eliminating
the consideration requirement for waiver or modification of a sales
contract or for a firm offer.

19 Ohio Rev. Code § 1305.02(A)(2) (UCC § 5-102(1)(b)).
20 Uniform Commercial Code op. cit. supra note 17, at 432; State of New Jersey
op. cit. supra note 3, at 449.
21 Ohio Rev. Code § 1305.02(A)(3) (UCC § 5-102(1)(c)).
22 Ohio Rev. Code § 1305.03 (UCC § 5-104).
23 See Lainborn v. National Park Bank, 240 N.Y. 520, 148 N.E. 664 (1925); Bank of
Italy v. Merchants National Bank, 197 App. Div. 150, 188 N.Y.S. 183 (1921); see also
Bankers Manual on the Uniform Commercial Code 72 (1958); 3 New York Law
24 Ohio Rev. Code § 1305.03(B) (UCC § 5-104(2)).
26 Ohio Rev. Code § 1305.02(A)(2) (UCC § 5-102(1)(b)).
27 Ohio Rev. Code § 1305.04 (UCC § 5-105).
29 Ohio Rev. Code § 1302.08 (UCC § 2-205).
Under the Uniform Customs and Practice, if the credit is to be irrevocable, it should be so designated. Article 3 thereof provides “all credits unless clearly stipulated as irrevocable are considered revocable even though an expiry date is specified.”\(^{30}\) The Commercial Code on the other hand is silent on the question of whether the credit will be considered revocable or irrevocable in the absence of a specific provision therein. Under Article 2 of the Commercial Code, however, where a contract for the sale of goods calls for the issuance of a letter of credit, unless otherwise provided, an irrevocable credit will be required.\(^{31}\) The question of revocability is of prime importance in regard to the modification and revocation of an established credit.

A credit is established as to the customer (usually the buyer of the goods) when the letter is sent to him or an authorized written advice of its issuance is sent to the beneficiary (usually the seller of the goods).\(^{32}\) It is established as to the beneficiary when he receives the letter or an authorized written advice of its issuance.\(^{33}\) Once the irrevocable credit is established as to the customer, it can be modified or revoked only with the customer’s consent while once it is established as to the beneficiary, it can only be modified or revoked with his consent.\(^{34}\) A revocable credit, however, may be modified or revoked without notice or the consent of the customer or the beneficiary.\(^{35}\) It should be noted that under these rules, the credit is established when sent in the case of the customer but only when received in the case of the beneficiary. This means that even in the case of an irrevocable credit, unilateral revocation may be allowed until actual receipt of the letter or written advice of its issuance.

In the case of revocable credits, innocent parties who have honored or negotiated drafts before notice of revocation are entitled to payment by or reimbursement from the issuer.\(^{36}\)

In accord with the Uniform Customs and Practice\(^{37}\) and with general trade usage, Revised Code section 1305.06\(^ {38}\) makes it clear that an advising bank (defined in section 1305.01\(^ {39}\) as one which gives notice of the establishment of a credit by another bank) assumes obligation only for the accuracy of its own statement of the terms of

\(^{30}\) Uniform Customs and Practice, Article 3.
\(^{31}\) Ohio Rev. Code § 1302.38 (UCC § 2-325).
\(^{32}\) Ohio Rev. Code § 1305.05(A) (1) (UCC § 5-106(1)(a)).
\(^{33}\) Ohio Rev. Code § 1305.05(A) (2) (UCC § 5-106(1)(b)).
\(^{34}\) Ohio Rev. Code § 1305.05(B) (UCC § 5-106(2)).
\(^{35}\) Ohio Rev. Code § 1305.05(C) (UCC § 5-106(3)).
\(^{36}\) Ohio Rev. Code § 1305.05(D) (UCC § 5-106(4)).
\(^{37}\) Uniform Customs and Practice op. cit. supra note 13, at Article 6.
\(^{38}\) Ohio Rev. Code § 1305.06(A) (UCC § 5-107(1)).
\(^{39}\) Ohio Rev. Code § 1305.01(A) (5) (UCC § 5-103(1)(e)).
the credit and does not undertake the performance of the issuer's obligations. A confirming bank on the other hand becomes directly obligated on the credit to the extent of its confirmation as though it were an issuer. The Code also adopts the provision found in most agreements between an issuer and its customer that the customer bears all risk of transmission and reasonable interpretation of any message relating to a credit.

One of the problems in the field of letter of credits has been in regard to the identification of conforming drafts which the issuer is required to pay. If the credit is available in portions, the beneficiary may draw several drafts thereunder and even if it is not so available, several drafts may be drawn on the issuer. It should be noted that unless otherwise specified the use of the credit in portions will be at the discretion of the beneficiary. One approach to this problem is the insertion of a requirement in the letter that each purchaser of a draft must make a notation of the amount on the credit. Under prior law, the effect of failure to make such a notation was not clear. Section 1305.07 makes it clear that the issuer is under no obligation to honor a draft drawn under a notation credit unless the credit or a signed statement that the notation has been made accompanies the draft. The issuer may also delay honor for a period of thirty days while such evidence is obtained.

Where the notation procedure is not followed, article 5 provides that the issuer may honor drafts or demands for payment in the order in which they are presented and the issuer will be discharged pro tanto by the amount of such draft or demand. As between competing good faith purchasers of such drafts, the person first purchasing has priority over a subsequent purchaser even though the later purchased draft was first honored. Although the issuer is protected in such a situation, the first purchaser would have an action against such subsequent purchaser.

One of the most basic concepts of letter of credit financing relates to the limited nature of the issuer's obligation to its customer. The banks which issue, advise or confirm letters of credit are not in the business of buying and selling goods. They are concerned with

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40 Ohio Rev. Code § 1305.06(B) (UCC § 5-107(2)).
41 Ohio Rev. Code § 1305.06(D) (UCC § 5-107(4)).
43 Ohio Rev. Code § 1305.09(A) (UCC § 5-110(1)).
45 Ohio Rev. Code § 1305.07(B) (UCC § 5-108(2)).
46 Ohio Rev. Code § 1305.07(C)(1) (UCC § 5-108(3)(a)).
47 Ohio Rev. Code § 1305.07(C)(2) (UCC § 5-108(3)(b)).
48 State of New Jersey, op. cit. supra note 3, at 462.
documents and not with the merchandise represented thereby. The letter of credit contract is considered to be a contract completely independent of the sales contract of the buyer and seller. The liability of the issuing bank runs directly to the beneficiary, and, if the terms of the letter are complied with, the bank will be liable even though the beneficiary may have shipped defective goods under the sales contract. In addition, should the buyer to whom the bank will be looking to for reimbursement become insolvent, the bank would, nevertheless remain liable on its letter of credit commitment. This approach is set forth in Article 10 of the Uniform Customs and Practices which provides that all parties concerned deal in documents and not in goods. Payment, negotiation or acceptance against documents in accordance with the credit binds the customer to take up the documents and reimburse the issuer.

This approach is also adopted by the Commercial Code in section 1305.08 which spells out the obligation of the issuer to its customer. The issuer must act in good faith and observe general banking usage. This obligation does not include, unless otherwise provided by the parties, liability or responsibility for performance of the underlying contract for sale or other transaction between the customer and the beneficiary. It also does not include liability or responsibility based on knowledge or lack of knowledge of a particular trade usage (as opposed to its responsibility in regard to banking usage). The Commercial Code in isolating the bank from the sales transaction and in effect limiting the bank's function to the financing of the sale has made it possible for the letter of credit to remain an economical and practical financing device. This low cost is due in part to the non-assumption of risks relating to the sale of the goods. The bank's function under the letter relates to the receipt, examination and payment of the documents accompanying the draft. This can be done in a standardized inexpensive manner.

Under section 1305.08, the issuer must examine the documents with care so as to ascertain that on their face they appear to comply with the terms of the credit. The issuer assumes no liability for the genuineness, falsification or effect of a document which on examination by the issuer appears to be regular on its face. Thus if the documents

49 See Uniform Customs and Practice, op. cit. supra note 13, at Article 1.
50 Ibid. at Article 10.
51 Ohio Rev. Code § 1305.13(C) (UCC § 5-114(3)).
52 Ohio Rev. Code § 1305.08 (UCC § 5-109).  
53 State of New Jersey, op. cit. supra note 3, at 446; Harfield, Trade Without Tears, or Around Letters of Credit in 17 Sections, 1952 Wis. L. Rev. 298, 300 (1952).  
54 Ohio Rev. Code § 1305.08(B) (UCC § 5-109(2)).
appear to be regular the issuer who honors the accompanying draft will be entitled to reimbursement from its customers even if the documents have been forged.

Article 5 has not attempted to set forth standards as to what documents are required and what such documents should contain. The Uniform Customs and Practice, however, goes into considerable detail as to what constitutes documentary compliance and those provisions will remain a basic guide for counsel in dealing with such problems. Article 15 of the Uniform Customs and Practice\textsuperscript{55} sets forth the documents which banks are to consider necessary unless otherwise instructed. In all cases a transferable policy or certificate of insurance and an invoice are required. In maritime traffic, a full set of sea or ocean bills of lading is also required. Documents required in inland traffic are either inland waterway bills, inland waterway consignment notes, railroad consignment notes, counterfoil waybills or railroad bill of laden. In postal traffic, a postal receipt or certificate of mailing issued by the postal authorities is needed. In airway traffic, an air mail receipt or air transportation waybill or air consignment note or receipt is required. Subsequent articles consider in some detail what banks may and may not accept in regard to bills of lading,\textsuperscript{66} insurance papers,\textsuperscript{57} and invoices.\textsuperscript{68} It is also provided that where other documents are required, such as warehouse receipts, certificates of origin, certificates of weight, etc., banks may accept such documents as tendered without responsibility on their part.\textsuperscript{69}

In accord with the Uniform Customs and Practice and general bank understanding, section 1305.08\textsuperscript{60} also provides that the issuer is not responsible for the acts or omissions of other persons or for loss or destruction of a draft or document in transit or in the possession of others.

Division (B) of Revised Code section 1305.09\textsuperscript{61} states the basic rule that a person presenting a documentary draft or demand for payment cannot effectively reserve a lien or claim to the documents after the bank has honored the draft. All such claims are relinquished on honor and the person transferring the draft or demand is deemed to have authorized the relinquishment to such claims. As is true under

\begin{itemize}
\item \textsuperscript{55} Uniform Customs and Practice, \textit{op. cit. supra} note 13, at Article 15.
\item \textsuperscript{56} \textit{Ibid.} at Articles 19-27.
\item \textsuperscript{57} \textit{Ibid.} at Articles 28-31.
\item \textsuperscript{58} \textit{Ibid.} at Articles 32-33.
\item \textsuperscript{59} \textit{Ibid.} at Article 34.
\item \textsuperscript{60} Ohio Rev. Code § 1305.08(A) (2) (UCC § 5-109(1)(b)).
\item \textsuperscript{61} Ohio Rev. Code § 1305.09(B) (UCC § 5-110(2)).
\end{itemize}
existing practice, an explicit reservation of a lien or claim will render
the draft or demand non-complying.

The beneficiary, by transferring or presenting the draft or
demand for payment, warrants that the necessary conditions of the
credit has been complied with. This warranty is made not only by
one who is a party to a fraud or forgery but also by the innocent
beneficiary who through inadvertance has failed to comply with the
terms of the credit. This warranty is in addition to those provided
for in other articles of the Commercial Code. The requirements of
section 1303.53, dealing with warranties on presentment and transfer
of commercial paper, and section 1307.35, dealing with warranties
on the negotiation or transfer of a document of title, will be applicable
when a documentary draft drawn under a letter is presented for
payment.

Banks participating in a letter of credit transaction whether as
an issuing, advising, confirming or collecting bank warrant as to a
draft thereunder only what a collecting bank warrants under article 4.
As to the accompanying documents, the bank warrants only its own
good faith and authority from the person for whom it is acting. This
provision has been said to codify the existing rule "that the handling
of documents in a commercial credit letter transaction does not
involve any warranty or representation by the various banks."

The bank to which the draft is presented is given the right to
defer honor until the close of the third banking day following receipt
of the documents unless the further deferment of honor has been
consented to by the presenting party. Failure to honor within this
time period constitutes dishonor of the draft or demand and of the
credit. This approach should be contrasted with the constructive
acceptance approach under the Negotiable Instruments Law. Under
section 1305.12 (which will be repealed as of the effective date of
the Commercial Code), a drawee who within twenty-four hours does
not accept or return the bill is deemed to have accepted it. In the
case of clean or non-documentary letter of credits, the three day rule

62 State of New Jersey, op. cit. supra note 3, at 464; Bankers Manual on the
63 Ohio Rev. Code § 1305.10(A) (UCC § 5-111(1)).
64 State of New Jersey, op. cit. supra note 3, at 465.
65 Ohio Rev. Code § 1303.53 (UCC § 3-417).
66 Ohio Rev. Code § 1307.35 (UCC § 7-507).
67 Ohio Rev. Code § 1305.10(B) (UCC § 5-111(2)).
68 Letter of Mr. Henry Harfield, dated May 24, 1954, New York Leg. Doc. 65 (D),
19, 24 (1954).
69 Ohio Rev. Code § 1305.11 (UCC § 5-112).
of section 1305.1171 will not apply and instead the time allowed for acceptance will be until the close of the next business day following presentment pursuant to section 1303.61.72

Where the bank has dishonored the draft, division (B) of section 1305.1173 permits the bank to retain the documents but to advise the presenter that it is holding the documents at his disposal. The usual rule requiring physical return of the documents may create a number of problems relating for example to the sale of the goods where the underlying documents have been returned to a physically distant point.74

In accord with well accepted banking practice,75 section 1305.1276 specifically recognizes the authority of a bank to seek an indemnity to induce honor, negotiation or reimbursement under a credit. An issuer, although the documents comply with the terms of the letter in most respects, is not obligated to honor the draft where one particular requirement is not met but may be induced to do so by the giving of an indemnity. Since the bank’s obligation is limited to the documents, the indemnity is also limited to defects in the documents. The question of whether a particular banking custom requires honor of documentary drafts accompanied by indemnities in place of missing or defective documents is not spelled out in this section but is rather to be determined by construing the terms of the credit. In so doing custom would be an important factor.77

The contract between the issuer and the beneficiary is independent of the sales contract between the beneficiary and the customer. The issuer is, however, under a duty to honor drafts which comply with the terms of the credit even though the goods or the documents do not conform to the sales contract. The issuer may not avoid this responsibility by a term in the credit that all documents must conform to it. However, particular documents can be required to conform.

When the documents appear on their face to comply with the terms of the credit but are actually forged or fraudulent or there is fraud in the transaction, the issuer may even if notified by its customer of such fraud or forgery honor such draft if the presenter

71 Ohio Rev. Code § 1305.11 (UCC § 5-112).
72 Ohio Rev. Code § 1303.61 (UCC § 3-506).
73 Ohio Rev. Code § 1305.11(B) (UCC § 5-112(2)).
74 Uniform Commercial Code, op. cit. supra note 17, at 447.
76 Ohio Rev. Code § 1305.12 (UCC § 5-113).
77 State of New Jersey, op. cit. supra note 3, at 468; Uniform Commercial Code op. cit. supra note 17, at 448.
is not in effect a holder in due course or it may refuse to honor such draft. Where the presenter is a holder in due course, however, the issuer must honor the draft. The customer has the right to seek a court injunction where a holder in due course is not involved.\textsuperscript{78}

Section 1305.13\textsuperscript{79} also spells out the basic rule, that unless otherwise agreed, an issuer who has duly honored a draft or demand for payment is entitled to immediate reimbursement.

Ohio has adopted the optional provisions\textsuperscript{80} relating to conditional payment where the issuer must make payment on receipt of a notice that the required documents are in the possession of a correspondent or other agent of the issuer. These provisions are intended to deal with the situation under the currency restrictions of a few countries where payment is required to be made under a credit before there is an opportunity to examine the documents.\textsuperscript{81}

Section 1305.14\textsuperscript{82} spells out the measure of damages where the issuer has wrongfully dishonored the draft or demand for payment. The person entitled to honor may then recover from the issuer the face amount of the draft plus incidental damages less any amount realized on resale or other disposition of the subject matter of the letter. Incidental damages include commercially reasonable charges, expenses or commissions incurred in stopping delivery, in the transportation, care and custody of the underlying goods, and in connection with return or resale of the goods.\textsuperscript{83} Under section 1302.81\textsuperscript{84} which is made applicable to the issuer’s wrongful dishonor of the draft or demand for payment, the person entitled to honor is given the right to stop delivery of the goods or to resell the goods should they arrive.

Should the issuer wrongfully repudiate the credit before the presentation of the draft, the beneficiary is given the rights of a seller after anticipatory repudiation by the buyer under section 1302.68.\textsuperscript{85} This gives the beneficiary the right to await performance or to resort to any remedy for breach under section 1302.77,\textsuperscript{86} and in any case the beneficiary has the right to identify goods to the contract in accordance with section 1302.78.\textsuperscript{87}

\begin{itemize}
\item \textsuperscript{78} Ohio Rev. Code § 1305.13 (UCC § 5-114).
\item \textsuperscript{79} Ohio Rev. Code § 1305.13(C) (UCC § 5-114(3)).
\item \textsuperscript{80} Ohio Rev. Code § 1305.13(D) and (E) (UCC § 5-114(4) and (5)). Of the first thirteen states adopting the Code, five including Ohio included these provisions.
\item \textsuperscript{81} Uniform Commercial Code, \textit{op. cit. supra} note 17, at 452.
\item \textsuperscript{82} Ohio Rev. Code § 1305.14 (UCC § 5-115).
\item \textsuperscript{83} Ohio Rev. Code § 1302.84 (UCC § 2-710).
\item \textsuperscript{84} Ohio Rev. Code § 1302.81 (UCC § 2-707).
\item \textsuperscript{85} Ohio Rev. Code § 1302.68 (UCC § 2-610).
\item \textsuperscript{86} Ohio Rev. Code § 1302.77 (UCC § 2-703).
\item \textsuperscript{87} Ohio Rev. Code § 1302.78 (UCC § 2-704).
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of the repudiation in time to avoid procurement of the documents, he is given an immediate right of action for wrongful dishonor.

These provisions of section 1305.14\(^8\) are applicable where there has been a wrongful dishonor of a draft for a portion of a credit since such dishonor under section 1305.11\(^9\) will also constitute a dishonor of the credit. None of the provisions of this section will be applicable unless the credit is irrevocable since under section 1305.05\(^0\) the issuer is given the right to modify or revoke a revocable credit without notice to either the beneficiary or the customer.

Under the common law, it is not clear whether the beneficiary in the case of a wrongful dishonor must mitigate damages.\(^1\) Under section 1305.14\(^2\) it appears that there would be no such duty in the case of a wrongful dishonor of the draft under division (A) of this section, but such a duty would exist in the case of a repudiation or cancellation under division (B).

When a buyer obtains a letter of credit in favor of a named beneficiary, he usually contemplates performance by the beneficiary alone. He may know and trust the beneficiary and have no desire for performance by another party.\(^3\) For this reason, section 1305.15\(^4\) provides that the right to draw under a credit can be transferred or assigned only when the credit is expressly designated as transferable or assignable. Where assignment is permitted, the prevailing view is that the assignable credit can be transferred only once.\(^5\) The Commercial Code is silent on this subject although Article 49 of the Uniform Customs and Practice\(^6\) is in accord with this limitation.

An entirely different situation exists where an assignment of the proceeds of the credit rather than an assignment of the credit is involved. Where the proceeds alone are assigned, the buyer should have little objection since the duty of the named beneficiary to perform is not affected. It should make little difference to him who receives the funds from the issuer. The issuer, so long as it is properly notified, should not object to such assignment. Thus section 1305.15\(^7\) specifically provides that the beneficiary may before performance

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\(^{8}\) Ohio Rev. Code § 1305.14 (UCC § 5-115).
\(^{9}\) Ohio Rev. Code § 1305.11 (UCC § 5-112).
\(^{0}\) Ohio Rev. Code § 1305.05 (UCC § 5-106).
\(^1\) State of New Jersey, op. cit. supra note 3, at 472.
\(^3\) State of New Jersey, op. cit. supra note 3, at 473.
\(^5\) Uniform Customs and Practice, op. cit. supra note 13, at Article 49.
\(^6\) Ohio Rev. Code § 1305.15 (UCC § 5-116).
assign his right to proceeds even if the credit provides that it is non-transferable or non-assignable.

The assignment of proceeds device is often used by a manufacturer or supplier who wants the beneficiary to perform his contract with the customer-buyer so that he in turn may be paid out of the proceeds due under the letter of credit. By taking an assignment, he receives greater assurance of payment provided the issuer is promptly notified of the assignment, the beneficiary actually does perform, and the beneficiary has not made a prior assignment.

The assignment of proceeds will be ineffective until delivery of the credit to the assignee who then has a perfected security interest under article 9 without any need of filing. The issuer is not bound until it receives notice of the assignment and even then may delay honor of drafts until it has been shown the letter of credit. Until receiving notice of the assignment, the issuer may continue to honor drafts which comply with the credit as if no assignment had been made. The beneficiary has, until he assigns either his right to draw, where allowed, or his right to assign, the right to transfer or negotiate drafts or demands for payment drawn under the letter of credit.

The last section of this article deals with the unfortunate situation where the issuer or a confirming or advising bank becomes insolvent before final payment under the credit. Although the bank engages its own credit, the indemnity offered by the customer and the obtaining of documents from the beneficiary, clearly distinguishes the letter of credit transaction from other transactions of the bank. Therefore, when insolvency does happen, the security held and funds provided to indemnify the bank and the related documents are considered by section 1305.16 as separate from the general assets of the bank. Where funds are turned over to the bank as indemnity against or specifically for payment of drafts drawn under the credit, such drafts are entitled to payment in preference over the depositors or other general creditors of the bank. In addition any unused funds or collateral so deposited is entitled to be returned. If consented to, a charge to an account with the bank for the purpose of such indemnity or payment falls under the same rules as if the funds had been drawn

98 State of New Jersey, op. cit. supra note 3, at 474, 475; Uniform Commercial Code op. cit. supra note 17, at 455. The back-to-back letter of credit is considered to be a much more satisfactory device to meet the needs of the supplier. See Harfield, "Secondary Uses of Letters of Credit," 44 Colum. L. Rev. 899, 908 (1944).


100 Ohio Rev. Code § 1305.16 (UCC § 5-117).

101 Uniform Commercial Code, op. cit. supra note 17, at 456, 457.

102 Ohio Rev. Code § 1305.16 (UCC § 5-117).
out in cash and then specifically turned over to the bank with specific instructions. These provisions will probably cause little change in what law exists in regard to this problem.

The bankers, merchants, and lawyers who have been using letters of credits will find that article 5 makes little change necessary in the way they have been operating. Article 5 codifies existing American practice in this field, it does not revolutionize it. For those banks, merchants, and lawyers who have had little contact with this financing device, article 5 will prove to be a welcome and concise statement of the governing principles in what has been a highly specialized area.