

The Drafting History of UCC Article 5

The Drafting History of UCC Article 5

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Preface

The Book

This is a source for persons seeking to understand the law of letters of credit under UCC Article 5. The book's purpose is to bring together material from four hard-to-access source materials, set them out by subject matter, and allow comparative analysis that will add meaning to the spare language of the 1995 version of UCC Article 5, the current legislation. Finally, students of legislative drafting will find here a record of the major participants in the fashioning of letter of credit law. Practicing lawyers, academics, and banks have jostled not just in the drafting of the 1995 version of Article 5 but in framing this legislation from the very beginning in the middle of the last century. It's an intriguing story.

Article 5 acknowledges that it is a basic platform for law that governs letters of credit. The statute assumes that case law and case law history continue to play critical roles in fashioning the superstructure for that platform.

Researchers can access current case law in treatises,¹ but the law on which the first version of Article 5, the 1952 version adopted only in Pennsylvania, relied is absent from most of the literature. Happily, before New York undertook to codify the law of letters of credit in Article 5, the New York Law Revision Commission asked Professor Rudolph Schlesinger to evaluate the 1952 version in light of then current case law. The Commission's Report first published in 1952, is not readily accessible. It is a superb restatement of letter of credit law at the time the drafters were first fashioning the letter of credit statute and provides the best restatement available of the platform on which the drafting process has proceeded.

Also largely inaccessible are the comments Henry Harfield, a leading letter of credit lawyer and commentator,² prepared for New York's now repealed 1962 version of Article 5.

1. There are three up to-up-date treatises dealing with U.S. letter of credit law and, to an extent, international letter of credit law. See J. Byrne, *Revised Article 5: Letters of Credit in 6B Uniform Commercial Code Series* (Thomson Reuters/West 2008) (w/ annual updates) (U.S.); J. Dolan, *The Law of Letters of Credit—Commercial and Standby Credits* (LexisNexis 4th ed. w/ updates, 2007); B. Wunnicke et als., *Standby and Commercial Letters of Credit* (Aspen Law & Business 2001, with updates, 2001). As of 2013, Professor Dolan no longer had any pecuniary interest in the treatise he authored.

2. Harfield was a partner in the New York law firm (Shearman & Sterling) that represented the largest issuer of letters of credit of the day. He authored and co-authored a treatise on letters of credit, H. Harfield, *Bank Credits and Acceptances* (5th ed. 1974); a handbook on the subject, H. Harfield, *Letters of Credit* (1979); and numerous articles. For some of those articles, often with clever and humorous titles and always with convincing analysis, see, e.g., Harfield, "Article 5—Trade without

This book makes the invaluable scholarship of this premier practitioner the “Harfield Practice Commentary” and this outstanding academic, the “Schlesinger Study” by republishing them throughout the chapters of the book.

Finally, the chapters dealing with each section of the current version of Article 5 contain Commentary by this author who writes frequently on the subject and has been recognized by courts and commentators as an authority on letter of credit law.

The book presents the Harfield Practice Commentary by setting it out after the 1962 version of Article 5 and the Schlesinger Study by presenting relevant portions of it after each section of the 1952 version of Article 5. Comments by the editor, many of them describing and evaluating the major role banks have played in this enterprise as “Dolan Commentary” are included at the end of each chapter.

Appendix A is the introduction and the conclusion of the Study, which are not set out in the chapters.

Sixteen of the book’s chapters cover, one by one, each section of the current (1995) version of Article 5 in the following format:

- Part 1
The 1995 Text and Official Comments
- Part 2
The 1962 Text and Official Comments
- Part 3
The Harfield Practice Commentary to the 1962 sections
- Part 4
The 1952 Text and Comments
- Part 5
Schlesinger Study on the 1952 text
- Part 6
Dolan Commentary

The effect of presenting this section-by-section chronology is to give the researcher entrée to the legislative and common law history of the entire letter of credit article from its earliest version to its current version with commentary by recognized letter of credit commentators.

Using the Book

Those seeking to understand the provenance of letter of credit law will not read the book from cover to cover, of course. Rather, confronting a specific provision of Article 5 and seeking to understand it by reviewing its legislative and common law history, the reader can look to the chapter covering the section and learn in a way that is not available to someone who looks only at the text of the 1995 letter of credit Article and the drafters’ comments and who does not have access to the two earlier drafts and comments, to the

Tears, or Around Letters of Credit in 17 Sections,” 1972 Wis. L. Rev. 298; Harfield, “Identity Crises in Letter of Credit Law,” 24 Ariz. L. Rev. 239 (1982); Harfield, “Are letters of credit an Endangered Species?” N.Y. State Bar J. (Mar./Apr. 1992); Harfield, “Guaranties, Standby Letters of Credit, and Ugly Ducklings,” 26 UCC L. J. 195 (1994). Schlesinger cites Harfield repeatedly in the New York Study.

Harfield Practice Commentary, to the Schlesinger Study, comments, and to this editor's comments.

The book does not give researchers post 1995 case law, or much post 1962 case law. For that information, the researcher must resort to treatises and the like.³

Dolan Commentary

“Dolan Commentary” appears at the end of most chapters. Those comments are not summaries or repetitions of what comes before. Rather, they address questions that your editor feels the language of the sections themselves, the drafters' official comments, the Harfield Practice Commentary, and the Schlesinger Study might leave open or might even, in the rare case, mislead. They should not be taken as criticism of the drafters, of Henry Harfield, or of Professor Schlesinger. They are simply comments on issues which the drafters and those well-educated commercial lawyers may have decided not to address or did not foresee. In the rare case this editor differs with Mr. Harfield but always with the greatest deference and respect.

The Banking Industry's Role

Prior to the Uniform Commercial Code sponsors' efforts to codify letter of credit law, the banking industry, through the International Chamber of Commerce (ICC) Banking Commission, as it is now known, fashioned much letter of credit “law” in officially promulgated ICC rules. Those rules are now the Uniform Customs and Practice for Documentary Credits (UCP 600).⁴ The Banking Commission and its predecessors worked diligently to persuade banks in all commercially important states to adopt the UCP. By 1980, banks in most commercial states acceded, thereby giving the UCP the force of law by choice. Banks still incorporate the UCP in their letters of credit. Revising the UCP periodically, and inviting the world's bankers and representatives of other industries to participate, the Commission has performed an invaluable service to the banking industry that was and is the primary issuer of letters of credit and an invaluable service to the commercial parties that use letters of credit. Understandably, the industry's focus was on practical matters, the form and role of certain documents (bills of lading, inspection reports, certificates of insurance, and the like), but the UCP went beyond documentary minutiae and addressed the kinds of letters of credit (payment, acceptance, negotiation, and deferred payment) and addressed the obligations of issuers, advisers, and confirmers. These efforts were helpful to courts and legal practitioners, notwithstanding the absence or limited role of judges and bank-independent commercial lawyers in the UCP drafting process.

That ICC process began in the 1920s and endured as the best source of letter of credit regulation for thirty years. When the UCC sponsoring agencies undertook the codification

3. In addition to the major treatises, for additional, serious treatment of letters of credit, see J. White and R. Summers, *Uniform Commercial Code* (West Group 5th ed. 2000); C. Gillette and S. Walt, *Sales Law—Domestic and International* (Foundation Press 1999).

4. For the current version of those rules, effective July 1, 2007, see International Chamber of Commerce, *The Uniform Customs and Practice for Documentary Credits (UCP 600, ICC Pub. No. 600)* (2006).

of letter of credit law as part of their grand design to achieve the unification of U.S. commercial law, the banking industry saw the codification process as undermining the industry's hegemony in letter of credit law and practice and, possibly, threatening their accomplishments. During the 1950s that unsettling prospect prompted the industry to balk at several points.

First, it objected vigorously to the whole idea of codifying letter of credit law.⁵ Those objections were unavailing, however. The codification proceeded. There followed remarkable instances of the industry's mistrust of the process. The major illustration was the industry's imposing on the New York version of the 1962 Code of the non-conforming provision that excepted, in the broadest terms, virtually any application of Article 5 to letters of credit that incorporated the UCP explicitly or implicitly.⁶ While New York courts successfully neutered that non-conforming section and brought credits issued by New York banks within the Article 5 writ, the non-uniform provision remained in the New York statute until New York adopted the official 1995 version, which fashions a less broad but nonetheless strong preference for the UCP in the event of conflict between the UCP and Article 5.⁷

The fact is that the banking industry's resistance to the codification effort notwithstanding, it played a major role in the codification of letter of credit law, most of it valuable, but some of it with a hint of paranoia. In the 1950s when the sponsoring agencies were drafting Article 5, bankers succeeded in forcing the replacement of the first reporter, an accomplished academic.⁸ At the outset of the drafting of the 1995 revision of Article 5, they learned of an early preference for one reporter and marshalled their forces against him. Once again, they prevailed. The candidate withdrew.⁹ Finally, by

5. "The New York Clearing House Association (NYCHA) in its report of December 1, 1961, recommended the entire elimination of Article 5 on letters of credit." Report No. 2 of the Permanent Editorial Board (PEB) for the Uniform Commercial Code 95 (Oct. 31, 1964). For the PEB's rather sharp retort to the banking lobby, see Appendix B.

6. "Unless otherwise agreed, this Article 5 does not apply to a letter of credit or a credit if by its terms or by agreement, course of dealing or usage of trade such letter of credit or credit is subject in whole or in part to the Uniform Customs and Practice for Commercial Documentary Credits fixed by the Thirteenth or by any subsequent Congress of the International Chamber of Commerce." NY UCC § 5-102(4) (McKinney Supp. 1962). The states of Alabama, Arizona, and Missouri also adopted this non-uniform provision.

7. See § 5-103(c) (1995).

8. Professor Karl Llewellyn selected as the original reporter for Article 5, Professor Friedrich Kessler of the Yale law faculty, later of the University of Chicago Law Faculty, and then later again at Yale. In its May 1949 report, two years after he left Chicago to return to Yale, the PEB indicated that Llewellyn and Kessler were joint reporters for Article 5. Uniform Commercial Code 499 (May 1949 Draft). Eventually, Llewellyn replaced Kessler altogether with the associate reporter for the UCC project, Professor Soia Mentschikoff, who was a member of the Harvard Law School faculty and later the University of Chicago Law School faculty. In a telephone discussion with Kessler, after his retirement in 1970 while he was living in Berkeley, California, this editor asked him why he had been replaced. His response was that he did not know. It may be significant that in its 1956 Recommendations, the PEB notes that there were six members of a special "advisory Committee" to the Article 5 Subcommittee, the only UCC article with an "advisory Committee." All six members of the advisory committee were employed by large Chicago banks. See 1956 Recommendations of the Editorial Board for the Uniform Commercial Code 9. Llewellyn had learned his lesson.

9. This editor was chair of the American Bar Association (ABA) Letter of Credit Subcommittee and was the first ABA liaison to the group that drafted the 1995 version of Article 5. He has first-hand knowledge of the above account of the banking lobby's veto of the academic first nominated for the reporter position. In 1962, the New York Clearing House Association acted for the banks. Later the United States Council for International Banking (U.S.C.I.B.) played the lobbying role. The U.S.C.I.B. later changed its name to the International Financial Services Association (IFSA), which continued in that role. The IFSA merged with the Bankers' Association for Finance and Trade (BAFT). The

adoption of a broad choice-of-law provision, bankers, to an extent, have once again preempted the official version of Article 5 for what they or someone else sees as a happier rule. That Article 5 provision permits letter of credit issuers to select the governing law for their undertakings without regard for the undertakings' relationship to the state law they choose. By virtue of the New York version of Article 5 dealing with attorney's fees, many non-New York banks choose New York law and its non-conforming provision on attorney's fees.¹⁰ What's more, the official version of Article 5 bows in the event of conflict between Article 5 and the UCP, to the UCP, the bankers' rules, making Article 5, to the extent it varies the rules of the UCP, subordinate to them when the issuer incorporates the rules into the credit.¹¹

No one can understand Article 5 without attending to this continuous tension between the sponsoring agencies and the country's bank lobby.

Summarizing the Letter of Credit History

The Uniform Commercial Code sponsoring agencies have drafted three versions of Article 5: the 1952 version and the widely adopted 1962 and 1995 versions. Only Pennsylvania adopted the 1952 version of Article 5, but that often ignored version is seminal and study of it and the ways later drafts amended it is edifying. That adoption and the then serious effort by law reformers to unify commercial law in the United States, prompted the New York Law Revision Commission to undertake a study of the 1952 text. The report of that study is the "Schlesinger Study," the comprehensive presentation of pre-code letter of credit law presented here after each article of the 1952 draft.

Rudolph Schlesinger was, at that time, a member of the Cornell Law faculty and a renowned commercial law scholar. His work, referenced here as the "Schlesinger Study," although undertaken at the request of the New York Law Revision Commission, was largely the consequence of the banking industry's dissatisfaction with the 1952 version of Article 5. The Schlesinger Study is an invaluable resource for understanding that, even today, more than fifty years later, Article 5 remains an incomplete codification of the common law of letters of credit.

The Reasons for Article 5

Letters of credit are idiosyncratic¹² undertakings, and the law that governs them moderately recondite. Far too often, courts, moved most likely by their lawyers' briefs, refer to a letter of credit as a "contract" and, at times, apply contract principles to letter of credit undertakings.¹³ More than any other misunderstanding in the reports of letter

merged enterprise is a subsidiary of the American Bankers Association. Go to www.aba.com/About/pages/aba-affiliates.aspx. (last visited June 6, 2014).

10. See Chapter Eleven and discussion of § 5-111(4).

11. The scope provision renders several Article 5 sections invariable. Those invariable sections do not, in any event, conflict seriously with the UCP. See § 5-111(4).

12. UCC Article 5 (official comment 1. 3d para.) (1995 version).

13. Currently, it is the fashion not to refer to letters of credit as "contracts," lest courts apply contract principles to them. "The unwashed characterize the letter of credit as a contract between the beneficiary and the issuer. . . ." *Montgomery Ward, LLC v. Wiseknit Factory, Ltd.* (In re *Montgomery*

of credit cases, that view leads to erroneous application of contract law to letters of credit. That unfortunate view, which extends to the enforcement of a letter of credit issuer's obligation, the rights of the beneficiary, warranties, and remedies, in large part prompts the publication of this book.

The law of letters of credit is ancient. That law comes largely from merchant courts and merchant practices, which pre-UCC common law courts adopted, but which many lawyers, it seems, have forgotten. The purpose of this work is to make a strong case against the error.

The effort takes each section of the 1995 version of Article 5, traces the section's statutory provenance with references to prior versions of and comments to each section, taking the course through the 1995 official version back to the initial version of Article 5 adopted in 1952.

Preceding the Statute

Any survey of the Article 5 statutory trajectory provides an incomplete picture of letter of credit law, however, if it ignores the fact that in 1952 there was a considerable body of common law governing letters of credit. Most of that law came from courts sitting in New York. New York banks in the 1950s and for more than fifty years before, issued most letters of credit in international trade, New York being the chief locus of trade finance in those days. New York courts not only issued most of the rulings that constituted U.S. letter of credit jurisprudence, but, in the opinion of this editor, wrote law that rivalled or bettered letter of credit law in any jurisdiction, anywhere. That law was tough, unforgiving law fashioned (1) to strengthen the letter of credit mechanism that merchants had created at the expense of the amateur and (2) as a rejection of the lawyers and judges who wanted to make the letter of credit a contract with all the vagaries and indefiniteness of that hoary old body of law. The law of letters credit fashioned by the pre-1952 courts made the doctrine of consideration irrelevant in letter of credit law, threw out all of the offer-and-acceptance analysis of contract law's formation rules, built an independent edifice for letter of credit obligations that abstracted them from related undertakings, redefined contract's fraud defense, erased detriment and reliance from enforcement analysis substituting the doctrine of preclusion for contract's creaky notion of estoppel, and reduced damages-for-breach inquiry to clear, simple terms. These and other differences made the letter of credit into a commercial device that, until now, was a staple of international trade and remains today, in its standby iteration, a staple of domestic commerce.

New York advocates saw the 1952 version of Article 5 as a serious challenge to the pre-eminence of New York letter of credit law and its unique treatment of letters of credit; and, therefore, they worried that the 1952 version of Article 5 might be construed as a departure in some respects from the efficient rules more than a half century of New York law making had framed to differentiate letters of credit from contracts—a critical step in their view.

Ward, LLC), 292 Bankr. Rep. 49, 54-55 (Bankr. D. Del. 2003), citing J. White and R. Summers Uniform Commercial Code at 113 (4th ed. 1995). See also *Rafool v. Evans* (In re Central Ill. Energy LLC), 2012 Bankr. LEXIS 5406 (Bankr. C.D. Ill. Nov. 20, 2012) (“As variously characterized, a letter of credit is a “unique commercial instrument,” an engagement, and an “absolute undertaking.” One thing it is not is a contract.”). *Id.* at *34 (footnotes omitted). Note, however, that, long ago, Harfield in his *Practice Commentaries to New York's 1962 version of Article 5* consistently referred to the letter of credit as a “contract.”

That concern gave rise to the New York Law Revision Commission's Study of the 1952 version of Article 5. That study is largely lost now, though it resides in a few law libraries and legislative archives. The Report, referred to here as the "Schlesinger Study," is reproduced with the purpose of highlighting the defense New York raised. That defense rings true to this day, for while the 1962 version of Article 5 that followed the Schlesinger Study, satisfied the drafting agencies, it did not satisfy the State of New York, which fashioned a non-conforming provision in the version that state adopted that gave New York letter of credit issuers an easy avenue out of Article 5.

Additional Matters

The last chapter in the text provides, for informational purposes, those provisions in the 1962 version and the 1952 version that have been repealed.

Note that the pagination of the Schlesinger Study as it is presented here does not match the pagination as the New York Law Revision Commission originally published it. References in the Study itself to the original pagination are altered to coincide with the pages published here. Footnote numbering in the Study has not changed.

History: Letters of Credit Come and Go

Letters of credit, which serve commerce, must either adapt or face extinction, for, more than the language of legal rules, changes in commercial practices impact the role letters of credit play. For centuries, letters of credit were a method for introducing travelers to distant bankers and merchants. With the arrival of reliable domestic credit reporting and quick, inexpensive communications, traveler's letters of credit disappeared from domestic commerce; and eventually, credit cards replaced the traveler's letter of credit in international activity to an extent that the traveler's letter of credit has now virtually disappeared.

During the same early era and after came commercial credits. "Commercials" enhanced the ancient documentary draft transaction by adding a layer of protection for sellers and buyers, a layer otherwise absent from the transaction. Commercials protected sellers who did not want to ship before payment and buyers who did not want to pay before delivery. Today, (a) increasingly reliable foreign credit reporting, (b) foreign accounts insurance, and (c) commerce's reluctance to rely on any product involving significant amounts of paper, as commercial credits heavily do, are reducing, if not eliminating entirely, the role of the commercial credit, which has departed most North Atlantic trade and much of Pacific trade. Commercials still play a vigorous role in Asian commerce and perhaps elsewhere.

At this writing, the standby letter of credit reigns supreme. The standby's name was unknown to the 1952 drafters. They may have thought of it as a type of "clean" credit, that is, a credit that did not call for any or at least not much, paper and, importantly in those days, did not involve bills of lading or warehouse receipts, the "documents" that commercials usually required. Everyone knew that all executory promises benefited from enhancement, but not everyone was aware that commerce had begun using what we now call standby letters of credit to enhance executory promises in virtually every industry, domestic and international. Merchant/debtors liable on such promises, as well as bankers and merchant/creditors taking such promises have seen the benefit of enhancing those

executory promises through the standby that bankers fashioned at low cost and with quick effect.

And, now, bankers, merchants, and legislative drafters face the arrival of electronic credits, payable against electronic documents. The consequences of paperless trade and the arrival of such products as the electronic bank payment obligation (BPO) will impact the future of the letter of credit, though so far they have not come into their own.

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Wayne State University and Wayne Law School administrators support scholarship generously with, in this case, research grants, sabbaticals and other leaves from teaching, and a distinguished professorship. For them it was part of the job description. May they know that in this case they performed their duties generously and well, among them most recently Law School Dean Jocelyn Benson and University Provost Margaret Winter.

And also to my Wayne Law colleagues, who rarely tired of expressing their surprise with a modicum of admiration for someone who could bury himself in what they took to be such a, shall we say, “dry” subject. My thanks to all of them, those still here and those who are gone.

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