

BILL ANALYSIS

Senate Research Center
76R2236 LJR-D

S.B. 85
By: Carona
Economic Development
2/8/1999
As Filed

DIGEST

Currently, in Texas, Chapter 5 of the Business & Commerce Code follows Article 5 of the Uniform Commercial Code (UCC), stating the rights and obligations created by a letter of credit. The official sponsors of the UCC have proposed a series of amendments to Article 5 in order to enhance the commercial acceptability of letter of credit. The recommendations both clarify the legal obligation of issuers to pay promptly and harmonize Article 5 with modern commercial practices with respect to letters of credit, including the increasing use of electronic communication. This bill revises the Texas enactment of Article 5.

PURPOSE

As proposed, S.B. 85 revises the Business & Commerce Code concerning letters of credit.

RULEMAKING AUTHORITY

This bill does not grant any additional rulemaking authority to a state officer, institution, or agency.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Chapter 5, Business & Commerce Code, as follows:

CHAPTER 5. LETTERS OF CREDIT

Sec. 5.102. New heading: DEFINITIONS. Defines “adviser,” “applicant,” “beneficiary,” “confirmer,” “dishonor,” “document,” “good faith,” “honor,” “issuer,” “letter of credit,” “nominated person,” “presentation,” “presenter,” “record,” and “successor of a beneficiary.” Provides locations of other definitions defined in other chapters of this code applicable to this chapter. Establishes that Chapter 1 contains additional applicable definitions and principles.

Sec. 5.103. SCOPE. Establishes that this chapter applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit. Provides that a statement of a rule in this chapter does not by itself require, imply, or negate application of the same or a different rule to a situation not provided for, or to a person not specified, in this chapter. Establishes that the effect of this chapter may be varied by agreement or by a provision stated or incorporated by reference in an undertaking, except for certain sections and subsections. Prohibits a term, in an agreement or undertaking excusing liability or limiting remedies for failure to perform obligations, from varying obligations prescribed by this chapter. Establishes that the rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract out of which a letter of credit arises, including certain specific contracts or arrangements. Deletes previous definitions and the scope of the chapter.

Sec. 5.104. New heading: FORMAL REQUIREMENTS. Authorizes the issuance of a letter of credit, confirmation, advice, transfer, amendment, or cancellation in any form that is a record and is authenticated by certain means. Deletes text requiring no form of phrasing for a credit and certain requirements for a credit or a modification of a credit. Deletes certain specifications for authentication.

Sec. 5.105. CONSIDERATION. Establishes that consideration is not required to issue, amend, transfer, or cancel a letter of credit, advice, or confirmation. Deletes text stating that no consideration is necessary for only establishing or modifying a credit.

Sec. 5.106. New heading: ISSUANCE, AMENDMENT, CANCELLATION, AND DURATION. Establishes that a letter of credit is issued and enforceable when the issuer sends or otherwise transmits it to the person requested to advise or to the beneficiary. Provides that a letter of credit is revocable only if it so provides. Provides that after a letter of credit is issued, all rights and obligations arising from that letter of credit are not affected by amendment or cancellation to which that person has not consented except to the extent the letter of credit is revocable or that letter of credit provides that the issuer may amend or cancel the letter of credit without consent. Provides that a letter of credit expires one year after its stated date of issuance or, if no date is stated, after the date on which it was issued, if there is no stated expiration date. Provides that a perpetual letter of credit expires five years after its stated date of issuance or, if no date is stated, after the date on which it is issued. Deletes text concerning the time and effect of the establishment of credit.

Sec. 5.107. New heading: CONFIRMER, NOMINATED PERSON, AND ADVISER. Provides that a confirmer is directly obligated on a letter of credit and has the rights and obligations of an issuer to the extent of its confirmation. Provides that a confirmer has rights against and obligations to the issuer as if the issuer were an applicant and the confirmer had issued the letter of credit for the issuer. Provides that a nominated person who is not a confirmer is not obligated to honor or otherwise give value for a presentation. Authorizes a person requested to give advice to decline to act as an adviser. Provides that an adviser that is not a confirmer is not obligated to honor or give value for a presentation. Provides for the duties and responsibilities of an adviser. Provides that even if the advice is inaccurate, the letter of credit, confirmation, or amendment is enforceable. Provides for the rights and obligations of a person who notifies a transferee beneficiary of the terms of a letter of credit, confirmation, amendment, or advice. Authorizes the terms of the notice to the transferee beneficiary to differ from the terms in any notice to the transferor beneficiary. Deletes text concerning advice of credit, the obligations of a confirming bank, errors in the statement of terms of a credit by an advising bank, and the burden of error in any message relating to a credit.

Sec. 5.108. New heading: ISSUER'S RIGHTS AND OBLIGATIONS. Requires an issuer to honor a presentation that, as determined by the standard practice, appears to strictly comply with the terms and conditions of the letter of credit, except as provided in Section 5.109. Requires an issuer to dishonor a presentation that does not appear to comply, except as provided in Section 5.113. Provides that an issuer has until the seventh day after receipt of presentation documents to take certain actions. Prohibits an issuer from asserting as a basis for dishonor any discrepancy if timely notice is not given or any discrepancy not stated in the notice, except as provided in Subsection (d). Establishes that failure to give the notice in Subsection (b) or to mention fraud, forgery, or expiration in the notice does not preclude the issuer from asserting fraud or forgery or expiration of the letter of credit as a basis for dishonor. Requires an issuer to observe the standard practice of financial institutions that regularly issue letters of credit. Establishes that the determination of an issuer's observance of the standard practice is a matter of interpretation by the court. Requires the court to offer the parties an opportunity to present evidence of the standard practice. Establishes that an issuer is not responsible for certain actions. Requires an issuer to disregard nondocumentary conditions in a letter of credit. Requires an issuer that has dishonored a presentation to return the documents or hold them at the disposal of, and send advice to that effect to, the presenter. Establishes certain rights, obligations, and prohibitions for an issuer that has honored a presentation.

Sec. 5.109. FRAUD AND FORGERY. Provides for certain actions by the issuer if a presentation is made which appears to strictly comply with the terms and conditions of the letter of credit, but a required document is forged or materially fraudulent, or honor of the presentation would facilitate a material fraud by the beneficiary of the issuer or applicant. Authorizes a court to temporarily or permanently enjoin an issuer from honoring a

presentation, if the applicant claims that a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, only if the court makes certain findings. Deletes existing Sections 5.109 and 5.110 regarding “notation credit,” the exhaustion of credit, and the issuer’s obligation to its customer.

Sec. 5.110. New heading: **WARRANTIES**. Sets forth certain warranties to be made by the beneficiary if the presentation is honored. Provides that those warranties are in addition to warranties arising under Chapters 3, 4, 7, and 8 because of the presentation or transfer of documents covered by any of those chapters. Provides that the warranties in Subsection (a) do not arise until the issuer honors the letter of credit, notwithstanding any agreement or term to the contrary.

Sec. 5.111. **REMEDIES**. Authorizes a beneficiary, successor, or nominated person presenting on its own behalf to recover from the issuer an amount wrongfully dishonored or repudiated. Authorizes the claimant to obtain specific performance or, at the claimant’s election, recover an amount equal to the value of performance if the issuer’s obligation is not for the payment of money. Authorizes the claimant to also receive incidental but not consequential damages. Provides that the claimant is not obligated to avoid damages that might be due from the issuer. Requires the claimant’s recovery from the issuer to be reduced by the avoided damages, if a claimant does avoid damages. Establishes that the issuer has the burden of proof as to the amount of avoided damages. Provides that the claimant need not present any document in the case of repudiation. Authorizes an applicant to recover certain damages if an issuer wrongfully dishonors a draft or demand presented or honors a draft or demand in breach of its obligation to the applicant. Provides that if an adviser or nominated person other than a confirmer breaches an obligation not covered in Subsection (a) or (b), a person to whom the obligation is owed may recover certain damages. Provides that a confirmer has the liability of an issuer specified in this subsection and Subsections (a) and (b) to the extent of the confirmation. Requires an issuer, nominated person, or adviser who is found liable under Subsections (a), (b), or (c) to pay interest on the amount owed from the date of wrongful dishonor or other appropriate date. Authorizes reasonable attorney’s fees and other litigation expenses to be awarded. Authorizes damages that would otherwise be payable for a breach of an obligation under this chapter to be liquidated by agreement or undertaking, but only for a reasonable amount in light of the anticipated harm. Deletes text of existing Section 5.111 regarding warranties on transfer and presentment. Deletes existing Section 5.112 regarding the time allowed for honor or rejection, the withholding of honor, or rejection by consent, and the definition of “presenter.” Deletes existing Section 5.113 regarding indemnities. Deletes existing Section 5.114 regarding an issuer’s duty and privilege to honor a draft or demand for payment, and an issuer’s right to reimbursement. Deletes existing Section 5.115 regarding a remedy for an improper dishonor or anticipatory repudiation.

Sec. 5.112. New heading: **TRANSFER OF LETTER OF CREDIT**. Prohibits the transference of the right of a beneficiary to draw or otherwise demand performance under a letter of credit, unless a letter of credit provides that it is transferable, except as provided in Section 5.113. Authorizes an issuer to refuse to recognize or carry out a transfer, even if the letter of credit states it is transferable, under certain conditions. Deletes text regarding the assignment of a right to draw under a credit.

Sec. 5.113. **TRANSFER BY OPERATION OF LAW**. Authorizes a successor of a beneficiary to consent to amendments, sign and present documents, and receive payment or other items of value in the name of the beneficiary without disclosing its status as a successor. Authorizes a successor of a beneficiary to consent to amendments, sign and present documents, and receive payment or other items of value in its own name as the disclosed successor of the beneficiary. Requires an issuer to recognize a disclosed successor of a beneficiary as a full substitution upon compliance with certain requirements. Provides that an issuer is not obliged to determine whether a purported successor is a successor of a beneficiary or whether the signature of the purported successor is genuine or authorized. Establishes that the honor of a purported successor’s apparently complying presentation

under Subsection (a) or (b) has the consequences specified in Section 5.108(i) even if the purported successor is not the successor of a beneficiary. Provides that certain documents are forged documents for the purposes of Section 5.109. Authorizes an issuer whose rights of reimbursement are not covered by Subsection (d) or substantially similar law and any confirmer or nominated person to decline to recognize a presentation under Subsection (b). Establishes that a beneficiary whose name is changed after the issuance of a letter of credit has the same rights and obligations as a successor of a beneficiary under this section.

Sec. 5.114. **ASSIGNMENT OF PROCEEDS.** Defines “proceeds of a letter of credit.” Authorizes a beneficiary to assign its right to all or part of the proceeds of a letter of credit. Authorizes a beneficiary to assign its right before presentation as a present assignment of its right to receive proceeds contingent upon its compliance with the terms and conditions of the letter of credit. Provides that an issuer or nominated person need not recognize an assignment of proceeds of a letter of credit until it consents to the assignment. Establishes that an issuer or a nominated person has no obligation to give or withhold its consent to an assignment, but consent may not be unreasonably held if the assignee possesses and exhibits the letter of credit and presentation is a condition to honor. Provides that the rights of a transferee beneficiary or nominated person are independent of the beneficiary’s assignment of the proceeds of a letter of credit and are superior to the assignee’s right to the proceeds. Establishes that neither the rights recognized by this section nor the issuer’s or nominated person’s payment of proceeds to an assignee or a third person affect the rights between the assignee and any other person other than the issuer, transferee beneficiary, or nominated person. Provides that the mode of creating and perfecting a security interest in or granting an assignment of a beneficiary’s rights to proceeds is governed by Chapter 9 or other law. Provides that the rights and obligations arising upon the creation of a security interest or other assignment of a beneficiary’s right to proceeds and its perfection, against persons other than the issuer, transferee beneficiary, or nominated person, are governed by Chapter 9 or other law.

Sec. 5.115. **STATUTE OF LIMITATIONS.** Requires an action to enforce a right or obligation arising under this chapter to be commenced within one year after the expiration date of the relevant letter of credit or one year after the cause of action accrues, whichever is later. Establishes when a cause of action accrues.

Sec. 5.116. **CHOICE OF LAW AND FORUM.** Establishes that the liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction chosen by a certain agreement, or by a provision in the person’s letter of credit, confirmation, or other undertaking. Provides that the chosen jurisdiction need not bear any relation to the transaction. Provides that, unless Subsection (a) applies, the liability of an issuer, nominated person, or adviser for action or omission is governed by the law of the jurisdiction in which the person is located. Establishes how a person’s address is determined. Provides that for the purpose of jurisdiction, choice of law, and recognition of interbranch letters of credit, but not enforcement of a judgment, all branches of a bank are considered separate judicial entities, and a bank is located at the place where its relevant branch is considered to be located under this subsection. Establishes that the liability of an issuer, nominated person, or adviser is governed by any rules of custom or practice to which the letter of credit, confirmation, or other undertaking is expressly made subject. Establishes that under certain conditions, the rules of custom and practice would govern over this chapter, except to the extent of any conflict with the nonvariable provisions in Section 5.103(c). Provides that if there is a conflict between this chapter and Chapter 3, 4, 4A, or 9, this chapter governs. Authorizes a forum for settling disputes arising out of an undertaking within this chapter to be chosen in the manner and with the binding effect that governing law may be chosen under Subsection (a). Deletes text concerning a beneficiary’s assignment of right to proceeds.

Sec. 5.117. **New heading: SUBROGATION OF ISSUER, APPLICANT, AND NOMINATED PERSON.** Establishes that an issuer that honors a beneficiary’s presentation is subrogated to the rights of the beneficiary to a certain extent. Establishes that an applicant that reimburses an issuer is subrogated to the rights of the issuer against any beneficiary, presenter, or nominated person to a certain extent. Provides that a nominated person who

pays or gives value against a draft or demand presented under a letter of credit is subrogated to the rights of certain individuals. Establishes that the rights of subrogation set forth in Subsections (a) and (b) do not arise until the issuer honors the letter of credit or otherwise pays, and the rights in Subsection (c) do not arise until the nominated person pays or otherwise gives value, notwithstanding any agreement or term to the contrary. Provides that until that point, the issuer, the nominated person, and the applicant do not derive under this section any rights forming the basis of a claim, defense, or excuse. Deletes existing Section 5.117 concerning the insolvency of bank holding funds for documentary credit.

SECTION 2. Amends Section 1.105(b), Business & Commerce Code, to include the provision for letters of credit, as specified in Section 5.116, as the governing provision.

SECTION 3. Amends Section 2.512(a), Business & Commerce Code, to make conforming and nonsubstantive changes.

SECTION 4. Amends Section 9.103(a), Business & Commerce Code, to include letters of credit among the instruments covered by the section, regarding the perfection of security interest in multiple state transactions.

SECTION 5. Amends Section 9.104, Business & Commerce Code, to include in the transactions to which this chapter does not apply, the transfer of an interest in a letter of credit other than the rights to proceeds of a written letter of credit.

SECTION 6. Amends Section 9.105(c), Business & Commerce Code, to include among the definitions in other chapters applicable to this chapter, "letter of credit," Section 5.102; and "proceeds of a letter of credit," Section 5.114.

SECTION 7. Amends Section 9.106, Business & Commerce Code, to include the rights to proceeds of written letters of credit among those items excluded from the definition of "general intangibles."

SECTION 8. Amends Sections 9.304 and 9.305, Business & Commerce Code, as follows:

Sec. 9.304. New heading: PERFECTION OF SECURITY INTEREST IN INSTRUMENTS, DOCUMENTS, PROCEEDS OF A WRITTEN LETTER OF CREDIT, AND GOODS COVERED BY DOCUMENTS; PERFECTION BY PERMISSIVE FILING; TEMPORARY PERFECTION WITHOUT FILING OR TRANSFER OF POSSESSION. Provides that a security interest in the rights to proceeds of a written letter of credit can be perfected only by the secured party's taking possession of the letter of credit.

Sec. 9.305. WHEN POSSESSION BY SECURED PARTY PERFECTS SECURITY INTEREST WITHOUT FILING. Deletes text specifying the type of security interest covered in this section. Authorizes a security interest in the right to proceeds of a written letter of credit to be perfected by the secured party's taking possession of the letter of credit.

SECTION 9. Effective date: September 1, 1999.

SECTION 10. Makes application of this Act prospective.

SECTION 11. Emergency clause.