Uniform Commercial Code - Article Five - A Bank May Be a Confirming Bank on the Credit of a Non-Bank Issuer

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UNIFORM COMMERCIAL CODE — ARTICLE FIVE — A BANK MAY BE A CONFIRMING BANK ON THE CREDIT OF A NON-BANK ISSUER.

Barclays Bank D.C.O. v. Mercantile National Bank (5th Cir. 1973)

On or about June 1, 1970, Allied Mortgage Consultants, Inc. (Allied), a customer of Mercantile National Bank (Mercantile), issued to Barclays Bank D.C.O. (Barclays) its irrevocable letter of credit in a sum not to exceed $400,000 for the account of Bay Holding Company, Ltd. (Bay Holding). In connection with Allied’s letter of credit, Mercantile delivered to Barclays its own letter, also dated June 1, 1970.

Upon receipt of these letters, Barclays advanced credit in the amount of $350,000 to Bay Holding. At the maturity date, a balance of $280,011.65 remained unpaid and Barclays presented its draft for that amount to Allied, where it was dishonored for lack of funds, and to Mercantile which denied liability.

Barclays then filed suit against Mercantile in the Federal District Court for the Northern District of Georgia alleging wrongful dishonor of the draft, the theory being that Mercantile was a confirming bank on an irrevocable letter of credit. The district court granted Barclays’ motion for summary judgment, holding that Mercantile was a confirming bank within the meaning of section 5-103(1)(f) of the Uniform Commercial Code (Code) and hence was primarily liable under section 5-107(2) of the Code; and that Mercantile’s letter was an independent letter of credit.

1. Allied Mortgage Consultants was an Atlanta based mortgage brokerage firm which at the time was engaged in real estate transactions with Bay Holding Company, Ltd. Barclays Bank D.C.O. v. Mercantile National Bank, 481 F.2d 1224, 1226 (5th Cir. 1973).

2. “Credit” or “letter of credit” means an engagement by a bank or other person made at the request of a customer and of a kind within the scope of this Article (Section 5-102) that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit. A credit may be either revocable or irrevocable. The engagement may be either an agreement to honor or a statement that the bank or other person is authorized to honor.

UNIFORM COMMERCIAL CODE § 5-103(1)(a) (1962 version).

3. The letter from Mercantile read, in pertinent part, as follows:

We hereby confirm the letter of credit and undertake to honor any drafts presented to us on or before expiration date of the letter of credit in accordance with the terms and conditions of said letter of credit.

481 F.2d at 1226, quoting Letter from Mercantile National Bank to Barclays Bank D.C.O., June 1, 1970. This language was added to the letter at the insistence of Barclays. 481 F.2d at 1227.

4. 481 F.2d at 1227.


6. Id. at 460. Mercantile later raised the issue that summary judgment was improvidently granted by the district court because there were factual issues in dispute. See note 42 and accompanying text infra.

7. The UNIFORM COMMERCIAL CODE [hereinafter UCC] was adopted in Georgia effective April, 1963. The text is contained in Title 109A of the Georgia Code Annotated (1962). For convenience, references are to the 1962 Official Text of the UCC as published by the American Law Institute and the National Conference of Commissioners on Uniform State Laws. In order to convert these references to the manner in which they appear in the Georgia Code Annotated, the reader should add the prefix “109A” to all of the sections cited.

8. 339 F. Supp. at 460. The court of appeals said not to discuss whether Mercantile’s letter was an independent letter of credit. 481 F.2d at 1226 n.2.
The United States Court of Appeals for the Fifth Circuit affirmed the district court holding that under sections 5-103(1)(f) and 5-102(3), a bank may confirm a credit issued by a nonbank, thus becoming primarily liable on the credit under section 5-107(2). Furthermore, the court determined that Mercantile’s letter of June 1 to Barclays was a confirmation of Allied’s letter of credit and therefore Mercantile was primarily liable. 9


A letter of credit is, in its most common form, a written promise by a bank, on behalf of its customer-buyer, to make payments to a seller of goods on the terms and conditions specified in the letter of credit. 11

The concept of obtaining goods from a distant seller by means of a guaranty of payment made by a party whose credit is known and respected by the seller has existed for centuries. 12 Historically, a wealthy merchant, desirous of buying goods in a distant market, would issue a letter promising to reimburse a seller for advances made to parties acting on behalf of the merchant. The most important factor in such a transaction was the buyer’s reputation, for it was that which induced the seller to advance the goods, and also upon which the seller relied for payment. 13 The utility of this means of financing trade was circumscribed by the reputation of the buyer in the seller’s locale and thus it was not amenable to use in credit transactions in more remote markets. 14 In order to serve the needs of expanding trade, a means of financing developed which overcame these obstacles: buyers began to have their banks promise prospective sellers that they would accept sellers’ drafts on the account of a buyer, thereby adding the bank’s credit standing to that of the buyer. 15 In essence, the buyer’s bank guaranteed payment to the seller so long as he complied with the terms of the
letter of credit. Ordinarily, the seller was notified of the terms and conditions of the letter of credit by a bank in his own country. This bank assumed no liability, however, except for the accuracy of its transmission.16

Even though the credit of a banking institution could be substituted for that of the buyer alone, this was not always satisfactory to the seller. Since the issuing bank was normally in the buyer's country, such a transaction still required the inconvenience and uncertainty of dealing with a foreign institution. To obviate this difficulty, a bank in the seller's country would "confirm" the issuer's letter of credit, thereby adding its commitment to honor the seller's drafts in connection with the letter of credit. This gave the seller a business arrangement of optimum security and convenience by securing to him the primary commitment of two banks, one of which was in his own country.17

It is important to recognize that the letter of credit was the invention solely of the law merchant.18 The law governing its use was entirely that of custom and practice until the early twentieth century, when increased international trade spurred the use of the letter of credit as a financing tool.19 With this rapid expansion in use,20 it became apparent that if the letter of credit was to be preserved as an efficient and economical financing tool, the forms and procedures surrounding its use would have to be standardized.21

Therefore, partly to provide a legal basis for the expanded use of letters of credit in the United States, the American Law Institute and the National Conference of Commissioners on Uniform State Laws published the Uniform Commercial Code in 1952.22 Article Five of the Code dealt with letters of credit, and specifically noted that it was an expression of the general theories underlying letters of credit and not a set of hard and fast rules.23 Comment 2 to section 5-102 made it clear that since the law of letters of credit was still developing, the Code was not intended to curtail that growth.24 Before the adoption of the Code,25 most of the cases involving letters of credit had arisen in New York.26 The sponsors

16. UCC § 5-103(1)(e) defines an "advising bank" and § 5-107(1) specifies that such a bank assumes no liability except for accuracy.
18. For example, one commentator has noted:
    The law merchant is a body of rules, first of custom, then of law, that has been built up over the course of occidental civilization under the pressure of the needs of commerce and without constructive contribution by lawyers.
    Trimble, supra note 12, at 981.
19. Miller, supra note 12, at 165.
22. Id.
23. UCC § 5-102(3) and Comments.
24. Id.
25. At this time, of the fifty states, only Louisiana has not adopted the Code.
of the Code hoped to give the other states the benefit of New York's body of case law thereby encouraging the growth of the letter of credit as an instrument for domestic finance.\(^{27}\)

The essentially non-legal development of the letter of credit has contributed to the continued existence of the dearth of case law and commentary dealing with the subject.\(^{28}\) Because of this, the Barclays court was compelled to resolve the legal issues in the instant case by making a detailed analysis of the policy considerations underlying the Code.\(^{29}\) The ultimate questions to be resolved were whether a bank could be primarily liable as a confirming bank on the credit of a nonbank, and, if so, was Mercantile's letter of June 1, 1970 a confirmation within the meaning of the Code?

The court began its analysis by examining the letter issued by Allied to determine whether it was a letter of credit within the meaning of the Code provisions. Turning to section 5-102, which sets forth the scope of Article Five, the court concluded that the Article applied since Allied's letter "conspicuously state[d] that it [was] a letter of credit."\(^{30}\) Next, the court determined that Allied's letter was within the Code's definition of a letter of credit since section 5-103(1)(a) clearly envisions letters of credit being issued by persons other than banks.\(^{31}\)

With this preliminary determination settled, the court focused upon the central issue on appeal — whether Mercantile could confirm the credit which had been issued by Allied, a nonbank. As the court noted,\(^{32}\) the problem resulted from the definition of a confirming bank set forth in section 5-103(1)(f):

A 'confirming bank' is a bank which engages either that it will itself honor a credit issued by another bank or that such a credit will be honored by the issuer or a third bank.\(^{33}\)

The lack of precision in the language of section 5-103(1)(f) and the absence of decisional law regarding non-bank issuers fostered the confusion that was at the root of this case. The language of the section is susceptible to two interpretations. The first interpretation, as argued by Mercantile, was that section 5-103(1)(f) precluded a bank from confirming the credit of a nonbank since the definition of "confirming bank" was divided into two clauses by the first conjunction "or." By this analysis, Mercantile could not be a confirming bank within the meaning of the first clause

\(^{27}\) Harfield, supra note 15, at 251.

\(^{28}\) One additional explanation for the dearth of litigation in this area is the fact that there are relatively few banks involved. One estimate is that only about 100 U.S. banks issue letters of credit at all. Chadsey, Practical Effect of the Uniform Commercial Code on Documentary Letter of Credit Transactions, 102 U. PA. L. Rev. 618, 620 (1954).

\(^{29}\) 481 F.2d at 1239.

\(^{30}\) Id. at 1228-29, quoting UCC § 5-102(1)(c). Allied's letter refers to itself as a letter of credit four times within its text. See 481 F.2d at 1227 n.3.

\(^{31}\) 481 F.2d at 1229. For the text of UCC § 5-103(1)(a), see note 2 supra.

\(^{32}\) 481 F.2d at 1239.

\(^{33}\) UCC § 5-103(1)(f).
because that clause plainly speaks of a credit "issued by another bank,"
and Allied was not a bank. Turning to the second part of the definition,
Mercantile argued that the meaning of "such a credit" was a credit "already
issued by another bank." Therefore, Mercantile could not be a confirming
bank under this part of the definition for the same reason, viz. Allied was
not a bank.\textsuperscript{34}

The second possible interpretation was that adopted by the Barclays
court, i.e., that there should be no difference between the confirmation
of a bank's credit and the confirmation of a nonbank's credit. As the court
stated, Mercantile's analysis was defective in that it failed to look behind
the words embodied in the definition of "confirming bank" and to advance
a policy justification for holding that a bank could not confirm the credit of
a non-bank issuer and thereby incur the obligations which the Code imposes
on confirming banks.\textsuperscript{35}

Despite its conclusion that there was no sound policy for holding that
a bank should be unable to confirm the credit of a nonbank, the court
stated that unless policies underlying the Code would be affirmatively
advanced by such a holding, it would have refrained from it simply because
the literal language of the applicable Code sections seemed to preclude it.\textsuperscript{36}
Therefore, the court embarked upon a policy analysis, turning first to
section 1-102(2),\textsuperscript{37} which outlines the purposes of the Code. Although
Mercantile had argued that it was not customary practice for a bank to
confirm the credit of a non-bank issuer and therefore the Code should
not govern the transaction, the court reasoned that, even granting this
argument, it was not dispositive of the question of liability. Although the
agreement between Allied and Barclays was a novel commercial practice,
the purpose of the Code was to accommodate such an expansion if the
parties mold their activities so as to come within the scope of the Code.
Therefore, since the letter between Allied and Barclays was within the
scope of the Code, it was the court's conclusion that the parties intended
the entire relationship to be governed by the Code. Furthermore, the
court reasoned that it would be anomalous to decide that the legal relations-
ships between Allied (the issuer) and Barclays (the beneficiary) were
controlled by the Code, but that Mercantile's purported confirmation of
that credit was not governed by the same set of rules.\textsuperscript{38} Such a conclusion

\textsuperscript{34} 481 F.2d at 1229-30. Mercantile also argued that, by analogy to the definition
of "advising bank," UCC § 5-103(1) (e), it could not be a "confirming bank." \textit{Id.}
at 1229 n.7.
\textsuperscript{35} \textit{Id.} at 1230.
\textsuperscript{36} \textit{Id.}
\textsuperscript{37} UCC § 1-102(2) provides:
The underlying purposes and policies of this Act are
(a) to simplify, clarify and modernize the law governing commercial transactions,
(b) to permit the continued expansion of commercial practices through custom,
usage and agreement of the parties;
(c) to make uniform the law in the various jurisdictions.
\textsuperscript{38} 481 F.2d at 1230-31.
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would not "simplify, clarify and modernize the law governing commercial transactions."89

After concluding that the general policy and purpose of the Code would be advanced by permitting a bank to confirm the credit of a nonbank, the court turned to an inspection of Article 5 to determine whether any policy peculiar to that Article would be advanced by such a holding. Looking to section 5-102(3), the court determined that the express intention of the drafters of the Code was that the principles set forth in Article 5 should be subject to judicially-overseen expansion in order to permit flexibility in meeting novel uses of the letter of credit. The transaction contemplated by the parties in the instant case was just such a novel use of the letter of credit; therefore, the court had the responsibility of developing analogically a new concept to deal with the situation. Thus, since a bank would become primarily liable under section 5-107(2) by confirming a credit issued by another bank,40 the court concluded that a bank confirming the credit of a nonbank also should be held directly liable.41

The second issue faced by the Barclays court was the argument of Mercantile that the question of the intent of the parties was one of fact which should have been submitted to the jury. While agreeing with Mercantile that the interpretation of a written agreement is generally a question of fact, the court rejected such an argument in this case relying on the rule that when it is clear that a reasonable man could come to but one conclusion on the issue, the court will make the factual determination.42

Mercantile advanced three additional defenses: (1) that Mercantile's obligation was a guaranty and as such was ultra vires for a national bank; (2) that Barclays had failed to provide the necessary documentation accompanying its draft to Mercantile; and (3) that Barclays had a duty to withhold payment to Bay Holding after an alleged repudiation by Allied of its letter of credit. These arguments were rejected by the court in almost summary fashion.

Regarding the first argument, the court noted that while a letter of credit is similar in many respects to a guaranty, it is not the same as a guaranty.44 The power of national banks to issue letters of credit had been resolved favorably in 1922 in the case of Border National Bank v. American National Bank.45

39. Id. at 1231, quoting UCC § 1-102(2) (a).
40. UCC § 5-107(2) provides:
A confirming bank by confirming a credit becomes directly obligated on the credit to the extent of its confirmation as though it were its issuer and acquires the rights of an issuer.
41. 481 F.2d at 1231-32.
42. Id. at 1234, quoting 3 A. CORBIN, CONTRACTS, § 554 at 219 (1960).
43. On August 4, 1970, Allied wrote to Barclays instructing that no further funds were to be advanced to Bay Holding without written authorization from Allied, for the reason that Bay Holding had not complied with the underlying real estate transaction between Allied and Bay Holding. 481 F.2d at 1235-36.
44. Id. at 1236, citing Halls, The Uniform Commercial Code in Minnesota: Article 5—Letters of Credit, 50 Minn. L. Rev. 453, 454 n.3 (1966).
45. 282 F. 73 (5th Cir.), cert. demed, 260 U.S. 701 (1922).
The *Barclays* court disposed of the documentation argument with equal dispatch, pointing out that the defendant, following the receipt of Barclays’ draft, had written a letter acknowledging that the draft had been accompanied by the required documentation. Thus, even assuming that the documentation was faulty, Mercantile could not raise this defense because “[b]y formally placing its refusal to pay on one ground, the defendant must be held to have waived all others.”

The final argument of Mercantile, that Allied had repudiated its agreement, was labeled “a last ditch effort” and rejected by the court. Terming the letter by Allied as at most an attempted modification of its letter of credit, the court pointed out that under section 5–106 of the Code, an irrevocable letter of credit may be modified only with the consent of the beneficiary. In this case, Barclays had not consented to any such modification. Furthermore, the court stated, since the relationship created by the letter of credit was independent of the underlying contract between the customer and the beneficiary, Barclays could not alter its relationship with Bay Holding on the basis of Allied’s alleged repudiation, nor could Mercantile alter its relationship with Barclays on that basis.

Although the *Barclays* court relied almost exclusively upon the language of the Code and comments thereto, there is some additional independent support for the conclusion reached. Professor Schlesinger, in 1955, commented that the scope of Article 5 was a reflection of existing law, which, in dealing with persons issuing or confirming letters of credit, treated banks and nonbanks alike. He wrote that the language employed by the drafters of the Code was a result of their inability to find a noun which described the person who advised or confirmed a credit.

A second source of support for the conclusion reached by the *Barclays* court can be found in the language of the comments to the 1952 Official Text of the Uniform Commercial Code. Comment 3 to section 5–102 reads as follows:

46. 481 F.2d at 1236-37.
47. Id. at 1236, quoting Bank of Taiwan v. Union National Bank, 1 F.2d 65, 66 (3rd Cir. 1924).
48. 481 F.2d at 1237-38.
49. UCC § 5-106(2) provides:
Unless otherwise agreed once an irrevocable credit is established as regards the beneficiary it can be modified or revoked only with his consent.
50. 481 F.2d at 1238-39.
51. The court cited only nine secondary sources in its opinion, none of which dealt primarily with confirmation of non-bank credits by banks.
52. See N.Y. LAW REVISION COMM’N STUDY OF THE UNIFORM COMMERCIAL CODE (Leg. Doc. No. 65, 1955) (hereinafter cited as REPORT). This report is based upon the 1952 version of the Code. Nonetheless, many of the comments are still relevant to the 1962 and 1972 official texts. A study of the Report will also provide the reader with some insight into the problems which the Code attempted to resolve.
53. Director of the study of Article 5 published in REPORT, supra note 52.
54. REPORT, supra note 52, at 15.
55. 1d.
Documentary letters of credit are commonly issued by banks. But if anyone else should issue or confirm one the governing law would obviously be the same, and subsection (2) of this Section so provides.\textsuperscript{56}

The Barclays court reached its decision under the 1962 Official Text as enacted in Georgia, so the question arises whether the language changed in the text of that version of the Act indicated a change in the meaning intended by the drafters of the Code.\textsuperscript{57} This question may be resolved by referring to the 1956 Recommendations of the Editorial Board for the Uniform Commercial Code,\textsuperscript{58} which suggested the change in the language. The Board gave as its reason for recommending the change in the definition of a confirming bank as being "simply for the purpose of making the definition more precise."\textsuperscript{59}

It is arguable that the decision in Barclays is an expansion of the law of letters of credit, particularly in view of the comments of the drafters in the 1952 official text.\textsuperscript{60} But there can be no doubt that the decision clarified the law concerning the confirmation of non-bank credits, and such a clarification is bound to have a salutary effect on the use of letters of credit. The fact that there has been so little litigation concerning the use of letters of credit\textsuperscript{61} suggests that among the financial institutions which use them the most there is widespread understanding of the meaning and legal effect of the terms.\textsuperscript{62} In this community, it is submitted, the decision in Barclays will have little effect. But the Code was drafted with the hope of fostering the use of letters of credit as a tool for domestic finance and of inducing the growth of commercial practice.\textsuperscript{63} Thus the greater the certainty of the law of letters of credit, the greater the probability that smaller financial institutions will find it beneficial to enter into this type of financing. Therefore, it may be expected that the Barclays decision will redound to the benefit of the general economy.

The decision does nothing to compel changes in current banking practice, but simply opens to banks another option in an area which hereto-
fore was somewhat uncertain, despite the lack of litigation mentioned above. If a bank wishes to become a confirming bank on the credit of a non–bank issuer, under the holding of Barclays, it may do so and be certain that the rules governing the transaction will be the same as those governing the confirmation of the credit of another bank. As the court stated:

This conclusion affords a liberal construction to the Code, and it will facilitate the continued and expanding use of the letter of credit as a financing tool in the hands of the business planner.64

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64. 481 F.2d at 1232.