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William J. Mitchell

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Oei and Kools de Visser v. Citibank, N.A.: Southern District of New York finds letter of credit applicant has no implied time limit to bring wrongful honor claim

A commercial letter of credit serves to facilitate a contract for the sale of goods between a buyer and seller.¹ In an international setting, without a guaranteed payment device, the seller runs the risk of shipping its goods and not receiving payment, and the buyer bears the risk of paying for, yet never receiving, the goods.² A letter of credit alleviates this risk by obtaining a commitment from a third party to make the payment.³ By permitting the seller to rely on the credit of the issuing bank, a letter of credit provides a convenient, economical, and predictable means of financing a transaction for a seller who is wary of relying on the buyer's credit.⁴ These inherent benefits have made

¹ See JOHN F. DOLAN, THE LAW OF LETTERS OF CREDIT ¶ 1.01 (rev. ed. 1996) [hereinafter DOLAN LETTERS]; see also *Alaska Textile Co., Inc. v. Chase Manhattan Bank*, 982 F.2d 813, 815 (2d Cir. 1992) (defining commercial letter of credit as "a common payment mechanism in international trade that permits the buyer in a transaction to substitute the financial integrity of a stable credit source (usually a bank) for his own"); Rufus James Trimble, *The Law Merchant and the Letter of Credit*, 61 HARV. L. REV. 981, 1004-05 (1948) (detailing various letter of credit agreements). For descriptions of variations on the letter of credit, such as the standby letter of credit and direct pay letter of credit, see DOLAN LETTERS, *supra*, ¶ 1.04, at 16 (distinguishing commercial letter of credit from standby letter of credit, which serves to reduce risk of nonpayment under contract that calls for performance). Distinct from a surety bond, the standby letter of credit acts almost as a surety, "payable upon certification of a party's nonperformance." *Id.*; see also Peter H. Weil, *Letters of Credit*, 754 PRAC. L. INST. COM. 511, 519-22 (1997) (distinguishing commercial letter of credit from standby letter of credit which is not expected to be paid, and is normally payable only upon proof that party *did not* perform). Furthermore, letters of credit are technically not collateral for the obligations of the buyer. See *id.* at 514. Direct pay letters of credit are derivatives, expected to be drawn upon at completion of an obligation, and are valued because they shift the risk of bankruptcy or nonperformance from the beneficiary to the issuer. See *id.* at 522. Commercial letters of credit are the most common type of letter of credit. See *id.* at 519.

² See DOLAN LETTERS, *supra* note 1, ¶ 1.01[1], at 3.

³ See Weil, *supra* note 1, at 513; see also *First Commercial Bank v. Gotham Originals, Inc.*, 64 N.Y.2d 287, 293, 475 N.E.2d 1255, 1258, 486 N.Y.S.2d 715, 718 (1985).

⁴ See *First Commercial Bank*, 64 N.Y.2d at 297-98, 475 N.E.2d at 1261, 486 N.Y.S.2d at 721. The advantages of speed, low cost, and certainty are remarkable in

the letter of credit a preferred instrument for facilitating commerce since its inception nearly 3000 years ago.⁵ Evolving through the English common law, the rules governing letters of credit have since found their way into American jurisprudence where they flourish today.⁶

The Southern District of New York recently reaffirmed the traditional principles that control letter of credit law in *Oei and Kools de Visser v. Citibank, N.A.*⁷ The court rendered a decision, however, that will change the way banks must draft their letter of credit application agreements.⁸ In reaching its decision, the court stated that there is no implied time limit imposed upon a letter of credit applicant to notify the issuing bank of any discrepancies in the documents presented by the beneficiary of the letter of credit.⁹ Therefore, banks must include an express time limit in the letter of credit application agreement in order to set a reasonable time beyond which the applicant can no longer challenge the bank's acceptance of the documents presented and subsequent payment of the letter of credit.¹⁰ This decision created a new precedent in New York letter of credit law.

In its classic form, the letter of credit arrangement consists of three wholly independent contracts between parties to a com-

view of the often complex transactions that the letter of credit serves, and in view of the availability of rival commercial devices, such as performance bonds, escrows, and other surety arrangements that are relatively more expensive and slow in creation and performance. See John F. Dolan, *Letter of Credit Disputes Between the Issuer and its Customer: The Issuers Rights Under the Misnamed "Bifurcated Standard,"* 105 BANKING L.J. 380, 385 (1988) [hereinafter Dolan Disputes].

⁵ See Trimble, *supra* note 1, at 984. It is believed that the Phoenician merchants used letters of credit in extending their commerce to cities in the Mediterranean. See *id.* The merchant bankers of Venice, Genoa, Florence, and other commercial cities of Europe freely used letters of credit in the fourteenth century. See *id.* at 984-85.

⁶ See *Voest-Alpine Int'l Corp. v. Chase Manhattan Bank*, 707 F.2d 680, 682 (2d Cir. 1983). Commercial letters of credit are a mercantile specialty entirely separate from other common law concepts and they must be viewed as entities unto themselves. See *id.* In addition, over 140 countries follow the International Chamber of Commerce's Uniform Customs and Practice for Documentary Credits [hereinafter U.C.P.], which is a restatement-like guideline covering letter of credit law. See *Alaska Textile Co.*, 982 F.2d at 816 n.1. In many foreign countries, letters of credit were needed by manufacturers to ensure compliance with quota restrictions on exports. See *Indu Craft Inc. v. Bank of Baroda*, 47 F.3d 490 (2d Cir. 1995). See generally Trimble, *supra* note 1, at 990-92.

⁷ 957 F. Supp. 492 (S.D.N.Y. 1997).

⁸ See *id.* at 514.

⁹ See *id.*

¹⁰ See *id.*

mercial transaction: (1) the underlying contract for the purchase and sale of goods between a seller, who is the beneficiary under the letter of credit, and the buyer; (2) the contract containing the application and instructions for payment between the issuer, typically a bank, and the buyer, or applicant; and (3) the letter of credit itself, which is the payment mechanism for the seller-beneficiary.¹¹ In order for the beneficiary of the letter of credit to receive payment, or draw on the letter of credit, the beneficiary must present to the issuing bank certain documents that are required in the letter of credit agreement.¹² Such proof typically consists of a draft or demand for payment, bills of lading, documents of title, certificates of origin and inspection, transport and insurance certificates, and commercial invoices.¹³ This documentary proof must strictly conform to the terms of the letter of credit.¹⁴ If the beneficiary presents the complying documents

¹¹ See *Alaska Textile Co.*, 982 F.2d at 815; see also N.Y. U.C.C. § 5-103(1)(d) (McKinney 1996) (defining "beneficiary"); N.Y. U.C.C. § 5-103(1)(c) (defining "issuer"); N.Y. U.C.C. § 5-103(1)(g) (defining "customer"). See generally BROOKE WUNNICKE, DIANE B. WUNNICKE, & PAUL S. TURNER, *STANDBY AND COMMERCIAL LETTERS OF CREDIT* § 2.6 (2d ed. 1996) (describing underlying transaction as sale of goods from beneficiary to applicant, and explaining that rights and obligations of parties are governed by their agreement). In the second agreement, the issuing bank agrees to issue the letter of credit to the beneficiary in return for the applicant's promise to pay for the letter of credit and reimburse the issuer when the letter is honored. See *id.* The third agreement is the letter of credit, where the issuer undertakes to honor the beneficiary's presentation of the documents specified in the credit. See *id.*; see also Kenneth Block & Jeffrey Steiner, *Letters of Credit: Documentary Compliance with Security Device is Essential*, N.Y. L.J., Sept. 17, 1997, at 5.

¹² See Block & Steiner, *supra* note 11, at 5.

¹³ See DOLAN LETTERS, *supra* note 1, ¶ 1.07[1], at 38-42; see also *Alaska Textile Co.*, 982 F.2d at 815.

¹⁴ See *Edmondston v. Drake*, 30 U.S. 624, 637 (1831) (requiring "exactness and precision which peculiarly distinguish commercial transactions, which is an important principle in the law and usage of merchants ..."); *Equitable Trust v. Dawson Partners, Ltd.*, 27 Lloyd's List Law Rep. 49, 52 (H.L. 1927) (setting forth criterion: "There is no room for documents which are almost the same, or which will do just as well"). New York courts have traditionally required strict compliance with the terms of letters of credit. See *Corporation De Mercadeo Agricola v. Mellon Bank Int'l*, 608 F.2d 43, 47 (2d Cir. 1979) (agreeing with District Court that it was "black letter law that the terms and conditions of a letter of credit must be strictly adhered to") (citations omitted); *North Am. Foreign Trading Corp. v. Chiao Tung Bank*, 1997 WL 193197, at *8 (S.D.N.Y.); *Sunlight Distrib., Inc. v. Bank of Communications*, 1995 WL 46636, at *1 (S.D.N.Y.) (following *Equitable Trust* and stating "[w]hile some courts have adopted the less stringent 'substantial compliance' test, 'strict compliance' remains the rule in this Circuit") (citations omitted); *United Commodities-Greece v. Fidelity Int'l Bank*, 64 N.Y.2d 449, 455, 478 N.E.2d 172, 174, 489 N.Y.S.2d 31, 33 (1985) (justifying New York's strict compliance with terms of letter of credit, rather than more relaxed standard of substantial compliance, because bank's role in

under the letter of credit in a timely fashion, the issuer must pay.¹⁵

The independent nature of the three contracts between the parties is known as the "independence principle."¹⁶ The independence principle requires the bank to ignore the underlying contract between the buyer and seller.¹⁷ Any attempt by the is-

transaction is ministerial and does not involve determining substantiality of discrepancies); *Fair Pavilions Inc. v. First-Nat'l City Bank*, 19 N.Y.2d 512, 227 N.E.2d 839, 281 N.Y.S.2d 23, 25 (1967); *DOLAN LETTERS*, *supra* note 1, ¶ 1.07, at 1-38 (stating "[i]t is a well-established principle of letter of credit law that the description of the goods in a commercial invoice must mirror the description in the credit itself"); *see also* *Western Int'l Forest Prods., Inc. v. Shinhan Bank*, 860 F. Supp. 151, 154 (S.D.N.Y. 1994) (holding that facsimile copy of inspection certificate stamped "original" did not conform to strict compliance rule that requires original document); *Trifinery v. Banque Paribas*, 762 F. Supp. 1119, 1122 (S.D.N.Y. 1991) (finding non-compliance where original invoice did not conform to letter of credit requirement for copy). *But see* *National Bank of N. Am. v. Alizio*, 103 A.D.2d 690, 691-92, 477 N.Y.S.2d 356, 357-58 (1st Dep't 1984) (stating that bank paying note on written "Advice of Payment" rather than "draft []," absent any prejudice to parties, was merely matter of "technical niceties" and parties could not avoid obligations), *aff'd*, 65 N.Y.2d 788, 482 N.E.2d 907, 493 N.Y.S.2d 111 (1995); *Bank of N.Y. & Trust Co. v. Atterbury Bros., Inc.*, 226 App. Div. 117, 119-20, 234 N.Y.S. 442, 449 (1st Dep't 1929) (holding that flaws such as name "A. James Brown" being written as "Arthur James Brown" were "trivial" and did not have "slightest causal relationship" to damage), *aff'd*, 253 N.Y. 569, 171 N.E. 786 (1930); REV. U.C.C. § 5-108 (explaining that strict compliance does not demand oppressive perfectionism, so that draft of "Letter of Credit No. 86-122-5" could be paid by "Letter of Credit No. 86-122-S" or where document addressed by foreign person to General Motors was written as "Jeneral Motors").

¹⁵ *See* N.Y. U.C.C. § 5-114(1) (defining issuer's duty and privilege to honor demand for payments regardless of whether goods or documents conform to underlying contract between buyer and seller); U.C.P. art. 14 (requiring that honoring documents appear on their face to be in compliance with terms and conditions of credit); REV. U.C.C. § 5-108(a) (defining issuer's rights and obligations regarding payment).

¹⁶ *Oei and Kools de Visser v. Citibank, N.A.*, 957 F. Supp. 492 (S.D.N.Y. 1997).

¹⁷ *See* N.Y. U.C.C. § 5-109(1)(a) (defining issuer's obligation to its customer as not including liability or responsibility for performance of underlying contract); *see also* *Voesst-Alpine Int'l Corp. v. Chase Manhattan Bank*, 707 F.2d 680, 682-83 (2d Cir. 1983) (explaining benefits of independence principle since banks, dealing only in documents, will be able to act quickly, enhancing letter of credit's fluidity); *Optopics Lab. Corp. v. Savannah Bank of Nigeria, Ltd.*, 816 F. Supp. 898, 908 (S.D.N.Y. 1993) (explaining independence principle and further explaining that each contract is "subject only to the terms bargained for by the parties to that particular contract"); *First Commercial Bank v. Gotham Originals, Inc.*, 64 N.Y.2d 287, 294, 475 N.E.2d 1255, 1259, 486 N.Y.S.2d 715, 719 (1985) (restating fundamental principle that bank's obligation to honor drafts drawn on letter of credit is separate and independent from applicant's obligation to beneficiary); *United Bank Ltd. v. Cambridge Sporting Goods Corp.*, 41 N.Y.2d 254, 259, 360 N.E.2d 943, 948, 392 N.Y.S.2d 265, 270 (1976) (stating that "[b]anks issuing letters of credit deal in documents and not in goods and are not responsible for any breach of warranty or nonconformity of the

suer to avoid payment premised on extrinsic considerations, such as a default in the underlying contract of sale, compromises the letter of credit's chief virtue as a predictable and reliable payment mechanism.¹⁸ "Similarly, independence relieves the issuing bank of the burden of determining the performance required in the underlying contract. The issuing bank need only look at the letter of credit and the documents on their face."¹⁹ However, independent transactions also require that the issuer meticulously comply with the terms of the letter of credit to ensure its reimbursement by the applicant.²⁰ Because the issuing bank sits in a better position to determine whether the presented documents conform to the letter of credit requirements, if it overlooks or ig-

goods involved in the underlying sales contract") (citations omitted); *CE Casecan Water & Energy Co. v. Korea First Bank*, N.Y. L.J., Aug. 28, 1997, at 22, col. 4 (Sup. Ct. N.Y. County 1997) (explaining that duties of bank do not extend beyond bank's contracts); *Sztejn v. Schroder Banking Corp.*, 177 Misc. 719, 721-23, 31 N.Y.S.2d 631, 634-35 (Sup. Ct. N.Y. County 1941) (explaining that independence principle is necessary to preserve efficiency of letter of credit as instrument for financing of trade). *But see First Commercial Bank*, 64 N.Y.2d at 295, 475 N.E.2d at 1259, 486 N.Y.S.2d at 719 (stating that issuer *must* pay draft on letter of credit to holder in due course); *United Bank Ltd.*, 41 N.Y.2d at 261, 360 N.E.2d at 949, 392 N.Y.S.2d at 271 (stating if intermediary bank was not holder in due course, it could be denied from recovering proceeds of draft on letter of credit); *Maurice O'Meara Co. v. National Park Bank of N.Y.*, 239 N.Y. 386, 402, 146 N.E. 636, 641 (1925) (Cardozo, J., dissenting) (criticizing majority for applying independence principle to shipment of bulk paper: "If that is so, the bales tendered might have been rags instead of paper, and still the bank would have been helpless, though it had knowledge of the truth, if the documents tendered by the seller were sufficient on their face"); *Andina Coffee, Inc. v. National Westminster Bank*, 160 A.D.2d 104, 110, 560 N.Y.S.2d 1, 5 (1st Dep't 1990) (finding negotiating bank's "apparently active role" in coercing revisions of documents fell short of holder in due course status); *Sztejn*, 177 Misc. at 722-23, 31 N.Y.S.2d at 634 (carving out exception to independence principle, allowing for judicial injunction against payment where issuer has knowledge of seller's fraud before documents are presented for payment). This exception to the independence principle has been recognized by the U.C.C. *See* N.Y. U.C.C. § 5-114(2) (allowing discretionary exception where holder of note is not holder in due course despite allegations of fraud).

¹⁸ *See Voest-Alpine Int'l Corp.*, 707 F.2d at 682. "For the document examiner to stray from the face of the documents and delve into the underlying transaction will take more time and result in more expense than the letter of credit can sustain." Dolan Disputes, *supra* note 4, at 415. After payment under the credit, inquiry beyond the face of the documents does not burden the credit as a commercial device. *See id.* Likewise, the independence principle compels the bank to pay on the letter of credit, even if it failed to secure proper collateral from the buyer or accidentally agreed to overpay. *See Mennen v. J.P. Morgan & Co.*, 229 A.D.2d 237, 653 N.Y.S.2d 1010 (4th Dep't 1997) (refusing to reallocate risks assumed by parties when entering into contract by precluding recovery to bank for overpayments).

¹⁹ Block & Steiner, *supra* note 11, at 5.

²⁰ *See Voest-Alpine Int'l Corp.*, 707 F.2d at 682-83.

nore's flaws in the paperwork, absent a waiver by the buyer, the bank may be liable to the buyer for wrongful honor.²¹

Wrongful honor cases involve disputes between the issuer and the applicant after the beneficiary has drawn on the letter of credit.²² These cases, however, are uncommon²³ and thus provide scattered precedent and little guidance with respect to several letter of credit nuances.²⁴ One unsettled issue involved whether the length of time an applicant had to bring a wrongful honor action against an issuer was controlled by the applicable statute of limitations or could be reduced by waiver. In *Oei and Kools de Visser v. Citibank, N.A.*,²⁵ the Southern District of New York interpreted New York law to reject implied time limits for applicants to bring flawed documents to the bank's attention.²⁶ As a result, the court set new precedent that will require banks to draft letters of credit with time limits that require applicants to promptly question any defects in the documentary proof presented by beneficiaries.

In *Oei*, plaintiff Kools de Visser ("Kools"), engaged in the wholesale and retail selling of clothing in the Netherlands.²⁷ The company hired Rudy Oei ("Oei") as a broker to purchase Levi

²¹ See *Oei*, 957 F. Supp. at 513-14. The court reasoned that the inspection of the seller's documents is solely the bank's task because: (1) the bank is the party paid to undertake the duty of scrutinizing documents; (2) the bank has expertise in such matters; (3) it is familiar with banking usage, the U.C.P., and the proper format of shipping documents; and (4) the buyer need not have any familiarity in such matters in order to conduct its business, since "[o]ne who deals in widgets may be presumed to be familiar with widgets or the market in widgets, not necessarily with the documents that underlie a shipment of widgets or the U.C.P." *Id.*

²² See James G. Barnes & James E. Byrne, Survey, *Letters of Credit: 1995 Cases*, 51 BUS. LAW. 1417, 1417-18 (Aug. 1996) (categorizing commercial letters generally into wrongful dishonor and wrongful honor, or post-honor, cases). Wrongful dishonor cases involve pre-honor disputes between the beneficiary and the issuer to compel honor or between the applicant and the issuer to prevent honor. See *id.* at 1418.

²³ See *id.* at 1428 (finding only one reported case of wrongful honor in United States in 1995).

²⁴ See *Oei*, 957 F. Supp. at 503-04 (noting disagreement as to whether standard for compliance in buyer-bank contract was strict compliance or substantial compliance). The court stated that there was no well-developed and authoritative body of law governing an applicant's duty to inspect and return documents of title, and subsequently found that no such duty existed. See *id.* at 511; see also Barnes & Byrne, *supra* note 22, at 1425-26 (considering defenses to payment).

²⁵ 957 F. Supp. 492 (S.D.N.Y. 1997).

²⁶ See *id.* at 511-12.

²⁷ *Id.* at 498.

jeans in the United States.²⁸ Oei arranged a transaction with Jade-USA ("Jade"), a purported Florida supplier of such jeans.²⁹ To effect this transaction, Kools transferred the necessary funds to Oei, which he used to apply for a letter of credit from Citibank, N.A. ("Citibank").³⁰ The letter of credit agreement provided that the letter of credit would be governed by the International Chamber of Commerce's Uniform Customs and Practice for Documentary Credits ("U.C.P."),³¹ with any gaps filled by New York law.³²

On three separate occasions during November, 1992, Jade presented documents to Citibank and requested payment for goods shipped under the letter of credit.³³ Citibank notified Jade on two occasions that its documents were not in compliance and would not be accepted.³⁴ Citibank, however, accepted the third set of documents and paid Jade in full on December 2, 1992.³⁵

²⁸ *See id.*

²⁹ *See id.*

³⁰ *See id.* The two defendants in the case were Citibank, N.A. and Citibank International, a Citibank, N.A. affiliate located in Miami which acted as an advising bank to Citibank, N.A. *See id.* Some of the roles between the two affiliates were disputed in the action. *See id.* For the purposes of this Recent Development, the two are referred to collectively as "Citibank."

³¹ *See id.* The parties used the 1983 version of the U.C.P. *See id.*; *see also* Bouzo v. Citibank, N.A., 96 F.3d 51, 57 n.3 (2d Cir. 1996) (explaining that "[t]he U.C.P. is a compilation of internationally accepted commercial practices that is often incorporated into parties' private contracts") (citations omitted).

³² *See Oei*, 957 F. Supp. at 498. Article 5 of New York's U.C.C. provides that the parties to a letter of credit agreement may opt for either the U.C.P. or the U.C.C. to govern. *See* N.Y. U.C.C. § 5-102(4) (allowing parties to exclude U.C.C. from transaction). "Unless otherwise agreed, this Article 5 does not apply to a letter of credit or a credit if by its terms or by agreement ... such letter of credit ... is subject in whole or in part to the Uniform Customs and Practice for Commercial Documentary Credits" *Id.*

³³ *See Oei*, 957 F. Supp. at 499. The funds represented by the letter of credit would be made available to Jade once it presented a sight draft, the invoice, an insurance policy, a packing list, a bill of lading, and a certificate of compliance of quality and inspection by Lloyds of London to Citibank. *See id.*

³⁴ *See id.* The documents presented by the Florida seller did not conform to the letter of credit requirements. For instance, the seller presented a truck bill of lading, rather than a marine bill of lading, purporting to show shipment by truck from Seattle, Washington to the Netherlands. *See id.* The same bill of lading, received by Citibank five days predated, failed to identify the goods, and it named Jade, rather than Kools, as consignor. *See id.* The second "original" bill of lading came from a marine company, rather than a trucking company, but again contained discrepancies. *See id.* Citibank reported that Jade would "fix" the problem. *See id.*

³⁵ *See id.* at 500. The third set of "original" shipping documents Citibank collected contained discrepancies such as: (1) incorrectly describing the goods in the invoice as "Levi JEANS 501 0191 NEW ORLEANS, MADE IN USA LABELS" in-

Oei received the documents from Citibank the same day and found discrepancies.³⁶ For the next several days, the plaintiffs tried to get an explanation of the discrepancies from Jade.³⁷ On December 11, 1997, Kools notified Jade that it was terminating its attempted purchase.³⁸ The goods, which turned out to be counterfeit, never arrived at Kools.³⁹ By January 30, 1993, Kools had "unequivocally" demanded a refund from Jade, but never received one.⁴⁰ Kools then commenced an action against Citibank.⁴¹ The court addressed several issues, including whether there was a time limit on the liability of the issuer after it had honored a letter of credit.⁴²

The court in *Oei* refused to reduce the statutory time limit on the bank's liability after it accepted nonconforming documents.⁴³ New York courts have traditionally followed the settled rule that documents presented to the bank must, on their face, strictly comply with the terms of the letter of credit.⁴⁴ A bank

stead of "LEVI JEANS 501-0191, NEW, ORIGINALS, MADE IN USA LABELS"; (2) a party other than Lloyds of London had done the inspection; and (3) major differences in weight, quantity; and date shipped. *See id.* at 499-500, 508.

³⁶ *See id.* at 500.

³⁷ *See id.* at 500-01.

³⁸ *See id.* at 501.

³⁹ *See id.* "The parties dispute the fate of the goods." *Id.* Defendants claim that the jeans arrived in the Netherlands and were seized as counterfeit by Dutch customs. *See id.* Plaintiffs claim the confiscated jeans were not intended for them, and that their shipment was never sent. *See id.*

⁴⁰ *Id.* at 501. In a settlement agreement from an earlier action, Jade signed a promissory note which it later failed to repay. *See id.* Kools subsequently obtained a judgment against Jade that remains unsatisfied. *See id.*

⁴¹ *See id.* at 497. Kools de Visser filed this action with Oei after unsuccessfully pursuing Citibank on its own. *See Kools v. Citibank*, 872 F. Supp. 67 (S.D.N.Y. 1995) (dismissing Kools' wrongful honor action for lack of standing as undisclosed principal); *see also Kools v. Citibank*, 73 F.3d 5 (2d Cir. 1995) (certifying question to New York Court of Appeals); *M.J.F.M. Kools v. Citibank, N.A.*, 87 N.Y.2d 937, 664 N.E.2d 507, 641 N.Y.S.2d 596 (1996) (accepting question); *cf. Kools v. Citibank*, 1996 WL 450776 (2d Cir. 1996) (withdrawing question).

⁴² *See Oei*, 957 F. Supp. at 511-16.

⁴³ *Id.* at 512 (stating that there is nothing in U.C.P. permitting automatic waiver because of applicant's failure to object promptly to discrepancies, and that New York does not impose duty on applicants to object promptly). Presumably, the statute of limitations for breach of contract would apply. *See N.Y. C.P.L.R. § 213* (McKinney 1996) (providing for six-year limit, unless contract is for sale of goods, in which case U.C.C. § 2-725 applies and limit is four years, N.Y. U.C.C. § 2-725 (McKinney 1981)). The sales contract statute of limitations would not be applicable because the application agreement is an entirely separate and independent contract from the underlying contract for the sale of goods between the buyer and the seller. *See supra* note 17 (discussing independence principle).

⁴⁴ *See supra* note 14 (discussing strict compliance with terms of letter of credit).

has a duty, independent from the underlying contract, to ensure that the documents presented conform to the specifications contained in the letter of credit, forcing the bank to carefully scrutinize the documents for compliance.⁴⁵ Consequently, Citibank's failure to strictly comply with the letter of credit requirements, and its subsequent acceptance of the nonconforming documents, constituted a breach.⁴⁶ Before the decision in *Oei*, however, it remained unclear how long the bank remained liable for subsequently found discrepancies in the documents.

Citibank argued that by failing to object promptly to facial discrepancies in Jade's documents, and by failing to return those documents to Citibank, Oei and Kools waived their right to sue for breach of the application agreement.⁴⁷ Citibank asserted that Oei and Kools had a duty to notify the bank that the documents did not conform to the letter of credit requirements and a further duty to return the documents within a reasonable time.⁴⁸ Citibank claimed that since U.C.P. Article 16 requires the issuing bank to notify the beneficiary of acceptance or rejection of documents within a reasonable time, the applicant should have a similar duty to notify the issuer within a reasonable time of any

⁴⁵ See *Voest-Alpine Int'l Corp. v. Chase Manhattan Bank*, 707 F.2d 680, 682-83 (2d Cir. 1983).

⁴⁶ See *supra* note 17 (discussing independence principle); see also Dolan Disputes, *supra* note 4, at 384 (comparing strict compliance with "bifurcated standard" which requires strict compliance in beneficiary-bank relationship, but only substantial compliance in applicant-bank relationship and proposing variation of bifurcated standard that should be used). To prevent confusion, practitioners and courts must distinguish beneficiary claims from applicant claims. See *id.* Professor Dolan is in agreement with the majority of courts when he states that courts should "consider the consequences, in the customer context, of the issuers payment over documentary defects." *Id.* When this is done, the courts are imposing a substantial compliance rule on the applicant-bank relationship. See *id.* However, Professor Dolan believes that the idea of a bifurcated standard is misleading. See *id.* at 415. He asserts that there should be a strict compliance standard with respect to the beneficiary-bank relationship. See *id.* With respect to the applicant-bank relationship, he states that the documents should be examined to determine the damages that result from the defects and payment by the applicant should be adjusted accordingly. See *id.* In *Oei*, Judge Mukasey recognized that there were differences over which standard should be applied, but ruled that Citibank failed under either standard. *Oei*, 957 F. Supp. at 503-04.

⁴⁷ See *id.* at 511.

⁴⁸ See *id.*; see also Dominic Bencivenga, *Letters of Credit: Pacts Redrafted After Judge Attacks Bank's Role*, N.Y. L.J., Apr. 17, 1997, at 5 (discussing various options that banks have to require timely notice of document discrepancies by applicant when drafting letter of credit).

nonconformity in the documents presented.⁴⁹ Citibank further argued that failure to comply would result "in a waiver of discrepancies that 'operates as a matter of law.'"⁵⁰

Two recent U.S. District Court decisions have provided for time limits on the liability of banks for wrongful honor due to document discrepancies.⁵¹ In *Petra International Banking Corp. v. First American Bank of Virginia*,⁵² the Eastern District of Virginia found an automatic waiver of discrepancies after a beneficiary's confirming bank waited one year before claiming that the documents did not conform to the letter of credit requirements.⁵³ In *Linkers (Far East) PTE., Ltd. v. International Polymers, Inc.*,⁵⁴ the Southern District of New York dismissed a claim by a buyer against a confirming bank that had accepted nonconforming documents.⁵⁵ In *Linkers*, the plaintiff-buyer received a shipment of "worthless scrap" instead of the product it had ordered.⁵⁶ However, the plaintiff failed to report any documentary discrepancies for several months, and then brought suit against the

⁴⁹ See U.C.P. art. 16 (stating that if issuing bank desires to refuse documents, it must do so "without delay"). "If the Issuing Bank and/or Confirming Bank, if any, fails to act in accordance with the provisions of this Article, ... [that bank] shall be precluded from claiming that the documents are not in compliance with the terms and conditions of the Credit." U.C.P. art. 16(e).

⁵⁰ *Oei*, 957 F. Supp. at 511 (quoting Def. 12/4/96 Mem. at 13). District Judge Mukasey wrote "[w]aiver in this [] sense is more properly termed 'forfeiture.'" *Id.* at n.5 (quoting *Smith v. Socialist People's Libyan Arab Jamahiriya*, 101 F.3d 239, 243 (2d Cir. 1996)). An issuing bank can receive permission, in the form of an implied or express waiver, to accept documents with discrepancies between the letter of credit requirements and what is actually received from the beneficiary. See *id.* at 509-15.

⁵¹ See *Linkers (Far East) PTE., Ltd. v. International Polymers*, 1996 WL 412854 (S.D.N.Y. 1996); *Petra Int'l Banking Corp.*, 758 F. Supp. 1120 (E.D. Va. 1991), *aff'd*, 953 F.2d 1383 (4th Cir. 1992); see also N.Y. U.C.C. § 5-103(1)(f) (defining a "confirming bank" as "a bank which engages either that it will itself honor a [letter of] credit already issued by another bank or that such a credit will be honored by the issuer or a third bank").

⁵² 758 F. Supp. 1120 (E.D. Va. 1991).

⁵³ See *id.* at 1128. In resolving the issue of whether a year was too long a delay, the court held against the buyer and the issuing bank, reasoning that because the buyer took possession of the goods using the nonconforming documents, and had already settled with the seller, the buyer had delayed for more than a reasonable amount of time, and the trivial defects did not contribute to the fraud. See *id.* at 1136.

⁵⁴ 1996 WL 412854 (S.D.N.Y. 1996).

⁵⁵ See *id.* at *1. The discrepancies that existed between the letter of credit and the documents submitted by the beneficiary were "de minimus," and would not have alerted the issuing bank to the beneficiary's fraud. *Id.*

⁵⁶ *Id.* at *1-2.

confirming bank.⁵⁷ The *Linkers* court determined that the non-compliance claim was precluded because of a U.C.P. provision defining the issuing bank's duty to provide timely notice of discrepancies to the beneficiary.⁵⁸ However, the court said nothing with regard to the duty an applicant owes to the issuing or confirming bank.⁵⁹ The *Oei* court distinguished *Petra* and *Linkers* not only on their facts, but on the law of letters of credit.⁶⁰

In its analysis, the *Oei* court correctly treated each of the three transactions as separate and independent.⁶¹ The U.C.P. and New York law governed the contract between Citibank and *Oei*.⁶² The U.C.P. provision followed in *Linkers* imposed time limits for notification of document discrepancies on the benefi-

⁵⁷ *See id.*

⁵⁸ *Id.* at *1. *See Oei*, 957 F. Supp. at 512 (finding no New York statutory law imposing duty on applicant to object promptly). The *Oei* court also found no New York case law creating a per se rule barring an applicant's cause of action for wrongful dishonor for not returning the documents to the issuing bank promptly. *Id.* at 512-13. The court barred the claim against the confirming bank because the issuer failed to object promptly to the confirming bank. *See id.*; see also *supra* note 49 (discussing U.C.P. provisions). Similarly, in *Habib Bank, Ltd. v. Convermat Corp.*, 145 Misc. 2d 980, 982, 554 N.Y.S.2d 757, 758 (App. Div. 1st Dep't 1990), an issuing bank that failed to refuse nonconforming documents was precluded, under Article 16 of the U.C.P., from claiming that the documents were not in accordance with the terms of the letter of credit after a one month delay. *See Bank of Cochin, Ltd. v. Manufacturers Hanover Trust Co.*, 808 F.2d 209 (2d Cir. 1986) (finding waiver after delay of 12 to 13 days).

⁵⁹ *See Oei*, 957 F. Supp. at 512.

⁶⁰ *See id.* at 512-13 (factually distinguishing those cases because plaintiffs in those cases were banks confirming credits for beneficiaries rather than applicant). Distinguishing the *Linkers* holding, the court stated that "there is no support in the U.C.P. 400 for an automatic waiver or preclusion arising from the applicant's failure to object promptly to discrepancies" and "[t]he [c]ourt said nothing of an applicant's duty to an issuer." *Id.* at 512 (emphasis added). Next, the court distinguished the instant case from *Petra* because in that case, the discrepancies there were trivial, plaintiffs waited one year before objecting, and plaintiffs actually received the goods. *See id.* at 515.

⁶¹ *Id.* at 508.

⁶² *See id.* at 498; see also *supra* note 32 (noting New York's version of Article 5 gives parties option of governing their contract by Uniform Commercial Code [hereinafter "U.C.C."] or by the U.C.P.). Revised Article 5 of the U.C.C. allows for a letter of credit to be governed by the U.C.P., even when it conflicts with the U.C.C., except where the provisions of the U.C.C. are set forth as nonvariable, in which case revised U.C.C. Article 5 will govern. *See REV. U.C.C. § 5-108*; see also Weil, *supra* note 1, at 516-17 (commenting that American Law Institute and National Conference of Commissioners on Uniform State Laws revised Article 5 in 1995, and that as of October 1, 1997, revised Article 5 has been enacted in 14 states plus District of Columbia).

ary-bank contract,⁶³ but no direct provision regarding a time limit on the applicant-issuer contract existed.⁶⁴ Because the independence principle required separate analysis of each contract, New York case law governed the interpretation of the application agreement between Citibank and Oei.⁶⁵ Furthermore, since the issuer is charged with inspecting the documents, "absence of an automatic waiver rule does not prejudice the issuer."⁶⁶ Stating that the governing contract law does not impose a duty on the applicant to "inspect the documents promptly, report discrepancies and return the documents," the court held that "an applicant does not, by operation of law, waive its right to sue for breach of the application ... by failing to object promptly and to return the documents to the issuer."⁶⁷

The court's holding in *Oei* has two effects: (1) an applicant's wrongful honor claim is not subject to an implied time limit, and (2) inaction by the applicant does not amount to an automatic waiver of the strict compliance requirement.⁶⁸

Issuing banks that routinely honor multi-million dollar letters of credit could find this decision troublesome, unless they revise their application contracts accordingly. The best solution for banks is to ensure strict compliance with essential terms of the letter of credit, thus eliminating any potential future liability to the applicant. In addition, it would be advisable to write an express time limit into the contract, after which the applicant is

⁶³ See *supra* note 49.

⁶⁴ See *Oei*, 957 F. Supp. at 512 ("[The U.C.P.] imposes no obligation on the applicant and concerns only the issuer's obligations to the beneficiary.").

⁶⁵ See *id.* at 502-03 (discussing possible sources of controlling law). The court further stated that although the official comment to U.C.C. § 5-113(2) seems to imply that an applicant has ten days to object to documents, the application agreement provided that the U.C.P. governed, rendering the U.C.C. inapplicable. See *id.* at 512. This same principle was also stated quite clearly in *Optopics Laboratories Corp.*, 816 F. Supp. at 902. In that case, the court distinguished the contracts between the parties by applying the independence principle and held against the issuer who claimed that since Nigerian law covered the application contract, it should also cover the other contracts. See *id.* However, the court held that the choice of law for the application contract had "no impact at all" on the bank-beneficiary contract. See *id.* at 902. Furthermore, New York case law had not created a per se rule barring an applicant from objecting to an issuer's honor of a letter of credit if such objection was not made promptly. See *Oei*, 957 F. Supp. at 512. Cases cited by Citibank were distinguishable from the instant case in that the discrepancies were trivial and were unrelated to any loss. See *id.* at 512-13.

⁶⁶ *Id.* at 514

⁶⁷ *Id.* at 511.

⁶⁸ *Id.* at 515.

estopped from recovering from the bank. This will protect the issuing bank from possible exposure to losses incurred when an applicant resurfaces months later, raising previously unnoticed discrepancies in the documents presented by the beneficiary. A time limit further places the applicant on notice that he or she must make a timely examination of the documents on his or her own, since the bank's liability will cease after a certain period, leaving the applicant-buyer with only warranty claims against the seller. This approach will ensure the continued widespread use of letters of credit as reliable payment mechanisms.

*William J. Mitchell**

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