Security Interests in Letter-of-Credit Rights

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INTRODUCTION

Revised Uniform Commercial Code Article 9 rationalizes the procedures for taking and perfecting a security interest in letter-of-credit rights and for determining the priority of such security interests. Generally, Revised Article 9 observes traditional distinctions in letter-of-credit law as they are codified in Article 5 of the Code, as they have been observed in the Uniform Customs and Practice for Documentary Credits, as they are observed in the

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1. As used in this article, “Revised Article 9” refers to the 1999 official text of Article 9. References to “Revised section 9-XXX” and “R. § 9-XXX” are to sections of Revised Article 9. “The Former Article” refers to the 1995 official text of Article 9.

2. See INTERNATIONAL CHAMBER OF COMMERCE, PUB. NO. 500, ICC UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (1993) [hereinafter UCP 500]. UCP 500 is the latest version of the rules fashioned by the International Chamber of Commerce
International Standby Practices, and as they were largely observed in the prior version of Article 9. Revised Article 9, however, and to some extent, Article 5 (which the sponsoring agencies promulgated in 1995), introduce some new locution into letter-of-credit practice.

This paper begins by noting current distinctions in letter-of-credit law that Revised Article 9 preserves. The paper then describes the methods for attaching and perfecting a security interest in letter-of-credit rights and the effects on those rights of the priority rules, the rules for amendments, and the rules for performance. Throughout, the paper highlights new letter-of-credit terminology in Revised Article 9. The paper concludes that security interests in letter-of-credit rights are problematic and that only lenders versed in letter-of-credit practice should rely heavily on such security interests.

I. TRADITIONAL DISTINCTIONS IN LETTER-OF-CREDIT LAW

Letter-of-credit law has long distinguished two features of a letter of credit that a beneficiary may exploit to leverage its financial ("ICC") for letters of credit. Prior to 1999, these rules or their predecessors were incorporated into most letters of credit, whether commercial or standby, issued, advised, or confirmed by banks in the United States. While there are no "official" comments to UCP 500, the ICC has published commentary on the Uniform Customs. See, e.g., CHARLES DEL BUSTO, ICC GUIDE TO DOCUMENTARY CREDIT OPERATIONS FOR THE UCP 500 (1994); INTERNATIONAL CHAMBER OF COMMERCE, PUB. NO. 511, DOCUMENTARY CREDITS UCP 500 & 400 COMPARED (Charles del Busto ed., 1993). The ICC has also published "case studies" on UCP 500. See CHARLES DEL BUSTO, CASE STUDIES ON DOCUMENTARY CREDITS UNDER UCP 500 (1995); INTERNATIONAL CHAMBER OF COMMERCE, PUB. NO. 596, MORE QUERIES AND RESPONSES ON UCP 500 (Gary Collyer ed., 1997); INTERNATIONAL CHAMBER OF COMMERCE, PUB. NO. 565, OPINIONS OF THE ICC BANKING COMMISSION 1995-1996 (Gary Collyer ed., 1997).

3. This is a regime for standby letters of credit promulgated by the Institute of International Banking Law & Practice, Inc., in cooperation with several money center banks, the ICC Commission on Banking Technique and Practice, the International Financial Services Association (an international banking trade group), and others. ISP98 is effective January 1, 1999 if it is incorporated by reference in the standby letter of credit. See INSTITUTE OF INTERNATIONAL BANKING LAW & PRACTICE, INC., INTERNATIONAL STANDBY PRACTICES ISP98 rule 1.01(b) (1998) [hereinafter ISP98]. Prior to January 1, 1999, most letters of credit, whether commercial or standby, issued in the United States were expressly subject to UCP 500. It is the obvious intent of the banking industry, which participated in the fashioning of ISP98, that in the future standby credits should be issued subject to ISP98, while commercial credits shall be issued subject to UCP 500. For a detailed account of the drafting of ISP98, see JAMES E. BYRNE, THE OFFICIAL COMMENTARY ON THE INTERNATIONAL STANDBY PRACTICES xvi-xx (1998).

4. In the simplest letter-of-credit transaction, there are three parties: the applicant which asks its bank to issue the credit, the bank itself which issues the credit, and the beneficiary to whom the credit is issued and who draws under it. Standby letters of credit often follow this simple pattern, diagrammed as follows:
position. The first is the power to perform the conditions\textsuperscript{6} of the credit and, having performed them, to demand that the issuer honor the credit obligation.\textsuperscript{6} Letter-of-credit law, rather imprecisely, calls this first feature of the credit "the right to draw."\textsuperscript{7} Revised Article 9 at one point refers to it as "drawing rights."\textsuperscript{8} Because they are incomplete, the use of these appellations is imprecise. There is more here than the right to draw; for the beneficiary not only has the right to draw, it also has the power to perform the credit's conditions, and, absent a proper transfer of this prerogative, no one else does. Traditionally, letter-of-credit law has declined to bifurcate the right to draw and the power to perform the conditions and has declined to

![Diagram](image_url)

Commonly, the letter of credit involves four parties: the three in the transaction diagrammed above and a fourth, the nominated bank which receives information from the issuer to the effect that the credit is opened, advises the beneficiary of the issuance, and then fulfills the issuing bank's obligations by paying, accepting, or negotiating the beneficiary's drafts. This four-party transaction arises in the international sale of goods, diagrammed as follows:

![Diagram](image_url)

5. Letters of credit are issued subject to documentary conditions. In the standby setting those conditions might be the presentation by the beneficiary of its invoice, its certificate reciting that the invoice is unpaid, and its draft in the amount of the invoice. See, e.g., Tosco Corp. v. FDIC, 723 F.2d 1242, 1247-48 (6th Cir. 1983); Roman Ceramics Corp. v. Peoples Nat'l Bank, 517 F. Supp. 526, 537 (M.D. Pa. 1981), aff'd, 714 F.2d 1207 (3d Cir. 1983). In a commercial letter of credit, the documentary conditions might be the presentation by the beneficiary/seller of its invoice, a bill of lading showing shipment to the applicant/buyer, a packing list, a certificate of insurance, and the beneficiary's draft for the amount of the invoice. For a case explaining the commercial letter-of-credit transaction in some detail, see Ng Chee Chong v. Austin Taylor & Co., 1 Lloyd's Rep. 156 (Eng. Q.B. 1974).

6. Letters of credit are available by payment, deferred payment obligation, acceptance, and negotiation. See UCP 500, supra note 2, art. 9(a). For purposes of simplicity, unless otherwise stated the text of this paper uses a payment credit paradigm.

7. See, e.g., UCP 500, supra note 2, art. 48; ISP98, supra note 3, rule 6.01.

8. See R. § 9-329 cmt. 3 ¶ 3. Elsewhere Revised Article 9 refers to the "right to demand payment or performance," see id. § 9-102(a)(51), and to "the rights of a transferee beneficiary," see id. § 9-109(c)(4). Cf. U.C.C. § 5-112 cmt. 2 (Supp. 1998) (referring to "drawing rights").
allow the beneficiary of the credit to alienate them freely.9

That is not to say that this feature of letter-of-credit law renders this right coupled with this power unavailable as a source of credit for the beneficiary. Often, issuers designate the letter of credit as "transferable." In that case, the issuer10 of the credit has signaled its willingness to allow the beneficiary to alienate, in whole or in part,11 its right and power to draw. Two points about transferability merit emphasis: (1) a beneficiary may transfer the right to draw only if the credit expressly indicates that it is transferable, and (2) for purposes of its creation and priority, such a transfer, its effect as a secured transaction notwithstanding, is subject to Article 5,12 not to Revised Article 9.13 Thus letter-of-credit law recognizes that the beneficiary of a letter of credit holds a valuable asset, and while that law's prohibition against free alienability of the right to draw remains vigorous under Revised Article 9,14 the law does permit the beneficiary to obtain credit by transferring drawing rights.

If a credit issuer issues a transferable credit, the beneficiary may transfer the credit to a creditor. An exporter, for instance, who is the beneficiary of a transferable credit may transfer part to a supplier. Such a transfer clearly operates as a financing device. The exporter is

9. See, e.g., Fletcher Guano Co. v. Burnside, 83 S.E. 935 (Ga. 1914); Walsh v. Bailie, 10 Johns. 179 (N.Y. 1813); Robbins v. Bingham, 4 Johns. 476 (NY Sup. Ct. 1809); see also HERMAN N. FINKELSTEIN, J.D., LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT 142-44 (1930); HENRY HARFIELD, BANK CREDITS AND ACCEPTANCES 179-94 (5th ed. 1974); JEAN STOUFFLET, LE CREDIT DOCUMENTAIRE 73-80 (1957).

10. This text uses the terms "issuer" and "nominated bank" somewhat interchangeably and sometimes resorts simply to the term "bank." In the standby transaction diagrammed in supra note 4, one should speak of the issuer, since it is the issuer that honors the credit and which transfers the credit, if it is to be transferred. In the commercial letter-of-credit transaction diagrammed in the same note, however, it is more precise to speak of the nominated bank, since it is the nominated bank which honors the issuer's obligation and which effects a transfer of the beneficiary's right to draw under the credit.

11. Under UCP 500, however, the presumption is that unless the credit expressly provides otherwise, the beneficiary may transfer the credit only once. See UCP 500, supra note 2, art. 48(g). The presumption under ISP98 is that the beneficiary may make multiple transfers. See ISP98, supra note 3, rule 6.02(b)(i). ISP98 provides, furthermore, that unless the credit expressly permits them, the beneficiary may not make partial transfers. See id. rule 6.02(b)(ii).

12. See U.C.C. § 5-114(e).

13. See R. §§ 9-109(c)(4), 9-329 cmt. 3. Revised Article 9 does apply to the extent a transferee may hold proceeds that exceed its claim against the debtor. See id. § 9-329 cmt. 4.

using the asset, the letter of credit, to finance its acquisition of the goods or raw materials that are the subject of the export sales contract. The supplier will ready the goods for transport and deliver them to a freight forwarder, thereby assisting in the generation of the documents that the primary beneficiary (the exporter) needs to satisfy the documentary conditions of the credit.

Even though this transfer resembles a secured transaction in its effect, it is a transfer, and transfers are not secured transactions for purposes of attachment, perfection, or priorities. This exclusion is consistent with current law and practice which generally view the transfer as a novation rather than the creation of a security interest.

Notwithstanding its general disposition against free transferability of the beneficiary's right to draw, letter-of-credit law has traditionally and vigorously supported the beneficiary's right to create a security interest in the "proceeds" of a letter of credit. This right need not be stated in the credit and generally is available to the beneficiary under prior law, current law, and practice, though presumably, a nominated bank or an issuer may withhold its consent to an assignment on reasonable grounds. Note, however, that Revised Article 9 renders "ineffective" any requirement that the banks consent to the assignment of a letter of credit that is a supporting obligation.

Revised Article 9 defines the beneficiary's interest in the letter-
of-credit proceeds as “letter-of-credit rights” and preserves the distinction between “assignment,” which generally refers to the alienation of the right to proceeds, and “transfer,” which generally refers to the alienation of the right to draw. Revised Article 9 fashions rules for the creation of a security interest only in assignments. Therefore, while a beneficiary may be able to transfer the right to draw under a credit, it generally does not have the ability to transfer that right without the bank’s consent, and in any event, that transfer is not a secured transaction. However, the beneficiary does have the ability to assign its interest in letter-of-credit rights, with a similar requirement that it obtain the nominated bank’s consent, which the bank may not withhold unreasonably. That conveyance is a secured transaction.

In short, UCC Article 5 governs the transferee’s rights. The transferee is not a secured party. Revised Article 9 governs the assignee’s rights. The assignee is a secured party. In all events, then, one cannot make sense of transactions involving alienation of interests under a letter of credit without sedulous observance of this distinction between transferees and assignees and between transfer of drawing rights and assignment of letter-of-credit rights.

The balance of this paper considers the method for creating a security interest in letter-of-credit rights, the method for perfecting that interest, and the priority rules that apply to it. The paper concludes with a summary of problems that attend this relatively precarious security interest.

II. CREATING THE SECURITY INTEREST IN LETTER-OF-CREDIT RIGHTS (ATTACHMENT)

There are three ways to create a security interest in letter-of-credit rights, two under Revised Article 9 and one under Article 5. It helps explain the scheme of Revised Article 9 for security interests in letter-of-credit rights to use two illustrations: first, a commercial letter-of-credit transaction, and second, a standby credit transaction.

22. Id. § 9-102(a)(51).
23. See, e.g., UCP 500, supra note 2, arts. 48-49; ISP98, supra note 3, rule 6.
25. This statement ignores the fact that a letter of credit itself may conceivably be proceeds from the disposition of collateral and, therefore, subject to the rule in Revised section 9-315(a)(2) that a security interest attaches automatically to the proceeds.
A. Commercial Letters of Credit

In a sale by a U.S. exporter of manufactured goods to a Chinese importer, the parties may elect to use a commercial letter of credit. In this transaction, the Chinese importer (the buyer) causes its bank, (Beijing Bank) to issue its letter of credit in favor of the exporter (the seller). Usually, Beijing Bank will nominate a U.S. bank in the exporter's market (Los Angeles Bank) to honor the seller's demand for payment under the credit. It is also customary in this international sale for Beijing Bank's credit to be conditioned on the presentation of the seller's draft up to the amount of the credit, accompanied by the seller's invoice, a bill of lading, a packing list, and evidence of insurance (collectively, the "documents"). In order to draw on this credit, then, the beneficiary/seller must draw a draft on Los Angeles Bank and present the draft with the documents to Los Angeles Bank on or before the credit's expiry.

In this commercial letter-of-credit transaction, the seller is not a producer, but an exporter, and in order to fulfill its contract with the Chinese buyer, the seller must obtain the goods and arrange for their shipment. If the seller needs to finance the acquisition of the goods, it may resort to the letter of credit, a handy asset. The seller can effect that financing by granting the supplier a security interest in the seller's letter-of-credit rights. Beijing Bank's credit is in the amount of $200,000, and the supplier is willing to deliver the goods for $165,000. Thus there is sufficient value in the credit to finance the acquisition of the goods and the transportation costs to China with enough left over for the exporter to realize a profit.

There are three requirements for the creation of the security interest in the supplier. First, there must be value. Second, the debtor in the secured transaction must have rights in the collateral.

26. This illustration follows the diagram of the commercial letter-of-credit transaction in supra note 4.
27. Article 5 sanctions the practice of issuing letters of credit that are available by performance, i.e., by "delivery of an item of value." U.C.C. § 5-102(a)(10). Most credits ultimately involve, however, the payment of money, and this paper does not make distinctions for credits involving the delivery of items of value.
28. The illustration involves a payment credit, but the results would be no different if the payment were available by deferred payment obligation, acceptance, or negotiation.
29. Note that the nominated bank performs the payment function, but it does so for the issuer. In fact, unless it confirms the credit, the nominated bank is under no obligation to the beneficiary. See UCP 500, supra note 2, art. 10(c).
30. See R. § 9-203(b)(1). In this illustration the supplier's agreement to deliver the goods against an assignment of letter-of-credit rights would constitute value under the definition of "value" in Article 1. See U.C.C. § 1-201(44).
the letter of credit. Third, the secured party must have either a security agreement authenticated by the debtor, or "control" of the letter-of-credit rights. "Control" for letter-of-credit rights purposes arises when the nominated bank (Los Angeles Bank) "consents to an assignment of the proceeds of the letter of credit under section 5-114(c) or otherwise applicable law or practice."

B. Letters of Credit as Supporting Obligations

In this second illustration, the letter of credit secures an obligation which obligation itself is the subject of a security interest. In this setting, the party that holds a security interest in the obligation automatically has a security interest in the letter-of-credit rights of a letter of credit that supports the obligation. Such a letter of credit is a "supporting obligation" in the parlance of Revised Article 9.

In a typical transaction, an Oklahoma supplier of propane sells product to distributors throughout the upper Midwest. The supplier ships through a pipeline periodically on open account. The arrangement requires the propane buyer to cause its bank to issue a standby letter of credit in favor of the supplier to secure payment of the open account obligation. Under the transaction, called an invoice standby transaction, the propane supplier's invoice calls for payment within sixty days of the invoice date. If the buyer fails to make timely payment, the supplier draws on the standby credit issuer by submitting a draft, a copy of the invoice, and a certificate that the invoice is unpaid.

Often, the supplier uses the obligations of his propane buyers, which are accounts under Revised Article 9, to secure the supplier's loans with its own working capital lender. That lender takes a perfected security interest in the accounts. Revised Article 9 stipulates that such a lender automatically obtains a security interest

31. See R. § 9-203(b)(2). The beneficiary of the credit has such rights even before it performs the documentary conditions of the credit. See id. § 9-102(a)(51).
32. See id. § 9-203(b)(3)(A), (D).
33. Id. § 9-107.
34. This illustrative transaction follows the diagram of the standby credit in supra note 4.
35. See R. § 9-203(f).
36. Under the definition of "supporting obligation," the underlying obligation may be an account, chattel paper, document, general intangible, instrument, or investment property. See id. § 9-102(a)(77).
37. For an illustration of an invoice standby credit, see THE LAW OF LETTERS OF CREDIT, supra note 16, app. E, document 16.
38. See R. § 9-102(a)(2).
in the standby credits securing the accounts.\textsuperscript{39} This rule stems from the assumption that it is “implicit under former Article 9.”\textsuperscript{40}

It is important to differentiate a letter of credit that is a supporting obligation from one that is not. Documents often arise in commercial letter-of-credit transactions such as that between the U.S. exporter and the Chinese buyer described in Part II.A above. In that transaction, the parties use a document, namely, a bill of lading, but the commercial letter of credit described there is not supporting performance of the document. Generally, it is a standby credit, such as that in the propane invoice standby illustration, that will serve as a supporting obligation.

\textbf{C. Security Interests Arising Under Article 5}

The Article 9 revision package includes a conforming amendment to Article 5, section 5-118. That section grants to a letter-of-credit issuer or nominated bank, which pays a beneficiary under a credit, a security interest in a document that the beneficiary presents to the bank in satisfaction of one of the documentary conditions of the credit.\textsuperscript{41} Although rare, it is possible that a beneficiary might be required, in order to satisfy the documentary conditions of letter of credit \(A\), to present to the issuer letter of credit \(B\). In that case, the issuer has a security interest in letter of credit \(B\), analogous to the security interest of a collecting bank under Article 4.\textsuperscript{42} The issuer or nominated bank’s security interest in letter of credit \(B\) is subject to Revised Article 9, but a security agreement is not necessary. The security interest will remain unperfected, however, until the bank takes steps to perfect.\textsuperscript{43}

\textbf{III. PERFECTING THE SECURITY INTEREST IN LETTER-OF-CREDIT RIGHTS}

There are two ways to perfect a security interest in letter-of-

\textsuperscript{39} See id. § 9-203(f).
\textsuperscript{40} Id. § 9-203 cmt. 8.
\textsuperscript{41} Revised section 5-118 requires the nominated bank or issuer to give value. When the nominated bank honors the credit by paying, accepting, incurring a deferred payment obligation, or negotiating, it will have given value.
\textsuperscript{42} See U.C.C. § 4-210.
\textsuperscript{43} The security interest is automatically perfected if letter of credit \(B\) is in a medium other than a written or tangible medium. See R. § 5-118(b)(2). Otherwise, section 5-118(b)(3) provides for automatic perfection of a security interest in some types of collateral but excludes letters of credit from the list. See id. § 5-118 cmt. 2.
credit rights: (1) control under Revised section 9-312(b) and (2) perfection under Revised section 9-308(d) of a security interest in collateral that a letter of credit "supports."

A. Control

Generally, a party that obtains a security interest in letter-of-credit rights will perfect that interest by control. The statutory route to that conclusion winds its way somewhat tortuously through a complex of Revised Article 9 sections. Revised section 9-310, the starting point, is the general provision governing perfection of Revised Article 9 security interests. It requires that all security interests be perfected by filing unless the section provides to the contrary. The section then stipulates two exceptions for perfecting a security interest in letter-of-credit rights. The first exception located in Revised section 9-308(d) is discussed below. The second exception is that for control.

The next stop on the statutory route is Revised section 9-314, which indicates that for purposes of letter-of-credit rights, one must look to Revised section 9-107. That section indicates that the secured party effects control by following the procedure in Article 5, section 5-114(c), for obtaining the nominated bank's consent to the assignment of proceeds or by following other "applicable law or practice." Section 5-114(c) stipulates that a nominated bank may decline to recognize an assignment of the proceeds, but not without reason. Customarily, the nominated bank will insist that the assignor execute an assignment of proceeds request form and pay a fee for the assignment. The nominated bank will usually also insist that the assignee exhibit the credit to the nominated bank at the time of payment.

In the illustrative transaction described earlier, Beijing Bank

44. See R. § 9-312 cmt. 6.
45. See id. § 9-310(a).
46. See id. § 9-310(b)(1).
47. See id. § 9-310(b)(8); cf. id. § 9-310(a) (referring to Revised section 9-312(b) which provides that except for the Revised section 9-308(d) rule, control is the only method for perfecting a security interest in letter-of-credit rights).
48. See id. § 9-314(a) & cmt. 2.
49. See id. § 9-107.
50. See U.C.C. § 5-114(d).
51. For an illustration of such a form, see THE LAW OF LETTERS OF CREDIT, supra note 16, app. E, document 22.
52. Cf. U.C.C. § 5-114(d) (provision anticipating such practice).
nominated Los Angeles Bank to pay the beneficiary upon the presentation of specified documents. When the beneficiary grants a security interest to its supplier, the supplier must see that the beneficiary completes Los Angeles Bank’s assignment form. When Los Angeles Bank receives the form and its fee, the bank gives notice of its consent to the assignment. That procedure constitutes control in the supplier.

While the Los Angeles Bank may decline to recognize the assignment, and while absent the nominated bank’s consent there is no control and, therefore, no perfection, section 5-114(d) allows the nominated bank to withhold its consent only if it acts reasonably. Banks have traditionally viewed assignments as something of a headache. The bank must determine first, that the person seeking to make the assignment is the beneficiary; second, that there has been no previous inconsistent assignment; and third, when the beneficiary presents its documents for payment, that the proceeds go to the correct parties, i.e., part to the supplier and part to the beneficiary. In cases involving partial shipments, the beneficiary may have multiple suppliers. In those situations, the nominated bank may have to oversee payments to multiple parties, who may have conflicting claims.53

Article 5 protects the nominated bank by permitting it to require the assignee to exhibit the letter of credit or other documents and permits the bank to charge a fee.54 Presumably computerized information retrieval systems make it easier for banks to track multiple assignments.

Note that Article 5 contemplates control other than by the system described here, which is customary in commercial letter-of-credit practice but may not be so well established in the standby industry, which involves a far greater number of issuers and many more commercial parties.55 It may be that in some geographic areas


54. Authority to charge a fee is implicit in section 5-114(d). Traditionally, banks have charged a fee for the service of observing notices of assignment. Presumably, a bank’s refusal to honor an assignment unless the beneficiary pays an inordinately high fee would constitute an unreasonable denial and violate the command of the section that the bank not refuse unreasonably to observe an assignment if the credit requires presentation of the credit instrument and if the assignee satisfies the condition.

55. Commercial letters of credit tend to arise in international banking centers. Parties that use them are normally exporters and importers or other participants in international trade. Banks engaged in this activity are usually members of the International Financial Services
and some industries, parties assign proceeds in standby credits under simple contract assignment rules. In that case mere notice to the nominated bank (or to the issuer) without any consent may suffice to effect control.\textsuperscript{56} Such an assignment may not impact the obligation of the issuer, however.\textsuperscript{57}

Article 5 makes it clear that perfection by control may occur before or after\textsuperscript{58} the beneficiary presents the required documents to the bank. This rule is commercially important, since many assignments will occur, as the illustrative transaction suggests, before the beneficiary presents its documents.

An assignment after the beneficiary presents the documents presumably must occur before the bank satisfies the letter-of-credit obligation. Under Article 5\textsuperscript{59} and codified rules,\textsuperscript{60} the bank has a reasonable time, not to exceed seven banking days, to examine the beneficiary’s documents to determine whether they comply with the terms of the credit. During that period, the beneficiary should be able to assign its letter-of-credit rights. Under some credits, moreover, payment is deliberately delayed, sometimes for periods of sixty or ninety days.\textsuperscript{61} In fact, the letter-of-credit industry denominates some credits “deferred payment credits.”\textsuperscript{62} Under these credits, after the issuer examines the documents, it advises the beneficiary that it will make payment on the date specified in the credit. Again, there is no commercial reason that beneficiaries should not be able to assign their right to payment under the deferred payment credit during the deferred period.

Other delayed payment credits call for the bank to accept time

\textsuperscript{56} This method of control works only if the courts read Revised section 9-107 as allowing that there may be procedures under “law” or “practice” other than that described in the text for effecting control.

\textsuperscript{57} See U.C.C. § 5-114(b).

\textsuperscript{58} See id.

\textsuperscript{59} See id. § 5-108(b).

\textsuperscript{60} See UCP 500, supra note 2, art. 13(b); cf. ISP98, supra note 3, rule 5.01(a)(i) (fashioning a “reasonable time rule” but then adding that three days “is deemed to be not unreasonable”).

\textsuperscript{61} Deferred payment credits and acceptance (sometimes called “usance”) credits arise when the applicant is a buyer that has negotiated credit terms in the underlying sales transaction.

\textsuperscript{62} See, e.g., UCP 500, supra note 2, art. 9(a)(ii).
drafts. Acceptance is not full performance of the credit obligation, for
the duty of an issuer of an acceptance credit is not just to accept the
drafts but also to pay them when they mature.63 It would be an
unfortunate reading of section 5-114(b), however, that permitted a
beneficiary to use letter-of-credit law to create and perfect a security
interest in letter-of-credit rights that are embodied in negotiable
acceptances. Once the bank accepts the drafts, it becomes obligated
as a matter of negotiable instruments law to pay the person entitled to
enforce the acceptances.64 Thus it should be too late to assign letter-
of-credit rights after the bank has accepted a time draft presented
under a letter of credit.65 In those cases, the security interest should be
taken in the acceptance itself, usually by possession.66 Even if courts
construe the rule to the contrary and permit a beneficiary to use
letter-of-credit law to assign letter-of-credit rights after the bank has
accepted the beneficiary’s drafts, any such security interest would be
cut off by a secured party that took delivery of the acceptance in a
manner that made it a holder in due course,67 as most secured parties
would do.

A banker’s acceptance generated under a credit would be
proceeds of the credit,68 and if the beneficiary has assigned the
proceeds properly, the assignee would be entitled to the acceptance.69

B. Revised Section 9-308(d) — Letter of Credit as Supporting
Obligation

The procedure outlined in Article 5 for obtaining control and
thereby perfecting a security interest in letter-of-credit rights is
unnecessary for the secured party with a security interest in collateral

63. See U.C.C. § 5-108(a) (imposing duty on issuer to honor beneficiary’s complying
presentation); U.C.C. § 1-201(21) (defining “honor” as “to pay or to accept and pay”) (emphasis
added); cf. UCP 500, supra note 2, art. 9(a)(iii)(a) (similar rule).
64. See U.C.C. § 3-413.
65. Thus if the credit calls for the nominated bank to accept the beneficiary’s draft, an
assignment after acceptance would come too late. In any event, a well advised bank would treat
the matter as one governed by acceptance law, not letter-of-credit law. Cf. All Serv. Exportacao,
(applying UCC Article 4, rather than UCC Article 5, to a dispute over acceptances arising
under letter of credit); First Commercial Bank v. Gotham Originals, Inc., 475 N.E. 2d 1255, 1260
67. See U.C.C. § 3-306.
68. See U.C.C. § 5-114(a); R. §§ 9-102(a)(64)(B), (C), 9-102(b).
69. See R. §§ 9-203(f), 9-315(a)(2).
that is "supported," as that term of art applies, by a letter of credit. The invoice standby transaction described in Part II.B above illustrates the operation of Revised section 9-308(d). If the account financer in that transaction perfects its security interest in the account, the financer automatically enjoys a perfected security interest in the standby letter of credit that qualifies as a "supporting obligation."70

C. Duration

Since perfection of a security interest in letter-of-credit rights does not entail any financing statement, the normal five-year limit on the effectiveness of a filing71 does not apply to security interests in letter-of-credit rights. The interest of a party claiming a security interest in letter-of-credit rights will expire, however, if the credit itself expires without performance by the beneficiary of the credit's conditions.

The letter of credit is a conditional obligation, and only the beneficiary has the power to perform the conditions. Many credits, especially standby credits, expire without a conforming draw. The party with a security interest in letter-of-credit rights, then, holds precarious collateral. As the credit's expiry approaches, the secured party is powerless, unless, through an action in equity or the like, it can force the beneficiary to perform the credit's conditions.72

Choice-of-law rules also bear on the termination of a security interest in letter-of-credit rights. The rules are moderately complex. First, Revised section 9-306(a) stipulates that the law of the issuer's (or nominated bank's) jurisdiction governs but only so long as that jurisdiction is a "State," as Revised Article 9 defines that term.73 If that jurisdiction is not a State, the law of the debtor's jurisdiction governs.74 Revised section 9-306(b) stipulates further that Article 5 choice-of-law rules determine the issuer's jurisdiction. Article 5 provides that the parties have virtually complete autonomy in selecting the applicable law, and if the letter of credit specifies a jurisdiction, that jurisdiction's law governs the obligation of the

70. Id. § 9-102(a)(77).
71. See id. § 9-515(a).
73. See R. § 9-102(a)(76) (defining "State").
74. See id. § 9-306 cmt. 2.
bank.\textsuperscript{75} Absent any choice by the parties, Article 5 designates the jurisdiction in which the issuer is located as governing.\textsuperscript{76}

Choice-of-law analysis is imperative under Revised section 9-316(f), which stipulates that a security interest perfected by control under the law of the nominated bank's jurisdiction expires four months after the nominated bank moves to a new jurisdiction.\textsuperscript{77} Since most creditors with a security interest in letter-of-credit rights will perfect by control, generally, the issuer's change of jurisdiction will not affect the duration of perfection. Perfection by control in State $A$ will constitute perfection by control in State $B$.

Control is not a sufficient method to perfect a security interest in letter-of-credit rights, however, when the credit is a supporting obligation. Revised section 9-308(d) mandates perfection as to the collateral that the credit supports as the method of perfecting a security interest in the letter-of-credit rights. One must read Revised section 9-316(f), then, as inapplicable to a security interest in such a letter of credit. It is fair to conclude that a change in the jurisdiction of the issuer of a credit that is a supporting obligation has no bearing on the duration of the secured party's interest.

\textbf{IV. PRIORITIES}

There are a number of priority rules peculiar to security interests in letter-of-credit rights. The general priority provision for letter-of-credit rights is Revised section 9-329, which governs security interests perfected by control. As this paper suggested earlier, control will be the most common method of perfecting such security interests under Revised Article 9. Revised section 9-329(b) provides that secured parties perfected by control enjoy priority in the order that they obtain control. The provision also carves out a preferred position for secured parties that perfect by control over parties that perfect by other means. The comment makes explicit what is implicit in that preferred position, namely, that a secured party with an automatically perfected security interest in letter-of-credit rights in a credit that is a supporting obligation holds a security interest inferior to that of the secured party that perfects by control.\textsuperscript{78}

\textsuperscript{75} See U.C.C. § 5-116.
\textsuperscript{76} See id. § 5-116(b).
\textsuperscript{77} See R. § 9-316(f)(2). This analysis does not apply to an automatically perfected security interest in letter-of-credit rights under Revised section 9-308(d). See id. § 9-306(c).
\textsuperscript{78} See id. § 9-329 cmt. 2.
For priority purposes, it is critical to understand the distinction noted earlier between what letter-of-credit law traditionally has called "assignment" of a letter of credit and what Revised Article 9 calls the transfer of drawing rights under a letter of credit. Only the former is a secured transaction.\textsuperscript{79} Under letter-of-credit law, moreover, the rights of a transferee beneficiary, that is, of a party which takes the right to draw, are superior to those of a creditor with a perfected security interest in the same credit. In short, if on May 1 the exporter/beneficiary in the commercial letter-of-credit transaction described in Part II.A above grants, say, its working capital lender a security interest, perfected by control, in the proceeds of the letter of credit, and if on May 2 the exporter/beneficiary effects a transfer of the credit to its supplier, the supplier's rights as transferee, even though they arise subsequently, are superior to the perfected security interest of the lender.\textsuperscript{80}

In theory, this special protection for transferee beneficiaries opens letter-of-credit financing to an obvious abuse. In all probability the exporter's later transfer of letter-of-credit drawing rights to its supplier would violate the spirit and probably the letter of the security agreement between the beneficiary and its working capital lender, yet the priority section prefers the transferee.

In practice, however, the risk of that abuse may be small. Usually, in order to transfer the right to draw under a letter of credit, the beneficiary must ask the nominated bank to issue a new advice to the transferee.\textsuperscript{81} In these circumstances, the nominated bank already knows of the lender's security interest, for perfection by control requires the nominated bank to consent to the assignment to the lender.\textsuperscript{82} Nominated banks, then, should decline in these circumstances to effectuate the transfer; that is, they should not issue the new advice to the transferee beneficiary without the secured party's consent. The nominated bank, then, will normally prevent this potential abuse.

The nominated bank's role arises by virtue of transfer procedures established by the international banking community, codified in the international banking community's rules,\textsuperscript{83} and

\textsuperscript{79} See id. § 9-109(c)(4); and the discussion in supra Part I.
\textsuperscript{80} See U.C.C. § 5-114(c); R. § 9-329 cmt. 3 para. 2.
\textsuperscript{81} Revised Article 9 recognizes this practice which it refers to as 'in effect a novation.' R. § 9-329 cmt. 3 para. 2.
\textsuperscript{82} See id. § 9-107.
\textsuperscript{83} See UCP 500, supra note 2, art. 48. The Uniform Customs are the product of the
recognized by the Code.84 That internationally recognized practice entails the issuance of a new advice to the transferee beneficiary, often in a form that permits the nominated bank to shield the parties' identities from each other.85 This need to shield identities is an eccentricity of commercial credit transactions such as the credit involving the exporter and the Chinese buyer in the illustration in Part II.A above. That need does not arise in standby letter-of-credit transactions, and there is some evidence that in standby transactions, the parties do not always invoke the rather cumbersome procedure of a novation. Rather, in the standby transaction, parties, it appears, sometimes have transferred the right to draw by simple delivery of the credit accompanied by the first beneficiary's authorization for the transferee to draw or by notation on the credit itself.86

A nominated bank that receives a draw from a transferee beneficiary should honor the draw, any notice of the secured party's interest notwithstanding. The Code's preference for transferees over secured parties confirms that result. Yet, the nominated bank in the traditional commercial letter-of-credit transaction and the issuer in the standby transaction are well advised to decline to issue a new advice (if there is to be one) unless the beneficiary obtains the secured party's consent to it.

Secured parties might try to avoid the danger of being trumped by a transfer by insisting, whenever they take a security interest in letter-of-credit rights, that the credit not be designated as transferable. Under letter-of-credit law, a credit may be transferred only if it is so designated.87 If the secured party wants to take a security interest in proceeds of a letter of credit that is transferable,
the secured party can ask the parties to amend the letter of credit, making it nontransferable. Unfortunately for the secured party, credits may be amended by the bank and the beneficiary without the secured party's consent, so that after the assignment of the security interest, the parties can, if they are perverse enough, amend the credit again and make it transferable. This possibility is all the more troubling by virtue of the fact that the issuer and the beneficiary, usually with the cooperation of the applicant, may amend a credit without the approval of the nominated bank. Thus a nominated bank may have consented to an assignment of a nontransferable credit and only later learn that the parties are amending the credit to make it transferable.

Although a transferee is not a secured party and does enjoy preferred status under Revised Article 9, the transferee is not completely free from Article 9 duties. If, in fact, the transferee takes a transfer as security for an underlying debt of the beneficiary, the transferee need not comply with the attachment and perfection provisions of Revised Article 9 but must account to parties protected by Revised Article 9 for any proceeds of the credit that exceed the amount due on the underlying obligation.

V. AMENDMENTS

The vulnerability of a perfected security interest in letter-of-credit rights to the intersection of secured transactions law and letter-of-credit amendment law is evident in the duration discussion in Part III.C and the transferee beneficiary priority discussion in Part IV. As those Parts demonstrate, these areas of commercial transactions law are not always compatible. Secured parties are especially vulnerable, furthermore, to amendments that reduce the amount of the credit, shorten its expiry, cancel it, or otherwise limit the letter-of-credit rights in which the secured party has taken an interest.

88. See U.C.C. § 5-106(b); UCP 500, supra note 2, art. 9(d)(i); ISP98, supra note 3, rule 6.07(b)(i).
89. In fact, the parties can cancel a credit even after the beneficiary has assigned it. See U.C.C. § 5-106 cmt. 2 para. 2; ISP98, supra note 3, rule 6.07(b)(i).
90. But cf. UCP 500, supra note 2, art. 11(b) (providing that if issuer uses advising bank to advise issuance of credit, it "must" use same bank to advise amendments); ISP98, supra note 3, rule 2.07(a) (creating similar rule).
91. See R. § 9-329 cmt. 4 para. 1.
92. See id. para. 2.
93. The Uniform Customs and Practice for Documentary Credits contains a provision that requires a first beneficiary that is transferring the right to draw to instruct the nominated bank...
Sometimes, the secured party is a bank, often one that is issuing a second letter of credit, in what is sometimes called a "back to back letter-of-credit transaction." The secured bank may avoid the risk of a harmful amendment to the prime credit by requiring the commercial parties to instruct the issuer of the prime credit to ask the second bank to confirm the prime credit. No amendment to the prime credit can affect the rights of a confirmer unless the confirmer agrees to the amendment.

**CONCLUSION**

Revised Article 9 provides clear rules for creating and perfecting a security interest in letters of credit. Most of the time, notice to and consent of the issuer of the nominated bank will create and perfect the security interest. In some cases of letters of credit as supporting obligations, however, creation of the security interest is automatic, and perfection depends on the secured party's perfection of a security interest in the supported collateral.

Problems arise by virtue of the fact that security interests in letter-of-credit rights are subject to the rights of transferee beneficiaries and to the rights of the issuer or the nominated bank and are vulnerable to amendment, cancellation, and expiry. While there are steps that a secured party can take to avoid these dangers, it is not clear that there are procedures for full protection. In all events, parties relying on a security interest in letter-of-credit rights must be vigilant and experienced in letter-of-credit law and practice.

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94. For discussion of the back to back letter-of-credit transaction, see THE LAW OF LETTERS OF CREDIT, supra note 16, ¶ 1.08.

95. See U.C.C. § 5-106(b); UCP 500, supra note 2, art. 9(d)(i); ISP98, supra note 3, rule 2.06.