

12A:5-101

LEGISLATIVE HISTORY CHECKLIST  
Compiled by the NJ State Law Library

NJSA: 12A:5-101 "Uniform Commercial Code"

LAWS OF: 1997 CHAPTER: 395

BILL NO: S2028

SPONSOR(S): Inverso, Bateman & Weingarten

DATE INTRODUCED: May 8, 1997

COMMITTEE: ASSEMBLY: \_\_\_\_\_  
SENATE: State Management

AMENDED DURING PASSAGE: Yes Amendments during passage denoted  
Second reprint enacted by superscript numbers

DATE OF PASSAGE: ASSEMBLY: January 12, 1998  
SENATE: December 15, 1997

DATE OF APPROVAL: January 19, 1998

FOLLOWING STATEMENTS ARE ATTACHED IF AVAILABLE:

SPONSOR STATEMENT: Yes Also attached: statement,  
adopted 12-1-97

COMMITTEE STATEMENT: ASSEMBLY: No  
SENATE: Yes

FISCAL NOTE: No

VETO MESSAGE: ~~No~~ No

MESSAGE ON SIGNING: ~~No~~ Yes

FOLLOWING WERE PRINTED:

REPORTS: Yes

HEARINGS: No

974.90 New Jersey. Law Revision Commission.  
L446 Annual report...1994, February 1, 1995.  
[p. 9-- and Appendix F]

974.90 New Jersey. Law Revision Commission.  
L446 Annual report...1995, February 1, 1996, Trenton.  
[see pp. 10-11]

974.90 New Jersey. Law Revision Commisision.  
L446 Annual report...1996, February 1, 1997.  
[see pp. ~~9-10~~ and Appendix B]

KBP:pp

5-6

§1,  
N.J.S. 12A:5-101 to  
12A:5-117  
Chapter 5  
Letters of Credit  
Repealed & Replaced  
§12  
Note To  
§§1-11

P.L. 1997, CHAPTER 395, *approved January 19, 1998*  
Senate, No. 2028 (*Second Reprint*)

1 **AN ACT** concerning commercial transactions, replacing chapter 5 of  
2 Title 12A of the New Jersey Statutes and revising various parts of  
3 the statutory law.

4  
5 **BE IT ENACTED** by the Senate and General Assembly of the State  
6 of New Jersey:

7  
8 1. Chapter 5 of Title 12A of the New Jersey Statutes  
9 (N.J.S.12A:5-101 through 12A:5-117, including any amendments or  
10 supplements thereto) is repealed and replaced as follows:

11  
12 **CHAPTER 5. LETTERS OF CREDIT**

13  
14 **PART 1**

15 **SHORT TITLE AND GENERAL MATTERS**

16 12A:5-101. Short Title

17 This chapter may be cited as "Uniform Commercial Code--Letters  
18 of Credit."

19 12A:5-102. Definitions.

20 a. As used in this chapter:

21 (1) "Adviser" means a person who, at the request of the issuer, a  
22 confirmer, or another adviser, notifies or requests another adviser to  
23 notify the beneficiary that a letter of credit has been issued, confirmed,  
24 or amended.

25 (2) "Applicant" means a person at whose request or for whose  
26 account a letter of credit is issued. The term includes a person who  
27 requests an issuer to issue a letter of credit on behalf of another if the  
28 person making the request undertakes an obligation to reimburse the  
29 issuer.

30 (3) "Beneficiary" means a person who under the terms of a letter  
31 of credit is entitled to have its complying presentation honored. The

**EXPLANATION - Matter enclosed in bold-faced brackets [thus] in the above bill is not enacted and intended to be omitted in the law.**

**Matter underlined thus is new matter.**

**Matter enclosed in superscript numerals has been adopted as follows:**

<sup>1</sup> Senate SSM committee amendments adopted June 12, 1997.

<sup>2</sup> Senate floor amendments adopted December 1, 1997.

1 term includes a person to whom drawing rights have been transferred  
2 under a transferable letter of credit.

3 (4) "Confirmer" means a nominated person who undertakes, at the  
4 request or with the consent of the issuer, to honor a presentation  
5 under a letter of credit issued by another.

6 (5) "Dishonor" of a letter of credit means failure timely to honor  
7 or to take an interim action, such as acceptance of a draft, that may be  
8 required by the letter of credit.

9 (6) "Document" means a draft or other demand, document of title,  
10 investment security, certificate, invoice, or other record, statement, or  
11 representation of fact, law, right, or opinion (a) which is presented in  
12 a written or other medium permitted by the letter of credit or, unless  
13 prohibited by the letter of credit, by the standard practice referred to  
14 in subsection e. of 12A:5-108; and (b) which is capable of being  
15 examined for compliance with the terms and conditions of the letter of  
16 credit. A document may not be oral.

17 (7) "Good faith" means honesty in fact in the conduct or  
18 transaction concerned.

19 (8) "Honor" of a letter of credit means performance of the issuer's  
20 undertaking in the letter of credit to pay or deliver an item of value.  
21 Unless the letter of credit otherwise provides, "honor" occurs:

22 (a) upon payment;

23 (b) if the letter of credit provides for acceptance, upon acceptance  
24 of a draft and, at maturity, its payment; or

25 (c) if the letter of credit provides for incurring a deferred  
26 obligation, upon incurring the obligation and, at maturity, its  
27 performance.

28 (9) "Issuer" means a bank or other person that issues a letter of  
29 credit, but does not include an individual who makes an engagement  
30 for personal, family, or household purposes.

31 (10) "Letter of credit" means a definite undertaking that satisfies  
32 the requirements of 12A:5-104 by an issuer to a beneficiary at the  
33 request or for the account of an applicant or, in the case of a financial  
34 institution, to itself or for its own account, to honor a documentary  
35 presentation by payment or delivery of an item of value.

36 (11) "Nominated person" means a person whom the issuer (a)  
37 designates or authorizes to pay, accept, negotiate, or otherwise give  
38 value under a letter of credit and (b) undertakes by agreement or  
39 custom and practice to reimburse.

40 (12) "Presentation" means delivery of a document to an issuer or  
41 nominated person for honor or giving of value under a letter of credit.

42 (13) "Presenter" means a person making a presentation as or on  
43 behalf of a beneficiary or nominated person.

44 (14) "Record" means information that is inscribed on a tangible  
45 medium, or that is stored in an electronic or other medium and is  
46 retrievable in perceivable form.

1 (15) "Successor of a beneficiary" means a person who succeeds to  
2 substantially all of the rights of a beneficiary by operation of law,  
3 including a corporation with or into which the beneficiary has been  
4 merged or consolidated, an administrator, executor, personal  
5 representative, trustee in bankruptcy, debtor in possession, liquidator,  
6 and receiver.

7 b. Definitions in other chapters applying to this chapter and the  
8 sections in which they appear are:

9 "Acceptance" 12A:3-409

10 "Value" 12A:3-303, 12A:4-211

11 c. N.J.S.12A:1-101 et seq. contains certain additional general  
12 definitions and principles of construction and interpretation applicable  
13 throughout this chapter.

14 12A:5-103. Scope.

15 a. This chapter applies to letters of credit and to certain rights and  
16 obligations arising out of transactions involving letters of credit.

17 b. The statement of a rule in this chapter does not by itself require,  
18 imply, or negate application of the same or a different rule to a  
19 situation not provided for, or to a person not specified, in this chapter.

20 c. With the exception of this subsection and subsections a. and d.  
21 of this section, paragraphs (9) and (10) of subsection a. of 12A:5-102,  
22 subsection d. of 12A:5-106 and subsection d. of 12A:5-114, and  
23 except to the extent prohibited in subsection (3) of 12A:1-102 and  
24 subsection d. of 12A:5-117, the effect of this chapter may be varied by  
25 agreement or by a provision stated or incorporated by reference in an  
26 undertaking. A term in an agreement or undertaking generally  
27 excusing liability or generally limiting remedies for failure to perform  
28 obligations is not sufficient to vary obligations prescribed by this  
29 chapter.

30 d. Rights and obligations of an issuer to a beneficiary or a  
31 nominated person under a letter of credit are independent of the  
32 existence, performance, or nonperformance of a contract or  
33 arrangement out of which the letter of credit arises or which underlies  
34 it, including contracts or arrangements between the issuer and the  
35 applicant and between the applicant and the beneficiary.

36 12A:5-104. Formal Requirements. A letter of credit, confirmation,  
37 advice, transfer, amendment, or cancellation may be issued in any form  
38 that is a record and is authenticated (a) by a signature; or (b) in  
39 accordance with the agreement of the parties or the standard practice  
40 referred to in subsection e. of 12A:5-108.

41 12A:5-105. Consideration. Consideration is not required to issue,  
42 amend, transfer, or cancel a letter of credit, advice, or confirmation.

43 12A:5-106. Issuance, Amendment, Cancellation, and Duration.

44 a. A letter of credit is issued and becomes enforceable according  
45 to its terms against the issuer when the issuer sends or otherwise  
46 transmits it to the person requested to advise or to the beneficiary. A

1 letter of credit is revocable only if it so provides.

2 b. After a letter of credit is issued, rights and obligations of a  
3 beneficiary, applicant, confirmer, and issuer are not affected by an  
4 amendment or cancellation to which that person has not consented  
5 except to the extent the letter of credit provides that it is revocable or  
6 that the issuer may amend or cancel the letter of credit without that  
7 consent.

8 c. If there is no stated expiration date or other provision that  
9 determines its duration, a letter of credit expires one year after its  
10 stated date of issuance or, if none is stated, after the date on which it  
11 is issued.

12 d. A letter of credit that states that it is perpetual expires five years  
13 after its stated date of issuance, or if none is stated, after the date on  
14 which it is issued.

15 12A:5-107. Confirmer, Nominated Person, and Adviser.

16 a. A confirmer is directly obligated on a letter of credit and has the  
17 rights and obligations of an issuer to the extent of its confirmation.  
18 The confirmer also has rights against and obligations to the issuer as  
19 if the issuer were an applicant and the confirmer had issued the letter  
20 of credit at the request and for the account of the issuer.

21 b. A nominated person who is not a confirmer is not obligated to  
22 honor or otherwise give value for a presentation.

23 c. A person requested to advise may decline to act as an adviser.  
24 An adviser that is not a confirmer is not obligated to honor or give  
25 value for a presentation. An adviser undertakes to the issuer and to  
26 the beneficiary accurately to advise the terms of the letter of credit,  
27 confirmation, amendment, or advice received by that person and  
28 undertakes to the beneficiary to check the apparent authenticity of the  
29 request to advise. Even if the advice is inaccurate, the letter of credit,  
30 confirmation, or amendment is enforceable as issued.

31 d. A person who notifies a transferee beneficiary of the terms of a  
32 letter of credit, confirmation, amendment, or advice has the rights and  
33 obligations of an adviser under subsection c. of this section. The  
34 terms in the notice to the transferee beneficiary may differ from the  
35 terms in any notice to the transferor beneficiary to the extent permitted  
36 by the letter of credit, confirmation, amendment, or advice received by  
37 the person who so notifies.

38 12A:5-108. Issuer's Rights and Obligations.

39 a. Except as otherwise provided in 12A:5-109, an issuer shall  
40 honor a presentation that, as determined by the standard practice  
41 referred to in subsection e. of this section, appears on its face strictly  
42 to comply with the terms and conditions of the letter of credit. Except  
43 as otherwise provided in 12A:5-113 and unless otherwise agreed with  
44 the applicant, an issuer shall dishonor a presentation that does not  
45 appear so to comply.

46 b. An issuer has a reasonable time after presentation, but not

1 beyond the end of the seventh business day of the issuer after the day  
2 of its receipt of documents:

3 (1) to honor;

4 (2) if the letter of credit provides for honor to be completed more  
5 than seven business days after presentation, to accept a draft or incur  
6 a deferred obligation; or

7 (3) to give notice to the presenter of discrepancies in the  
8 presentation.

9 c. Except as otherwise provided in subsection d. of this section, an  
10 issuer is precluded from asserting as a basis for dishonor any  
11 discrepancy if timely notice is not given, or any discrepancy not stated  
12 in the notice if timely notice is given.

13 d. Failure to give the notice specified in subsection b. of this  
14 section or to mention fraud, forgery, or expiration in the notice does  
15 not preclude the issuer from asserting as a basis for dishonor fraud or  
16 forgery as described in subsection a. of 12A:5-109 or expiration of the  
17 letter of credit before presentation.

18 e. An issuer shall observe standard practice of financial institutions  
19 that regularly issue letters of credit. Determination of the standard  
20 practice is a matter of interpretation for the court. The court shall  
21 offer the parties a reasonable opportunity to present evidence of the  
22 standard practice.

23 f. An issuer is not responsible for:

24 (1) the performance or nonperformance of the underlying contract,  
25 arrangement, or transaction;

26 (2) an act or omission of others; or

27 (3) observance or knowledge of the usage of a particular trade  
28 other than the standard practice referred to in subsection e. of this  
29 section.

30 g. If an undertaking constituting a letter of credit under paragraph  
31 (10) of subsection a. of 12A:5-102 contains nondocumentary  
32 conditions, an issuer shall disregard the nondocumentary conditions  
33 and treat them as if they were not stated.

34 h. An issuer that has dishonored a presentation shall return the  
35 documents or hold them at the disposal of, and send advice to that  
36 effect to, the presenter.

37 i. An issuer that has honored a presentation as permitted or  
38 required by this chapter:

39 (1) is entitled to be reimbursed by the applicant in immediately  
40 available funds not later than the date of its payment of funds;

41 (2) takes the documents free of claims of the beneficiary or  
42 presenter;

43 (3) is precluded from asserting a right of recourse on a draft under  
44 12A:3-414 and 12A:3-415;

45 (4) except as otherwise provided in 12A:5-110 and 12A:5-117, is  
46 precluded from restitution of money paid or other value given by

1 mistake to the extent the mistake concerns discrepancies in the  
2 documents or tender which are apparent on the face of the  
3 presentation; and

4 (5) is discharged to the extent of its performance under the letter  
5 of credit unless the issuer honored a presentation in which a required  
6 signature of a beneficiary was forged.

7 12A:5-109. Fraud and Forgery.

8 a. If a presentation is made that appears on its face strictly to  
9 comply with the terms and conditions of the letter of credit, but a  
10 required document is forged or materially fraudulent, or honor of the  
11 presentation would facilitate a material fraud by the beneficiary on the  
12 issuer or applicant:

13 (1) the issuer shall honor the presentation, if honor is demanded by  
14 (a) a nominated person who has given value in good faith and without  
15 notice of forgery or material fraud, (b) a confirmer who has honored  
16 its confirmation in good faith, (c) a holder in due course of a draft  
17 drawn under the letter of credit which was taken after acceptance by  
18 the issuer or nominated person, or (d) an assignee of the issuer's or  
19 nominated person's deferred obligation that was taken for value and  
20 without notice of forgery or material fraud after the obligation was  
21 incurred by the issuer or nominated person; and

22 (2) the issuer, acting in good faith, may honor or dishonor the  
23 presentation in any other case.

24 b. If an applicant claims that a required document is forged or  
25 materially fraudulent or that honor of the presentation would facilitate  
26 a material fraud by the beneficiary on the issuer or applicant, a court  
27 of competent jurisdiction may temporarily or permanently enjoin the  
28 issuer from honoring a presentation or grant similar relief against the  
29 issuer or other persons only if the court finds that:

30 (1) the relief is not prohibited under the law applicable to an  
31 accepted draft or deferred obligation incurred by the issuer;

32 (2) a beneficiary, issuer, or nominated person who may be  
33 adversely affected is adequately protected against loss that it may  
34 suffer because the relief is granted;

35 (3) all of the conditions to entitle a person to the relief under the  
36 law of this State have been met; and

37 (4) on the basis of the information submitted to the court, the  
38 applicant is more likely than not to succeed under its claim of forgery  
39 or material fraud and the person demanding honor does not qualify for  
40 protection under paragraph (1) of subsection a. of this section.

41 12A:5-110. Warranties.

42 a. If its presentation is honored, the beneficiary warrants:

43 (1) to the issuer, any other person to whom presentation is made,  
44 and the applicant that there is no fraud or forgery of the kind described  
45 in subsection a. of 12A:5-109; and

46 (2) to the applicant that the drawing does not violate any

1 agreement between the applicant and beneficiary or any other  
2 agreement intended by them to be augmented by the letter of credit.

3 b. The warranties in subsection a. of this section are in addition to  
4 warranties arising under 12A:3-101 et seq., 12A:4-101 et seq., 12A:7-  
5 101 et seq. and 12A:8-101 et seq. because of the presentation or  
6 transfer of documents covered by any of those chapters.

7 12A:5-111. Remedies.

8 a. If an issuer wrongfully dishonors or repudiates its obligation to  
9 pay money under a letter of credit before presentation, the beneficiary,  
10 successor, or nominated person presenting on its own behalf may  
11 recover from the issuer the amount that is the subject of the dishonor  
12 or repudiation. If the issuer's obligation under the letter of credit is  
13 not for the payment of money, the claimant may obtain specific  
14 performance or, at the claimant's election, recover an amount equal to  
15 the value of performance from the issuer. In either case, the claimant  
16 may also recover incidental but not consequential damages. The  
17 claimant is not obligated to take action to avoid damages that might  
18 be due from the issuer under this subsection. If, although not  
19 obligated to do so, the claimant avoids damages, the claimant's  
20 recovery from the issuer must be reduced by the amount of damages  
21 avoided. The issuer has the burden of proving the amount of damages  
22 avoided. In the case of repudiation, the claimant need not present any  
23 document.

24 b. If an issuer wrongfully dishonors a draft or demand presented  
25 under a letter of credit or honors a draft or demand in breach of its  
26 obligation to the applicant, the applicant may recover damages  
27 resulting from the breach, including incidental but not consequential  
28 damages, less any amount saved as a result of the breach.

29 c. If an adviser or nominated person other than a confirmer  
30 breaches an obligation under this chapter or an issuer breaches an  
31 obligation not covered in subsection a. or b. of this section, a person  
32 to whom the obligation is owed may recover damages resulting from  
33 the breach, including incidental but not consequential damages, less  
34 any amount saved as a result of the breach. To the extent of the  
35 confirmation, a confirmer has the liability of an issuer specified in this  
36 subsection and subsections a. and b. of this section.

37 d. An issuer, nominated person, or adviser who is found liable  
38 under subsection a., b., or c. of this section shall pay interest on the  
39 amount owed thereunder from the date of wrongful dishonor or other  
40 appropriate date.

41 e. Reasonable attorney's fees and other expenses of litigation may  
42 be awarded to the prevailing party in an action in which a remedy is  
43 sought under this chapter.

44 f. Damages that would otherwise be payable by a party for breach  
45 of an obligation under this chapter may be liquidated by agreement or  
46 undertaking, but only in an amount or by a formula that is reasonable

1 in light of the harm anticipated.

2 12A:5-112. Transfer of Letter of Credit.

3 a. Except as otherwise provided in 12A:5-113, unless a letter of  
4 credit provides that it is transferable, the right of a beneficiary to draw  
5 or otherwise demand performance under a letter of credit may not be  
6 transferred.

7 b. Even if a letter of credit provides that it is transferable, the  
8 issuer may refuse to recognize or carry out a transfer if:

9 (1) the transfer would violate applicable law; or

10 (2) the transferor or transferee has failed to comply with any  
11 requirement stated in the letter of credit or any other requirement  
12 relating to transfer imposed by the issuer which is within the standard  
13 practice referred to in subsection e. of 12A:5-108 or is otherwise  
14 reasonable under the circumstances.

15 12A:5-113. Transfer by Operation of Law.

16 a. A successor of a beneficiary may consent to amendments, sign  
17 and present documents, and receive payment or other items of value  
18 in the name of the beneficiary without disclosing its status as a  
19 successor.

20 b. A successor of a beneficiary may consent to amendments, sign  
21 and present documents, and receive payment or other items of value  
22 in its own name as the disclosed successor of the beneficiary. Except  
23 as otherwise provided in subsection e. of this section, an issuer shall  
24 recognize a disclosed successor of a beneficiary as beneficiary in full  
25 substitution for its predecessor upon compliance with the requirements  
26 for recognition by the issuer of a transfer of drawing rights by  
27 operation of law under the standard practice referred to in subsection  
28 e. of 12A:5-108 or, in the absence of such a practice, compliance with  
29 other reasonable procedures sufficient to protect the issuer.

30 c. An issuer is not obliged to determine whether a purported  
31 successor is a successor of a beneficiary or whether the signature of a  
32 purported successor is genuine or authorized.

33 d. Honor of a purported successor's apparently complying  
34 presentation under subsection a. or b. of this section has the  
35 consequences specified in subsection i. of 12A:5-108 even if the  
36 purported successor is not the successor of a beneficiary. Documents  
37 signed in the name of the beneficiary or of a disclosed successor by a  
38 person who is neither the beneficiary nor the successor of the  
39 beneficiary are forged documents for the purposes of 12A:5-109.

40 e. An issuer whose rights of reimbursement are not covered by  
41 subsection d. of this section or substantially similar law and any  
42 confirmer or nominated person may decline to recognize a presentation  
43 under subsection b. of this section.

44 f. A beneficiary whose name is changed after the issuance of a  
45 letter of credit has the same rights and obligations as a successor of a  
46 beneficiary under this section.

1 12A:5-114. Assignment of Proceeds.

2 a. In this section, "proceeds of a letter of credit" means the cash,  
3 check, accepted draft, or other item of value paid or delivered upon  
4 honor or giving of value by the issuer or any nominated person under  
5 the letter of credit. The term does not include a beneficiary's drawing  
6 rights or documents presented by the beneficiary.

7 b. A beneficiary may assign its right to part or all of the proceeds  
8 of a letter of credit. The beneficiary may do so before presentation as  
9 a present assignment of its right to receive proceeds contingent upon  
10 its compliance with the terms and conditions of the letter of credit.

11 c. An issuer or nominated person need not recognize an assignment  
12 of proceeds of a letter of credit until it consents to the assignment.

13 d. An issuer or nominated person has no obligation to give or  
14 withhold its consent to an assignment of proceeds of a letter of credit,  
15 but consent may not be unreasonably withheld if the assignee  
16 possesses and exhibits the letter of credit and presentation of the letter  
17 of credit is a condition to honor.

18 e. Rights of a transferee beneficiary or nominated person are  
19 independent of the beneficiary's assignment of the proceeds of a letter  
20 of credit and are superior to the assignee's right to the proceeds.

21 f. Neither the rights recognized by this section between an assignee  
22 and an issuer, transferee beneficiary, or nominated person, nor the  
23 issuer's or nominated person's payment of proceeds to an assignee or  
24 a third person, affect the rights between the assignee and any person  
25 other than the issuer, transferee beneficiary, or nominated person. The  
26 mode of creating and perfecting a security interest in or granting an  
27 assignment of a beneficiary's rights to proceeds is governed by 12A:9-  
28 101 et seq. or other law. Against persons other than the issuer,  
29 transferee beneficiary, or nominated person, the rights and obligations  
30 arising upon the creation of a security interest or other assignment of  
31 a beneficiary's right to proceeds and its perfection are governed by  
32 12A:9-101 et seq. or other law.

33 12A:5-115. Statute of Limitations. An action to enforce a right or  
34 obligation arising under this chapter must be commenced within one  
35 year after the expiration date of the relevant letter of credit or one year  
36 after the cause of action accrues, whichever occurs later. A cause of  
37 action accrues when the breach occurs, regardless of the aggrieved  
38 party's lack of knowledge of the breach.

39 12A:5-116. Choice of Law and Forum.

40 a. The liability of an issuer, nominated person, or adviser for action  
41 or omission is governed by the law of the jurisdiction chosen by an  
42 agreement in the form of a record signed or otherwise authenticated  
43 by the affected parties in the manner provided in 12A:5-104 or by a  
44 provision in the person's letter of credit, confirmation, or other  
45 undertaking. The jurisdiction whose law is chosen need not bear any  
46 relation to the transaction.

1       b. Unless subsection a. of this section applies, the liability of an  
2 issuer, nominated person, or adviser for action or omission is governed  
3 by the law of the jurisdiction in which the person is located. The  
4 person is considered to be located at the address indicated in the  
5 person's undertaking. If more than one address is indicated, the  
6 person is considered to be located at the address from which the  
7 person's undertaking was issued. For the purpose of jurisdiction,  
8 choice of law, and recognition of interbranch letters of credit, but not  
9 enforcement of a judgment, all branches of a bank are considered  
10 separate juridical entities and a bank is considered to be located at the  
11 place where its relevant branch is considered to be located under this  
12 subsection.

13       c. Except as otherwise provided in this subsection, the liability of  
14 an issuer, nominated person, or adviser is governed by any rules of  
15 custom or practice, such as the Uniform Customs and Practice for  
16 Documentary Credits, to which the letter of credit, confirmation, or  
17 other undertaking is expressly made subject. If (i) this chapter would  
18 govern the liability of an issuer, nominated person, or adviser under  
19 subsection a. or b. of this section, (ii) the relevant undertaking  
20 incorporates rules of custom or practice, and (iii) there is conflict  
21 between this chapter and those rules as applied to that undertaking,  
22 those rules govern except to the extent of any conflict with the  
23 nonvariable provisions specified in subsection c. of 12A:5-103.

24       d. If there is conflict between this chapter, 12A:5-101 et seq., and  
25 12A:3-101 et seq., 12A:4-101 et seq., 12A:4A-101 et seq., or 12A:9-  
26 101 et seq., this chapter governs.

27       e. The forum for settling disputes arising out of an undertaking  
28 within this chapter may be chosen in the manner and with the binding  
29 effect that governing law may be chosen in accordance with subsection  
30 a. of this section.

31       12A:5-117. Subrogation of Issuer, Applicant, and Nominated  
32 Person.

33       a. An issuer that honors a beneficiary's presentation is subrogated  
34 to the rights of the beneficiary to the same extent as if the issuer were  
35 a secondary obligor of the underlying obligation owed to the  
36 beneficiary; and of the applicant, to the same extent as if the issuer  
37 were the secondary obligor of the underlying obligation owed to the  
38 applicant.

39       b. An applicant that reimburses an issuer is subrogated to the rights  
40 of the issuer against any beneficiary, presenter, or nominated person  
41 to the same extent as if the applicant were the secondary obligor of the  
42 obligations owed to the issuer and has the rights of subrogation of the  
43 issuer to the rights of the beneficiary stated in subsection a. of this  
44 section.

45       c. A nominated person who pays or gives value against a draft or  
46 demand presented under a letter of credit is subrogated to the rights

1 of:

2 (1) the issuer against the applicant to the same extent as if the  
3 nominated person were a secondary obligor of the obligation owed to  
4 the issuer by the applicant;

5 (2) the beneficiary to the same extent as if the nominated person  
6 were a secondary obligor of the underlying obligation owed to the  
7 beneficiary; and

8 (3) the applicant to the same extent as if the nominated person  
9 were a secondary obligor of the underlying obligation owed to the  
10 applicant.

11 d. Notwithstanding any agreement or term to the contrary, the  
12 rights of subrogation stated in subsections a. and b. of this section do  
13 not arise until the issuer honors the letter of credit or otherwise pays  
14 and the rights in subsection c. of this section do not arise until the  
15 nominated person pays or otherwise gives value. Until then, the  
16 issuer, nominated person, and the applicant do not derive under this  
17 section present or prospective rights forming the basis of a claim,  
18 defense, or excuse.

19

20 2. N.J.S.12A:1-105 is amended to read as follows:

21 12A:1-105. Territorial application of the act; parties' power to  
22 choose applicable law.

23 (1) Except as provided hereafter in this section, when a transaction  
24 bears a reasonable relation to this State and also to another state or  
25 nation the parties may agree that the law either of this State or of such  
26 other state or nation shall govern their rights and duties. Failing such  
27 agreement this act applies to transactions bearing an appropriate  
28 relation to this State.

29 (2) Where one of the following provisions of this act specifies the  
30 applicable law, that provision governs and a contrary agreement is  
31 effective only to the extent permitted by the law (including the conflict  
32 of laws rules) so specified:

33 Rights of creditors against sold goods. 12A:2-402.

34 Applicability of the Chapter on Leases. 12A:2A-105 and  
35 12A:2A-106.

36 Applicability of the Chapter on Bank Deposits and Collections.  
37 12A:4-102.

38 Governing law in the Chapter on Funds Transfers. 12A:4A-507.

39 Letters of Credit. 12A:5-116.

40 Applicability of the Chapter on Investment Securities.  
41 <sup>2</sup>[12A:8-106] 12A:8-110<sup>2</sup>.

42 Perfection provisions of the Chapter on Secured Transactions.  
43 12A:9-103.

44 (cf: P.L.1997, c.252, s.16)

45

46 3. N.J.S.12A:2-512 is amended to read as follows:

1 12A:2-512. (1) Where the contract requires payment before  
2 inspection, non-conformity of the goods does not excuse the buyer  
3 from so making payment unless

4 (a) the non-conformity appears without inspection; or  
5 (b) despite tender of the required documents the circumstances  
6 would justify injunction against honor under the provisions of [this Act  
7 (12A:5-114) 12A:5-109(b)].

8 (2) Payment pursuant to subsection (1) does not constitute an  
9 acceptance of goods or impair the buyer's right to inspect or any of  
10 his remedies.

11 (cf: N.J.S.12A:2-512)

12

13 4. N.J.S.12A:9-103 is amended to read as follows:

14 12A:9-103. Perfection of Security Interests in Multiple State  
15 Transactions.

16 (1) Documents, instruments, letters of credit, and ordinary goods.

17 (a) This subsection applies to documents [~~and~~], instruments, rights  
18 to proceeds of written letters of credit, and [~~to~~] goods other than  
19 those covered by a certificate of title described in subsection (2),  
20 mobile goods described in subsection (3), and minerals described in  
21 subsection (5).

22 (b) Except as otherwise provided in this subsection, perfection and  
23 the effect of perfection or nonperfection of a security interest in  
24 collateral are governed by the law of the jurisdiction where the  
25 collateral is when the last event occurs on which is based the assertion  
26 that the security interest is perfected or unperfected.

27 (c) If the parties to a transaction creating a purchase money  
28 security interest in goods in one jurisdiction understand at the time  
29 that the security interest attaches that the goods will be kept in another  
30 jurisdiction, then the law of the other jurisdiction governs the  
31 perfection and the effect of perfection or nonperfection of the security  
32 interest from the time it attaches until 30 days after the debtor receives  
33 possession of the goods and thereafter if the goods are taken to the  
34 other jurisdiction before the end of the 30-day period.

35 (d) When collateral is brought into and kept in this State while  
36 subject to a security interest perfected under the law of the jurisdiction  
37 from which the collateral was removed, the security interest remains  
38 perfected, but if action is required by subchapter 3 of this chapter to  
39 perfect the security interest,

40 (i) if the action is not taken before the expiration of the period of  
41 perfection in the other jurisdiction or the end of four months after the  
42 collateral is brought into this State, whichever period first expires, the  
43 security interest becomes unperfected at the end of that period and is  
44 thereafter deemed to have been unperfected as against a person who  
45 became a purchaser after removal;

46 (ii) if the action is taken before the expiration of the period

1 specified in subparagraph (i), the security interest continues perfected  
2 thereafter;

3 (iii) for the purpose of priority over a buyer of consumer goods  
4 (subsection (2) of 12A:9-307), the period of the effectiveness of a  
5 filing in the jurisdiction from which the collateral is removed is  
6 governed by the rules with respect to perfection in subparagraphs (i)  
7 and (ii).

8 (2) Certificate of title.

9 (a) This subsection applies to goods covered by a certificate of title  
10 issued under a statute of this State or of another jurisdiction under the  
11 law of which indication of a security interest on the certificate is  
12 required as a condition of perfection.

13 (b) Except as otherwise provided in this subsection, perfection and  
14 the effect of perfection or nonperfection of the security interest are  
15 governed by the law (including the conflict of laws rules) of the  
16 jurisdiction issuing the certificate until four months after the goods are  
17 removed from that jurisdiction and thereafter until the goods are  
18 registered in another jurisdiction, but in any event not beyond  
19 surrender of the certificate. After the expiration of that period, the  
20 goods are not covered by the certificate of title within the meaning of  
21 this section.

22 (c) Except with respect to the rights of a buyer described in the  
23 next paragraph, a security interest, perfected in another jurisdiction  
24 otherwise than by notation on a certificate of title, in goods brought  
25 into this State and thereafter covered by a certificate of title issued by  
26 this State is subject to the rules stated in paragraph (d) of subsection  
27 (1).

28 (d) If goods are brought into this State while a security interest  
29 therein is perfected in any manner under the law of the jurisdiction  
30 from which the goods are removed and a certificate of title is issued  
31 by this State and the certificate does not show that the goods are  
32 subject to the security interest or that they may be subject to security  
33 interests not shown on the certificate, the security interest is  
34 subordinate to the rights of a buyer of the goods who is not in the  
35 business of selling goods of that kind to the extent that he gives value  
36 and receives delivery of the goods after issuance of the certificate and  
37 without the knowledge of the security interest.

38 (3) Accounts, general intangibles and mobile goods.

39 (a) This subsection applies to accounts (other than an account  
40 described in subsection (5) on minerals) and general intangibles (other  
41 than uncertificated securities) and to goods which are mobile and  
42 which are of a type normally used in more than one jurisdiction, such  
43 as motor vehicles, trailers, rolling stock, airplanes, shipping containers,  
44 road building and construction machinery and commercial harvesting  
45 machinery and the like, if the goods are equipment or are inventory  
46 leased or held for lease by the debtor to others, and are not covered by

1 a certificate of title described in subsection (2).

2 (b) The law (including the conflict of laws rules) of the jurisdiction  
3 in which the debtor is located governs the perfection and the effect of  
4 perfection or nonperfection of the security interest.

5 (c) If, however, the debtor is located in a jurisdiction which is not  
6 a part of the United States, and which does not provide for perfection  
7 of the security interest by filing or recording in that jurisdiction, the  
8 law of the jurisdiction in the United States in which the debtor has its  
9 major executive office in the United States governs the perfection and  
10 the effect of perfection or nonperfection of the security interest  
11 through filing. In the alternative, if the debtor is located in a  
12 jurisdiction which is not a part of the United States or Canada and the  
13 collateral is accounts or general intangibles for money due or to  
14 become due, the security interest may be perfected by notification to  
15 the account debtor. As used in this paragraph, "United States" includes  
16 its territories and possessions and the Commonwealth of Puerto Rico.

17 (d) A debtor shall be deemed located at his place of business if he  
18 has one, at his chief executive office if he has more than one place of  
19 business, otherwise at his residence. If, however, the debtor is a  
20 foreign air carrier under the Federal Aviation Act of 1958, <sup>2</sup>49 U.S.C.  
21 ss.1301 et seq.,<sup>2</sup> as amended, it shall be deemed located at the  
22 designated office of the agent upon whom service of process may be  
23 made on behalf of the foreign air carrier.

24 (e) A security interest perfected under the law of the jurisdiction  
25 of the location of the debtor is perfected until the expiration of four  
26 months after a change of the debtor's location to another jurisdiction,  
27 or until perfection would have ceased by the law of the first  
28 jurisdiction, whichever period first expires. Unless perfected in the  
29 new jurisdiction before the end of that period, it becomes unperfected  
30 thereafter and is deemed to have been unperfected as against a person  
31 who became a purchaser after the change.

32 (4) Chattel paper.

33 The rules stated for goods in subsection (1) apply to a possessory  
34 security interest in chattel paper. The rules stated for accounts in  
35 subsection (3) apply to a nonpossessory security interest in chattel  
36 paper, but the security interest may not be perfected by notification to  
37 the account debtor.

38 (5) Minerals.

39 Perfection and the effect of perfection or nonperfection of a  
40 security interest which is created by a debtor who has an interest in  
41 minerals or the like (including oil and gas) before extraction and which  
42 attaches thereto as extracted, or which attaches to an account resulting  
43 from the sale thereof at the wellhead or minehead are governed by the  
44 law (including the conflict of laws rules) of the jurisdiction wherein the  
45 wellhead or minehead is located.

46 (6) <sup>2</sup>Uncertificated securities.

1 The law (including the conflict of laws rules) of the jurisdiction of  
2 organization of the issuer governs the perfection and the effect of  
3 perfection or nonperfection of a security interest in uncertificated  
4 securities.] Investment property.

5 (a) This subsection applies to investment property.

6 (b) Except as otherwise provided in paragraph (f), during the time  
7 that a security certificate is located in a jurisdiction, perfection of a  
8 security interest, the effect of perfection or non-perfection, and the  
9 priority of a security interest in the certificated security represented  
10 thereby are governed by the local law of that jurisdiction.

11 (c) Except as otherwise provided in paragraph (f), perfection of a  
12 security interest, the effect of perfection or non-perfection, and the  
13 priority of a security interest in an uncertificated security are governed  
14 by the local law of the issuer's jurisdiction as specified in subsection d.  
15 of 12A:8-110.

16 (d) Except as otherwise provided in paragraph (f), perfection of a  
17 security interest, the effect of perfection or non-perfection, and the  
18 priority of a security interest in a security entitlement or securities  
19 account are governed by the local law of the securities intermediary's  
20 jurisdiction as specified in subsection e. of 12A:8-110.

21 (e) Except as otherwise provided in paragraph (f), perfection of a  
22 security interest, the effect of perfection or non-perfection, and the  
23 priority of a security interest in a commodity contract or commodity  
24 account are governed by the local law of the commodity intermediary's  
25 jurisdiction. The following rules determine a "commodity  
26 intermediary's jurisdiction" for purposes of this paragraph:

27 (i) If an agreement between the commodity intermediary and  
28 commodity customer specifies that it is governed by the law of a  
29 particular jurisdiction, that jurisdiction is the commodity intermediary's  
30 jurisdiction.

31 (ii) If an agreement between the commodity intermediary and  
32 commodity customer does not specify the governing law as provided  
33 in subparagraph (i) of this paragraph, but expressly specifies that the  
34 commodity account is maintained at an office in a particular  
35 jurisdiction, that jurisdiction is the commodity intermediary's  
36 jurisdiction.

37 (iii) If an agreement between the commodity intermediary and  
38 commodity customer does not specify a jurisdiction as provided in  
39 subparagraphs (i) or (ii) of this paragraph, the commodity  
40 intermediary's jurisdiction is the jurisdiction in which is located the  
41 office identified in an account statement as the office serving the  
42 commodity customer's account.

43 (iv) If an agreement between the commodity intermediary and  
44 commodity customer does not specify a jurisdiction as provided in  
45 subparagraphs (i) or (ii) of this paragraph and an account statement  
46 does not identify an office serving the commodity customer's account

1 as provided in subparagraph (iii) of this paragraph, the commodity  
2 intermediary's jurisdiction is the jurisdiction in which is located the  
3 chief executive office of the commodity intermediary.

4 (f) Perfection of a security interest by filing, automatic perfection  
5 of a security interest in investment property granted by a broker or  
6 securities intermediary, and automatic perfection of a security interest  
7 in a commodity contract or commodity account granted by a  
8 commodity intermediary are governed by the local law of the  
9 jurisdiction in which the debtor is located.<sup>2</sup>

10 (cf: P.L.1997, c.252, s.2)

11

12 5. N.J.S.12A:9-104 is amended to read as follows:

13 12A:9-104. This chapter does not apply

14 (a) To a security interest subject to any statute of the United States  
15 such as the Ship Mortgage Act, 1920, to the extent that such statute  
16 governs the rights of parties to and third parties affected by  
17 transactions in particular types of property; or

18 (b) To a landlord's lien; or

19 (c) To a lien given by statute or other rule of law for services or  
20 materials except as provided in 12A:9-310 on priority of such liens;  
21 or

22 (d) To a transfer of a claim for wages, salary or other  
23 compensation of an employee; or

24 (e) To a transfer by a government or governmental subdivision or  
25 agency; or

26 (f) To a sale of accounts or chattel paper as part of a sale of the  
27 business out of which they arose, or an assignment of accounts or  
28 chattel paper which is for the purpose of collection only, or a transfer  
29 of a right to payment under a contract to an assignee who is also to do  
30 the performance under the contract or a transfer of a single account to  
31 an assignee in whole or partial satisfaction of a preexisting  
32 indebtedness; or

33 (g) To a transfer of an interest in or claim in or under any policy of  
34 insurance, except as provided with respect to proceeds (12A:9-306)  
35 and priorities in proceeds (12A:9-312); or

36 (h) To a right represented by a judgment (other than a judgment  
37 taken on a right to payment which was collateral); or

38 (i) To any right of set-off; or

39 (j) Except to the extent that provision is made for fixtures in  
40 12A:9-313, to the creation or transfer of an interest in or lien on real  
41 estate, including a lease or rents thereunder; or

42 (k) To a transfer in whole or in part of any claim arising out of  
43 tort; or

44 (l) To a transfer of an interest in any deposit account (subsection  
45 (1) of 12A:9-105), except as provided with respect to proceeds  
46 (12A:9-306) and priorities in proceeds (12A:9-312); or

1 (m) To a chattel mortgage of the character described in [section]  
2 R.S.46:28-14 [of the Revised Statutes]; or

3 (n) to a transfer of an interest in a letter of credit other than the  
4 rights to proceeds of a written letter of credit.

5 (cf: P.L.1981, c.138, s.8)

6

7 6. N.J.S.12A:9-105 is amended to read as follows:

8 12A:9-105. Definitions and Index of Definitions.

9 (1) In this chapter unless the context otherwise requires:

10 (a) "Account debtor" means the person who is obligated on an  
11 account, chattel paper or general intangible;

12 (b) "Chattel paper" means a writing or writings which evidence  
13 both a monetary obligation and a security interest in or a lease of  
14 specific goods, but a charter or other contract involving the use or hire  
15 of a vessel is not chattel paper. When a transaction is evidenced both  
16 by such a security agreement or a lease and by an instrument or a  
17 series of instruments, the group of writings taken together constitutes  
18 chattel paper;

19 (c) "Collateral" means the property subject to a security interest,  
20 and includes accounts and chattel paper which have been sold;

21 (d) "Debtor" means the person who owes payment or other  
22 performance of the obligation secured, whether or not he owns or has  
23 rights in the collateral, and includes the seller of accounts or chattel  
24 paper. Where the debtor and the owner of the collateral are not the  
25 same person, the term "debtor" means the owner of the collateral in  
26 any provision of the chapter dealing with the collateral, the obligor in  
27 any provision dealing with the obligation, and may include both where  
28 the context so requires;

29 (e) "Deposit account" means a demand, time, savings, passbook or  
30 like account maintained with a bank, savings and loan association,  
31 credit union or like organization, other than an account evidenced by  
32 a certificate of deposit;

33 (f) "Document" means document of title as defined in the general  
34 definitions of chapter 1 (12A:1-201), and a receipt of the kind  
35 described in subsection (2) of 12A:7-201;

36 (g) "Encumbrance" includes real estate mortgages and other liens  
37 on real estate and all other rights in real estate that are not ownership  
38 interests;

39 (h) "Goods" includes all things which are movable at the time the  
40 security interest attaches or which are fixtures (12A:9-313), but does  
41 not include money, documents, instruments, <sup>2</sup>investment property,<sup>2</sup>  
42 accounts, chattel paper, general intangibles, or minerals or the like  
43 (including oil and gas) before extraction. "Goods" also includes  
44 standing timber which is to be cut and removed under a conveyance or  
45 contract for sale, the unborn young of animals, and growing crops;

46 (i) "Instrument" means a negotiable instrument (defined in

1 12A:3-104), or <sup>2</sup>[a certificated security (defined in 12A:8-102) or]<sup>2</sup>  
2 any other writing which evidences a right to the payment of money and  
3 is not itself a security agreement or lease and is of a type which is in  
4 ordinary course of business transferred by delivery with any necessary  
5 indorsement or assignment <sup>2</sup>. The term does not include investment  
6 property<sup>2</sup>;

7 (j) "Mortgage" means a consensual interest created by a real estate  
8 mortgage, a trust deed on real estate, or the like;

9 (k) An advance is made "pursuant to commitment" if the secured  
10 party has bound himself to make it, whether or not a subsequent event  
11 of default or other event not within his control has relieved or may  
12 relieve him from his obligation;

13 (l) "Security agreement" means an agreement which creates or  
14 provides for a security interest;

15 (m) "Secured party" means a lender, seller or other person in  
16 whose favor there is a security interest, including a person to whom  
17 accounts or chattel paper have been sold. When the holders of  
18 obligations issued under an indenture of trust, equipment trust  
19 agreement or the like are represented by a trustee or other person, the  
20 representative is the secured party.

21 (2) Other definitions applying to this chapter and the sections in  
22 which they appear are:

23 "Account." 12A:9-106.

24 "Attach." 12A:9-203.

25 <sup>2</sup>"Commodity contract." 12A:9-115.<sup>2</sup>

26 <sup>2</sup>"Commodity customer." 12A:9-115.<sup>2</sup>

27 <sup>2</sup>"Commodity intermediary." 12A:9-115.<sup>2</sup>

28 "Construction mortgage." 12A:9-313 (1).

29 "Consumer goods." 12A:9-109 (1).

30 <sup>2</sup>"Control." 12A:9-115.<sup>2</sup>

31 "Equipment." 12A:9-109 (2).

32 "Farm products." 12A:9-109 (3).

33 "Fixture." 12A:9-313<sup>2</sup>(1)<sup>2</sup>.

34 "Fixture filing." 12A:9-313<sup>2</sup>(1)<sup>2</sup>.

35 "General intangibles." 12A:9-106.

36 "Inventory." 12A:9-109 (4).

37 <sup>2</sup>"Investment property." 12A:9-115.<sup>2</sup>

38 "Lien creditor." 12A:9-301 (3).

39 "Proceeds." 12A:9-306 (1).

40 "Purchase money security interest." 12A:9-107.

41 "United States." 12A:9-103 (3).

42 (3) The following definitions in other chapters apply to this  
43 chapter:

44 <sup>2</sup>"Broker." 12A:8-102.<sup>2</sup>

45 <sup>2</sup>"Certificated security." 12A:8-102.<sup>2</sup>

46 "Check." 12A:3-104.

- 1       <sup>2</sup>"Clearing corporation." 12A:8-102.<sup>2</sup>  
2       "Contract for sale." 12A:2-106.  
3       <sup>2</sup>"Control." 12A:8-106.<sup>2</sup>  
4       <sup>2</sup>"Delivery." 12A:8-301.<sup>2</sup>  
5       <sup>2</sup>"Entitlement holder." 12A:8-102.<sup>2</sup>  
6       <sup>2</sup>"Financial asset." 12A:8-102.<sup>2</sup>  
7       "Holder in due course." 12A:3-302.  
8       "Letter of Credit." 12A:5-102.  
9       "Note." 12A:3-104.  
10      "Proceeds of a letter of credit." 12A:5-114.  
11      "Sale." 12A:2-106.  
12      <sup>2</sup>"Securities intermediary." 12A:8-102.<sup>2</sup>  
13      <sup>2</sup>"Security." 12A:8-102.<sup>2</sup>  
14      <sup>2</sup>"Security certificate." 12A:8-102.<sup>2</sup>  
15      <sup>2</sup>"Security entitlement." 12A:8-102.<sup>2</sup>  
16      <sup>2</sup>"Uncertificated security." 12A:8-102.<sup>2</sup>

17      (4) In addition chapter 1 contains general definitions and principles  
18      of construction and interpretation applicable throughout this chapter.  
19      (cf: P.L.1997, c.252, s.3)

20

21      7. N.J.S.12A:9-106 is amended to read as follows:

22      12A:9-106. Definitions: "Account"; "General Intangibles."

23      "Account" means any right to payment for goods sold or leased or  
24      for services rendered which is not evidenced by an instrument or  
25      chattel paper, whether or not it has been earned by performance. All  
26      rights to payment earned or unearned under a charter or other contract  
27      involving the use or hire of a vessel and all rights incident to the  
28      charter or contract are accounts. "General intangibles" means any  
29      personal property (including things in action) other than goods,  
30      accounts, chattel paper, documents, instruments, <sup>2</sup>investment  
31      property.<sup>2</sup> rights to proceeds of written letters of credit, and money.  
32      (cf: P.L.1997, c.252, s.4)

33

34      8. N.J.S.12A:9-304 is amended to read as follows:

35      12A:9-304. Perfection of Security Interest In Instruments,  
36      Documents, Proceeds of a Written Letter of Credit, and Goods  
37      Covered by Documents; Perfection by Permissive Filing; Temporary  
38      Perfection Without Filing or Transfer of Possession.

39      (1) A security interest in chattel paper or negotiable documents  
40      may be perfected by filing. A security interest in the rights to proceeds  
41      of a written letter of credit can be perfected only by the secured party's  
42      taking possession of the letter of credit. A security interest in money  
43      or instruments (other than <sup>2</sup>[certificated securities or]<sup>2</sup> instruments  
44      which constitute part of chattel paper) can be perfected only by the  
45      secured party's taking possession, except as provided in subsections  
46      (4) and (5) of this section and subsections (2) and (3) of 12A:9-306 on

1 proceeds.

2 (2) During the period that goods are in the possession of the issuer  
3 of a negotiable document therefor, a security interest in the goods is  
4 perfected by perfecting a security interest in the document, and any  
5 security interest in the goods otherwise perfected during such period  
6 is subject thereto.

7 (3) A security interest in goods in the possession of a bailee other  
8 than one who has issued a negotiable document therefor is perfected  
9 by issuance of a document in the name of the secured party or by the  
10 bailee's receipt of notification of the secured party's interest or by  
11 filing as to the goods.

12 (4) A security interest in instruments <sup>2</sup>[(other than certificated  
13 securities)], certificated securities,<sup>2</sup> or negotiable documents is  
14 perfected without filing or the taking of possession for a period of 21  
15 days from the time it attaches to the extent that it arises for new value  
16 given under a written security agreement.

17 (5) A security interest remains perfected for a period of 21 days  
18 without filing where a secured party having a perfected security  
19 interest in an instrument <sup>2</sup>[(other than a certificated security)], a  
20 certificated security,<sup>2</sup> a negotiable document or goods in possession of  
21 a bailee other than one who has issued a negotiable document therefor:

22 (a) Makes available to the debtor the goods or documents  
23 representing the goods for the purpose of ultimate sale or exchange or  
24 for the purpose of loading, unloading, storing, shipping, transshipping,  
25 manufacturing, processing or otherwise dealing with them in a manner  
26 preliminary to their sale or exchange, but priority between conflicting  
27 security interests in the goods is subject to subsection (3) of  
28 12A:9-312; or

29 (b) Delivers the instrument <sup>2</sup>or certificated security<sup>2</sup> to the debtor  
30 for the purpose of ultimate sale or exchange or of presentation,  
31 collection, renewal, or registration of transfer.

32 (6) After the 21-day period in subsections (4) and (5) perfection  
33 depends upon compliance with applicable provisions of this chapter.  
34 (cf: P.L.1997, c.252, s.11)

35

36 9. N.J.S.12A:9-305 is amended to read as follows:

37 12A:9-305. When Possession by Secured Party Perfects Security  
38 Interest Without Filing.

39 A security interest in [letters of credit and advices of credit  
40 (subsection (2) (a) of 12A:5-116),] goods, instruments <sup>2</sup>[(other than  
41 certificated securities)]<sup>2</sup>, money, negotiable documents or chattel  
42 paper may be perfected by the secured party's taking possession of the  
43 collateral. A security interest in the right to proceeds of a written  
44 letter of credit may be perfected by the secured party's taking  
45 possession of the letter of credit. If such collateral other than goods  
46 covered by a negotiable document is held by a bailee, the secured party

1 is deemed to have possession from the time the bailee receives  
2 notification of the secured party's interest. A security interest is  
3 perfected by possession from the time possession is taken without  
4 relation back and continues only so long as possession is retained,  
5 unless otherwise specified in this chapter. The security interest may  
6 be otherwise perfected as provided in this chapter before or after the  
7 period of possession by the secured party.

8 (cf: P.L.1997, c.252, s.12)

9

10 10. Section 25 of P.L.1948, c.67 (C.17:9A-25) is amended to read  
11 as follows:

12 25. Additional powers of banks.

13 In addition to the powers specified in section 24, every bank shall,  
14 subject to the provisions of this act, have the following powers,  
15 whether or not such powers are specifically set forth in its certificate  
16 of incorporation:

17 (1) To discount, buy, invest in, hold, assign, transfer, sell, and  
18 negotiate promissory notes, drafts, bills of exchange, mortgages, trade  
19 acceptances, bankers' acceptances, bonds, debentures, bonds or notes  
20 secured by mortgages, installment obligations, balances due on  
21 conditional sales, and other evidences of debt for its own account, or  
22 for the account of customers;

23 (2) To accept for payment at future dates drafts drawn upon it by  
24 its customers;

25 (3) To issue letters of credit [authorizing holders thereof to draw  
26 drafts upon it or upon its correspondents at sight or on time;] to  
27 guarantee the payment by its customers of amounts due or to become  
28 due upon the purchase by such customers of real or personal property;

29 (4) To receive interest and noninterest bearing demand and time  
30 deposits, to be repaid on such terms as may be agreed upon between  
31 the depositors and the bank, and to furnish security for such deposits  
32 when required by the laws of this State or of the United States, or by  
33 rules or orders of any court of this State or of the United States or by  
34 the regulations of an officer or agency of this State or of the United  
35 States, made pursuant to such law; provided that no bank shall be  
36 required to give security for deposits made by this State, or any  
37 political subdivision thereof, or any other body politic existing under  
38 the laws of this State, to the extent that such deposits are insured  
39 under any federal legislation providing for the insurance of bank  
40 deposits;

41 (5) To maintain savings departments for the receipt of interest and  
42 noninterest bearing deposits, to be repaid on such terms as may be  
43 agreed upon between the depositors and the bank, and to commingle  
44 such deposits with deposits otherwise received;

45 (6) During hours other than the bank's usual hours for receipt of  
46 deposits, to provide the equipment for receiving, and to receive,

1 containers purporting to contain moneys or instruments for the  
2 payment of money;

3 (7) To make loans, secured or unsecured, including loans to its  
4 stockholders;

5 (8) To extend credit by honoring overdrafts upon deposit accounts,  
6 but no credit shall be so extended except pursuant to written  
7 agreement made in advance;

8 (9) To buy and sell gold and silver bullion, foreign coin, and  
9 exchange;

10 (10) To purchase and sell debt and equity securities of other  
11 corporations, without recourse, solely upon order and for the account  
12 of customers. This paragraph shall not limit the power of a bank to  
13 take securities of other corporations as collateral security for loans,  
14 discounts, or other extensions of credit, or to acquire those securities  
15 when their acquisition is necessary to prevent or minimize loss upon  
16 debts previously contracted in good faith. Equity securities acquired  
17 pursuant to this paragraph shall be sold within five years after their  
18 acquisition, except that the commissioner may, by order, extend the  
19 time within which sales of equity securities described in such order  
20 shall be made; but this paragraph shall not invalidate the holding of any  
21 equity securities lawfully acquired on or before the effective date of  
22 this act. This paragraph shall not apply to any case in which, pursuant  
23 to any other provision of this act, or pursuant to any other act, a bank  
24 is expressly authorized to subscribe for, purchase or otherwise acquire  
25 or hold securities;

26 (11) To receive any tangible personal property for safekeeping and  
27 storage on the terms provided by chapter 7 of Title 12A of the New  
28 Jersey Statutes, and to keep, maintain, and rent out for hire, space for  
29 the storage and safekeeping of personal property of such kind and  
30 description, or represented by the depositor thereof to be of such kind  
31 and description, as the commissioner may by regulation from time to  
32 time prescribe; but nothing herein contained shall limit the power of a  
33 bank to let space for the storage and safekeeping of personal property  
34 to which the bank has security title or in which it has a lien interest;

35 (12) To avail itself of the provisions of any federal legislation  
36 providing for the extension of any lawful banking activity in the  
37 making of loans or the extension of credit to individuals, or for the  
38 financing of business enterprises, or in such other banking activity as  
39 may be specified in such legislation and made available for  
40 participation by banks; except that the power by this paragraph  
41 conferred shall not be exercised unless the commissioner shall make a  
42 general order authorizing such participation upon such terms and  
43 conditions as may in such order be prescribed;

44 (13) To act as the fiscal agent of the United States, and of any  
45 corporation, and of any State, county, municipality, board, commission  
46 or other body politic, and to perform all duties as such fiscal agent as

1 may lawfully be required of it;

2 (14) To assist customers or act for customers in the preparation,  
3 handling and disbursement of payrolls and payroll deductions and in  
4 the preparation, maintenance and furnishing of records and statistical  
5 information in connection therewith.

6 (cf: P.L.1985, c.528, s.3)

7

8 11. Section 213.1 of P.L.1948, c.67 (C.17:9A-213.1) is amended  
9 to read as follows:

10 213.1. Except as in this act or otherwise by law provided, and  
11 except for letters of credit issued pursuant to N.J.S.12A:5-101 et seq.,  
12 no bank or savings bank shall have power to guarantee the obligations  
13 of others; or to insure or indemnify against the acts, omissions,  
14 undertakings, liabilities or losses of others.

15 (cf: P.L.1948, c.67, s.213.1)

16

17 12. This act shall take effect immediately <sup>1</sup>and shall apply to all  
18 letters of credit issued on and after the effective date<sup>1</sup>.

19

20

21

22

23 Revises law on letters of credit.

1 Jersey Statutes, and to keep, maintain, and rent out for hire, space for  
2 the storage and safekeeping of personal property of such kind and  
3 description, or represented by the depositor thereof to be of such kind  
4 and description, as the commissioner may by regulation from time to  
5 time prescribe; but nothing herein contained shall limit the power of a  
6 bank to let space for the storage and safekeeping of personal property  
7 to which the bank has security title or in which it has a lien interest;

8 (12) To avail itself of the provisions of any federal legislation  
9 providing for the extension of any lawful banking activity in the  
10 making of loans or the extension of credit to individuals, or for the  
11 financing of business enterprises, or in such other banking activity as  
12 may be specified in such legislation and made available for  
13 participation by banks; except that the power by this paragraph  
14 conferred shall not be exercised unless the commissioner shall make a  
15 general order authorizing such participation upon such terms and  
16 conditions as may in such order be prescribed;

17 (13) To act as the fiscal agent of the United States, and of any  
18 corporation, and of any State, county, municipality, board, commission  
19 or other body politic, and to perform all duties as such fiscal agent as  
20 may lawfully be required of it;

21 (14) To assist customers or act for customers in the preparation,  
22 handling and disbursement of payrolls and payroll deductions and in  
23 the preparation, maintenance and furnishing of records and statistical  
24 information in connection therewith.

25 (cf: P.L.1985, c.528, s.3)

26  
27 11. Section 213.1 of P.L.1948, c.67 (C.17:9A-213.1) is amended  
28 to read as follows:

29 213.1. Except as in this act or otherwise by law provided, and  
30 except for letters of credit issued pursuant to N.J.S.12A:5-101 et seq.  
31 no bank or savings bank shall have power to guarantee the obligations  
32 of others; or to insure or indemnify against the acts, omissions,  
33 undertakings, liabilities or losses of others.

34 (cf: P.L.1948, c.67, s.213.1)

35  
36 12. This act shall take effect immediately.

### 37 38 39 STATEMENT

40  
41 This bill repeals existing Uniform Commercial Code Chapter 5  
42 Letters of Credit and replaces it with Uniform Commercial Code  
43 Revised Chapter 5. The revision is a product of the National  
44 Conference of Commissioners on Uniform State Laws and has been  
45 adopted in 14 states. The New Jersey Law Revision Commission has  
46 reviewed Revised Chapter 5 to determine its suitability for New

1 Jersey, and has reported that it would improve our commercial law.

2 Revised Chapter 5 updates existing law to accomodate changes in  
3 technology in the banking industry. It also settles several ambiguities  
4 in current law and conforms domestic law as applied through this  
5 chapter of the U.C.C. to the international standards and practices  
6 governing letters of credit.

7 This bill contains two provisions which deviate from the Official  
8 Text of Revised Chapter 5 recommended by the New Jersey Law  
9 Revision Commission. First, subsection e. of 12A:5-111 makes the  
10 award of attorney's fees and expenses of litigation discretionary with  
11 the court rather than mandatory. This deviation reflects well-  
12 established New Jersey principles on allocation of legal costs. Each  
13 party bears its own attorney's fees and expenses of litigation. Second,  
14 subsection e. of 12A:5-108 clarifies that the court determines standard  
15 banking practices regarding letters of credit but does not decide  
16 disputed questions of fact when the case is tried to a jury. This  
17 deviation is not a change in meaning of the Official Text but corrects  
18 an ambiguity of language in that text.

19 Letters of credit are an important payment instrument for business  
20 firms both in domestic and international transactions. Revised Chapter  
21 5 modernizes relevant New Jersey law and creates an efficient legal  
22 environment for the letter of credit industry.

23

24

25

26

27 Revises law on letters of credit.

SENATE STATE MANAGEMENT, INVESTMENT AND  
FINANCIAL INSTITUTIONS COMMITTEE

STATEMENT TO  
**SENATE, No. 2028**

with committee amendments

**STATE OF NEW JERSEY**

DATED: JUNE 12, 1997

The Senate State Management, Investment and Financial Institutions Committee reports favorably and with committee amendments Senate Bill No. 2028.

This bill, as amended, repeals existing Uniform Commercial Code Chapter 5 Letters of Credit and replaces it with Uniform Commercial Code Revised Chapter 5. The revision is a product of the National Conference of Commissioners on Uniform State Laws and has been adopted in 14 states. The New Jersey Law Revision Commission has reviewed Revised Chapter 5 to determine its suitability for New Jersey, and has reported that it would improve our commercial law.

Revised Chapter 5 updates existing law to accommodate changes in technology in the banking industry. It also settles several ambiguities in current law and conforms domestic law as applied through this chapter of the U.C.C. to the international standards and practices governing letters of credit.

This bill contains two provisions which deviate from the Official Text of Revised Chapter 5 recommended by the New Jersey Law Revision Commission. First, subsection e. of 12A:5-111 makes the award of attorney's fees and expenses of litigation discretionary with the court rather than mandatory. This deviation reflects well-established New Jersey principles on allocation of legal costs. Each party bears its own attorney's fees and expenses of litigation. Second, subsection e. of 12A:5-108 clarifies that the court determines standard banking practices regarding letters of credit but does not decide disputed questions of fact when the case is tried to a jury. This deviation is not a change in meaning of the Official Text but corrects an ambiguity of language in that text.

Letters of credit are an important payment instrument for business firms both in domestic and international transactions. Revised Chapter 5 modernizes relevant New Jersey law and creates an efficient legal environment for the letter of credit industry.

COMMITTEE AMENDMENT

The amendment to the bill clarifies that the provisions of the bill apply only to letters of credit issued on or after the effective date of the act.

STATEMENT TO  
[First Reprint]  
**SENATE, No. 2028**

with Senate Floor Amendments  
(Proposed By Senator INVERSO)

ADOPTED: December 1, 1997

These amendments are technical in nature and conform the text of the statutes amended in various sections of this bill to the most recent version of those statutes as amended by P.L.1997, c.252.

*From Governor's News Release, Jan. 20, 1998*

**S-1931**, sponsored by Senator John Mattheussen (R-Camden/Gloucester) and Assembly Members John Arnone (R-Monmouth) and George Geist (R-Camden/Gloucester), which reduces continuous service requirement for tenure of municipal court administrators to five years. Current law provides that the governing body pass a resolution authorizing tenure. The bill, an initiative of the AOC and MCAA, is intended to provide an incentive for certification and will, thus, help professionalize the position of municipal court administrator.

**S-1962**, sponsored by Senators Lou Bassano (R-Essex/Union) and Robert Singer (R-Burlington/Monmouth/Ocean) and Assembly Member Nick Felice (R-Bergen/Passaic), which reduces certain certificate of need application fees.

**S-2007**, sponsored by Senator Robert Littell (R-Sussex/Hunterdon/Hudson) and Assembly Members Guy Gregg (R-Sussex/Hunterdon/Morris) and Leonard Lance (R-Warren/Hunterdon/Mercer), which authorizes Division of Fish Game and Wildlife personnel to use certain weapons when controlling or conducting research on wildlife.

**S-2010**, sponsored by Senator Peter Inverso (R-Mercer/Middlesex) and Assembly Member Marion Crecco (R-Essex/Passaic), permits certain retired public employees who later become employed in a position covered by PERS to be enrolled in PERS. The bill is intended to apply to former members of the City of Newark Retirement System to enroll in PERS.

**S-2028**, sponsored by Senator Peter Inverso (R-Mercer/Middlesex) and Assembly Members Kip Bateman (R-Morris/Somerset) and Joel Weingarten (R-Essex/Union), which revises law on letters of credit. The bill replaces existing code with the Uniform Commercial Code Revised Chapter 5. The bill is intended to update the law to accommodate changes in technology in the banking industry.

**S-2117**, sponsored by Senator James Cafiero (R-Cape May/Atlantic/Cumberland) and Assembly Members Nick Asselta (R-Cape May/Atlantic/Cumberland) and John Gibson (R-Cape May/Atlantic/Cumberland), which allows retirees to purchase service credit for certain prior employment. The bill reopens the window of opportunity to purchase up to ten years of credit for past service for an additional 30 day period following the enactment of the bill.

**S-2273**, sponsored by Senator Leonard Connors (R-Atlantic/Burlington/Ocean) and Andrew Ciesla (R-Monmouth/Ocean) and Assembly Members Jeffrey Moran (R-Atlantic/Burlington/Ocean) and Chris Connors (R-Atlantic/Burlington/Ocean), which appropriates \$540,685 to the Department of Corrections from the 1982 Bond Act for renovation of the Ocean County Correctional Facility.

**S-2336**, sponsored by Senators Robert Singer (R-Burlington/Monmouth/Ocean) and John Adler (D-Camden) and Assembly Members Jeffrey Moran (R-Atlantic/Burlington/Ocean) and Anthony Impreveduto (D-Bergen/Hudson), which allows interior designers to enter into business relationships which architects under certain circumstances. The bill would change current law to allow interior designers to employ or be employed by licensed architects. The bill requires architects to exercise independent professional judgement when affiliated with an interior designer.

*News releases are also available on our website at: [www.state.nj.us](http://www.state.nj.us)*

from NJ Law Revision Commission Annual Report, 1994

However, the majority of these statutes were enacted before the Criminal Code. As a result, some have become unnecessary because of the more general provisions of the Code. In addition, many are phrased in pre-Code language and define "misdemeanors" rather than crimes graded by degree.

This project examines the penal provisions that are outside Titles 2A, 2C and 24 to determine whether they should be repealed as superseded by the Criminal Code, should be incorporated into the Criminal Code, or should be amended to be made consistent with the Criminal Code.

#### C. Uniform Commercial Code Revised Article 5

The Commission completed a Tentative Report Relating to Uniform Commercial Code Revised Article 5 - Letters of Credit and distributed it for public comment (see Appendix F).

The National Conference of Commissioners on Uniform State Laws approved Uniform Commercial Code Revised Article 5 -- Letter of Credit (With Conforming and Miscellaneous Amendments to Article 9) at its 1994 Annual Meeting. A letter of credit is an engagement by an issuer, usually a bank, to honor a demand for payment by the beneficiary on the presentation of documents identified in the letter of credit. The letter of credit facilitates the sale of goods between distant merchants by assuring the seller of payment. Existing Article 5, enacted forty years ago, was revised to accommodate contemporary developments and practices regarding letters of credit, and to conform to international letter of credit standards. The likely effect of the adoption of Revised Article 5 is to make payment of letters of credit more certain and to allow parties freedom of contract to modify letter of credit arrangements to meet commercial needs.

- e. The hearing in any such proceeding shall be without a jury;
- f. Any such proceeding may be brought in the name of the Director of the Division of Motor Vehicles, in the Department of Law and Public Safety or in the name of the State of New Jersey;
- g. Any sums received in payment of any fines imposed in any such proceeding shall be paid to the Director of the Division of Motor Vehicles and shall be paid by him into the State Treasury.

**COMMENT**

Using false statements to claim a benefit is theft under 2C:20-4.

**58:10-23.11k. Claims; limitations; forms and procedures; false information; misdemeanor; notice**

Claims shall be filed with the administrator not later than one year after the date of discovery of damage. The administrator shall prescribe appropriate forms and procedures for such claims, which shall include a provision requiring the claimant to make a sworn verification of the claim to the best of his knowledge. [Any person who knowingly gives or causes to be given any false information as a part of any such claim shall, in addition to any other penalties herein or elsewhere prescribed, be guilty of a misdemeanor.] Upon receipt of any claim, the administrator shall as soon as practicable inform all affected parties of the claim.

**COMMENT**

Any false swearing is made criminal by 2C:28-2. Using false statements to make a claim constitutes theft under 2C:20-4.

STATE OF NEW JERSEY  
NEW JERSEY LAW REVISION COMMISSION

TENTATIVE REPORT

relating to

Uniform Commercial Code Article 5

September 1994

This tentative report is distributed to advise interested persons of the Commission's tentative recommendations and to notify them of the opportunity to submit comments. The Commission will consider these comments before making its final recommendations to the Legislature. The Commission often substantially revises tentative recommendations as a result of the comments it receives. If you approve of the tentative report, please inform the Commission so that your approval can be considered along with other comments.

COMMENTS SHOULD BE RECEIVED BY THE COMMISSION NOT LATER THAN  
DECEMBER 10, 1994.

Please send comments concerning this tentative report or direct any related inquiries, to:

John M. Cannel, Esq., Executive Director  
NEW JERSEY LAW REVISION COMMISSION  
15 Washington Street, Room 1302  
Newark, New Jersey 07102  
201-648-4575  
(Fax) 648-3123

## Introduction

The National Conference of Commissioners on Uniform State Laws approved Uniform Commercial Code Revised Article 5 -- Letters of Credit (With Conforming and Miscellaneous Amendments to Article 9) at its 1994 annual meeting. The Revised Article 5 is recommended for adoption in all states, and replaces the original Article 5 enacted in New Jersey in 1961. Several reasons prompted the drafting of the revision. Professor James E. Byrne, Chair of the Task Force on the Study of UCC Article 5, explains that "forty years of hard use have revealed weaknesses, gaps, and errors in the original statute which compromise its relevance."<sup>1</sup> Professor James J. White, the Reporter for the Revised Article 5, states that "the use of letters of credit has expanded and developed, and the case law concerning these developments is, in many respects, discordant."<sup>2</sup> In addition, it was generally agreed that the UCC should be harmonized with international standards governing letters of credit.

"A letter of credit is an engagement by an issuer (usually a bank) at the request and for the account of its customer, to honor drafts or demands for payment by the beneficiary if the documents presented to the issuer comply with the terms and conditions of the letter of credit."<sup>3</sup> The letter of credit was developed to facilitate the sale of goods between distant buyers and sellers. "It was an arrangement under which a bank, whose credit was acceptable to the seller, would at the instance of the buyer agree to pay drafts drawn on it by the seller, provided that certain documents, such as a bill of lading, accompanied the draft."<sup>4</sup> A letter of credit also may guarantee the performance of contract obligations. Such an instrument is known as a standby letter of credit. A standby letter of credit is payable when the applicant on the letter of credit defaults on the underlying contract.

The Revised Article 5 is short, consisting of 16 sections. The revised Article 5 solves some statutory problems identified by the Task force, achieves a significant degree of conformity with international letter of credit standards and, by retaining the skeletal structure of the original statute, remains "responsive to commercial reality and in particular to the customs and expectations of the international banking and mercantile community." *Id.* However, it is not the sole source of letter of credit law. Revised Article 5 is supplemented by non-displaced general principles of law and equity.<sup>5</sup> It also interfaces with statutes such as the federal Bankruptcy Code. Moreover, if the United States enacts the United Nations Commission on International Trade Law (UNCITRAL) Convention on International Guaranty Letters, standby letters of credit may be governed by the UNCITRAL convention. In addition, only eight of the provisions of Revised Article 5 are mandatory. The non-mandatory provisions may be displaced by provisions of a private contract or by adoption in the contract of the Uniform Customs and Practice for

<sup>1</sup> The Task Force on the Study of U.C.C. Article 5, An examination of U.C.C. Article 5 (Letters of Credit), 45 Bus. Law 1521, 1532 (1990).

<sup>2</sup> Revised U.C.C. 5-101 Reporter's Comment.

<sup>3</sup> Avidon, Subrogation in the Letter of Credit Context, 56 Brooklyn L. Rev. 129, 130 (1990).

<sup>4</sup> New Jersey Bank v. Palladino, 77 N.J. 33, 41 (1978).

<sup>5</sup> UCC 1-103 states that principles of law and equity supplement its provisions unless the Code specifically displaces these general principles of law.

Documentary Credits (UCP) published by the International Chamber of Commerce.<sup>6</sup> Therefore, while Revised Article 5 provides an independent theoretical frame for the development of letter of credit of law, it does not provide a comprehensive statement of law. Nor, except for its mandatory provisions, does it provide legal rules to regulate letters of credits if parties opt to apply non-UCC law.

Revised Article 5 adopts the vocabulary of the UCP, and defines the relationship between the UCC and UCP, a relationship that the original Article failed to clarify. Revised Article 5 also omits sections contained in the original Article, such as notation credits (5-108) and indemnities (5-113), and includes sections not contained in the original Article, such as subrogation (5-116) and choice of law (5-115). In addition, Revised Article 5 specifically refers to the independence principle (5-103) and clarifies that letters of credit are irrevocable and transferable unless otherwise specified (5-106). The likely effect of adoption of Revised Article 5 is to make payment of letters of credit more certain and to allow parties freedom of contract to modify letter of credit arrangements to meet commercial needs. To what extent general principles of law and equity outside Revised Article 5 would affect the development of letter credit law depends on judicial interpretation. However, Revised Article 5 admonishes courts not to impede the economic purpose of the letter of credit.

If adopted in New Jersey, Revised Article 5 would not substantially alter New Jersey law governing letters of credit. That law is extremely thin. There are only seven reported New Jersey decisions under Article 5, and there are two state banking laws and one accompanying bank regulation applying to letters of credit. Decisions such as *Lustrelon, Inc. v. Prutscher*, 178 N.J. Super. 128 (A.D. 1981) and *New Jersey Bank v. Palladino*, 77 N.J. 33 (1978) support the letter of credit concept adopted by Revised Article 5 and, had the New Jersey courts used Revised Article 5 to decide those cases, the courts probably would have reached the same results.<sup>7</sup> Likewise, state banking law authorizing state banks to issue letters of credit, 17:9A-25, and the banking department regulation governing standby letters of credit, N.J.A.C. 3:11-9.1, are consistent with Revised Article 5.

#### Recommendation

The Law Revision Commission recommends Revised Article 5 for adoption by the New Jersey legislature. The business value of letters of credit depends on certainty of payment. The Revised Article 5 assures prompt payment of letters of credit after examination of documents. In addition, domestic letter of credit law must be sensitive to international standards and

<sup>6</sup> The UCP is a set of rules governing the use of documentary credits in international commerce. See ICC Publication No. 500. While the UCP does not have the force of law, parties to letters of credit often apply the UCP to their transactions by private contract. See Appendix A. The authority of the UCP in international commerce is evidenced by the fact that the State of New York amended 5-104 to make the UCC inapplicable to any letter of credit governed by the UCP.

<sup>7</sup> Revised Article 5's emphasis that a letter of credit is payable on presentation of required documents probably would not have altered the court's finding in *Palladino* that the reference in the letter of credit to a "notice of default" meant a written notice of default. Likewise, the definition of "good faith" that was at issue in *Lustrelon* is not affected by Revised Article 5 since the latter uses the same standard of "good faith" as the original Article 5.

perspectives. The Revised Article 5 is a law with national and international implications. It yields to the non-conflicting provisions of the international standards of the UCP. There is no reason to justify a New Jersey departure from the Revised Article 5. The Law Revision Commission also recommends amendments to the Banking Act of 1948 so that state banking law mirrors letter of credit law.

#### The Revision Process

The Task Force on the study of UCC Article 5 was appointed by the Chair of the Uniform Commercial Code Committee's Letter of Credit Subcommittee on April 12, 1986. Four years later, the Task Force published its report entitled *An examination of U.C.C. Article 5* reprinted in 45 Bus. Law 1521 (1990). The report analyses and makes recommendations for each section of the original statute. In response, a drafting committee and reporter were appointed to draft a revised Article 5. As noted, NCCUSL approved the draft at its annual meeting in 1994.

Coinciding with the revision of Article 5 was the revision of the UCP. The International Chamber of Commerce has completed its revision of the UCP and the revised UCP was made effective January 1994. In addition, UNCITRAL has drafted a Convention on International Guaranty Letters, and it is expected that the Convention will be adopted during the 1995 session.<sup>8</sup> These disparate developments provide rules for the regulation of letters of credit, though the UCP lacks legislative force and the UNCITRAL Convention has not been approved for adoption and applies only to standby letters of credit.

#### Letters of Credit

Letters of credit are of two types: commercial credits and standby credits. A commercial letter of credit is used in a sales transaction in order to reduce the risk of nonpayment of the purchase price under a contract for the sale of goods. Commercial letters of credit are payment devices ordinarily used when the buyer and seller of goods are in different locations. For example, B, a seller of steel in Germany, enters into a contract of sale with C, a buyer in New Jersey. B does not want to ship the steel to C without payment and C does not want to pay until he knows the goods are shipped. C, the buyer, therefore asks his New Jersey bank to issue a letter of credit to B, the seller. The letter of credit assures B of payment when B presents the letter of credit and complying documents indicating that the goods were shipped. It assures C that payment is not made until the bank has evidence that the goods are shipped. Commercial letters of credit are primary bank obligations and are payable to the named beneficiary on presentation of documents.<sup>9</sup> In this example, the New Jersey bank would appoint a correspondent bank near B to pay the letter of credit.<sup>10</sup>

<sup>8</sup> The draft convention dated August 1, 1993 is discussed in Bergstein, *A New Regime for International Independent Guarantees and Stand-by Letters of Credit: The UNCITRAL Draft Convention on Guarantee Letters*, 27 Int'l Law 859 (1993). Since the publication of the article, UNCITRAL has revised the draft.

<sup>9</sup> Letters of credit also are issued by non-banks, and revised Article 5 so provides. Revised UCC 5-102(a)(9).

<sup>10</sup> A sample letter of credit is attached as Appendix A.

A standby letter of credit is used in a nonsales transaction to reduce the risk of nonperformance under a contract that calls for performance. "Some common uses of standby letters of credit include securing the developer's equity in real estate development projects, securing subdivision improvements in connection with obligations under municipal regulation, and guaranteeing payment of revenue and development bonds."<sup>11</sup> The standby credit is payable upon certification of a party's nonperformance of the agreement. It is not unusual to find that a standby credit is payable upon presentation of the beneficiary's draft accompanied by a conclusory certificate that the customer has not performed.<sup>12</sup> The standby letter of credit is used in place of a surety contract because it is cheaper for the applicant to buy.

Conventional analysis divides the letter of credit transaction into 3 separate contracts: (1) the contract between the customer (applicant) and the bank, (2) the contract between the bank and beneficiary and (3) the contract between the applicant and the beneficiary. Letter of credit law attempts to make the contract between the bank and beneficiary -- the letter of credit -- almost totally independent from the other contracts making up the letter of credit transaction. This is called the "independence principle." The independence principle shores up the certainty of payment under the letter of credit by permitting the bank to pay on the presentation of required documents. Unlike a surety, whose liability is derivative of the principal, the bank is primarily liable to pay on the letter of credit. In addition, the bank pays regardless of non-documentary conditions bearing on the contract between the applicant and the beneficiary. For example, a breach of contract, such as shipment of non-conforming goods, does not affect the bank's obligation pay the beneficiary. If the required documents are presented, the bank is obligated to pay and is entitled to demand reimbursement from the applicant.

Payment of the letter of credit on presentation of required documents differentiates the letter of credit from other payment instruments such as bank checks. The document requirement is clearly set forth in the Revised Article 5 letter of credit definition, "Letter of credit means a definite undertaking that satisfies the requirements of section 5-104 by an issuer to a beneficiary at the request or for the account of an applicant or, in the case of a financial institution, for its own account, to honor a documentary presentation by payment or delivery of an item of value."<sup>13</sup> (emphasis added). A document can virtually be anything, but it cannot be oral.<sup>14</sup> Required documents generally fall into the following categories: (1) drafts, (2) commercial invoices, (3) bills of lading, (4) insurance certificates, (5) consular documents and (5) certificates of origin and

<sup>11</sup> Moringiello, *Silencing the Loose Cannon: The Need for the Bankruptcy Code to Recognize Letters of Credit*, 27 Loyola of LA 619 n 4 (cases omitted).

<sup>12</sup> J. Dolan, *The Law of Letters of Credit*, 1-15 to 1-16 (1991).

<sup>13</sup> UCC 5-104 sets forth the formal requirements for a letter of credit. The letter of credit must be issued in a form that is a record and must be authenticated by a signature. A record means "a durable representation of information which is in, or is capable of being converted to, perceivable form." Revised UCC 5-102(a)(14).

<sup>14</sup> A document "means a draft or other demand, document of title, investment security, certificate or other record, statement, or representation of fact, law, right or opinion that (i) is presented in a written or other medium permitted by the letter of credit or, unless prohibited by the letter of credit, by the standard practice referred to in section 5-108(e) and (ii) is capable of being examined for compliance with the terms and conditions of the letter of credit. A document may not be oral." Revised UCC 5-102(a)(6).

inspection.<sup>15</sup> While these five kinds of document are the main letter of credit documents, parties are free to identify the required documents of a letter of credit.

#### New Jersey Banking Law Related to Letters of Credit

As noted, there are three statutes and one regulation concerning letters of credit in New Jersey Banking law. The statutes are (1) 17:9A-25(3), (2) 17:9A-62 and (3) 17:9A-213.1. These statutes are found in the Banking Act of 1948 (hereafter Banking Act). The banking department regulation is N.J.A.C. 3:11-9.1.

17:9A-25(3) specifically states that a bank is authorized "To issue letters of credit authorizing holders thereof to draw drafts upon it or upon its correspondents at sight or on time; to guarantee the payment by its customers of amounts due or to become due upon the purchase by such customers of real or personal property."

17:9A-62 places limitations on a bank's liability. Section 62(a) states the general rule that "Except as provided in this article, the total liabilities of any person shall not exceed 10% of the capital funds of the bank." This limitation on liability applies to standby letters of credit pursuant to N.J.A.C. 3:11-9.2.

17:9A-213.1 contains a prohibition against a bank guaranteeing obligations of other persons. It states, "Except as in this act or otherwise by law provided, no bank or savings bank shall have power to guarantee the obligations of others; or to insure or indemnify against the acts, omissions, undertakings, liabilities or losses of others."

17:9A-25(3) which allows the issuance of letters of credit constitutes an exception to this section. However, the language of 17:9A-25(3) is unfortunate and unnecessary. First, it limits letters of credit to those payable by draft at sight or on time. Not all letters of credit are payable by draft. For example, Professor John Dolan in his authoritative treatise on letters of credit describes the "deferred payment credit." This credit does not use a draft and calls for payment on a date that is a fixed period of time after a specified date. "The deferred payment credit differs from the acceptance credit in that it generates no draft and no acceptance."<sup>16</sup> Rather, "the

<sup>15</sup> A commercial credit traditionally is payable against the beneficiary's draft either at sight or at a given time. J. Dolan, *supra* note 12 at 1-33. The draft is an order to pay and therefore is a demand by the beneficiary that the issuer pay the letter of credit. A commercial invoice "is a document prepared by the seller that describes the goods."<sup>15</sup> The description of the goods in the commercial invoice must mirror the description of goods in the letter of credit. The bill of lading is a document of title. If a commercial credit transaction goes well, the issuer sends the applicant the bill of lading so that the applicant can take possession of the goods. If a commercial credit transaction goes awry, and the bill of lading is negotiable and endorsed to the issuer, the issuer acquires title to the document and goods under UCC 7-502. An insurance certificate provides evidence that the seller has obtained insurance. It also gives the holder of the certificate the right to insurance proceeds in the event the goods are lost or destroyed. A consular invoice is a certificate made by a consular official of the importing country that the shipment complies with the regulations of the importing country. Certificates of origin and inspection provide proof of the seller's compliance with the underlying contract.

<sup>16</sup> J. Dolan, *supra* note 12 at 1-11.

issuer signals its obligation by letter, by advice, or by some other nonnegotiable undertaking."<sup>17</sup> Revised Article 5 does not contain a requirement that a letter of credit be payable by draft. In addition, subsection 25(3) appears to encompass both commercial and standby letters of credit, but the language is ambiguous. The first part of that subsection applies to commercial letters of credit; the second part of that subsection, that which follows the semi-colon, may be read to modify commercial letters of credit or may authorize the issuance of standby letters of credit. In any case, because Revised Article 5 defines letters of credit, both commercial and standby, all language in subsection 25(3) except for the phrase "to issue letters of credit" is superfluous.

The language of 17:9A-213.1, while not incorrect, could state clearly that it does not apply to letters of credit. The introductory phrase of 17:9A-213.1, which prohibits bank guarantees, contains a vague exception to this general rule using the stock language, "Except as in this act or otherwise by law provided." Courts have said the exception carved out by subsection 25(3) covers letters of credit, but it would be better to make an explicit reference to Revised Article 5 here.

<sup>17</sup> *Id.*

## Selected Differences between Original Article 5 and Revised Article 5

### 1. Fraud and Injunctions

Original Article 5-114(2) gives a court the authority to enjoin payment of a letter of credit when "there is fraud in the transaction." The statute provides that a court may enjoin a letter of credit when:

"(2) ... a required document does not in fact conform to the warranties made on negotiation or transfer of a document of title (12A:7-507) or of a certificated security (12A: 8-306) or is forged or fraudulent or there is fraud in the transaction."

The term "fraud in the transaction" has raised 2 problems. First, the Task Force Report states that the American concept of fraud is so broad that it includes conduct that is not egregious. This concept of fraud, the Task Force Report states, "is too broadly defined to be applied in the ordinary commercial markets in which letters of credit operate. If fraud were defined with such a broad brush, virtually every controversial drawing would be subject to a claim of fraud with the result that the viability of the credit as an independent undertaking would suffer greatly."<sup>18</sup> Second, it is not clear whether the term "fraud in the transaction" applies to the underlying transaction or to the credit transaction.<sup>19</sup>

Revised Article 5 cures both problems. Revised Article 5-109 provides that an applicant may request a court to enjoin a letter of credit when "a required document is forged or materially fraudulent, or honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant." The omission of "fraud in the transaction" as a basis for an injunction eliminates the confusion over what transaction the term "fraud" was intended to apply. The revised language of "honor of presentation would facilitate a material fraud by the beneficiary on the issuer or applicant" clarifies that the fraud must be of a serious nature to justify court intervention. The Reporter's Comment stresses that the use of the word "fraud" requires that the fraudulent aspect of the document or the fraudulent act be significant to the participants in the underlying transaction." Reporter's Comment 5-109. The net effect of the revision is to make it more difficult to interrupt payment of a letter of credit and thus to force allegations of fraud to be litigated between parties outside the letter of credit transaction.

### 2. Subrogation

"Subrogation arises ... by operation of law where a person having a liability ... pays a debt due by another under such circumstances that he is in equity entitled to the security or obligation held by the creditors whom he has paid."<sup>20</sup> The question has arisen, that due to the independence of letters of credit from the commercial transactions underlying them, and the distinction

<sup>18</sup> Task Force Report, *supra* note 1 at 1615.

<sup>19</sup> J. Dolan, *supra* note 12 at 7-41 to 7-48.

<sup>20</sup> Avidon, *supra* note 3 at 132.

between letters of credit and guarantees, whether ordinary principles of subrogation should apply to letters of credit. The original Article 5 did not address the issue of subrogation, and court decisions in this area were inconsistent.

Revised Article 5-116 entitled Subrogation of Issuer, Nominated Person and Applicant specifically addresses the subrogation issue and settles the caselaw inconsistency. The Revised Article 5 takes the position that once the letter of credit is paid and has fulfilled its functions there is no reason why usual subrogation rules that apply to guaranties should not apply to letters of credit providing that the person seeking subrogation would have those rights if the person were a secondary obligor. "If the secondary obligor would not have a right to subrogation in the circumstances in which one is claimed under this section, none is granted by this section."<sup>21</sup>

### 3. Nonwaivability

The Original Article 5 did not identify its mandatory provisions explicitly. Revised Article 5 explicitly identifies its 8 mandatory provisions:

(1) Section 5-103(a). This section states that Article 5 applies to letters of credit as defined in Section 5-102(a)(10) and to certain rights and obligations arising out of transactions involving letters of credit. Section 5-102(a)(1) states that a letter of credit is "a definite undertaking that satisfies the requirements of Section 5-104 by an issuer to a beneficiary at the request or for the account of an applicant, or in the case of a financial institution, for its own account, to honor a documentary presentation by payment or delivery of an item of value." Section 5-104 sets formal requirements. They are issued in any form that is a "record" and authenticated by a signature. A "record", as defined by Section 5-102(a)(14), is a durable representation of information capable of being converted to perceivable form. The effect of this nonwaivable provision is to make all letters of credit subject to the nonwaivable provisions of Article 5.

(2) Section 5-103(d) sets forth the independence principle that makes a letter of credit independent from the underlying transaction.

(3) Section 5-102(a)(9) defines an issuer as "a bank or other person that issues a letter of credit, but does not include an individual who makes an engagement for personal, family or household purposes."

(4) Section 5-102(a)(10) sets forth the definition of letter of credit. (see number 1 above).

(5) Section 5-106(d) states that a "perpetual" letter of credit is valid for a period of five years after is stated date of issuance.

<sup>21</sup> Reporter's Comment to 5-116.

(6) Section 5-113(d) states that an issuer or nominated person does not have an obligation to consent to an assignment of proceeds except that a withholding of consent cannot be unreasonably withheld.

(7) Section 5-116(d) states that rights of subrogation do not arise until the issuer honors or the nominated person pays under the letter of credit thus protecting the stability of letters of credit.

(8) Section 1-102(3) sets forth the general code principle that variations by agreement cannot disclaim the obligations of good faith, diligence, reasonableness and care prescribed by the code.

These mandatory provisions do not interfere substantially with freedom of contract and except for some subtle differences, such as 5-113(d) applying to assignment of proceeds, do not vary from the UCP.

### 4. Revocability

Original Article 5-103(10)(a) states that "a credit may be either revocable or irrevocable." Improving on this language, Revised Article 5-106 states that "A letter of credit is revocable only if it so provides." This conforms the UCC with UCP section 6(c) that states "In the absence of such indication (that the credit is revocable) the Credit shall be deemed to be irrevocable." While this change is minor, it conforms the UCC to international practice.

### Conclusion

The Commission recommends that the New Jersey Legislature (1) enact Revised Article 5, (2) amend the New Jersey Banking law as proposed and (3) make conforming amendments to Article 9 regarding the perfection of security interests in letters of credit.

### Recommended Amendments to Banking Act of 1948

17:9A-25:

\* \* \*

(3) To issue letters of credit ~~authorizing holders thereof to draw drafts upon it or upon its correspondents at sight or on time; to guarantee the payment by its customers of amounts due or to become due upon the purchase by such customers of real or personal property;~~

17:9A-213.1

Except as in this act or otherwise by law provided, and except for letters of credit issued pursuant to 12A:5-101 to 12A:5-116, no bank or savings bank shall have power to guarantee the obligations of others; or to insure or indemnify against the acts, omissions, undertakings, liabilities or losses of others.

## VI. WORKS IN PROGRESS

### A. Environmental Protection Projects

In 1993, the Commission entered ~~into~~ a working agreement with the Department of Environmental Protection to revise the state's extensive environmental statutes. The project was suggested by Senator Robert E. Littell. The first stage of the project involved identifying the numerous statutes to be included in the project, which are currently scattered through 13 existing titles of the New Jersey Statutes. The second phase involved reorganizing these statutes into eight new subtitles, to be organized under the new title "Environment."

In 1995, the Commission completed work on the proposed new subtitle "Natural and Historic Resources" (see heading Final Reports, supra.) In addition, work has continued on the subtitles "Navigation" and "Riparian Lands," preliminary drafts of which have been circulated in the Department of Environmental Protection and elsewhere for preliminary comment and review. ( See Appendix F, "Proposed Subtitle - Navigation, Preliminary Draft March 13, 1995" and Appendix G, "Subtitle - Tidelands, Revised Preliminary Draft - 12/13/95.") Work has also begun on the subtitle "Land Use Regulation."

### B. Uniform Commercial Code Article 5 – Letter of Credit

In 1995, the National Conference of Commissioners on Uniform State Laws approved Uniform Commercial Code Revised Article 5 – Letters of Credit, with conforming and miscellaneous amendments to Article 9. Revised Article 5 is intended to replace existing Article 5 enacted in New Jersey in 1961.

Revised Article 5 modernizes the law of letters of credit and attempts to achieve consistency with international banking practices codified in the Uniform Customs and Practice for Documentary Credits. Revised Article 5 is mainly a default statute, that is, with few exceptions, its rules may be varied by agreement. A principal objective of the revision is to shore up the "independence principle," and to adopt the "strict compliance" standard for honoring a letter of credit. The independence principle separates the credit from the sales and other contracts underlying the transaction. A bank's decision to honor a letter of credit is based solely on documentary conditions. The strict compliance standard requires a bank to honor a letter of credit only if the documents strictly conform to its terms.

Three issues have elicited public comment: (1) mandatory attorney's fees, Section 5-111(e), (2) court determined issue of bank's compliance with industry standards, Section 5-108(e) and (3) the definition of "good faith,"

Section 5-102(a)(7). It is argued that the mandatory award of attorney's fees to the prevailing party may chill the beneficiary's right to sue the bank for wrongful dishonor; the court determination of bank behavior is violative of a party's right to jury trial; and the proposed definition of good faith as "honesty in fact" is inadequate to protect non-bank parties to a credit transaction.

The Commission held hearings to consider these issues and received several position papers from letter of credit experts. The Commission is in the process of deliberating these issues and is expected to publish a Final Report in 1996.

#### C. Revision of Chapter 15 of Title 2A

Staff continues to review and revise the statutes in Chapter 15 of Title 2A. Chapter 15 contains 100 sections dealing with civil actions generally. These sections cover a variety of subjects, including the arcane writs of capias ad respondendum and capias ad satisfaciendum. This project is a continuation of the Commission's decision to revise Title 2A in its entirety. The Commission expects to publish a Tentative Report on these subjects in 1996.

The Commission proposals involve a codification of current practice, as well as some significant changes to simplify and shorten the process of public sale. For example, the Commission proposal requires that the sale be advertised in newspapers only one time. That change and the inclusion of an example of a sufficient advertisement should reduce both the time and cost of advertisement. The proposal also reduces the length of the adjournments that the sheriff may grant the debtor from one month to 14 days. Adjournments are routinely given; reducing their time period will shorten the foreclosure process. In addition, on issues where practice varies, the Commission proposal establishes a standard.

The Commission proposal attempts to deal with the constitutional requirement that notice be given to holders of subordinate liens before property is sold to satisfy a prior lien. See New Brunswick Savings Bank v. Markouski, 123 N.J. 402 (1991). Under current law, the creditor or foreclosing party must conduct searches up to the date of actual sale and must notify creditors of the sale. The Commission proposes the filing of a notice of the sale in the land records and the notification of interest holders based on a single search before the first scheduled date of sale. This solution balances the constitutional rights of interest holders with the practical burden of multiple searches.

#### *Foreclosure*

The Commission simplifies the mortgage foreclosure process, codifies existing law and adds new provisions to expedite the foreclosure process. For example, this proposal dispenses with the writ of execution currently required, and allows the sale of property upon a judgment of foreclosure. Most significantly, the Commission proposes that if the sheriff cannot conduct the sale within 45 days after the judgment of foreclosure, and if the debtor agrees or if the debtor has abandoned the property, the court may order that the sale be conducted by someone other than the sheriff. New provisions also derive from the Fair Foreclosure Act, recently enacted by the Legislature. The most important of these provisions are those relating to "cure" of default by a debtor. These provisions promote the policy of helping homeowners retain their homes by reinstating their mortgages after missed payments.

#### B. Uniform Commercial Code Article 5 -- Letter of Credit

In 1996, the Commission completed the Report and Recommendations Relating to Uniform Commercial Code Revised Article 5 - Letters of Credit (see Appendix B). Revised Article 5 modernizes the law of letters of credit and harmonizes that law with international banking practices, codified in the Uniform Customs and Practice ~~for~~ Documentary Credits. The Report and

Recommendations recommends that the Legislature enact the uniform statute with two non-uniform amendments and conforming amendments to New Jersey law.

The non-uniform amendments pertain to Sections 5-108(e) and 5-111(e). Regarding the former, the Commission's recommendation revises the second sentence to state that the court determines standard banking practices but does not determine the fact question of whether a bank has complied with those standards. Regarding the latter, the Commission's recommendation makes the award of attorneys' fees discretionary with the court.

### C. Evidence

In 1996, the Commission completed the Report and Recommendations Relating to Evidence (see Appendix C). That report follows the 1993 enactment of the New Jersey Rules of Evidence. The procedure used for adopting the 1993 rules was the one established by the Evidence Act, 2A:84A-33 through -39. That procedure represents a compromise settlement of the difficult issue of whether the Supreme Court or the Legislature has the power to enact valid rules of evidence. See Busik v. Levine, 63 N.J. 351, 367-368 (1973). The procedure involves acquiescence by both the Legislature and the Court; by using this procedure any question of which branch has the power to make rules becomes moot. As a result, it is desirable that the New Jersey Rules of Evidence be what was intended, a comprehensive statement of the law of evidence.

A number of statutory sections that deal with the admissibility of evidence overlaps with or duplicates the rules. In some instances, differences in terminology create the potential for confusion. In all cases, the overlap obscures the statutory intention of stating evidence rules comprehensively in one place. Some of these sections were identified as superseded both in the current Rules of Evidence and in its predecessor. These sections serve no purpose.

The Report recommends the deletion of all statutory sections that duplicate or conflict with the Evidence Rules. However, in many instances, an evidence provision is part of a statute that deals with other subjects. Elimination of these provisions would require the revision of the sections in which they are embedded. The Report does not recommend amendments to repeal these provisions except when they are in clear conflict with the Rules.



State of New Jersey

# N J L R C

New Jersey Law Revision Commission

FINAL REPORT

UNIFORM COMMERCIAL CODE

REVISED ARTICLE 5. - LETTERS OF CREDIT

15 Washington Street, Room 1302

Newark, New Jersey 07102

201-648-4575

(Fax) 648-3123

*email: [reviser@superlink.net](mailto:reviser@superlink.net)*

*web site: <http://www.lawrev.state.nj.us>*

June 1996

Appendix B c:\rptstucc5.doc

## Table of Contents

INTRODUCTION	3
Letters of Credit	3
The Revision Process	3
Select List of Benefits of Revised Article 5	4
The Commission's Study	5
DISCUSSION	5
Section 5-108(e). Right of Jury Trial	5
Section 5-111(e). Mandatory Attorney's Fees	7
PROPOSED NON-UNIFORM AMENDMENTS AND COMMENTS	8
Right of Jury Trial	8
Attorney's Fees	10
RECOMMENDED AMENDMENTS TO LOCAL LAW	10
Conforming Amendments	11

## **Introduction**

The New Jersey Law Revision Commission (Commission) reviewed Revised Article 5. Letters of Credit pursuant to its statutory mandate to consider recommendations of the National Conference of Commissioners on Uniform State Laws (NCCUSL). The Commission studied the revision, held public hearings and received written submissions from experts in the field. As a result of its study, the Commission recommends that the Legislature enact Revised Article 5. Letters of Credit (with conforming and miscellaneous amendments to Articles 1, 2 and 9) with non-uniform amendments to Sections 5-108(e) and 5-111(e). The Commission also recommends that the Legislature enact conforming amendments to state banking law.

### *Letters of Credit*

The documentary credit, or letter of credit, is a payment device used by distant buyers and sellers of goods in an international trade transaction. The documentary credit solves several considerations surrounding the payment process. On the one hand, the seller may refuse to extend credit to a buyer whose credit standing it does not know. On the other hand, the buyer may want to avoid payment of the goods prior to shipment. The documentary credit solves these payment considerations by interposing a bank that acts as a neutral paymaster between the parties.

In a typical transaction, a bank undertakes to pay the seller the value of the credit provided the seller complies with the documentary conditions specified in the credit. The applicant (buyer), the bank and beneficiary (seller) set the documentary conditions, usually documents evidencing shipment, place of origin, insurance and the like. Normally, after shipment of goods, the seller presents the letter of credit and the required documents to the bank. The bank examines the letter's terms and the documents. If the documents comply with credit's terms, the bank pays the seller the value of the credit. In most cases, the transaction is completed and the expectations of the parties are satisfied.

Letters of credit known as standbys serve a second purpose. Standby letters of credit function as a guarantee of payment in the event of a specified default. These credits often are used in domestic transactions to support an underlying obligation such as the obligation to complete a construction contract. Payment is due when the party entitled to enforce the letter of credit presents the letter and certification of default to the bank. Standby letters of credit are used by public and private entities.

### *The Revision Process*

In August 1995, NCCUSL and the American Law Institute approved Uniform Commercial Code Revised Article 5 -- Letters of Credit (with Conforming and Miscellaneous Amendments to Articles 1, 2 and 9) and forwarded the revised article for enactment by state legislatures. Revised Article 5 replaces the original article drafted 40 years ago, and adopted by the New Jersey legislature in 1961.

The revision is the product of a lengthy process of study and debate. The Chair of the Uniform Commercial Code Committee's Letter of Credit Subcommittee appointed an

American Bar Association task force on the study of UCC Article 5 on April 12, 1986. Four years later, the Task Force published its report entitled An examination of U.C.C. Article 5 reprinted in 45 Bus. Law 1521 (1990). The report analyzed and made recommendations for each section of the original statute. In response, a drafting committee and reporter were appointed to draft a revised Article 5.

The revision was prompted by changes in commercial practice and problems in existing law. Professor James E. Byrne, Chair of the Task Force on the Study of UCC Article 5, explained that "forty years of hard use have revealed weaknesses, gaps, and errors in the original statute which compromise its relevance."<sup>1</sup> Additionally, case law developed along discordant lines in reaction to developments in letter of credit practices.<sup>2</sup> Moreover, it was generally agreed that the UCC should conform to the Uniform Customs and Practices for Documentary Credits (UCP). The UCP, which contains internationally recognized standards for letters of credit, governs virtually all commercial letters of credit.

#### **Select List of Benefits of Revised Article 5**

Revised Article 5 embodies the freedom of contract principle by allowing the parties to vary most provisions by agreement. The virtue of this approach is its flexibility. As letter of credit practices evolve parties may adjust their agreements to reflect varying allocations of rights and liabilities. There are only eight mandatory provisions. These provisions control basic issues such as scope, good faith and the independence principle.

Revised Article 5 also adopts the "strict compliance" standard for bank examination of documents. This standard clarifies the bank's duty, since, under existing law, the "substantial compliance" standard was applied by some jurisdictions. Adopting the stricter standard ensures that banks pay only upon a tender of the required documents, thus enforcing the applicant's conditions of payment. Beneficiaries cannot expect payment by a tender of imperfect documents.

Additionally, the revision tracks UCP international standards. It does so by allowing parties to agree to be governed by the UCP rather than the Article 5 rules. This approach, which conforms domestic to international law, is totally appropriate in the letter of credit context, since commercial letters of credit are almost always international transactions. The UCP, which is published by the International Chamber of Commerce (ICC) in Paris, France, promotes international trade and business. The ICC periodically revises the UCP to reflect current letter of credit trade practices. Permitting parties to incorporate the UCP by agreement appropriately recognizes the importance of international rules in this area.

<sup>1</sup> The Task Force on the Study of U.C.C. Article 5, An examination of U.C.C. Article 5 (Letters of Credit), 45 Bus. Law 1521, 1532 (1990).

<sup>2</sup> The Prefatory Note to the revision states "Measured in terms of these areas which are vital to any system of commercial law, the current combination of statute and case law is found wanting in major respects both as to predictability and certainty." U.C.C. Revised Article 5, Letters of Credit, Prefatory Note at 1 (1995).

Moreover, Revised Article 5 restates the "independence principle." This principle recognizes the independence of the letter of credit from the contract between the applicant and beneficiary, and other contracts surrounding the sale. It thereby protects the letter of credit from disputes arising between the applicant and beneficiary. Because of the "independence principle," the bank ignores non-documentary conditions when making its decision to honor the credit.

#### **The Commission's Study**

The Commission's review extended over several months and drew the attention of letter of credit experts, the Executive Director of NCCUSL and the Chair of the Drafting Committee of Revised Article 5. The review process produced a vigorous and public debate among interested parties concerning several provisions of the revised article.<sup>3</sup>

While the Commission supported the provisions of Revised Article 5, it developed serious reservations about recommending the enactment of Official Text Sections 5-108(e) and 5-111(e). After considering the arguments and written submissions of experts, the Commission, by letter dated April 2, 1996, informed NCCUSL and the American Law Institute that it would not refer the Official Text statute to the Legislature for enactment because of concerns with Sections 5-108(e) and 5-111(e). The Commission requested NCCUSL to reconsider these provisions, since it was still early in the enactment process.

In response, on April 25, 1996, Frederick Miller, Executive Director of NCCUSL, and Carlyle C. Ring, Jr., Chair of the Revised Article 5 Drafting Committee, appeared before the Commission. Margaret L. Moses, Esq., a letter of credit expert, and representatives from the letter of credit user community also appeared before the Commission. The policy, economic and legal issues related to Sections 5-108(e) and 5-111(e) were extensively debated and explored by the Commission. Subsequently, on May 25, 1996, the Commission voted to recommend that the Legislature adopt Revised Article 5 with non-uniform amendments to Sections 5-108(e) and 5-111(e).

#### **Discussion**

##### **Section 5-108(e). Right of Jury Trial**

Official Text Section 5-108(e) provides:

An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination of the issuer's observance of the standard practice is a matter of interpretation for the

<sup>3</sup> Margaret L. Moses, Look Before Leaping to Adopt Revised Article 5, 143 N.J.L.J. 35 (1996) at 11; Sandra Schnitzer Stern, Revised Article 5 Brings Uniformity, Predictability to Letters of Credit, 143 N.J.L.J. 779 (1996) at 11; Robert Rosenblith, Esq., NatWest Bank, untitled memorandum (on file with the Commission); and letter dated February 20, 1996 from Carlyle C. Ring Jr., vice-president and General Counsel of Atlantic Research Corporation and Chair of Revised Article 5 Drafting Committee to John J. A. Burke, Associate Counsel, New Jersey Law Revision (on file with the Commission).

court (underline added). The court shall offer the parties a reasonable opportunity to present evidence of the standard practice.

The Commission's inquiry centered on the meaning of the underlined sentence and particularly on the meaning of the term "issuer's observance." Ms. Moses maintained that Section 5-108(e) violated the right of jury trial guaranteed by the Seventh Amendment of the United States Constitution and New Jersey Constitution, art. 1 par. 9. She asserted that the question of whether the issuer observed standard practice was an ordinary fact question for the jury. This question required the jury to evaluate the conduct of the issuer in the letter of credit transaction and to determine whether that conduct met the obligations of standard practice. By assigning this fact question to the court, she argued, Section 5-108(e) was unconstitutional.

N.J. Const. (1947) art. 1, par. 9 provides a right of jury trial in cases where that right existed at common law at the time the state constitution was adopted. State v. Anderson, 127 N.J. 191, 207 (1992). For this analysis, our courts generally refer to the 1947 constitution. The pre-1947 judicial system provided jury trials for cases where a legal remedy was sought. Since a suit to require payment of a letter of credit is legal in nature, a jury trial right has always applied to letter of credit cases. In jury trial cases, matters of law are decided by the court and matters of fact are left to the jury. Consequently, unless the parties waive the jury trial right, the New Jersey Constitution requires that, in letter of credit cases, the jury resolves disputes about ordinary facts.

Having found that juries decide facts, the Commission next considered the question to what degree Section 5-108(e) requires the court to determine them. The language of the section states that the court determines the "issuer's observance of the standard practice." Evaluating whether a bank meets a standard practice is clearly a fact question. Hence, the Commission found that whether the issuer complied with standard practices was a fact dispute that required jury determination. Since Section 5-108(e) assigns an ordinary fact question to the court, it abridges the constitutional right of jury trial. N.J. Const. (1947) art. 1, par. 9.

However, Frederick Miller, Executive Director of NCCUSL, informed the Commission that they were misreading Section 5-108(e). According to Mr. Miller, Section 5-108(e) does not assign an ordinary fact dispute concerning the issuer's conduct to the court. Rather, it assigns to the court only the question of what constitutes a standard practice. If there is a fact dispute of whether the issuer actually complied with standard practices, this fact dispute goes to the jury. Mr. Miller maintained that Section 5-108(e) does not usurp the jury function with respect to ordinary fact questions concerning the issuer's conduct in a letter of credit transaction. On the basis of Mr. Miller's presentation, the Commission concluded that it had no substantive disagreement with the intent of the Official Text. Its concern was how to manifest that finding.

Mr. Miller proposed that the ambiguity of Section 5-108(e) could be corrected by an Official Comment. He offered to work with the Commission to prepare appropriate commentary to amend the existing Official Comment to Section 5-108. The proposed amendment then would be presented to the Conference for approval at its 1996 Annual

Meeting. Mr. Miller encouraged the Commission not to recommend a non-uniform amendment because he considered this section a central provision of the revision.

The Commission considered two alternatives to resolve this problem of interpretation: (1) clarification by comment or (2) making a non-uniform amendment to the Official Text. The Commission chose to amend the Official Text rather than cure the ambiguity by comment. This decision follows from the Commission view that the Official Text language can support several reasonable interpretations. The Commission decided that the text of the statute should be clear; that it was preferable not to rely on an explanatory comment since comments are not legislation. The Commission determined that the best way to state the drafter's purpose and minimize confusion about the meaning of Section 5-108(e) was to remove the term "issuer's observance of." This amendment clarifies that the court determines standard practices, and that ordinary facts in dispute are resolved by juries if the case is tried to one.

The Commission rejected the position that the New Jersey Constitution required a jury to resolve disputed fact questions concerning the interpretation of written and non-written standard practices. The Commission found that the Legislature has the authority to require the court to determine standard practices as a matter of law without contravening the jury trial right on ordinary fact questions.

#### **Section 5-111(e). Mandatory Attorney's Fees**

Section 5-111(e) provides:

Reasonable attorney's fees and other expenses of litigation must be awarded to the prevailing party in an action in which a remedy is sought under this article.

This section adopts the English rule whereby the losing party pays the costs of litigation of the prevailing party. The Commission was informed that the drafting committee fully debated this issue and adopted the rule in lieu of imposing consequential damages on banks and of broadening the good faith standard. The Official Comment indicates that the rule's purpose is to protect the applicant from undeserved loses under the reimbursement agreement which usually shifts the issuer's litigation costs to the applicant.

In general, New Jersey follows the American rule that each party bears its cost of litigation. While New Jersey has enacted fee shifting statutes, these statutes generally protect parties without substantial economic or political power, or implement broad public policy.<sup>4</sup> The award of mandatory attorney's fees to the prevailing party in Article 5 litigation does not fall within New Jersey exceptions to the American rule. Since the New Jersey Supreme Court exclusively controls the practice of law, and since the Court

<sup>4</sup> E.g., Consumer Fraud Act, N.J.S. 56:8-19 (requiring court to award to prevailing consumer reasonable attorney's fees, costs of suits and filing costs); Law Against Discrimination, N.J.S. 10:5-27.1 (giving court discretion to award to prevailing party reasonable attorney's fees); Residential Tenant's Security Deposit Return, N.J.S. 46:8-21.1 (giving court discretion to award to prevailing tenant reasonable attorney's fees).

permits deviations from the American rule only to achieve public policy objectives, it is likely that the court would disfavor Section 5-111(e).

The rule also may have a chilling effect on the beneficiary's exercise of its right to sue on a letter of credit. A beneficiary obtains a letter of credit for the purpose of having a bank assume the payment obligation and risk of insolvency of the applicant. While the credit is not a guarantee of payment, the beneficiary knows that, if the required documents are tendered, the bank is obligated to honor the letter of credit regardless of any disputes arising from the underlying transaction. Section 5-111(e) may penalize a beneficiary in some wrongful dishonor cases.

Under Revised Article 5, the documents must "strictly comply" with the credit's terms. The "strict compliance" standard requires an almost mirror image of the documents specified in the letter of credit. The strict "compliance standard" reduces the uncertainty of whether a bank should honor the beneficiary's presentation. But whether the documents "strictly comply" with the documentary conditions in the credit is not a matter of scientific certainty. Cases where reasonable minds can differ are bound to exist.

A beneficiary is likely to sue the issuer when the applicant is insolvent and the issuer is the sole recourse for payment. In order to refuse payment of the credit, a bank may rely on a minor discrepancy that, were the applicant solvent, it would waive to accommodate the applicant. Since a bank may err in examining documents, and since the strict compliance standard is a matter of interpretation, penalizing a beneficiary which brings a good faith wrongful dishonor suit by requiring the beneficiary to pay the bank's attorney's fees if the bank prevails is unwarranted. The rule shields banks from liability on the letter of credit. In the case of the insolvent applicant, the application of the rule does not achieve its stated purpose of protecting the applicant. It thwarts the beneficiary's expectation of payment.

Section 5-111(e) has the salutary goal of discouraging frivolous litigation. However, New Jersey has already enacted a frivolous claims statute to deal with this issue. A beneficiary that uses the legal system improperly to recover payment on a letter of credit is subject to payment of the bank's attorney's fees under this frivolous claims statute.<sup>5</sup> Although the Commission does not oppose a revised section discouraging frivolous claims, such a provision duplicates existing state law.

#### **Proposed Non-Uniform Amendments and Comments**

##### ***Right of Jury Trial***

Section 5-108(e) is recommended in the following form:

An issuer shall observe standard practice of financial institutions that regularly issue letters of credit. Determination [of the issuer's observance] of the standard practice is a matter of interpretation for the

<sup>5</sup> N.J.S. 2A:15-59.1.

court. The court shall offer the parties a reasonable opportunity to present evidence of the standard practice.

##### *Comment*

The second sentence of Section 5-108(e) is a non-uniform amendment of the Official Text recommended by the New Jersey Law Revision Commission (hereafter the Commission). The Official Text states "Determination of the issuer's observance of the standard practice is a matter of interpretation for the court." The New Jersey amendment strikes the phrase "the issuer's observance of" from the Official Text, leaving the sentence to say "Determination of the standard practice is a matter of interpretation for the court."

The Commission's amendment addresses the ambiguity surrounding the meaning of the second sentence of this subsection. The Commission found that the term "issuer's observance of" supported more than one reasonable interpretation of the court's duty with regard to the issuer's conduct. One interpretation was that the second sentence required the court to determine the ordinary fact question of whether the issuer complied with standard practices related to letters of credit. This interpretation is based on reading the term "issuer's observance of" to mean "issuer's compliance with" standard practice, a reasonable understanding of the term "observance."

However, if read this way, Section 5-108(e) might abridge the constitutional right of jury trial. *N.J. Const. (1947)* art. 1, par. 9 provides a right of jury trial in cases where that right existed at common law at the time the state constitution was adopted. *State v. Anderson*, 127 N.J. 191, 207 (1992). For this analysis, our courts generally refer to the 1947 constitution. The pre-1947 judicial system provided jury trials for cases where a legal remedy was sought. Since a suit to require payment of a letter of credit is legal in nature, a jury trial right has always applied to letter of credit cases. In jury trial cases, matters of law are decided by the court and matters of fact are left to the jury. Evaluating whether a bank complied with standard practice is clearly an ordinary fact question. Since Section 5-108(e) may be read to take this question from the jury, it is susceptible of being interpreted so as to violate the right of jury trial.

Although the language of the second sentence supports this result, it does not reflect the intended meaning of this subsection. According to the drafters of Revised Article 5, the second sentence of this section is intended only to make certain that the court determines standard practice of financial institutions that regularly issue letters of credit. The second sentence does not mean that the court resolves factual disputes surrounding the conduct of the issuer. The drafter's maintain that ordinary fact questions related to the issuer's conduct in a particular transaction is a question for the trier of fact, which, if the case is tried to a jury, is a jury question.

The Commission considered clarifying this subsection by comment, but determined that this method of correction was inappropriate because the statute remains the legitimate statement of the law. The Commission decided that the best way to solve the problem of interpretation was to amend the statute by removing the ambiguous term "issuer's observance of," while indicating in comment that no change from the approved

reading of the subsection is intended by the amendment. Consequently, as amended, the second sentence states the drafter's intention in a clear and definite manner. The question of what constitutes standard practice is a question of law for the court. The question of whether the issuer complied with that standard, if in dispute, is a question for the trier of fact.

#### **Attorney's Fees**

Section 5-111(e) is recommended in the following form:

Reasonable attorney's fees and other expenses of litigation [must] may be awarded to the prevailing party in an action in which a remedy is sought under this article.

#### *Comment*

This section is a non-uniform amendment to the Official Text recommended by the New Jersey Law Revision Commission. The Official Text uses the word "must" instead of "may" in this section. The New Jersey amendment makes the award of attorney's fees and expenses of litigation discretionary, rather than mandatory, with the court. This amendment is consistent with New Jersey practice disfavoring mandatory transfer of the cost of attorney's fees.

The amendment was motivated by its potential adverse effect on beneficiaries in wrongful dishonor litigation. These cases often involve difficult questions of whether the beneficiary tendered complying documents to the bank when making its presentation for payment. The "strict compliance" standard, while reducing the degree of uncertainty about whether a bank should honor the letter of credit, is not a matter of scientific certainty. Reasonable minds can differ on whether documents "strictly comply" with the letter of credit. No policy reason justifies punishing a beneficiary that loses a wrongful dishonor suit by making that beneficiary pay the bank's attorney's fees.

In general, a plaintiff that brings a reasonable, though ultimately unsuccessful suit, should not be required to pay the attorney's fees of the prevailing party. The transfer of the cost of attorney's fees and litigation is appropriate where, for example, a party brings a suit in bad faith or raises frivolous claims. In multiple issue cases, the court has the discretion to determine the prevailing party.

#### **Recommended Amendments to Local Law**

The Commission recommends conforming amendments to two New Jersey banking statutes related to letters of credit. N.J.S. 17:9A-25(3) states that a bank is authorized "To issue letters of credit authorizing holders thereof to draw drafts upon it or upon its correspondents at sight or on time; to guarantee the payment by its customers of amounts due or to become due upon the purchase by such customers of real or personal property." 17:9A-62 places limitations on a bank's liability, the general rule being that "Except as provided in this article, the total liabilities of any person shall not exceed 10% of the capital funds of the bank." This limitation on liability applies to standby letters of credit pursuant to N.J.A.C. 3:11-9.2.

N.J.S. 17:9A-213.1 contains a prohibition against a bank guaranteeing obligations of other persons. It states, "Except as in this act or otherwise by law provided, no bank or savings bank shall have power to guarantee the obligations of others; or to insure or indemnify against the acts, omissions, undertakings, liabilities or losses of others."

#### **Conforming Amendments**

17:9A-25 is amended as follows:

(3) To issue letters of credit ~~authorizing holders thereof to draw drafts upon it or upon its correspondents at sight or on time;~~ to guarantee the payment by its customers of amounts due or to become due upon the purchase by such customers of real or personal property;

#### *Comment*

This amendment conforms this section with U.C.C. Revised Article 5. Letters of Credit (1995) which explicitly recognizes deferred credits. 17:9A-25(3) limits letters of credit to those payable by draft at sight or on time. However, the deferred payment credit does not use a draft and calls for payment on a date that is a fixed period of time after a specified date. "The deferred payment credit differs from the acceptance credit in that it generates no draft and no acceptance."<sup>6</sup> Rather, "the issuer signals its obligation by letter, by advice, or by some other nonnegotiable undertaking."<sup>7</sup>

17:9A-213.1 is amended as follows:

Except as in this act or otherwise by law provided, and except for letters of credit issued pursuant to 12A:5-101 to 12A:5-116, no bank or savings bank shall have power to guarantee the obligations of others; or to insure or indemnify against the acts, omissions, undertakings, liabilities or losses of others.

#### *Comment*

The amendment clarifies that 17:9A-213.1 does not apply to letters of credit. While courts have recognized an exception for letters of credit, it is preferable that the statute make an explicit reference to U.C.C. Revised Article 5. Letters of Credit (1995).

<sup>6</sup> John Dolan, *The Law of Letters of Credit* at 1-11 (1991).

<sup>7</sup> *Id.*