

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based only on the provisions contained in the legislation as of the latest date listed below.)

BILL: CS/CS SB 740

SPONSOR: Judiciary and Commerce and Economic Opportunities Committees and Senator Campbell

SUBJECT: Uniform Commercial Code--Letters of Credit

DATE: March 11, 1999 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Olafson</u>	<u>Maclure</u>	<u>CM</u>	<u>Favorable/CS</u>
2.	<u>Forgas</u>	<u>Johnson</u>	<u>JU</u>	<u>Favorable/CS</u>
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____

I. Summary:

This committee substitute revises Article 5 of the Uniform Commercial Code, relating to letters of credit. These revisions authorize the use of electronic technology, expressly permit deferred payment letters of credit, expressly permit two-part letters of credit, provide standard expiration dates for letters of credit, provide for perpetual letters of credit, provide rules for non-documentary conditions, clarify and establish rules for successors by operation of law, and conform to existing practice for assignment of proceeds.

This committee substitute amends, by substantially rewording, the following sections of the Florida Statutes: 675.101, 675.102, 675.103, 675.104, 675.105, 675.106, 675.107, 675.108, 675.109, 675.110, 675.111, 675.112, 675.113, 675.114, 675.115, 675.116, and 675.117. This committee substitute also amends the following sections of the Florida Statutes: 95.11(5)(c), 671.105, 672.512, 679.103, 679.104, 679.105, 679.106, 679.304, and 679.305.

II. Present Situation:

Chapter 675, ss. 675.101-675.117, F.S., is entitled the "Uniform Commercial Code--Letters of Credit." The Uniform Commercial Code (UCC) serves as the foundation for commercial law in all 50 states. Article 5 of the UCC relating to letters of credit was originally drafted in the 1950s and first adopted in Florida in 1965. This chapter defines the letter of credit and key terms, sets rules for establishing a letter of credit, provides some basic rules prescribing the obligations of parties to a letter, including the obligations of conformers and advisers, and establishes basic remedies for breach of these obligations. In general terms, letters of credit are issued by banks to assure a payment to a third party for a stated amount to be paid within a stated period of time on specified terms.

The Bankruptcy/Uniform Commercial Code Committee and the Financial Institutions Committee of the Florida Bar Business Law Section established a subcommittee, the UCC Study Group, to study and review potential revisions to Florida's Uniform Commercial Code. The UCC Study

Group was assigned the responsibility of reviewing proposed revisions to Article 5 of Florida's UCC, relating to letters of credit, and issued a report as a result of the effort.

In summary, the group found that given advances in technology and the move toward "paperless" transactions in commerce, existing Article 5 is in great need of revision. The group reports that when the original Article 5 was drafted 40 years ago, it was written for paper transactions and before many innovations in letters of credit. Now electronic and other media are used extensively. Since the 1950s, standby letters of credit, which provide a financial guarantee of payment to the beneficiary if the other party to the underlying contract does not perform its obligations under the contract, have developed and now nearly \$500 billion standby letters of credit are issued annually worldwide, of which \$250 billion are issued in the United States. The use of deferred payment letters of credit, which provide for payment at a date after the letter of credit has been presented to the issuer, has evolved and is reflected in the Uniform Customs and Practice (UCP), usually incorporated into letters of credit, particularly international letters of credit, which have seen four revisions since the 1950s. The current version became effective in 1994 (UCP 500). Lastly, in a number of areas, court decisions have resulted in conflicting rules. Litigation has increased as the volume of credits and the uncertainties of the law have stimulated controversies.

The American Law Institute (ALI) and the National Conference of Commissioners on Uniform State Laws (NCCUSL) describe the goals of the drafting committee for revised Article 5 as follows:

- Conforming the Article 5 rules to current customs and practices;
- Accommodating new forms of letters of credit, changes in customs and practices, and evolving technologies, particularly the use of electronic media;
- Maintaining letters of credit as an inexpensive and efficient instrument to facilitate trade; and
- Resolving conflicts among reported decisions.

The ALI and NCCUSL have indicated that Revised Article 5 will promote uniformity in the law by placing U.S. law in accord with international rules and practices regarding letters of credit. Uniform laws would promote domestic and international trade by clarifying matters which have been disputed in existing Article 5. At this time, 38 states and the District of Columbia have adopted Revised Article 5.

The following Florida Statutes have some interplay with chapter 675:

Section 95.11, F.S., provides a statute of limitations of 5 years for actions on written contracts other than for the recovery of real property. Some Florida courts have interpreted a letter of credit as being a contract, although not in cases involving a statute of limitations issue. Section 95.11(5)(c), F.S., provides a one year statute of limitations for actions to enforce rights under the Uniform Commercial Code--Bulk Transfers; (chapter 676, F.S., the Uniform Commercial Code--Bulk Transfers, was repealed by s. 3, ch. 93-77, L.O.F.)

Chapter 671, F.S., provides general provisions for the UCC. Section 671.105, F.S., 1998 Supp., provides for territorial application of the code and specifies parties' power to choose applicable law in certain situations.

Chapter 672, F.S., is the UCC for governing sales transactions. Section 672.512, F.S., provides that where a contract requires payment before inspection, nonconformity of the goods does not excuse the buyer from making payment unless certain conditions are met.

Chapter 679, F.S., is the UCC for governing secured transactions. Section 679.103, F.S., 1998 Supp., provides procedures for the perfection of security interests involving transactions in multiple states. Section 679.104, F.S., provides for exclusions from ch. 679, F.S. Section 679.105, F.S., 1998 Supp., provides for definitions and an index for ch. 679, F.S. Section 679.106, F.S., 1998 Supp., defines "account" and "general intangibles." Section 679.304, F.S., 1998 Supp., provides for the perfection of security interests in instruments, documents, and goods covered by documents; perfection by permissive filing; and temporary perfection without filing or transfer of possession. Section 679.305, F.S., 1998 Supp., provides situations when possession by a secured party perfects a security interest without filing.

III. Effect of Proposed Changes:

This committee substitute revises Article 5 of the Uniform Commercial Code, relating to letters of credit. These revisions authorize the use of electronic technology, expressly permit deferred payment letters of credit, expressly permit two-part letters of credit, provide standard expiration dates for letters of credit, provide for perpetual letters of credit, provide rules for non-documentary conditions, clarify and establish rules for successors by operation of law, and conform to existing practice for assignment of proceeds.

Section 1 amends, by substantially rewording, the existing statutory provisions that comprise ch. 675, F.S., which codifies the "Uniform Commercial Code--Letters of Credit." As substantially reworded:

- Section 675.101, F.S., provides that this article may be cited as the "Uniform Commercial Code--Letters of Credit."
- Section 675.102, F.S., limits the scope of ch. 675, F.S., to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit. This section provides that under certain circumstances the provisions governing letters of credit may be varied by agreement or incorporated by reference in an undertaking. This section further provides that the rights and obligations of an issuer of a letter of credit to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary. Terms generally excusing liability or limiting remedies for failure to perform obligations are not sufficient to vary obligations prescribed by this chapter.

- Section 675.103, F.S., provides definitions for the Uniform Commercial Code--Letters of Credit.
- Section 675.104, F.S., requires letters of credit to be a record, authenticated by a signature or in accordance with the agreement of the parties or the standard practice. This section declines to specify a particular medium in which the letter of credit must be established so as to leave room for future technological developments. This changes the current law requirements that a letter of credit be “in writing” and “signed by the issuer”.
- Section 675.105, F.S., provides that consideration is not required to issue, amend, transfer, or cancel a letter of credit, advice, or confirmation. This expands current law which only applies to “enlarging” or modifying the terms of a letter of credit.
- Section 675.106, F.S., provides that a letter of credit is irrevocable if it is silent as to revocability; that, with exceptions, parties to a letter of credit who do not consent to its amendment are not bound by such amendment; that if a letter of credit does not contain an expiration date it expires one year after issuance; and that if a letter of credit states it is perpetual, it expires five years after its date of issuance. The provisions regarding irrevocability and expiration dates are new, while the remaining provisions are consistent with current law.
- Section 675.107, F.S., provides that a confirmer is directly obligated on a letter of credit and has the rights and obligations of an issuer, and also has rights against and obligations to the issuer as if the issuer were an applicant and the confirmer had issued the letter of credit at the request and for the account of the issuer. This section provides that a nominated person is not obligated to honor or otherwise give value for a presentation unless such person is also a confirmer, and it provides that an adviser, unless also a confirmer, has no obligation to honor a letter of credit. The current law’s provision, which places the risk of errors in transmission and translation of any message relating to a letter of credit on the customer, has been deleted.
- Section 675.108, F.S., provides for an issuer’s rights and obligations. This section: clarifies and modifies existing law by stating that strict compliance with the terms and conditions of a letter of credit, as determined by reference to standard practice, is required before an issuer is required to honor the letter of credit; provides that an issuer has a reasonable time after presentation, but not more than seven business days, to honor a presentation, accept a draft, or provide notice of discrepancies in the presentation; newly provides that except with respect to dishonoring a letter of credit on the basis of fraud, forgery, or expiration of the letter before presentation, an issuer is precluded from asserting any discrepancy as a basis for dishonor if it does not give notice of such discrepancy within the period provided; newly requires an issuer to observe the standard practice of financial institutions that regularly issue letters of credit; provides, consistent with current law, that the issuer has no liability for the performance of the underlying contract, acts or omissions of others, and observance of knowledge of the usage of a particular trade; requires that non-documentary conditions in letters of credit be ignored; and provides rights and requirements for issuers who have honored a presentation.

- Section 675.109, F.S., sets forth the circumstances in which an issuer must honor or dishonor a presentation when a required document is forged, materially fraudulent or honoring the presentation would facilitate a material fraud. This section further sets forth requirements that must be met before a court may temporarily or permanently enjoin the honor of a letter of credit or grant similar relief. The current section imposes no requirements in connection with the issuance of such an injunction.
- Section 675.110, F.S., enumerates a beneficiary's warranties relating to the absence of fraud and forgery, the drawing's compliance with agreements secured by the letter of credit, and other warranties in various UCC articles. The section basically recodifies the existing section with the exception that the new provisions limit the types of warranties provided and the persons to whom they are provided. Additionally, the new warranties are narrower than those currently provided.
- Section 675.111, F.S., provides for remedies available for the wrongful dishonor or repudiation relating to a letter of credit. This section: provides that an issuer may be responsible for money damages or specific performance in an action for wrongful dishonor or repudiation of the issuer's obligation under the letter of credit; provides for recovery of damages to the applicant resulting from the wrongful dishonor or honor of a draft or demand presented under a letter of credit; provides for recovery of damages for an issuer's breach of obligations not elsewhere covered; creates liability for an adviser or nominated person other than a confirmer that breaches an obligation; and provides interest, attorney's fees, and damages to be paid by liable parties. This basically recodifies the current corresponding section but does not include some modifications. The revised section provides more detailed guidelines for the determination of damages. Incidental damages expressly include attorney's fees, other litigation expenses and interest. Consequential damages are explicitly excluded. Finally, specific performance is now included as a permissible remedy.
- Section 675.112, F.S., provides for the transfer of a letter of credit under certain circumstances. Nothing in the revision is contrary to existing Florida law as this merely elaborates on the issuer's ability to impose reasonable requirements within standard practice or any requirements expressly stated in the letter of credit.
- Section 675.113, F.S., creates new provisions for the rights of successors to beneficiaries by operation of law to make presentation and receive payment or acceptance of a letter of credit.
- Section 675.114, F.S., provides for a beneficiary's assignment of the proceeds of a letter of credit. This section further prioritizes the rights of a transferee beneficiary, nominated person, and assignee.
- Section 675.115, F.S., creates a one-year statute of limitations for claims arising under ch. 675, F.S. Currently, some Florida courts have referred to a letter of credit as a contract, although not when construing the statute of limitations. A letter of credit, unlike a contract, does not require consideration and is *sui generis*. This provision's one year statute of limitation is narrower than the five year limit contained in s. 95.11(2)(b),

F.S. The drafters have suggested creating a new subparagraph in subsection (5) of s. 95.11, F.S., to expressly reflect this section's one year limit.

- Section 675.116, F.S., is new and validates the parties' agreed choice of law as expressed in the letter of credit, confirmation, other undertaking, or agreement with respect to the liability of an issuer, nominated person, or adviser. The parties are free to choose the law of any jurisdiction, even if the jurisdiction does not bear any relation to the transaction. This section sets forth the choice of law rules if the parties have not done so and in such cases provides that the liability of an issuer, nominated person, or adviser is governed by the law of the jurisdiction where the person is located. This section provides that if the parties expressly incorporate rules of custom and practice, such as the Uniform Customs and Practice for Documentary Credits, those rules will control.
- Section 675.117, F.S., is new and sets forth the subrogation rights of an issuer, applicant, or nominated person in a completed letter of credit transaction. Currently, chapter 675 does not expressly address whether the right of subrogation exists in such a transaction. An issuer that has honored a draw or demand for payment is subrogated to the beneficiary's or applicants' rights to the same extent as if the issuer were a secondary obligor of the underlying obligation owed. An applicant that reimburses the issuer is subrogated to the issuer's rights against the beneficiary, presenter, or nominated person as if the applicant were a secondary obligor of the obligations owed to the issuer and has the subrogation rights of the issuer to the rights of the beneficiary previously stated. A nominated person who pays or gives value against a draft or demand under a letter of credit is subrogated to the rights of the issuer against the applicant, the beneficiary, and the applicant as if the nominated person were a secondary obligor.

Section 2 amends s. 671.105, F.S., 1998 Supp., providing that when a provision relating to a letter of credit specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by law.

Section 3 amends s. 672.512, F.S., conforming a cross reference.

Section 4 amends s. 679.103, F.S., 1998 Supp., adding rights to proceeds of written letters of credit to a statutory provision governing perfection of security interests in instruments, documents, and goods in multiple states.

Section 5 amends s. 679.104, F.S., providing that a transfer of an interest in a letter of credit, other than the rights to proceeds of a written letter of credit, are not subject to the provisions of ch. 679, F.S., relating to secured transactions.

Section 6 amends s. 679.105, F.S., 1998 Supp., providing references for the definitions of "letter of credit" and "proceeds of a letter of credit."

Section 7 amends s. 679.106, F.S., 1998 Supp., to include rights to proceeds of written letters of credit in the definition of "general intangibles."

Section 8 amends s. 679.304, F.S., 1998 Supp., relating to the perfection of a security interest through filing, to specify that a security interest in the rights to proceeds of a written letter of credit can be perfected only by the secured party's taking possession of the letter of credit.

Section 9 amends s. 679.305, F.S., 1998 Supp., relating to the perfection of a security interest without filing, to specify that a security interest in the rights to proceeds of a written letter of credit may be perfected by the secured party's taking possession of the letter of credit.

Section 10 provides that this act applies to a letter of credit that is issued on or after July 1, 1999. Further, it provides that this act does not apply to any transaction, event, obligation, or duty arising out of or associated with a letter of credit issued before July 1, 1999, including any amendment to the letter of credit that was made after such date, unless the amendment provides otherwise.

Section 11 provides that a transaction arising out of or associated with a letter of credit that was issued before July 1, 1999, and the rights, obligations, and interests flowing from that transaction are governed by any statute or other law amended or repealed by this act as if repeal or amendment had not occurred and that such transaction may be terminated, completed, consummated, or enforced under such law prior to its amendment or repeal.

Section 12 amends s. 95.11 (5)(c), F.S., to specify that the statute of limitations for actions to enforce rights under a letter of credit is one year. This section also deletes from s. 95.11(5)(c), F.S., actions arising under the Uniform Commercial Code--Bulk Transfers, ch.675, F.S.

Section 13 provides that this act shall take effect July 1, 1999.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:**A. Tax/Fee Issues:**

None.

B. Private Sector Impact:

This committee substitute conforms Florida law with the UCC regarding letters of credit. Modern language contained in the revised Article 5 conforms Florida law with international law and practice, which may help facilitate international trade. The precise impact on the private sector, however, cannot be determined.

C. Government Sector Impact:

None.

VI. Technical Deficiencies:

None.

VII. Related Issues:

None.

VIII. Amendments:

None.