DRAFTING COMMERCIAL PRACTICES AND THE GROWTH OF COMMERCIAL CONTRACT LAW∝

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I. INTRODUCTION

The importance of commercial practices as a source of commercial contract law in today's global marketplace is beyond dispute. Massive numbers of commercial and financial transactions are governed by rules freshly harvested from commercial practices by global, regional, and local associations. Among these practices are the International Commercial Terms (INCOTERMS)[1] and the Uniform Customs and Practices for Documentary Credits (UCP),[2] both of which were compiled and published by the International Chamber of Commerce (ICC); the Credit Derivatives Definitions and Master Agreement, which was compiled and drafted by the International Association for Swaps and Derivatives (ISDA);[3] and the standard trading terms for quality, warranties, shipping documents, payment terms, insurance, default, and breach of contract remedies drafted by the Grain and Feed Trade Association (GAFTA).[4] In addition, there are countless standard terms and conditions for the performance of commercial and professional services compiled by their respective national and international, as well as public and private associations.[5]

For each subject transaction, the above compilations establish, in varying detail, who does what, when, and how and who is responsible for the failure to comply. This article discusses the development of secured lending practices in Republican and Imperial Rome and draws lessons from the difficulties experienced in generating practices acceptable to lenders and borrowers alike. It

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1 The Incoterms are internationally recognized and are used throughout the world in contracts for the sales of goods. *See* INT'L CHAMBER OF COMMERCE, INCOTERMS 2010, *available at* http://www.iccwbo.org/products-and-services/trade-facilitation/incoterms-2010/.

2 *See infra* text accompanying notes 106–07. The UCP has been the living law for letters of credit throughout the world for nearly a century.

3 The ISDA publishes and sells a Master Agreement, which was last published in 2002. *See* INT'L SWAPS & DERIVATIVES ASS'N, MASTER AGREEMENT, *available at* http://www.isda.org/publications/isdamasteragrmnt.aspx.

4 *Contracts*, GRAIN & FEED TRADE ASS'N (GAFTA), http://www.gafta.com/contracts (last visited Aug. 27, 2013).

5 Performing a Google search for "General Terms and Conditions of Trade" illustrates this point.

compares the Roman experience with that of twentieth century bankers from many nations relying upon contemporary standard practices to draft viable commercial letter of credit practices for banking associations worldwide. Why was it that six centuries of contractual and extra-contractual practices, accompanied by countless administrative and judicial decisions, did not produce viable secured transactions practices in Rome, while it took only half of a century to draft viable Letter of Credit (LOC) practices for bankers and their customers throughout the world?

Compilations of commercial and financial practices, as well as the rules of law derived from them, can encourage or discourage the viability of their respective transactions. They encourage it when regular market participants observe and trust them as cost effective, reasonable, and fair. They discourage them when they induce or facilitate sharp dealing, abuses of rights, and spurious excuses for non-performance. Consider, for example, a contract in which "A," a manufacturer of restaurant equipment and fixtures, sells some of them to "B," the owner of a small restaurant. This sale is subject to standardized terms and conditions adopted by the "World Wide Association of Manufacturers of Restaurant Equipment and Fixtures."[6] One of these terms provides:

> This agreement contains all the terms and conditions agreed upon by the parties and is effective between or among them as well with respect to their assignees, purchasers, or creditors without need for further formality or notice than the execution of this contract. In the event of B's failure to pay any owed installment, A is authorized to repossess all the sold fixtures and equipment sold by A.

Shortly before defaulting on his debt to A, B sold his restaurant to C for its cash market value, which included the unpaid price of the fixtures and equipment bought from A. Based upon his standardized agreement with B, and prior to C taking possession of the restaurant, A repossessed all the equipment and fixtures he sold to B. While this conditional sale practice fulfills the reasonable expectations of A and B, it ignores those of C. Surely C could sue B for breach of contract, conversion, or unjust enrichment, but by that time B is likely insolvent or incarcerated. Hence, a practice that fails to provide notice to actual or potential third parties and thus renders the transaction secret where third parties are concerned discourages loans to a going concern and lowers the market price. It discourages future secured lenders because they cannot determine, prior to lending, which of the going concern's assets are subject to a prior and superior security interest. Additionally, it discourages future buyers because they do not know which assets should be relied on as part of their offered purchase price.

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6 This is a hypothetical entity and any similarity with an actual one is coincidental.

II. THE NUCLEAR ELEMENTS OF A VIABLE COMMERCIAL PRACTICE: COST EFFECTIVENESS, SELFISHNESS, ALTRUISM, HONESTY, REASONABLENESS, AND FAIRNESS

As E. O. Wilson and Adam Smith, among other prescient observers of human nature remind us, selfishness and altruism are indispensable impulses of commercial cooperation. And although their dosage per practice is not subject to precise measure (at least not with the present tools of social science), their presence, in what I will refer to metaphorically as the nucleus of a viable commercial practice, is always discernible.

While I do not know enough legal history (let alone biology) to draw a precise analogy between the elements of a viable commercial practice and those of a cell's nucleus, I have observed enough commercial practices (some from their infancy to their demise) to ascertain that they stem from a transaction whose DNA-like features are replicated in the practices of their offspring. I have also observed that regardless of the economic sector, a viable, cost-effective practice is one that takes into account a business's fixed, variable, and marginal costs,[7] while tempering the selfish impulses of its practitioners with altruism and with the duties to act honestly, reasonably, and fairly.

A. Selfishness: Good Faith, Reasonableness, and Fairness

Selfishness is commonly equated with the pursuit of profit exclusively or primarily for oneself. However, unless a merchant can convince his counter-parties that he has taken into account their reasonable expectations of profitability, he will soon have no counter-parties with whom to deal. This is true even when the selfish merchant fully discloses the terms and conditions of his promised (selfish) performance and expressly disclaims any responsibility for it. Consider, for example, a practice in which a "jobber" offered goods at a price advertised as: "At least 50% of their prevailing market price."[8] The meaning of this disclosure and disclaimer came into question in a recently mediated dispute.[9] In it, the sale of industrial products was subject to an "as is" clause that expressly disclaimed their merchantability. The buyer asked the seller about the portion of the entire lot that was likely to be worth "very little if anything," to which the seller replied:

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7 For simple illustrations of these concepts, see *Economic Basics for Civil Engineers: Lesson 1*, CONCRETE BASICS, http://www.concretebasics.org/articlesinfo/conceptsofcost.php (last visited Aug. 24, 2013).

8 In United States' trade parlance, a jobber is a merchant who buys merchandise or equipment from manufacturers and sells it to retailers. *Jobber Definition*, THE FREE DICTIONARY, www.thefreedictionary.com/jobber (last visited Aug. 21, 2013).

9 I was consulted by one of the attorney-mediators who asked me to report on jobbers' practices. While I was authorized to publish the above redacted version of my opinion, I am not at liberty to disclose the name of the parties, the mediators, or experts, including my interviewees.

"Probably less than 10% of the goods purchased." But he then repeated the disclaimer to his buyer and added: "Please remember that in this 'as is' sale we do not warrant the quality of what we sell, regardless of the percentage of merchantable goods." Soon after buying the goods, the buyer discovered that at least 80% of the goods were seriously defective and could not be resold.

After interviewing three respected jobbers who sold the same type of goods on the same "as is" basis, I expressed my opinion as follows:

> Even in an "as is" practice, the seller has a duty to act honestly and reasonably . . . . An "as is" price that is advertised as "At least fifty percent of the market value" of the goods must honestly and reasonably reflect such a value. These duties were not fulfilled in this case and therefore a serious downward adjustment of the price paid by the buyer is in order.

The major premise of this opinion is that even a fully-disclosed, selfish version of a practice is subject to the requirements of honesty, reasonableness, and fairness, especially because more than a fair price was paid by the "as is" purchaser. The U.C.C.'s § 1-203 warns: "Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."[10] Good faith means "honesty in fact and the observance of reasonable commercial standards of fair dealing,"[11] as also stated in U.C.C. § 2-103(1)(j), "'[g]ood faith' means honesty in fact and the observance of reasonable commercial standards of fair dealing."[12] To this definition, I would add Lord Mansfield's principle: "A warranty extends to all faults known and unknown to the seller. Selling for a sound price without warranty may be a ground for an assumpsit, but in such a case, it ought to be laid that the defendant knew of the unsoundness."[13] A literalist may argue that the "as is" disclaimer in the dispute above renders inoperative the seller's public representation that the price charged warrants at least 50% of the commercial value. But, if so, what is the legal import of a representation that clearly exceeds the boundaries of puffery?

Finally, bear in mind that as a variant of justice, fairness requires equal treatment of equals, and thus, it potentially involves a larger number of "constituents" than does reasonableness. The term reasonable, at least in my linguistic experience, generally involves the behavior of the parties to a representative transaction or relationship. Thus, where commercial contracts are concerned, what is reasonable is determined by asking how an "archetypal other" contracting party would act under the circumstances.[14] The question of what is

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[10] U.C.C. § 1-203 (2013).

[11] *Id.* § 1-201(20).

[12] *Id.* § 2-103(*l*)(j).

[13] Stuart v. Wilkins, (1778) 99 Eng. Rep. 15 (Ct. of King's Bench).

[14] See BORIS KOZOLCHYK, THE LAW OF COMMERCIAL CONTRACTS IN A COMPARATIVE AND ECONOMIC DEVELOPMENT PERSPECTIVE ch. XXII [hereinafter

fair can be asked in connection with performance in a contract or relationship, but it is also frequently asked in connection with the impact that a contract, course of dealing, or usage of trade, will have, or is likely to have, on an entire class of third parties such as consumers.

B. Altruism

Altruism is at times reflected in one party's willingness to be the first in giving something of value to the other, although in doing so, she usually expects that her giving will be followed by a comparable giving by her counter-party. This everyday contractual practice is mostly utilitarian because the initial giving is part of a business strategy to induce the trust and continuing business of the recipient. The same is true with the "loss leader" pricing practice so common among retailers worldwide. In this practice, the seller foregoes profits in some of his sales with the intent to attract a larger clientele for profitable transactions.

At times, however, altruistic conduct involves a significant giving of time and money by one or more members of a class of merchants or bankers whose intent is to assure the survival of the larger group. This was the case when J. P. Morgan (one the most influential financiers in the United States at the turn of the twentieth century), with a group of financiers he gathered, was able to rescue a growing number of insolvent banks by restoring their liquidity, and thereby ending the "Panic of 1907."[15] J. P. Morgan's "restoration of liquidity" practice was not new and continues to be used in many countries with a comparable mixture of altruistic-utilitarian motives. Finally, there is the plain altruism of merchants, bankers, and other professionals who are willing to sacrifice some of their profits or incur some losses to help out a colleague, a client, or (more rarely) third parties in dire need.

Of the preceding practices, only those with a utilitarian component become elements of the nucleus of commercial and financial practices. Adam Smith's observation that good or virtuosity, as well as selfishness, can be part of the same economic conduct. Recall how this observation echoed a similar one in a fifth century observation by a Talmudic scholar who pointed to the instances in which selfish, and at times evil, motives lead to virtuous results and vice-versa.[16] The large volume of commercial credit found in sixteenth- and seventeenth-century England—the largest per capita usage of commercial credit known at that

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KOZOLCHYK, COMMERCIAL CONTRACTS], on Legal Institutions that Guide the Interpretation of Commercial Contracts.

[15] *See generally* ROBERT F. BRUNER & SEAN D. CARR, THE PANIC OF 1907: LESSONS LEARNED FROM THE MARKET'S PERFECT STORM (2009).

[16] *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 14, ch. XXII nn.109–14 and accompanying text.

time—was attributable to lending practices that combined an altruistic initial giving with the lender's profit-making.[17]

C. The Importance of Factual (Non-Formally Logical) Research When Identifying the Nuclear Elements of a Practice

To understand a commercial or financial practice, one must first identify its nuclear or formative elements. This is an empirical, fact-based, search for answers to questions such as: what is the socio-economic context of the practice? And as part of such a context, what are the economic forces that drive the practice? Is it urban-based or rural-based? Who are its regular participants and shapers, and who are the most likely third parties? Who are its most and least respected practitioners, and why? Clearly, the answers will not be found in pre-existent formally logical definitions and classifications, inspired as they may or may not have been by other and very different practices. In fact, almost invariably, attempts to capture the gist of new practices using formally logical methodological lenses leads at best to inertia and at worst to normative blockage.[18] An equally skeptical question voiced by a scholastically trained professor is yet another example: how could conditional sales exist if sales are consensual agreements that transfer the title to the purchaser from the moment he and the seller agree on the goods sold and their price?[19]

Another similar skepticism was found in the practice of issuing mortgage bonds to finance the construction of public housing by selling them to the public, as voiced by a lawyer to the housing authority of a developing nation.[20] With questions such as: is not a mortgage an accessory obligation to the loan agreement, the principal obligation? As an accessory obligation (based on what the nineteenth century civil code said it was), how could a mortgage bond exist or be created for a loan that does not yet exist? In fact, no money has been advanced in that practice to the borrower mortgagor until someone, an underwriter or secondary market buyer, pays the purchase price of the bond. As with the rejection of the conditional sale practice, this formally logical reasoning ignores the empirical fact that mortgage bonds or certificates were used successfully at least since the seventeenth century in European nations and that the German Civil Code devotes several of its provisions to the so called "territorial debt," which relies on mortgage certificates as financing tools.[21]

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[17] See KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 14, ch. XXI, on the formation of contracts.

[18] *Id.* ch. II (comparing scholastic logic and the logic of the reasonable).

[19] *Id.*

[20] *Id.*

[21] *See, e.g.*, GERMAN CIVIL CODE [BGB] div. 7 ("Mortgage, land charge, annuity land charge.").

D. The Nuclear Elements of a Contemporary Secured Transaction

The nucleus of a practice is best examined once that practice has reached maturity or when its archetypal participants and third parties regard it as cost effective, reasonable, and fair.[22] One of the main purposes of a secured commercial loan is to encourage commercial lenders to lend to merchants who are unable to obtain unsecured loans, or even if they were able to obtain them, the interest rates would be prohibitive. The secured loan enables lending at reasonable rates of interest to such merchants by financing their acquisition of business assets, such as raw materials and inventory, that when transformed (with the use of equally financed equipment) and resold, facilitate significantly the repayment of the secured loan. Thus, a peculiar feature of secured or asset-based lending is what the *NLCIFT 12 Principles of Secured Transactions Law in the Americas* refer to as the loan's self-liquidation.[23]

Further, the practice of "line of credit financing," which enlarges or shrinks the amounts lent depending upon the debtor's streams of revenue and reliability of repayment, has shown that it is possible, and indeed necessary in many cases, to perfect a security interest in collateral prior to the time when the loan is disbursed. Accordingly, collateral can be a future thing that comes into existence after the security has been created, or it can be the right to demand the performance of a contract, or it can be the account receivable that is a *prima facie* indication that such performance has taken place. Similarly, collateral can be not only the thing pledged or mortgaged, but also the proceeds obtained from the sale of the collateral.

The contemporary security interest or right *in rem* in the collateral can be created by means of a consensual or informal contract, as well as by a statutory, administrative, or judicial provision. Surprising to many, a contemporary civil law lawyer who believes that in Roman law only owners could pledge their assets, Roman law actually allowed some non-owner debtors to pledge or mortgage things they did not own, but lawfully possessed.[24] In United States' secured transactions law, this practice became a legal principle. Thus, the heading of U.C.C. § 9-202 proclaims, "Title to Collateral Immaterial." The practice that required that the debtor only have rights in the collateral (as contrasted with his ownership of it) also became a nuclear element of the security interest of § 9-203(b). It enables a debtor who has "rights in the collateral or the power to

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[22] What follows is a summary of the NLCIFT's *Twelve Principles of Secured Transactions Law in the Americas*. *See* NAT'L LAW CTR. FOR INTER-AM. FREE TRADE, NLCIFT 12 PRINCIPLES OF SECURED TRANSACTIONS LAW IN THE AMERICAS (2006).

[23] *Id.* princ. 1.

[24] *See, e.g.*, 1 THE DIGEST OF JUSTINIAN § 13.7.20, at 410 (Alan Watson ed., 2009). ("Property belonging to another can be given as a pignus with its owner's consent. Even if the pledge is made without his knowledge and he later ratifies, the *pignus* is valid.").

transfer rights in the collateral to a secured party" to create a security interest in the collateral.[25]

Additionally, to be effective and quickly convertible into cash, the *in rem* right of a secured transaction, especially in the case of moveable and perishable goods, requires a summary repossession or foreclosure procedure that in most instances should be extra-judicial and by means of the creditor's self-help. Finally, another nuclear element of a security interest against third parties (defined as any party other than the original secured creditor and debtor) is that it be publicized by a functional and accurate form of public notice.

III. SECURED LENDING IN IMPERIAL ROME: ARCHETYPAL SMALL FARMERS, LANDHOLDERS, AND LENDERS

A. Socio Economic Context: The Republican and Imperial Commercial Archetypes

Rome's brand of capitalistic morality was exemplified by Cato's "Practical Catechism." Cato's depiction of the small farmer-soldier, lauded by the ancestors as a model man (*virum bonum*) who, unlike merchants, "do[es] not think evil thoughts."[26] Professor Jo-Ann Shelton of the University of California, Santa Barbara quotes Cato's views on the profitability of property ownership in contrast with the profitability and morality of money lending. After listing raising livestock and crops as the most profitable, the questioner asked Cato: "What about moneylending?" to which Cato replied: "What about murder?"[27] Apparently, Cato's distaste for money lending as an occupation was even stronger than that for commerce. At the same time, he made his fortune through investing and lending in maritime (bottomry) loans.[28]

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25 U.C.C. § 9-203(b)(2) (2013); *see generally* Boris Kozolchyk, *What to do About Mexico's Antiquated Secured Financing Law*, 12 ARIZ. J. INT'L & COMP. L. 523 (1995).

26 THEODOR MOMMSEN, I HISTORIA DE ROMA 1114 (A. Garcia Moreno trans., 1960) (author's translation); *see also* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 14, ch. IV(C)(2).

27 JO-ANN SHELTON, AS THE ROMANS DID: A SOURCEBOOK IN ROMAN SOCIAL HISTORY 126 (2d ed. 1998).

28 MOMMSEN, *supra* note 26, at 1114 n.2. Mommsen tried to mitigate the clear appearance of Cato's hypocrisy:

> Cato, as well as others, placed his capital in cattle and analogous commercial enterprises. But he tried not to violate the law . . . he did not belong to commecial companies that profited from usurious loans . . . . The maritime loan [bottomry] in which he repeatedly participated was not, by far, a prohibited usurious loan.

Id.

Cato's hypocrisy reflects the radical change in social attitudes and values that Republican Rome was undergoing. One of Cato's writings was a manual on how to run a farm (*De Agri Cultura*) "On Agriculture"[29] (a vital component of Rome's internal commerce). This writing, among others, enabled Theodor Mommsen (the great Swiss historian of Rome) to provide a compelling description of the evolution of Cato's archetypal farmer-tenant in *Historia de Roma*. I rely on Mommsen's analysis for the following summary of the socio-economic context of practices associated with secured lending during the late Roman Republic and Empire.

During most of the Republic, the farmer was still viewed as:

> [R]obust and practical . . . "the earliest to rise and latest to go to bed; as severe and demanding of himself as of those who work for him, aware of how to earn the respect of the woman who makes his home; forever vigilant of his workers and his farm animals; ready to lend his hand in farm chores, but without reaching the point of exhaustion as is the case with his slaves, unwilling to borrow or lend; host banquets or worship gods other than the domestic ones. Finally, glad to leave commercial dealings in the hands of . . . his landholder . . . .[30]

Yet, this version of the Roman farmer did not last much longer. The long-term or life tenancy was disappearing in the late Republic, where the most common tenancy was of short duration and was of the "half and half" variety. In it, profits were split evenly between landowners and tenants, although the latter bore the costs of planting and cultivation.[31] By the end of the Republic, the most typical form of land tenure was by absentee landowners. Many of them owned several plots, which they occasionally visited, but primarily managed through employees and increasingly, slaves. In Mommsen's words:

> [T]he agrarian economy in Italy was being transformed while at the same time ignoring the best uses of the various forms of capital. [For this economy] everything was the same, cattle or slaves. "A good guard-dog—said a Roman agronomist—should not be sweet with his fellow slaves." As long as the ox and the house servant did their work, they were equally fed . . . when they could no longer perform they were sold as old furniture . . . . "The slave—stated a Cato aphorism—, must work whenever he is not asleep." Compassion had no place [in this economy.][32]

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29 MARCUS CATO, DE AGRICULTURA (W.D. Hooper & Harrison B. Ash trans., Loeb Classical Library 1934) (c. 160 B.C.E.), *available at* http://penelope.uchicago.edu/ Thayer/E/Roman/Texts/Cato/De_Agricultura/ home.html.

30 MOMMSEN, *supra* note 26, at 1089 (quoting CATO, *supra* note 29).

31 *Id.* at 1083.

32 *Id.* at 1088.

The sharp decline in the price of cereal grains was a major factor in the transformation of rural land tenure and in the emergence of a new dominant commercial and financial archetype. In an attempt to satisfy the populist clamor for lower prices for grain by the urban population, Rome's official policy was to increase the imports of the cheapest possible cereal grains and to encourage the acquisition of small farms by large landholders and money lenders. By manning these farms with large numbers of slaves, the cost of production of grain was reduced, but this was at the expense of the small farmers.[33] Their loss of a decent livelihood broke down their moral values, to the point that the "sobriety of their customs" was lost.[34] They were replaced by "herds of slaves, unburdened by women and children."[35]

According to Mommsen, the new archetypal merchant was a financier or money lender (*fenerator*, the generator, or recipient of interest). He was the principal player in the commercial agriculture and finance of late Republican and Imperial Rome.[36] Where commercial agriculture was concerned, he was much more than the traditional money lender. He helped manage large commercial farms, both in Italy and abroad. In that capacity, he shaped lending and collection practices that we will be discussing in the following sections. He did this as a monopolist of agricultural and related commercial credit. Mommsen attributes to this money lender the wide use of informal contracts, which he could easily enforce by his contacts with administrative and judicial officials.[37] He did not believe in giving without receiving something in return. And as stated by the historian Polibius: "In Rome . . . no one gives, if he is not obligated to do so, no one pays a penny prior to the date of maturity of the debt, even among relatives!"[38]

Mommsen summarizes the behavior of a thoroughly commercialized imperial Rome as a society and community corrupted to the core in which "the most unbridled selfishness took the place of humanity and of love of country."[39] It is now time to turn to the secured lending practices that came out of the socio-economic transformation Mommsen so painstakingly described.

B. The Creditor's Fiduciary Ownership (*Fiducia*), his Possesory Pledge (*Pignus*), and his Non-Possessory Mortgage (*Hypotheca*)

A review of juristic opinions on pledges and mortgages in the Justinian Digest and of imperial and praetorian responses to queries by officials and

33 *Id.* at 1091–101.
34 *Id.* at 1095.
35 MOMMSEN, *supra* note 26, at 1096.
36 *Id.* at 1099–100.
37 *Id.* at 1105–06.
38 *Id.* at 1106.
39 *Id.* at 1112.

disputants in the Justinian Code (*rescripta principum*)[40] reflects a widespread and imaginative use of these security devices. In the words of the Jurist Marcian:

> Property can be mortgaged for any obligation, such as loan, dowry, sale, hire, or mandate, whether immediate, future, or conditional and whether the contract is present or past. It can also be mortgaged for a future obligation; for part as well as for the whole sum; and for a civil, praetorian, or natural obligation . . . . [And] [t]he difference between pignus and hypotheca is purely verbal.[41]

Having this description in mind, I will briefly examine the characteristics of each of these security devices, and subsequently, their nuclear elements, despite Marcian's observation of functional equivalence.

1. The Fiducia, the *Pignus*, and the *Hypotheca*

In his epoch-making *Das Recht des Besitzes*[42] (translated as "Treatise on Possession: or, the Jus Possessionis of the Civil Law"), Friedrich Karl von Savigny referred to the possession of the pledgee as a "derivative" right based on the pledge agreement (*contractus pignoris*).[43] Savigny acknowledged that the holders of non-contractual pledges, such as the so-called praetorian pledges, also had rights to the things, but these rights were not equivalent to those derived from the contract of pledge.[44]

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40 BERGER, ENCYCLOPEDIC DICTIONARY OF ROMAN LAW (*rescripta principum*) 680 ("Written answers given by the emperor to queries of officials . . . or to petitions of private persons . . . .").

41 2 THE DIGEST OF JUSTINIAN § 20.1.5, at 582 (Alan Watson ed., 2009).

42 FRIEDRICH KARL VON SAVIGNY, DAS RECHT DES BEITZES (1803). The book was later translated into English. FRIEDRICH KARL VON SAVIGNY, VON SAVIGNY TREATISE ON POSSESSION: OR THE JUS POSSESSIONES OF THE CIVIL LAW (Erskine Perry trans., S. Sweet 1848), *available at* books.google.com/books?id=OLY3AQAAMAAJ&dq=praetorian+pledge&sourdce=bl&ots=mz283qezw&sig=snCEall2SZG2V6sRVHCOghPpf48. Rudolf von Ihering referred to the *Recht des Besitzes* as the book that helped us regain the juridical method of the Romans and with it the birth of modern jurisprudence. It should be noted that von Ihering made this assessment despite his disagreement with one of Savigny's principal findings with respect to the intent to own the thing possessed (*animus dominii* or *rem sibi habendi*) as an essential element for the protection of possession in Roman law. *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 14, ch. XII.

43 VON SAVIGNY, *supra* note 42, at 215.

44 *Id.* at 216. Berger's *Encyclopedic Dictionary of Roman Law* defines the praetorian pledge as a pledge taken by the creditor upon an order from a magistrate including the Praetor to secure, among other obligations, those flowing from an execution of a judgment debt. BERGER, *supra* note 40, at 631.

As a predecessor of the *Pignus,* the *Fiducia* was a transfer in trust of the ownership of the collateral to the creditor. This was a simulated transfer because despite its appearance as a formal conveyance of rights *in rem*, the creditor was not supposed to acquire such rights. In fact, according to typically undisclosed agreements, the debtor retained the right described by Savigny as the re-delivery of the thing at some future time by means of the *actio pigneraticia*. And as he emphasized, the creditor had "no *animus domini*, and, consequently, no original Possession [was transferred] . . . ."[45]

Professor Rudolf Sohm was a distinguished late nineteenth- and early twentieth-century Roman and Canonic law scholar. His version of the *Fiducia* varies somewhat from Savigny's.[46] Sohm characterized the security interest of the pledgee-creditor in the pledge agreement as an *in rem* right, which enabled the creditor to secure payment of what was owed to him "through the medium of a thing."[47] As did Savigny, Sohm noted that the *Fiducia* was the pledge's principal ancestor in Roman law, and its creation was by means of a formal, simulated formal conveyance (*mancipatio, imaginaria venditio nummo uno*) by the debtor to the creditor with the understanding that once the debtor paid, the creditor would reconvey the entrusted thing to him.[48] But then Sohm added an important fact: as the ostensible fiduciary owner, the secured creditor was in strict law entitled to deal with the conveyed property as he liked, including reselling it to satisfy his claim if the debtor defaulted.[49] Yet, this fiduciary's resales were often at the expense of the debtor's remaining or reversionary rights. Consequently, debtors were reluctant to use this device and gradually the *Pignus* replaced the *Fiducia*.

The *Pignus* avoided the debtor's insecurity by not requiring him to part with his ownership. In the pledge, the secured creditor acquired his security interest in the collateral by becoming its possessor; his security interest was perfected by the delivery of the thing (*traditio*) to the creditor. However, the *Digest* quotes an opinion by the invariably subtle Ulpian.[50] In this opinion, Ulpian focuses on the elements of creation of a security interest, and implicitly, on its perfection:

> The contract of *pignus* is made not only by delivery but also by mere agreement even in the absence of any delivery. 1. If, therefore, agreement alone suffices for the formation of *pignus*, it becomes a question, if someone points out gold as about to be pledged and then hands over bronze, whether the gold is charged as a *pignus*. And the effect [of having an agreement] is that the

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45 VON SAVIGNY, *supra* note 42, at 216.

46 RUDOLF SOHM, THE INSTITUTES: A TEXTBOOK OF THE HISTORY AND SYSTEM OF ROMAN PRIVATE LAW 272 (James Crawford Ledlie trans., 3d ed. 1892).

47 *Id.*

48 *Id.*

49 *Id.*

50 *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 14, ch. IV.

> gold is charged, but the bronze is not, since that was foreign to the parties' agreement.[51]

Thus, this opinion expressly requires only the agreement to create the pledge and allows the inference that the transfer or delivery of the thing, to which he also refers, as the means to perfect the enforcement of a right *in rem* not only against the pledger, but also against third parties in possession of the pledge. For as an owner of the thing pledged, the debtor could recover it from anyone who obtained possession of it wrongfully, and as soon as he repaid the secured loan, the creditor had to return it to him.[52] The debtor-pledgor also had a special action for the recovery of the pledge against its wrongful retention by the secured creditor (the above mentioned *actio pigneraticia*).[53] On the other hand, as pointed out by Professor Reinhard Zimmermann, while the possessory pledge was a standard practice in early Roman law, in classical law the debtor could remain in possession of the pledged thing while a lesser possessory right in favor of the pledgee could still be carved out.[54] At a later time, this right was recognized as a right in the property of others (*ius in re aliena*).[55]

Meanwhile, the praetor fashioned summary remedies, known as possessory interdicts, in favor of lawful possessors who had been deprived of their possession.[56] These remedies did not require or determine ownership rights, as was the case with the *actio rei vindication*, and for this reason, they often failed to recover goods in the hands of bona fide purchasers or adverse possessors.[57] To resolve this problem, the secured creditors resorted to yet another practice in which an agreement or clause stipulated that in the event of debtor default, the ownership of the pledged collateral would be forfeited and transferred to the creditor as a penalty. This practice was sanctioned by the *Lex Commissoria.* During early days of Imperial Rome, this agreement or clause was supplemented by another agreement that gave the creditor the right to sell the collateral to satisfy the debtor's obligation (*Pactum Venditionis*).[58] Thus, in contrast with the *fiducia,* the debtor did not transfer ownership of the pledged thing to the creditor, but instead transferred possession. Finally, the praetor's edict was also instrumental in popularizing the *Hypotheca* practice. This practice seemed to provide greater certainty to both parties than the *Fiducia* and the *Pignus*. It allowed the debtor to retain ownership (and in many instances also possession) of the collateral. In addition, the debtor of a *Hypotheca* could agree with his creditor on the application of the *Lex Commissoria*, which, by rescinding the *convenio pignoris*,

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51 1 THE DIGEST OF JUSTINIAN, *supra* note 24, § 13.7.1, at 406.

52 SOHM, *supra* note 46, at 273.

53 REINHARD ZIMMERMANN, THE LAW OF OBLIGATIONS: ROMAN FOUNDATIONS OF THE CIVILIAN TRADITION 221 (1996).

54 *Id.*

55 *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 14, ch. IV.

56 SOHM, *supra* note 46, at 253, 273.

57 *See id.* at 272–74.

58 *See id.* at 273–76.

allowed the creditor to gain possession of the collateral. In addition, a *Pactum Venditionis* allowed the creditor to sell the collateral and pay himself out of the proceeds of the sale. Armed with these agreements, the mortgagee could defeat third parties holding lesser rights *in rem*.[59]

The *Hypotheca* enabled small and tenant farmers to mortgage their farming stock *(invecta et iliata*), and their mortgagee-lenders could obtain the possession of this collateral when the farmers defaulted by means of the *Interdictum Salvianum*, as well as by means of the *Actio Serviana*.[60] Unlike the *Pignus*, then, the *Hypotheca* allowed the debtor to remain in productive possession of the real or personal property collateral, thereby allowing the debtor to generate revenues with which to repay the loan.

In sum, the nuclear element of a *Fiducia* consisted of an "imaginary" or simulated transfer of ownership, but a transfer nonetheless. It exposed the debtor-transferor to the risk of losing his collateral to bad faith practices by creditors. The nuclear elements of the Roman pledge were an agreement to pledge, however informal, whose purpose was to secure loans and a contemporary or subsequent transfer of possession to the creditor, but not as an essential requisite for the creation of the pledge. As with the pledge, a mortgage could be created informally by a consensual contract, and the mortgagor could remain in possession of the thing pledged. Thus, many mortgagor-farmers remained in possession of the land, farm animals, and crops during the life of the *hypotheca*.[61]

If you find only minor differences between Roman pledges and mortgages, you are in good company. After comparing these practices, the above quoted jurist Marcian concluded, "The difference between *pignus* and *hypotheca* is purely verbal."[62] When I first read this opinion, I found its simplification of the seemingly contrasting features of pledges and mortgages reassuring, but after recalling the phenomenon of legal invertebration in Latin American, Soviet, and Chinese law, I wondered if the Roman law and practice on pledges and mortgages did not evidence a similar invertebration in the above laws and practice. When it comes to the enforcement of rights against a member of the same family, close friend, or business associate of the judge or administrator, legal precision and the rule of law gave way to simulatory and fraudulent practices that blurred the distinctions between established legal institutions, but I am jumping ahead of the story.

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[59] *See id.* at 274.

[60] *See id.*

[61] *See* CHARLES PHINHEAS SHERMAN, II ROMAN LAW IN THE MODERN WORLD 185 (1922) ("The essence of hypotheca is the agreement to hypothecate — that is, the retention of possession by the debtor.").

[62] 2 THE DIGEST OF JUSTINIAN, *supra* note 41, § 20.1.5, at 582.

2. The Sale of Collateral by Creditors in the Justinian Digest and Code

Professor Sohm's reference to the practice in which an agreement or clause enabled the creditor's sale of the debtor's pledged thing (*Pactum venditionis*), referred to a practice that allowed the pledgee to repay himself with the proceeds of the sale of the pledged thing. A review of the Justinian Digest and Code reveals that this practice was the subject of numerous disputes reflecting conflicting policies of creditor and debtor protection. On the one hand, the creditor's sale was viewed by Ulpian and some Imperial Rome rescripts as valid and desirable, even in the absence of an enabling agreement or clause. On the other hand, other Imperial Rescripts evince concern with depriving debtors of their rights in the collateral and try to establish, albeit feebly, some due process standards for the creditors' sales.

Ulpian, *Sabinus*, *book 41*:

> If there is an agreement for the *pignus* to be sold, made either initially or later, not only is a sale valid but also the buyer becomes owner of the thing. However, even if there is no agreement for the pledge to be sold, the rule we apply is that the sale is still allowed, unless, indeed, there is an agreement that it shall not be allowed. Indeed, when there is an agreement forbidding sale, the creditor, if he sells, is liable for theft, except where the debtor has been given three warnings to pay and has failed to respond.[63]

The Emperors Diocletian and Maximian, and the Caesars, to Eudemia:

> Where property has been pledged according to law, and the creditor makes a legitimate sale of the same, the debtor by afterwards offering to refund the price to the purchaser, or by tendering the amount of the debt to the creditor, cannot evict the possessor of the property.[64]

The Same Emperor [Justinian] to Julian, Praetorian Prefect:

> And, as We have found in agreements made with reference to pledges or hypothecations that relief is not only ordinarily granted to the creditor in possession, but also, when he is deprived of the property pledged, whether by his own fault, or not, or through accident, We have thought it to be more humane to assist the creditor by means of the praetorian pledge, no

63 *Id.* § 13.7.4, at 407.

64 THE JUSTINIAN CODE FROM THE CORPUS JURIS CIVILIS 8.10.2 (Samuel Parsons Scott ed. & trans.) [hereinafter THE JUSTINIAN CODE], *available at* http://www.freewebs.com/vitaphone1/history/ justinianc.html.

> matter how he may have lost possession of the property, whether by his own fault or not, or through accident. For even though he ought to take such care of his pledge that it may not suffer any damage, still, in order not to deal harshly with creditors, We incline to a liberal interpretation of the law, and grant them the right of recovery.[65]

On the other hand, and despite the presence of conflicting policies, the living law of the time, on the whole, favored the interests of the upper class creditors.

The Emperor Alexander to Pacata:

> A tract of land, which has been pledged, can by no means be sold if the creditor has collected the amount due out of the profits of the same, as the pledge is, under such circumstances, released by operation of law.[66]

The Same to Crescens:

> When a creditor is about to sell property which has been hypothecated or pledged to him, he should notify the debtor, and act in good faith, and when the sale takes place he should make the announcement in the presence of a witness. Therefore, if you can prove that fraud was committed in the sale of the country seat in question, which was pledged, apply to the judge having jurisdiction of such matters, in order that the action to which you are entitled in a case of this kind may be brought.[67]

The Same Emperors [Diocletian and Maximian] and Caesars to Rufinus:

> The creditor who buys land that has been pledged, but not through someone who represents him, or does not appropriate it for himself, cannot prejudice the rights of the debtor; but the property remains in the same condition in which it was before this fraudulent act took place. If, however, he should purchase it from the debtor, who sold it to him, it would establish a bad precedent to set aside the sale made with the consent of both parties, if neither the fraud of the adverse party, nor the employment of duress by him is proved. Therefore, if you can show by clear, positive evidence that the creditor always held possession through a fictitious purchaser, and that he afterwards bought in good faith the property which was fraudulently

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65 *Id.* at 8.22.2.
66 *Id.* at 8.28.1.
67 *Id.* at 8.28.4.

> disposed of, you can compel the creditor to make restitution of the same, after having tendered him the payment of the debt with interest.[68]

These and other rescripts confirm the widespread use of creditor-inspired, simulatory, bad faith practices. For example, a rescript by emperor Diocletian involved yet another creditor's simulated sale of the debtor's land (*praedium)* to a colluding buyer. Diocletian ruled that a creditor could not acquire ownership of the estate by purchasing it through an imaginary person, but that the debtor could regain the property by offering to pay the principal and interest owed to the landholder.[69]

3. Unbridled Selfish Practices and Legal Invertebration

Tulane University Professor Dennis P. Kehoe's recent study, *Law and the Rural Economy in the Roman Empire*, dates the imperial concern with creditors and large landholders' simulatory and fraudulent practices to the reign of Marcus Aurelius (121-80 A.D.), who in a rescript insisted that the creditors use the courts, rather than self-help, to proceed against the debtor.[70] He also quotes the jurist Modestinus' (a student of Ulpian's) reference to emperor Julian's law on the use of private force (*lex Iulia de vi privata*) by a creditor who unlawfully and coercively seized the property of a debtor. Such a creditor would be subject to serious sanctions, including the loss of one third of his property and the declaration of infamy with a possible loss of civil rights and a removal from decent society.[71] Still, please keep in mind that the use of the *Lex Commissoria* and the debtor's forfeiture of his rights in the collateral, as well as his authorization to resell the collateral (*Pactum Venditionis*), remained valid until emperor Constantine's decree nullifying them in 326 A.D.[72] Could the jurists have harmonized such seemingly contradictory policies by establishing the meaning of concepts, such as the U.C.C.'s "breach of the peace"[73] or the French abuse of rights (*abus de droit*), as applicable to the Roman secured creditors' sales of collateral?[74] Or were the Roman jurists too biased in favor of landholders and lenders' secured creditors' rights and remedies? The answer to both of these questions is *yes*. According to Professor Kehoe, although many of these jurists

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[68] *Id.* at 8.28.10.

[69] *See* DENNIS P. KEHOE, LAW AND THE RURAL ECONOMY IN THE ROMAN EMPIRE 152 n.59 and accompanying text (2007).

[70] *Id.* at 152.

[71] *Id.*

[72] 1 THE THEODOSIAN CODE 65 (Clyde Pharr ed. & trans., 1952), *cited in* Boris Kozolchyk & Dale Beck Furnish, *The OAS Model Law on Secured Transactions: A Comparative Analysis*, 12 SW. J. L. & TRADE AM. 235, at 16 n.57 (2005-2006).

[73] U.C.C. § 9-609(b)(2) (2012).

[74] *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 14, ch. XXVII.

adhered to a "closed intellectual tradition, one divorced from social concerns and largely subject to its own internal logic," they were in fact sympathetic to the interests of large landholders.[75] And in several areas of the law these jurists were more concerned with those problems that "impinged directly on the interests of the upper classes" than they were with debtor protection.[76]

In addition, Professor Kehoe found a substantial disparity "between the written law and the practice of the courts."[77] This disparity may have been caused by the aristocratic extraction of judges and their lack of legal training, as well as the large volume of litigation. But more likely, conflicting policies and contradictory legal directives caused it. These factors, plus the pervasive presence of corruption (as the usual companion of simulations and fraudulent schemes), explain why so many small farmers turned for relief not to the courts, but to the emperor.[78] Further, the injustices inflicted upon the small farmers and tenants paled into insignificance when compared with the inhumanities inflicted upon the slaves who worked the farms. Not surprisingly, slave revolts and insurrections were not uncommon. In one of these revolts alone, 7,000 slaves were condemned to death.[79] This explains why agricultural lending practices not only failed to mature into clearly and precisely formulated concepts, principles, and rules, but also why legal invertebration persisted until secured agricultural and commercial lending lost its vigor as a formula of economic growth and why Rome's rural population suffered a significant decline.[80]

4. Questions, Comments, and Conclusions

No reasonable and fair commercial and financial practices can be expected from the interaction between sharply unequal participants, regardless of whether the inequality stems from their vastly different economic or political powers or from their different functions in the transactions in question. It is still hard to decipher how such an unequal bargaining environment produced the "half and half" practice apparent in late Republic short-term leases. Yet, regardless of how that practice came about, it is a testimony to its reasonableness and fairness that many centuries later it is still found in nations who pride themselves in the Romanistic roots of their civil law tradition.[81]

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[75] KEHOE, *supra* note 69, at 12.
[76] *Id.*
[77] *Id.* at 14.
[78] *See id*. at 18.
[79] MOMMSEN, *supra* note 26, at 1118.
[80] *Id.* at 1117–19 (providing an analysis of the decline of Rome's rural population and its causes during the late Republic and early Empire).
[81] *Id.* at 1082 n.1 (referring to Article 1818 of the *Code Civil* as an heir to the Roman "half and half" practice with respect to cattle raising). The same practice can be observed in Central and South American share cropping.

The contrast between the viable "half and half" practice and the failed, one-sided sale of collateral practices highlights the importance of honesty, reasonableness, and fairness when shaping viable and long-lasting commercial practices. The failure of the Roman practices was not because the jurists did not identify the nuclear elements of the sale of collateral practice as they did with so many other practices. Review the above opinions of Ulpian and Marcian, among others, and you will soon realize how many of these elements they correctly identified. Consider, for example, their identification of the pledge agreement as the principal nuclear element in the formation of the pledge, regardless of the transfer of possession to the creditor. In fact, for much of the twentieth century, the civil codes of several civil law countries failed to appreciate the wisdom of Ulpian's previously discussed opinion on the ancillary role of transfer of possession in the creation of a pledge.[82] Or consider the jurists' observation that an open number of things could be used as collateral. As stated by Gaius: "Future property can be mortgaged, for example, unharvested crops, offspring of a female slave, and the young of animals once born."[83] Such collateral was unavailable in the secured transactions laws of many civil law countries well into the twentieth century.[84]

Unlike many of their intellectual heirs, Roman jurists also discerned the collateral value of groups of similar animals or things as units of assets, as they also discerned the value of continuing the security interest in the things or animals that replenished their original number. Thus, as opined by the Jurist Marcian: "If a flock is mortgaged, later born animals are included. Indeed, if the whole flock dies and is renewed, it remains subject to mortgage."[85] Similarly, Roman jurists and emperors or their legal assistants perceived the value of contract rights as collateral, even though these rights were incorporeal things. In the words of emperors Diocletian and Maximinian: "After it was settled that the contracts of debtors could be given in pledge, it seemed to be the rule that equitable actions could be granted to the creditor himself who made the demand (as has already been decided) after the sale of the claim."[86] In contrast, one of the most influential civil codes in the Western Hemisphere to this day still requires that the thing pledged must be corporeal.[87] Finally, consider a rescript by Emperor Septimius

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82 Boris Kozolchyk, *Law and the Credit Structure in Latin America*, 7 VA. J. INT'L L. 1, 3 (1967).

83 2 THE DIGEST OF JUSTINIAN, *supra* note 41, § 20.1.15, at 581.

84 Kozolchyk, *supra* note 82, at 4–8.

85 2 THE DIGEST OF JUSTINIAN, *supra* note 41, § 20.1.13, at 583.

86 THE JUSTINIAN CODE, *supra* note 64, at 4.39.7 (providing a reply by Emperors Diocletian and Maximian to Manassa).

87 *See, e.g.*, CÓD.CIV. art. 2384 (1857) (Chile). Article 2384 states: "By means of the pledge agreement a moveable thing is delivered to the creditor for securing his loan. The delivered thing is called a pledge." ("*Por el contrato de empeño o prenda se entrega una cosa mueble a un acreedor para la seguridad de su crédito. La cosa entregada se llama prenda.*"). *Id.* Obviously, a delivered thing must be a corporeal thing. Chile's Civil Code served as a model for many other civil codes in the Western Hemisphere. *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 14, ch. XIV.

Severus that stated that crops from a property held as security should be credited against the debt owed and that any crops left over should be returned to the debtor.[88] It was not until well into the twentieth century that Latin American statutes allowed the use of crops and their fruits as collateral separate from the land on which they grew.

Despite all these visionary contributions to the future law of secured transactions, the Roman standard secured transactions practice reflected in the Justinian Digest and Code of Justinian still missed two of the most important nuclear elements: (1) a fair and functional notice system to alert third parties interested in lending on the strength of the collateral or in buying it that a pledge or mortgage would be senior to their potential rights; and (2) a fair and reasonable self-help procedure that would (a) enable the secured creditor to repossess the collateral upon the debtor's default, (b) sell it for a fair market price, and (c) at the same time protect the remainder rights of the debtor in the sold collateral. Hence, while the jurists visualized most of the nuclear elements that would have made it possible for parties with relatively similar bargaining power and equal information on the facts of the transaction to maximize their respective rights, they did little to remedy the unreasonableness and unfairness of overreaching and oppressive practices between unequal contracting parties and with respect to third parties.

It was not until the twelfth century that potential secured lenders in the former Roman colonies, such as Britain, were able to lend to parties other than those with whom they had close relationships. This was because they lacked accurate and timely notice of the pre-existence of pledges and mortgages. According to Sir Roy Goode, during the reign of Richard I (in twelfth-century England), debtors were, as with the Roman law *Hypotheca*, allowed to remain in possession of the collateral.[89] However, unlike the *Hypotheca*, the "Jewish" mortgage practice in Britain required that secured creditors provide public notice of their security interests by a filing in a public registry.[90] This critical mutation of the Roman nuclear secured lending practice made it possible for many more potential secured lenders and purchasers to become interested in lending or purchasing.

And as was concluded in the previous section, the reason for the inability to work out the appropriate legal and equitable formula of creditors' sales and foreclosures was not the absence of highly skilled and pragmatic legal professionals and administrators. Instead, the reasons were deeper: a pronounced and unbridgeable inequality between creditors and debtors. Even those practices that seemed ready to incorporate reasonable and fair nuclear elements were quickly undermined by the continuing resort to simulations and other bad faith

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[88] KEHOE, *supra* note 69, at 153. Additionally, Professor Kehoe refers to emperor Caracalla's citations to rescripts that upheld the exclusive authority of a judge to alienate property pledged as security. *Id.*

[89] ROY GOODE, COMMERCIAL LAW 585 (3d ed. 2004).

[90] *Id.* at 585 n.50 ("An exception was the Jewish mortgage, a non-possessory security interest perfected by local registration under a system established by King Richard I.").

practices. The final blow to the Roman practices of self-help came when the *Pactum Commissorium* was outlawed by Emperor Constantine in 326 A.D. His justification for outlawing this *Pactum*, which he referred to as *Lex Commissoria*, albeit terse, bears reflection: "Since among other captious practices, the harshness of the provision for forfeiture (*lex commissoria*) is especially increasing, it is our pleasure that this provision shall be invalidated [and that hereafter all memory of it shall be abolished]."[91]

In sum, the nuclear elements present in both the pledge and the mortgage (as aided by the *Pactum Commissorium* and the *Pactum Vendendi*) conferred rights of possession, either actual or future, upon a secured creditor once the debtor defaulted in his repayment obligation. Nevertheless, the manner in which these potential elements of the secured transactions nucleus were being used, especially by large landholders and lenders, made them unreasonable and unfair, and thus failed practices.

IV. DRAFTING COMMERCIAL LETTER OF CREDIT PRACTICES

A. Why LOC Practices?

In the following sections, I examine the compilation of practices and drafting of rules associated with the commercial LOC transaction.[92] LOC practices originated during the first half of the nineteenth century and are still used today throughout the trading and financial worlds. Thus, enough information exists about them to answer questions such as: how did they come about? What are their "nuclear" elements? What made some practices viable and others not? How did they mutate into new practices? Who are the principal drafters of practice-based rules, and what characterizes their drafting? What is the role of lawyers as advisors and assistants in the drafting of rules based on LOC practices?

One reason for selecting LOC practices is that they illustrate how relatively equally-situated bankers compiled them and drafted what eventually became binding rules of practice throughout the banking world. By "relatively equal" I mean bankers who, despite the differing size of their assets or of their economic or political powers, still perform interchangeable functions with and for each other and earn standardized commissions, fees, or rates of interest when discharging those functions. As will be discussed shortly, bank A, who issued a LOC this morning and asked bank B to confirm it and authorized bank C to negotiate it, can be asked later during the same morning by bank B to confirm its LOC and can be authorized by bank C to negotiate its LOC.

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91 1 THE THEODOSIAN CODE, *supra* note 72, at 65.

92 For a distinction between commercial and stand-by letters of credit, see Boris Kozolchyk, *The Emerging Law of Standby Letters of Credit and Bank Guarantees*, 24 ARIZ. L. REV. 319 (1982); *see also* Boris Kozolchyk, *Commercial and Standby Letters of Credit*, *in* III UNITED STATES LAW OF TRADE AND INVESTMENT 24-1 (Boris Kozolchyk & John F. Molloy eds., 2001).

Another reason for the choice of topic is to allow the reader to compare the rules arrived at by banks and by representatives of commercial sectors with the "merchant rules" drafted by Professor Llewellyn discussed in the preceding chapter.[93] A final reason is that I have spent a major part of my professional life studying, testifying, arbitrating, and on occasion, compiling and drafting rules based on these practices. This familiarity allowed me to witness the birth, development, mutation, and demise of LOC practices and observe what made some of them work and others not. And even though LOCs are not as widely used now as they were a decade ago (having often been replaced by a secured transaction practice known as "supply chain financing"),[94] much can still be learned from what made LOCs the highly popular means of payment and finance for close to two centuries.

B. The Basic Commercial LOC Transaction

An irrevocable LOC promises to pay its beneficiary (usually the supplier or seller of goods or services) a stipulated amount against his presentation of documents specified in the LOC. Typical among these documents are an invoice describing the goods, their quantity and price, a negotiable ocean bill of lading attesting to the shipment of the goods in apparent good order, an insurance policy or certificate covering the risk of loss or destruction of the goods, and possibly other documents, such as certificates attesting to the origin, quality, or weight of the goods shipped.

As a payment instrument, the LOC promises to pay to the named beneficiary, his transferees, or *bona fide* holders of the draft the amount specified therein. It can be paid upon the presentation of the documents or at a stipulated time thereafter. In the latter case, it is also a credit instrument. As a credit instrument, it enables the bank's applicant for the credit to wait a certain period of time before providing the issuing bank the funds necessary to pay the beneficiary. The draft or bill of exchange accepted by the issuing or confirming bank also becomes an instrument of credit for the beneficiary. He is able to negotiate the LOC draft prior to its maturity either with the bank that issued or confirmed it or with another bank the issuing bank authorized to negotiate it. In doing this, the beneficiary or the holder of the draft obtains the amount stated in the draft less the discount or negotiation commission charged by the negotiating bank.

To perform its global payment and credit functions, the LOC relies on a network of correspondent banks acting as issuers, advisers, or notifiers; confirmers of the issuing banks' and their own liability to the beneficiaries; presenters of the beneficiaries' documents to the issuers or confirmers; negotiators of the beneficiaries; payors of the LOC; and reimbursers of this payment. Of

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[93] *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 14, ch. XXII(D)(3) (discussing merchant rules in the U.C.C.).

[94] *See generally* Boris Kozolchyk, *Supply Chain Financing, Straight Bills of Lading and Standby Letters of Credit*, 2 GEO. MASON J. INT'L COM. L. 100 (2011).

these, the issuing and confirming banks are the central participants because their promises of payment or acceptance of the beneficiary's draft are highly liquid, i.e., easily and inexpensively convertible into cash. As will be discussed in the following section, the fact that the functions of LOC bankers are interchangeable provides an easier and almost organic path to reasonable and fair practices.

Three legal features make the LOC promises highly liquid:[95] (a) their irrevocability from the moment they are issued; (b) their primary liability (i.e., the fact that the beneficiary can claim payment first from the issuing or confirming bank without having to show that he tried to collect first from the bank's applicant-buyer or from any other party); and (c) their independent or abstract liability (i.e., its promise of payment does not depend upon the occurrence of acts, events, or transactions underlying the issuance of the LOC, but only on the compliance of the documents presented to the issuing or confirming banks). Thus, if the goods shipped do not meet all the specifications of the underlying sale agreement, but the tendered documents meet the specifications of the LOC, then the issuing or confirming banks must pay. Only when the fraud perpetrated by the beneficiary is egregious enough to leave the banks with worthless paper are extraordinary or equitable remedies granted to the paying bank or its applicant, such as injunctions against payment or attachments of funds related to the LOC.

C. The Interchangeable Functions of Correspondent LOC Banks and Their Organic Marketplace Standard of Fairness

As just noted, the roles and functions of the above listed banks, especially those of the issuing and confirming banks, are interchangeable. This interchangeability incorporates, organically so to speak, a marketplace standard of fairness as the governing standard of correspondent banks' transactions. The issuing banker who questions whether his confirming banker acted properly when paying or checking documents can obtain his answer by asking himself: what would I have done as an archetypal confirming bank? Such a marketplace standard of fairness is not as easily ascertainable in other trades or when the parties to the contract belong to different trades or professions. The functional need for reasonable and fair practices for LOCs makes it easier to discern their nuclear elements.

D. Standard and Best Practices for the Examination of LOC Documents

1. The Birth of a Nuclear LOC Practice, its Shapers, and its Practitioners

During the early nineteenth century, English merchant bankers developed a multi-faceted form of banking which included loans to governments and

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[95] Kozolchyk, *The Emerging Law of Standby Letters of Credit and Bank Guarantees, supra* note 92, at 331.

reputable merchants. Their success obviously depended upon their knowledge of the trades they practiced and financed. The House of Brown,[96] one of the oldest and most respected merchant banking houses, started its business in Ireland by trading in linen, a commodity it knew well.[97] It sold its and others' goods on commission and extended credit to importers and exporters, especially to and from the United States.[98] Most of these credits were documented by an accepted bill of exchange or draft that the beneficiary seller or exporter drew on the House of Brown as the acceptor and payor of the draft. Such drawing was based upon a previous authorization to draw given by the House of Brown to the beneficiary in question.

By the mid-nineteenth century, the House of Brown was a major issuer of promises to accept bills of exchange based on the abovementioned "authorizations" to draw. An 1838 communication by the House of Brown to its correspondent in New Orleans summarized this practice in connection with a possible purchase of cotton from a seller's commission agent:

> You are aware that our usual custom is to advance 2/3rd's or 3/4th's of the cost of the cotton . . . . We would arrange the business as follows. You may give him [the seller's commission agent or factor] an order for one thousand Bales or more on such terms as you may think proper and we will confirm the same *by authorizing him to draw on our New York house or here if it be done on as good terms as 60 days sight* . . . .[99]

The House of Brown would purchase the cotton and issue its "authorization" to the seller of the cotton at the same time so that it could be assured of acceptance and payment by a banker of known solvency. The time of payment was set at sixty days from the time the bill of exchange was presented. This authorization to draw the draft when followed by the presentation of a draft and accompanying documents to be accepted and/or paid by the issuing merchant banker became the first element of the nuclear practice of the commercial letters of credit, especially when issued not only on behalf of the House of Brown, but on behalf of other importers.[100] The above quote illustrates the birth of a nuclear practice: it started as a course of performance in a small number of contracts between the House of

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[96] Among the members of the House of Brown were Alexander Brown and Sons in Baltimore, Brown Brothers & Co. in New York, William and James Brown & Co. in Liverpool, and Brown and Shipley & Co. in London. EDWIN J. PERKINS, FINANCING ANGLO-AMERICAN TRADE, THE HOUSE OF BROWN, 1800-1880, at 19–25 (1975).

[97] The House of Brown was founded by Alexander Brown, a successful Irish linen merchant who immigrated to the United States in the late 1790's. *Id.* at 17–20.

[98] *Id.*

[99] *Id.* at 283 (emphasis added). Professor Perkins estimated that based on an average price of eight cents per pound and bale weight of 400 pounsa, this order was in the range of U.S. $32,000. *Id.*

[100] Professor Perkins found the first reference to a LOC in the House of Brown records for 1820. *Id.* at 25.

Brown and its initial clients. Eventually, it was transformed into a course of dealing involving a larger number of clients and a longer period of time, and eventually, after being tested in the marketplace, it became the nuclear practice of a usage of trade.

The practice of authorizing and accepting the beneficiary's draft largely replaced another practice in which a draft and documents were presented to a bank or other trusted third party located at the buyer's place of business. The bank or trusted third party notified the buyer that the seller's draft and shipping documents had arrived and that the latter (mostly as a negotiable ocean bill of lading) would be delivered to the buyer if he paid for them at sight or if he signed as an acceptor of the bill of exchange or draft, promising to pay it at a designated future time. Clearly, in this transaction, known as "documents against (the buyer's) payment or acceptance," the seller assumed the risks of the buyer's non-payment and possession of documents "of title" to the goods, such as the negotiable ocean bill of lading. This risk was eliminated by the House of Brown LOC, which embodied an irrevocable promise by an issuing or confirming bank of known solvency at a time prior to the presentation of the draft and documents.

Please note that the nuclear LOC practice of issuing the authorization to draw a draft against the issuing merchant banker was initiated by giving something of value to the beneficiary (the authorization to draw) without receiving an immediate equivalent from him. The beneficiary's giving in return did not happen until the documents required by the LOC were presented to the issuing or confirming bank. And even though some English judges were not satisfied with the absence of an immediate *quid pro quo* as consideration for the issuing bank's promise,[101] the issuing bank gained the trust of the beneficiary and of subsequent participants in the transaction, including its correspondent banks; for the issuing bank that was sufficient consideration.

Each of the nuclear participants in the LOC had to trust each other, some when issuing their binding promises, others (such as the beneficiary) by procuring shipping documents prior to being paid by the LOC, and still others (such as the issuing or confirming banks) by paying against documents instead of the actual goods. Because of this ever-present trust, all of these regular participants were expected to act honestly, reasonably, and fairly. Put simply, the elements of Karl Llewellyn's version of good faith that encompassed honesty, reasonableness, and fairness were the essential elements of the nucleus in which the other elements of the LOC lived and interacted with each other. Once the above described "authorization to draw" nuclear practice came about and its regular and occasional participants were identified and their functions tested in the marketplace, the living law of LOCs was created, first by courses of dealing, and eventually by trade usages.

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[101] BORIS KOZOLCHYK, COMMERCIAL LETTERS OF CREDIT IN THE AMERICAS 573–90 (1966).

2. Macro- and Micro-Economic Forces that Encouraged or Discouraged LOC Practices in the United States

In 1962, almost a century and a half after its initial use by a small number of Anglo-American merchant bankers, 55% of the international sales of the United States were paid or financed by LOCs,[102] and much of the world's significant LOC litigation took place in the United States. The United States' markets for goods and services and banks were the engines that moved LOC transactions worldwide. Yet it was not until 1962 that Article 5 of the U.C.C., the first LOC statute of the United States, was enacted.[103] It seemed apparent that LOCs did not require a code or statute to enable them to attain the commercial, financial, and economic prominence they had.

In fact, however, the prominence of the LOC as an international payment and financial device occurred in the United States because of the enactment of the Federal Reserve Act of 1913.[104] The Act made it possible for United States banks to do what the House of Brown was doing in England since the middle of the nineteenth century: authorize the presentation of the beneficiaries' drafts and accept and discount U.S. dollar-denominated drafts regardless of their provenance. As described by Wilbert Ward of Citibank, a lawyer's lawyer who was also a banker's banker and chairman of the New York Commercial Credit Conference,[105] as well the principal architect of LOC law and practice in the United States until the end of the Second World War:

> The federal reserve banking system brought the gold reserves of the [United States] . . . into the federal reserve banks, and the reserves of the member banks were carried primarily as credits in the books of the federal reserve banks. The secondary reserve of the member banks consisted of paper eligible for rediscount with the federal reserve banks . . . . In order to mobilize our mercantile credits, however, *it was necessary to change the business habits of the nation by converting these credits from book accounts and promissory notes into trade acceptances. The ability of the national banks to finance foreign trade was assisted by authorizing them to accept bills*

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[102] *Id.* at 32.

[103] *Id.* at 351.

[104] *See* Federal Reserve Act, 12 U.S.C. §§ 221-522 (1913); *see also* KOZOLCHYK, *supra* note 101, at 609–10.

[105] This Conference was a study group of LOC practices comprised of thirty-four experienced international bankers from New York. For its history and influence on the drafting of the earliest compilation of LOC practices, see Dan Taylor, *U.S. Council on International Banking and the UCP – A Brief History*, 6 LETTER OF CREDIT UPDATE 11, 11–12 (1990).

> *having not over 6 months to run and growing out of the importation or exportation of goods.*[106]

The italicized text summarizes the principal statutory basis for the issuance of LOC's as part of the business of banking. But it was more than that: it was the mechanism that enabled member banks to create their own highly liquid form of money (also referred to as quasi-money) in the form of widely marketable trade acceptances and not merely as accounts in the books of the issuing bank ("book accounts" in Mr. Ward's terminology). Thus, the Federal Reserve Act was not only the pioneering, but also the visionary statute and the macro-economic force behind the pre-eminent role played by United States banks in LOC transactions world-wide following the First World War.

Mr. Ward was also a shrewd observer of the effect that micro-economic market forces had upon commercial and banking practices, including the abandonment of good faith by many importers when expected profits were likely to dwindle or unexpected losses were about to occur. He noticed that differences in the interpretation of LOC terms did not lead to too many disputes as long as the prices of exports continued to rise. In good times, importers were willing to forego disputes knowing that prompt possession of the goods meant higher profits. As a reaction to those attitudes by their commercial applicants, New York banks adopted a policy of liberal interpretation of credit terms "in the interest of the prompt movement of goods . . . ."[107] Yet, as prices stabilized, and in some cases dropped sharply, attitudes changed and the number of disputes grew geometrically.

Typically, when prices dropped sharply, issuers were instructed by applicants to "reject documents if the least irregularity appeared."[108] Ambiguous terms became excuses to reject payment or reimbursement. One such term during Ward's time was an ocean bill of lading "evidencing shipment" of the merchandise. Because of the scarcity of vessels following World War I, carriers started issuing "received for shipment" or "received for transportation" bills of lading instead of the traditional "on board" bills of lading. A "received for shipment" bill was issued prior to the actual loading of the merchandise and evidenced receipt of the goods by the carrier, but not on board the carrying vessel. Therefore, unlike the "on board" bill of lading, the arrival of "received for

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[106] WILBERT WARD, AMERICAN COMMERCIAL CREDITS 15–16 (1922) (emphasis added); *see also* JAMES E. BYRNE ET AL., UCP 600: AN ANALYTICAL COMMENTARY, at iii (2010) (attributing to Wilbert Ward the chairmanship of the ICC Committee of Bills of Exchange and Cheques, which later became the ICC Commission on Banking Technique and Practice, and oversaw the adoption of UCP 82 (1933) and its 1951 revision (UCP 151)). Byrne also quotes from a communication by Ward to the ICC dated October 1926 in which he stated, "The International Chamber of Commerce could render a practical service to international trade by seeking to obtain international uniformity . . . by adopting international regulations for export commercial credits." *Id.*

[107] WARD, *supra* note 106, at 22.

[108] *Id.* at 23.

shipment" goods could not be predicted or estimated. As Ward observed: "Merchants welcomed the new received-for-shipment [bills of lading] when they were exporters, and objected to it when they were importers."[109]

The banks found themselves in the middle of such disputes, and their solution was to state as clearly as possible to United States beneficiaries and to foreign correspondent banks what documents and clauses were acceptable. Nonetheless, the importer bank's clients' reactions to unexpected lower profits, higher losses, or the unavailability of cargo space in the port of New York created bad faith practices calculated to avoid having to reimburse banks that had used reasonable care in the examination of LOC documents. Most often these selfish practices resorted to specious and hypertechnical objections to the bankers' examination of the LOC documents.

V. THE LIMITED ROLE OF JUDICIAL, STATUTORY, OR CODIFIED LOC LAW

Prior to the enactment of Article 5 of the U.C.C., Article 3 of the U.C.C., which replaced the Negotiable Instruments Law, did not enforce promises or authorizations to draw, unless they were accepted and signed in the draft or bill presented for acceptance and payment.[110] Yet, if the nuclear promise of the LOC transaction was to accept the beneficiary's draft *written in advance of the presentation of his draft or bill of exchange and accompanying documents*, as just noted, how could such an acceptance enforce the draft if such a draft did not exist at the time the bank issued its promise of acceptance?

It is true that there was substantial case law on acceptances signified in documents other than the bill of exchange itself, and indeed some of these were called "extrinsic" and others "virtual" acceptances.[111] Yet, these practices were not of much assistance to the various LOC banks, especially when the LOC practice required an organic connection between the obligation to pay upon the presentation of a specified set of documents (as signified in the extrinsic document) and the negotiation, endorsement, and payment functions lodged with the draft or bill. What if these two documents did not travel together or contained inconsistent stipulations? Consequently, the transactional innovation introduced by the House of Brown authorization and acceptance practice lacked a statutory or judicial basis for its enforcement.

The enforcement of such a legally unpedigreed promise was at first only handled by Anglo-American court decisions, some of which were responsible for either enunciating or validating some of the basic principles and rules for the

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[109] *Id.* at 25.

[110] U.C.C. § 4-110 (1962), as well as its present version in § 3-409(a) (2013), require that the acceptance must be written on the bill of exchange.

[111] To this day, the best treatment of the subject of virtual and extrinsic acceptances in English and United States law is by Herman Finkelstein. *See* HERMAN N. FINKELSTEIN, LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT 42–92 (1930).

judicial or arbitral enforcement of LOC rights and duties. However, starting in the 1950s with promulgation of the 1951, and much later, 1962 revisions of the UCP, courts in important United States financial centers, such as New York, Massachusetts, Illinois, Pennsylvania, and California, relied on the UCP as the principal source for the adjudication of documentary compliance issues in a growing number of judicial, albeit equitable, actions for remedies.

Not surprisingly, and much to the chagrin of the drafters of Article 5 of the U.C.C., the state of New York (among other states) adopted a "non-conforming" amendment to Article 5 in 1964. Accordingly, Original Article 5 was applied only if the credit did not expressly incorporate the UCP. If the LOC stated that it was governed by the UCP, it governed instead of the U.C.C.[112] This New York amendment illustrated the power enjoyed by the UCP as a positive law source of LOC law. Even though the UCP was a usage of trade, and thus a customary law source, it displaced statutory law as the pre-eminent source, and it did so in the most important LOC jurisdiction in the world.[113]

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[112] New York adopted a non-conforming amendment to § 5-102 (4) of the U.C.C., which provided:

> Unless otherwise agreed, this Article 5 does not apply to a letter of creditif by its terms or by agreement, course of dealing or usage of trade such letter of credit or credit is subject in whole or in part to the Uniform Customs and Practice for Commercial Documentary Credits fixed by the Thirteenth or any other Congress of the International Chamber of Congress.

N.Y. U.C.C. LAW § 5-102(4) (McKinney 1964). Similar non-conforming amendments were enacted by Alabama, Arizona, and Missouri. *See* ALA. CODE § 7-5-102(4) (1977); ARIZ. REV. STAT. ANN. § 47-5102 (D) (1967); MO. REV. STAT. 400.5-102(4) (West 1983).

[113] It is also worth mentioning as an indication of the legitimating and remedial power of banking practice that even France's *Cour de Cassation* (whose preference for positive law over commercial customary law is well known) had been granting appeals based on the misinterpretation of the UCP as positive law. For examples of appeals to the *Cour de Cassation* based upon the lower courts' misinterpretation of law, see Cour de cassation [Cass.] [supreme court for judicial matters] com., Apr. 9, 1996, Bull. Civ. IV, No. 94-20.407 (Fr.) (where one of the grounds for the cassation type of appeal was that "*la cour d'appel a viole l'article 1134 du Code civil, ensemble les articles 44 et 45 des regles et usances uniformes*" (the court of appeals misinterpreted article 1134 of the Civil Code and articles 44 and 45 of the UCP)); Cour de cassation [Cass.] [supreme court for judicial matters] com., Nov. 29, 1994, Bull Civ. IV, No. 92-15175 (Fr.) (where the basis for appeal was the misinterpretation of Article 16 of UCP 400). Similar deference to the UCP as a primary source of LOC law was apparent in Japanese and German decisions. For Japanese decisions that defer to the UCP as a primary source of law, see Tōkyō Chihō Saibansho [Tōkyō Dist. Ct] Aug. 28, 1989, Kinyu Shoji Hanrei 8–9, 33–38 (court upheld UCP 290 Articles 3 and 4 exemptions for the loss of documents by a correspondent bank "unless the choice or supervision of a correspondent was grossly negligent . . . .") (translation by Professor Kazuaki Sono); Tōkyō Chihō Saibansho [Tōkyō Dist. Ct] May 29, 1987, Kinyu Shoji Hanrei 781, 38–43 (court applied and upheld UCP 290 Article 12 (a)'s allocation of the risk because "reliance upon the UCP has become a commercial custom . . . ")

I have selected the process of drafting of UCP 500, which was published in 1993, as the focal point for discussion and comparison with the Roman secured lending practices because as a participant in that process, I had the opportunity to observe the transformation of standard practices into practice-inspired and formally adopted rules. In addition, UCP 500 was the revision that promulgated the largest amount of significant new rules and profited most from interaction between bankers and lawyers. But before we study the drafting of UCP, it will be helpful to be able to contrast its distinctive features with some of the UCP's customary law predecessors.

VI. PREDECESSORS OF UCP 500

A. The International Chamber of Commerce and its Compilation of the Uniform Customs and Practice for Documentary Credits

As the bankers of other continents began to master the LOC business and acquired the necessary solvency and liquidity to act as confirming and negotiating banks of the LOCs issued by their correspondent banks in other nations, the drafting of LOC practices on the examination of documents underwent a fundamental shift. They were no longer the practices of a group of banks in a major financial and trading center. The time had come for truly international practices. The ICC seemed to be at the right place and time to help develop such practices by acting as the host for their compilation and drafting.

The ICC was created during an international congress of chambers of commerce and industrial associations in Atlantic City, New Jersey in 1919. A year later, it opened its doors in Paris as a non-governmental federation of worldwide commercial, industrial, and professional associations.[114] Unlike other organizations, it could rely on a vast network of national associations representing economic sectors gathered under umbrella organizations or councils. Proposals for international harmonization or standardization of commercial and financial practices could be initiated by national members through their respective councils or directly by national members participating in the ICC international sectoral committees.[115] Before we turn to these formal, institutionally sponsored or hosted

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(translation by Professor Kazuaki Sono). For German decisions, see KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 14, ch. XXIII, app. II. Consequently, by the 1970s and 80s, the UCP was regarded as both positive and living law throughout most of the commercial banking world, especially on issues of documentary compliance.

114 ERIC A. CAPRIOLI, LE CREDIT DOCUMENTAIRE: EVOLUTION ET PERSPECTIVES 119–20 (1992). For a more detailed history and description of activities of the ICC, see generally GEORGE L. RIDGEWAY, MERCHANTS OF PEACE: THE HISTORY OF THE INTERNATIONAL CHAMBER OF COMMERCE (1959).

115 In the case of LOCs, the sectoral committee was at first called Checks, Bills of Exchange and Documentary Credits, and eventually renamed the Commission on Banking Technique and Practice.

international compilations of checking practices, we need to pay a short visit to individual bank sources of LOC practices.

B. Bankers' Documentary Examination Manuals and Checklists

As part of their daily business of examining documents, the most experienced and respected LOC bankers started drafting internal manuals full of directives on the acceptability or rejection of documents. Known in the LOC trade as checklists, these manuals were exchanged with correspondent banks, and at that stage of the interaction, often served as an initial laboratory of the viability of the practice. Generally, the checklists were nothing more than terse, unexplained instructions on how to examine the document in question, what statements or descriptions to look for, and so on. Occasionally, a highly experienced and respected banker would also provide the reasons for a suggested practice in an examination manual. One such a manual was Frank Sauter's *Random Notes on Commercial Credits*, a set of two booklets.[116] Sauter was a vice president of First National City Bank of New York during the 1950s and 60s. He was not only a model document checker, but also a teacher of standard and best practices in the United States and other countries where his bank had offices. He attributed his motivation for writing *Random Notes on Commercial Credits* to a request by a young banker who came to him "not seeking information alone or trying to learn whether the answers were yes or no . . . . [but wanting] to know the 'why' behind the answers . . . ."[117]

His discussion of "stale" bills of lading illustrates why this young banker sought him out. Article 43 of the UCP (1933) had attempted to define a stale bill of lading, but had done so in a circular manner: "Documents must be presented without delay. Banks may refuse documents if presented to them too late, in other words at a date not justified by the usual time to cover the distance between the place of dispatch and the place where payment is made."

Yet, terms such as "too late" or "usual time," when related to the time it took to cover the distance between the place of dispatch and where payment was to be made, did not explain why a bill of lading was truly stale. Sauter rightly pointed out that the above provision "is the rule but not the answer which so many seek to this frequently heard question."[118] He added that this rule seems to give the banks the last word on what constitutes a stale bill of lading when in fact it is not the bank's judgment of what is the usual time, but transactional considerations, such as the availability of the bill of lading to the bank's applicant when the vessel arrives at its port of destination:

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[116] FRANK SAUTER, I RANDOM NOTES ON COMMERCIAL CREDITS (1960) [hereinafter SAUTER I]; FRANK SAUTER, II RANDOM NOTES ON COMMERCIAL CREDITS (1963) [hereinafter SAUTER II].

[117] SAUTER I, *supra* note 116, at *Forward*.

[118] *Id.* at 24.

> [A]t one time it was popular [for bankers] to say offhand and with some authority that the bill of lading was stale if it was presented so many days late . . . . When this question is put to us in New York, *we answer it by saying that as a rule if we can airmail documents in time to reach their destination on or before the arrival of the vessel carrying the goods*, we will not regard the documents as stale.[119]

Note that in contrast with Article 43 of UCP 1933, Sauter's version of staleness was focused on the unavailability of the bill of lading at the time of the arrival of the vessel. The reason for this focus was that the arrival of the goods prior to the arrival of the bill of lading could cause significant costs to the applicant. They include the need to store the goods in expensive refrigerated warehouses, as well as the payment of costly demurrage and damages owed by the applicant-consignee of the goods to third parties, as a result of their failure to receive them at a promised date. This transactional fact meant that a bill of lading could be stale even if it arrived within the usual time to cover the distance between the place of dispatch and the place where payment is made. In my opinion, Sauter's version of staleness is still the best explanation for a practice of presentation of transport documents that the UCP, for sound pragmatic reasons, limits to a 21-day period.[120]

The same was true with the proverbial formulation of a nuclear element of the LOC cellular transaction, imbedded in the UCP since its 1951 revision: "In documentary credit operations, all parties concerned deal in documents and not in goods."[121] He illustrated the centrality of this proverbial principle with an anecdote in which an applicant requested that his bank "sell" him an LOC that would assure him that the same olive oil in a bottled sample he handed over to the bank would be the one received from the foreign seller. In response to this request, Sauter stated:

> Of course, we could have accommodated him if we had wanted to, but experience has taught us to "mind our own business," and that is the banking business . . . . No bank that knows the commercial credit business would enter into a transaction of this kind just to accommodate this stranger, or even its very best applicant. It would be impractical for a bank to do so anyhow when you stop to think about it, as the stranger did after a while.[122]

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[119] *Id.* (emphasis added).

[120] *See, e.g.*, INT'L CHAMBERS OF COMMERCE, UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS, UCP No. 500, art. 43(a) (1993) [hereinafter UCP 500]; INT'L CHAMBERS OF COMMERCE, UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS, UCP No. 600, art. 14(c) (2007) [hereinafter UCP 600].

[121] INT'L CHAMBERS OF COMMERCE, UNIFORM CUSTOMS AND PRACTICES FOR COMMERCIAL DOCUMENTARY CREDITS, UCP No. 151, art. 10 (1951) [hereinafter UCP 151].

[122] SAUTER II, *supra* note 116, at 45.

Clearly, the practices suggested and explained by Sauter had a discernible purpose that was cost effective, profitable, reasonable, and fair to correspondents, whether customers or third parties.

C. The Uniform Customs and Practices for Documentary Credits (UCP 1933 revision)

Despite the occasional presence of enlightened practice manuals that could contribute to a better understanding of LOC practices everywhere, the time had come for a truly international compilation of standard and best LOC practices. Given its international, worldwide character, the natural host entity for such a compilation was the ICC and the vehicle was a set of internationally uniform customs and practices. The first version of the UCP, known as the *Uniform Customs and Practices for Documentary Credits Fixed by the 7th Congress of the International Chamber of Commerce*, was published in 1933 by the ICC as Brochure 82. It was heavily influenced by a set of banking practices labeled *Uniform Regulations for Commercial Documentary Credits*, which were adopted during the ICC's 1929 Amsterdam Congress and whose authorship was attributed by an ICC brochure to United States bankers. The purpose of these regulations was to harmonize those previously adopted and published by banking associations in various countries. As with the New York 1920 Regulations, the Amsterdam Regulations continue the emphasis on setting forth a uniform nomenclature, and thus define "commercial documentary credits"[123] as well as the main types. It also set forth the issuing and confirming bank's standard of care for the examination of the LOC documents and instructed the banker to "ascertain that on their face they appear to be in regular form."[124] And it enunciated the so-called independence principle as follows: "Commercial Credits are essentially distinct transactions from the sales contracts on which they may be based and with which banks are not concerned."[125]

This 1933 revision adopted, albeit in a more succinct form, the same principle of independence found in the 1929 Uniform Regulations. Thus, LOCs were "distinct transactions from sales contracts, on which they may be based, with which banks are not concerned."[126] Similarly, it adopted a standard for the examination of documents and papers that required "care so as to ascertain that on their face [the documents and papers] appear to be in order."[127] *The absence of a*

[123] *See* INT'L CHAMBERS OF COMMERCE, UNIFORM REGULATIONS FOR COMMERCIAL DOCUMENTARY CREDITS, §§ A(1)-(9) (1929) [hereinafter Uniform Regulations] (available at the NLCIFT data base, letter of credit library).

[124] *Id.* § B(1).

[125] *Id.* § A(1).

[126] INT'L CHAMBERS OF COMMERCE, UNIFORM CUSTOMS AND PRACTICES FOR COMMERCIAL DOCUMENTARY CREDITS, UCP No. 82, art. 1 (1933) [hereinafter UCP 1933].

[127] *Id.* art. 10.

reference to strict compliance as the standard for the LOC documents in this first version of the UCP is noteworthy. It reflected the foreignness of this judicial doctrine of strictness for the sake of strictness to what bankers regarded as their examination practice.[128] The fact is that the judicially created principle of strict compliance had misperceived the kind of compliance that archetypal document checkers regarded as reasonable and desirable, as I will discuss in a later section.

D. The Uniform Customs and Practices for Documentary Credits (UCP 1951 revision)

Two features of the 1951 revision of the UCP deserve attention. The first was Article 10's proverbial formulation of the principle of independence or abstraction: "In documentary credit operations, *all parties concerned deal in documents and not in goods.*"[129] I should add that when the principle behind a commercial practice can be expressed in such a proverbial fashion, it is a sign that the underlying practice has gained widespread, if not universal, acceptance.[130] The second feature was its reference to "all parties concerned," suggesting an inclusion of occasional participants in the circle of regular participants and an incipient concern with the status of third parties. This revision was not characterized by the inclusion of new practices, but by widespread adoptions of the UCP, as it stood in earlier versions, by many banking associations around the world.

E. The 1962, 1974, and 1983 Revisions: Bernard Wheble and Lawyers as Participants in the Drafting Groups

In 1961, the British Bankers' Association (BBA) joined the ICC Working Group in drafting the 1962 revision of the UCP[131] and named Bernard S. Wheble, at first an observer, and subsequently a participant in this group. Wheble was a senior LOC banker for London's Brown and Shipley's (of House of Brown fame). He was Great Britain's and one of the world's most respected LOC bankers. Soon after joining the ICC's Commission on Banking Technique and

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[128] Article 10 of UCP 1933 only requires from a bank that negotiates or pays and seeks reimbursement for it that its payment or negotiation be "in conformity with the terms and conditions of the relevant letter of credit." *Id.*

[129] UCP 151 art. 10 (emphasis added).

[130] In fact, this proverbial formulation had been used in the beginning sentence of Article 10 of UCP 1933, but perhaps because of the much larger number of LOC's issued in 1951, this version was often credited as being the one that introduced this proverbial principle.

[131] This was the first revision designated not only by its date but also by the number of the ICC publication. The 1962 revision of the UCP was also referred to as ICC Publication 222.

Practice, he became the leading draftsman and principal author of the two subsequent (1974 and 1983) revisions of the UCP.

Times were changing and fast. By the time Wheble chaired the 1974 and 1983 revisions, the regular participants in the LOC transaction and their third parties were a much more heterogeneous group than those he dealt with at Brown and Shipley's. The group included Charles Bontoux, one of France's most distinguished banking lawyers and one of the draftsmen of the 1951 revision of UCP, as well as of the 1962, 1974, and 1983 revisions.[132] I was fortunate to have corresponded with this fine jurist and banker for a number of years, and as a result, became aware of the differing points of view between him, Bernard Wheble and myself on the role of lawyers as draftsmen of the UCP.

UCP 290 (1974) was largely drafted by Wheble and was adopted by bank associations in over 150 countries, including most socialist nations.[133] It ushered in a new group of transport documents prompted by the container revolution.[134] It also added certainty to one aspect of the issuer's and confirmer's promise to the beneficiary: it made it clear that the issuer's undertaking to purchase or negotiate the beneficiary's draft was without recourse on the beneficiary, thereby making their payment final.[135]

From Bontoux, I learned of Wheble's reluctance to accept my suggestion of a reasonable document checker standard for the examination of documents despite the repeated references to the document checker's reasonable care in earlier versions of the UCP.[136] The same was true with legal or equitable

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[132] *See* INT'L CHAMBER OF COMMERCE, TRIBUTE TO CHARLES BONTOUX, Doc. No. 470/496 (1987).

[133] *See* Boris Kozolchyk, *Towards New Customs and Practices for Documentary Credits: The Methodology of the Proposed Revision*, *in* COMMERICAL LAW ANNUAL 1993, at 371, 377 n.11 and accompanying text (Louise F. Del Duca & Patrick Del Duca eds., 1992) [hereinafter Kozolchyk, *Towards New Customs*].

[134] *See* INT'L CHAMBERS OF COMMERCE, UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDIT, UCP No. 290, art. 23 (1974) [hereinafter UCP 290].

[135] *See id.* art. 3(a)(iii) ("to purchase/negotiate, without recourse to drawers and/or bona fide holders . . . ."). As noted by E.P. Ellinger, *The Uniform Customs and Practices for Documentary Credits – The 1993 Revision*, [1994] L.M.C.L.Q. 377, at n.17: "[W]ithout such a provision, the law of negotiable instruments would lead to the opposite conclusion: Bills of Exchange Act 1882, ss. 43(2)."

[136] See Boris Kozolchyk, *In Which the Writer Takes a Tongue-in-Cheek Look at American v. British English*, 3 DOCUMENTARY CREDIT INSIGHT (1997), where I refer to an article written by Wheble in the same publication under the pseudonim Mercator (on file with author). In this article, he criticized my suggestion of using the standard of reasonableness in connection with the banker's examination of the documents as being contrary to its ordinary usage in England. "According to the said Wheble, 'reasonable' in British English denoted someone who was neither particularly good nor bad at what he or she was doing . . . just middling; certainly he or she could not be one who could persuasively testify in court on what honest and knowledgeable bankers would do under the circumstances. Consequently, argued Wheble, the term 'reasonable banker' or 'reasonable document checker' would be misleading to British courts, bankers and banking lawyers. He suggested the use of other terms more consistent with British English such as 'reasoned'

remedies. Wheble agreed that given the private status of the ICC as a law giver, the UCP could not be drafted as a supra-national mandatory law. Its usage of trade status should be maintained and strengthened. Additionally, in his view, it was not necessary for the UCP to rely on equitable remedies or sanctions because LOC bankers are as good as their word, and if they did not observe the UCP or acted in bad faith, they would not remain in the LOC business for long. That, he concluded, was as much of a sanction as the UCP could or should provide.

When I became one of the drafters of UCP 500 in the early 1990s, Wheble sill retained these views. Wheble and I became friends, and in many enjoyable exchanges of opinions, he heard my reasoning. For example, on the need for the UCP to consider relying on equitable remedies, I pointed to Article 16 of UCP 400, where the preclusion rule was the UCP's most cost effective non-judicial dispute resolution practice. It addressed the situations in which an issuing or confirming bank did not return the supposedly non-complying documents to the beneficiary in a manner timely enough to enable the cure of the discrepancies and re-presentation of the documents, or in which an issuing or confirming bank returned the documents in a timely manner, but did not state the reason for their rejection.

According to Article 16 of the UCP 400, if an issuing or confirming bank found discrepancies that merited the refusal of the documents, it was obligated to give timely notice of the defects and of the fact that the documents were being held at the disposal of the beneficiary or presenting bank. If the issuing or confirming bank failed to do so, the bank was "precluded from claiming that the documents are not in accordance with the terms and conditions of the credit."[137] This preclusion was strict in the sense that the beneficiary did not have to show that the bank's dereliction caused him material damage. In addition, it relied on an extra-judicial remedy effected by merely debiting the account of the derelict bank or crediting the account of the diligent bank with a paying bank. Despite its informality, this remedy, or sanction, had saved and continues to save banks, their applicants, and beneficiaries incalculable sums in transactional and judicial costs and fees.

I also reminded Wheble of another living law remedy that saves considerable transactional and judicial costs—the abandonment of goods with the negligent or bad faith banker by the applicant or beneficiary. An aggrieved applicant can abandon the goods improperly paid for by the issuing bank by leaving them with the bank. And an aggrieved beneficiary can abandon the goods with the bank that wrongfully dishonored his presentation of complying documents. While this remedy would still be unacceptable in civil law

checker." *Id.* I pointed out that learned English judges starting with Lord Mansfield to many in our time relied on the term reasonable to depict a merchant or bank that not only knew his trade but had the interest of other traders in mind when selecting a course of dealing and eventually a practice. *Id.*

137 INT'L CHAMBERS OF COMMERCE, UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS, UCP No. 400, art. 16(e) (1983) [hereinafter UCP 400].

jurisdictions that require all contractual rescissions to be judicial,[138] it is widely used in other less formalistic jurisdictions and in private negotiations, mediation, and arbitration. Towards the end of our discussions, and sadly shortly before his death, I had the impression that he was beginning to relent in his opposition to what he referred to as "lawyers' intrusions" into the sacred domain of banking practices.

VII. UCP 400 PROBLEMS AND UCP 500 CURES

With the marked increases in the worldwide use of LOCs, and despite Wheble's best efforts when drafting UCP 400, bad faith practices proliferated during its lifetime (1984-1993).[139] Some of these practices involved applicants and issuing banks attempting to mislead beneficiaries and third parties into thinking that the credits issued were irrevocable when in fact they could be revoked. Others took place during the negotiation of the drafts and documents and resulted in the charge by purported negotiating banks of fees or commissions in exchange for insignificant or valueless services. UCP 400 also granted to FIATA, a Belgian-based association of freight forwarders, the exclusive right to issue ocean bills of lading as agents for the carrier, a right that was not enjoyed by other freight forwarders, whether acting as associations or as individuals.[140]

The large majority of bad faith practices were associated with a hypertechnical strict examination of the documents by issuing banks.[141] In this respect, the challenge faced by UCP 500 when trying to encourage good faith practices in the marketplace and in the courtroom was reminiscent of that faced by the Roman praetor when he had to resort to the *exceptio doli*.[142] Please bear in mind as we proceed with the analysis of UCP 500 that the same praetorian rationale that disallowed reliance on strict law as a shield for abusive or malicious practices could have applied to the judicial versions of strict compliance of LOC documents that will be discussed shortly.

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[138] *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 14, chs. XXVI, XXVIII.

[139] UCP 400; *see also* James E. Byrne, *The 1983 Revision of the Uniform Customs and Practice for Documentary Credits*, 102 BANKING L. J. 151, 171-72 (1985); *see generally* Boris Kozolchyk, *The 1983 Revision, Trade Practices and Court Decisions: A Plea for a Closer Relationship*, 9 CAN. BUS. L. J. 214 (1984).

[140] For a brief account of the decision to remove the FIATA privilege and an attempt to reinstate it, see Boris Kozolchyk, *The Unwarranted Comeback of the FIATA Bill of Lading*, *in* ANNUAL SURVEY OF LETTER OF CREDIT LAW & PRACTICE 135 (James E. Byrne & Christopher S. Byrnes eds., 2006) [hereinafter Kozolchyk, *The Unwarranted Comeback*].

[141] For a graphic illustration of the problems reported by LOC to the Working Committee that drafted UCP 500, see Kozolchyk, *Towards New Customs*, *supra* note 133, at 407–08.

[142] *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 14, ch. XXIII(C)(1) (discussing the *exceptio doli's* role in shaping the Roman law doctrine of good faith).

A. Revocability–Express or Hidden and Uncertainty of the Credit Promise

One of the main goals of UCP 500 was to support the integrity and reliability of the documentary credit promise.[143] The Working Group was aware of complaints by national delegations concerning the periodic issuance of LOCs that were silent or ambiguous on their revocability. It agreed that the generalized uncertainty about revocability among beneficiaries and correspondent banks required UCP 500's reversal of the presumption of revocability.[144]

Another problem with the uncertainty of revocability was the issuance of revocable LOCs disguised as irrevocable. These LOCs were labeled irrevocable, but contained conditions that left the irrevocability of the LOC in the hands of issuing banks and their applicants. A popular disguise of irrevocability was that of LOCs known in LOC practice as "pre-advices." Typically, the issuer of a pre-advice informed the beneficiary that his payment would be made upon receipt of funds from the applicant. Other pre-advices, such as that in the 1999 decision of *Hamilton Bank, N.A*, listed as a condition to the issuer's payment the presentation of "a copy of an authenticated telex *from the issuing bank* to the advising bank, indicating quantity to be shipped, destination and nominating transporting company."[145] In other words, despite the irrevocable designation of its LOC, Hamilton Bank would instruct its correspondent not to pay until Hamilton had submitted an authenticated telex authorizing payment.[146]

Having in mind the serious effects that these bad faith practices had against applicants, beneficiaries, and correspondent banks, the Working Group warned banks not to issue such pre-advices unless their issuer was prepared to issue "the operative credit instrument or amendment thereto." Where such a pre-advice had been issued, unless the recipient disclosed that it was not binding, Article 11(c) of UCP 500 deemed the deceptive issuer "irrevocably committed to issue or amend the Credit, in terms not inconsistent with the pre-advice, without delay."[147] Thus, this rule applied another equitable, extra-judicial remedy (a species in the genus of specific performance), and thereby strengthened the aggrieved beneficiary's or correspondent bank's extra-judicial remedy in an arbitration proceeding and facilitated the claim for specific performance before a court of law.

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[143] *See* BORIS KOZOLCHYK, TOWARDS NEW CUSTOMS AND PRACTICES FOR DOCUMENTARY CREDITS: THE METHODOLOGY OF THE PROPOSED REVISION 376 (1993).

[144] Article 1(c) of UCP 290 (1974) stated: "In the absence of such indication the credit shall be deemed to be revocable." This presumption was repeated in Article 7(c) of UCP 400 (1984). It was reversed by sub Article 6(c) of UCP 500: "In the absence of such indication the Credit shall be deemed to be irrevocable."

[145] Hamilton Bank, N.A. v. Kookmin Bank, 44 F. Supp. 2d 653, 655 (S.D.N.Y 1999) (emphasis added).

[146] *Id.* at 656. As apparent in this court decision, this deceitful practice was the object of a complaint to the Office of the Comptroller of the Currency of the United States.

[147] UCP 500 art. 11(c).

B. An Issuer or Confirmer's Primary Liability

Uncertainty also prevailed among regular participants and third parties, including secured creditors interested in using the LOC as collateral. The main uncertainty was created by the manner in which UCP 290 and 400 referred to the LOC as an undertaking. According to Article 10(a)(i) of UCP 400, an irrevocable LOC was "a definite undertaking of the issuing bank . . . if the credit provides for sight payment – to pay, *or that payment will be made* . . . ."[148] The words "or that payment will be made" were being used by banks in some Asian countries to place primary liability not on the issuing or confirming banks, but on the applicant and his surety or sureties. Thus, it was not clear to potential secured creditors, among others, whether the beneficiary or his transferee who presented the required documents to the issuing bank had to claim first from the applicant or sureties, and then only if they did not pay could they claim the definite undertaking of the issuing or confirming bank. Considering that such a definition led to uncertainty and to bad faith practices, the words "or that payment will be made" were eliminated.

C. An Uncertain Time of Establishment

An additional uncertainty was caused by not knowing when liability of an irrevocable LOC was established. Assume that a correspondent bank that had been asked to confirm an LOC by telex (still a popular method of inter-bank communication during the 1980s) had issued such a confirmation only to receive a phone communication by the issuing bank instructing it to cancel it a few hours later. During my interviews with both money center and inland bank document checkers in the United States, it became clear that a confirming bank could not be reasonably expected to rely on the Society for Worldwide Interbank Financial Telecommunication (hereafter S.W.I.F.T.) message asking it to confirm an LOC via S.W.I.F.T. if it was going to be instructed to retract that message hours or minutes later by a phone message. Consequently, the unanimous opinion of the Working Group of UCP 500 was that the time of establishment of liability should be fixed when the LOC was issued and sent to the correspondent bank or beneficiary by whatever means.

This practice was unacceptable to some of the banking associations, and it was shelved only to be adopted by Article 5 of the U.C.C. and by the United Nations Convention on Independent Guarantees and Stand-By Letters of Credit.[149]

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[148] UCP 400 art. 10(a)-(10)(a)(i) (emphasis added).

[149] U.C.C. § 5-106 (2012) states: "A letter of credit is issued and becomes enforceable according to its terms against the issuer when the issuer sends or otherwise transmits it to the person requested to advise or to the beneficiary." Similarly, Article 7 (1) of the United Nations Convention on Independent Guarantees and Stand-By Letters of Credit states that "Issuance of an undertaking occurs when and where the undertaking leaves the sphere of control of the guarantor/issuer concerned." Sub-section (3) adds: From

Eventually, Article 7(b) of UCP 600 reverted to the original version of the UCP 500 establishment rule: "An issuing bank is irrevocably bound to honour as of the time it issues the credit."[150]

D. Uncertain Finality of Payment by the Confirming Bank

Many banks were uncertain whether the rule of finality of payment of the issuing bank in UCP 290 and UCP 400 was also applicable to issuing banks. In other words, was the payment by the confirming bank to the beneficiary at the maturity of the LOC or at an earlier time as a result of its negotiation of the beneficiary's draft? This was an important clarification because the issuing and the confirming banks performed equal and parallel undertakings. It was also important because a growing number of confirming banks, when acting as negotiators of the LOCs they had confirmed, treated their negotiations of the beneficiaries' drafts as subject to recourse against the beneficiary if they were not reimbursed by the issuing banks that nominated them as confirmers. Article 9, subsections (a)(iv) and (b)(iv) of UCP 500 clarified that the negotiations by both the issuing and the confirming bank were without recourse on the beneficiary.

E. Negotiation of the LOC Draft and Commissions: Good Faith and Reasonableness

The responses to the surveys conducted by Charles del Busto, then the president of the ICC Banking Commission, as well as to my questionnaires and interviews, showed that the term negotiation was in urgent need of clarification. From an operational standpoint, a major source of disputes regarding negotiation among beneficiaries and negotiating, issuing, or confirming banks was the charge of a negotiation commission that beneficiaries thought was unjustified. In some of these disputes, different banks acting as negotiating, issuing, or confirming banks claimed to have been the true negotiators and thus entitled to the negotiation commission.

From a strictly legal and procedural standpoint, the most important disputes on negotiation concerned the holder in due course status claimed by banks who allegedly had negotiated the beneficiary's drafts drawn against the issuing or confirming bank. When such a bank succeeded in attaining the status of holder in due course, it was immunized in most jurisdictions against claims by the applicant and the issuing or confirming bank that it had negotiated fraudulent documents, and thus was not entitled to payment or reimbursement of the amount

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the time of issuance of an undertaking, a demand for payment may be made . . . ." G.A. Res. 50/48. Art. 7, U.N. Doc. A/RES/50/48 (Jan. 26, 1996).

[150] UCP 600 art. 7(b).

due on the LOC.[151] As often happens with rules based upon commercial or banking practices, symmetry must exist between the operational and legal terminology—in our case between the operational meaning of negotiation and the legal meaning of holding the beneficiary's draft in due course.

Since the claims of fraudulent tender of documents multiplied during the 1980s, especially with the large volume of shipments to and from China, this legal clarification was of considerable commercial and economic significance. The UCP 500's mission was to provide an answer that was satisfactory to correspondent bankers disputing their claims to negotiation commissions and to the courts, lawyers, and bankers involved in LOC fraud disputes. The meaning of negotiation was central in four different practices and in the determination of whether a given bank was a holder in due course.

According to Practice One, negotiation meant that the issuing or confirming banks would examine the documents submitted to them at a date prior to the specified date for the acceptance of the draft or for payment of the LOC. This examination was followed by the negotiating bank's acceptance or payment of an amount that reflected the discounted value of the acceptance or advanced payment. This negotiation was without recourse on the beneficiary, and thus, it amounted to a final payment of the LOC.

In Practice Two, the acceptance or payment was made by a bank that had been authorized to negotiate the LOC as part of a general or individual authorization. The commission or fee for negotiation would also take into account the discounted value of the advanced acceptance or payment, as well as whether it was negotiated with or without recourse on the beneficiary.

In Practice Three, the same negotiating bank as in Practice Two would examine the documents, report to the issuing or confirming bank that in its opinion, the documents were in compliance with the LOC, and would ask the issuing or confirming bank if it wished the negotiating bank to accept or pay on the credit. If the LOC required payment at sight, the negotiating bank would request the issuing or confirming bank to wire the payment to it. With this remittance, it would pay the beneficiary, charge a commission for negotiation, and assume the risk that if the documents were refused by the issuing or confirming bank, it would reimburse these banks for the amount previously wired and paid to the beneficiary.

In Practice Four, the same bank would inform the issuing or confirming bank that in its opinion, the documents were in compliance, inform the beneficiary of the same, and ask the issuing or confirming bank to wire the funds with which to pay the beneficiary. Upon receipt of the funds wired by the issuing or confirming bank, it would pay the LOC and charge a negotiation commission or

[151] Boris Kozolchyk, *Letters of Credit*, *in* IX INTERNATIONAL ENCYCLOPEDIA OF COMPARATIVE LAW 113–34 (Jacob S. Ziegel et al. eds., 1978) [hereinafter Kozolchyk, *Letters of Credit*]; *see also* Boris Kozolchyk, *The Immunization of Fraudulently Procured Letter of Credit Acceptances: All Services Exportacao, Importacao Comercio, S.A. v. Banco Bamerindus Do Brazil, S.A. and First Commercial v. Gotham Originals*, 58 BROOK. L. REV. 369 (1992).

fee. However, this negotiating bank would not assume responsibility for recovering from the beneficiary the amount it had paid on behalf of the issuing or confirming bank, nor would it warrant to the issuing or confirming bank or the beneficiary that the documents it had examined complied with the LOC.

During my surveys and interviews on the meaning of negotiation, I prefaced my request for the bankers' definition of negotiation in connection with respect to Practice Four by stating:

> In characterizing this practice as a negotiation, please place yourself in the position of an issuing or confirming bank that wired the funds paid to the beneficiary to the presenting-negotiating bank. Assume that when you deduct your commission for your negotiation, your beneficiary asks you if you are not charging a commission for the same service performed earlier by the negotiating presenting bank.

The gist of the responses to this question, at least of those that can be summarized in polite company, was:

> Imagine the chutzpah of such a presenting-negotiating bank. It charges a negotiation commission for providing the beneficiary with no money or promise of payment of it is own. In contrast, we provide the money and because the presenting-negotiating bank charged a commission for negotiation, our charge, which is legitimate, is jeopardized.

Most respondents agreed that Practices One and Two entitled the negotiating bank to a payment of negotiation commission. A majority agreed that Practice Three also allowed for a negotiation commission. Only one banker, among dozens, agreed with the practice that entitled the purported negotiator in Practice Four to a negotiating commission. Clearly, in the first three practices, the negotiating bank gave tangible value to the beneficiary when acquiring his draft, whereas in Practice Four, the purported negotiator did not give such value. The result of this inquiry, then led to the negotiation practice sanctioned by Article 10(b)(ii) of UCP 500: "Negotiation means the giving of value for Draft(s) and/or document(s) by the bank authorised to negotiate. Mere examination of the documents without giving value does not constitute a negotiation."[152]

Please note that the reasonableness that this provision relies on is objective and archetypal. It takes into account what a negotiating bank would consider reasonable if it acted as an issuing or confirming bank that made a final (non-recourse) payment on the LOC in advance of its date of maturity.

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[152] UCP 500 art. 10(b)(ii).

F. Elimination of a Monopolistic Bill of Lading Practice

The increased involvement of other sectors of the economy in the issuance of documents that triggered payment of LOCs, such as the transportation sector, soon resulted in attempts by members of this sector to monopolize the issuance of documents, such as "port to port" ocean bills of lading when they were not issued by the ocean carriers or their agents. Article 25(d) of UCP 400 made this monopolistic practice possible by providing: "Unless otherwise stipulated . . . banks will reject a transport document issued by a freight forwarder unless it is the FIATA Combined Transport Bill of Lading . . . or otherwise indicates that it is issued by a freight forwarder acting as a carrier or agent of a named carrier."[153] If a freight forwarder was not a member of FIATA, he could only issue bills of lading if he was the owner of the vessel or was appointed by the owner of the vessel as his agent, a status not easily earned.

After a review of the legality and fairness of such a practice, the position paper submitted by the United States Council on International Banking (USCIB), which represented the banks doing LOC business in the United States, stated in relevant part:

> The USCIB disagrees with the UCP's continuing endorsement of FIATA documents on an exclusive basis. In our view, the UCP should state the banking criteria for accepting or rejecting transport documents. Whatever document meets these criteria should be acceptable, regardless of the business logo or professional association of the issuer. We believe it was a mistake to endorse one particular entity (an endorsement which is, invariably, at the expense of unendorsed entities) . . . ."[154]

The Working Group and UCP 500 adopted this recommendation and eliminated the FIATA monopoly.

G. Bad Faith Excuses not to Pay or Reimburse: A Judicial Mirror Image Version of Strict Compliance

By the 1980s, the doctrine of strict compliance had become "judicialized" by courts throughout the United States and other countries. There was even a Florida version of Lord Sumner's dictum in *Equitable Trust Co. of New York*: "[T]here is no room for documents which are almost the same or

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[153] UCP 400 art. 25(d).

[154] For a more detailed explanation of the reasons for the objection to the FIATA endorsement, see Kozolchyk, *The Unwarranted Comeback*, *supra* note 140, at 135.

which will do just as well."[155] As found in a 1979 Florida state court decision, the standard for the examination of documents was as demanding as Lord Sumner's, but more reminiscent of Florida's sun and fun than of London's wet and dreary Mincing Lane: "Compliance with the terms of a LOC is not like pitching horseshoes. No points are awarded for being close."[156] Nonetheless, the courts' understanding of the function of these documents and how they should be examined (and interpreted) according to standard banking practices was equally thin on both sides of the Atlantic Ocean.

Lord Sumner's principle assumes mirror image compliance. On the one side is a detailed, unambiguous formulation of requirements in the operative credit instrument. On the other are the required documents, replicating to the last minute detail the credit terms and conditions. The issuing, confirming, negotiating, or paying banks are supposed to hold the mirror image of the credit terms to the tendered documents. Any deviation, no matter how slight, is unacceptable. Yet, in actual banking practice, this assumed mirror image practice of examination more often than not results in a blur.

Countless issuances contain shorthand formulations of trade terms whose full import is explained in extrinsic sources such as INCOTERMS.[157] And LOCs seldom specify what each required document must state in response to the shorthand reference or trade term. Consequently, the document checker must ascertain that, for instance, a seller's FOB invoice tendered in response to a credit's stipulation of FOB terms does not contain a charge for marine insurance. After all, under FOB terms, it is the responsibility of the buyer to procure the marine insurance even though the letter of credit itself does not specify that the FOB invoice should not contain an insurance charge.

Second, the mirror image examination is also unhelpful when a credit requirement does not mean in the beneficiary's and confirming bank's place of business what it means in the applicant's. Take, for example, the amended requirement in the LOC in the *Equitable Trust* case, which asked for the beneficiary's tender of a certificate of quality supplied by experts and signed by the Chamber of Commerce of Batavia.[158] It so happened that there was no Chamber of Commerce in Batavia. There was, however, a Commercial Association of Batavia which was in every respect, including legal status, the functional equivalent of chambers of commerce elsewhere. Invoking as discrepancies an improper and insufficient number of signatures, the applicant refused to reimburse the plaintiff bank. The Lords of Appeal held that the

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[155] Equitable Trusts Co. v. Dawnson Partners Ltd., (1927) 27 Lloyd's List L.R. 49, 52 (H.L.) (Eng.), *cited in* Boris Kozolchyk, *Is Present Letter of Credit Law Up to Its Task?*, 8 GEO. MASON L. REV. 285, 319 n.60 and accompany text (1985-1986).

[156] Fid. Nat'l Bank v. Dade County, 371 So. 2d 545, 546 (Fla. Dist. Ct. App. 1979).

[157] For the most recent version of INCOTERMS, see INT'L CHAMBER OF COMMERCE, INCOTERMS (2010), *available at* http://www.iccwbo.org/products-and-services/trade-facilitation/incoterms-2010/.

[158] *See* Kozolchyk, *Is Present Letter of Credit Law Up to Its Task?*, *supra* note 155, at 320 n.64 and accompanying text.

evidence indicated that the Commercial Association of Batavia could be regarded as the equivalent of a chamber of commerce.[159]

Thus, *Equitable Trust,* the paradigmatic version of judicial strict compliance, seemed ready to allow a certification by a "Commercial Association" instead of by a "Chamber of Commerce" once it was apparent that the former was the latter's functional legal equivalent. This functional legal equivalence of documents or terms may be interpreted either as an exception or as an approval of a version of strict compliance that acknowledges commercial and legal realities of the place of tender. Indeed, several UCP revisions have exempted paying banks from liability for having paid credits because of requirements of foreign law and usage.[160]

Third, the mirror image requirement is unhelpful when verifying that the statements in some documents are consistent with the statements in others. The mirror image examination assumes that these statements must be identical, whereas UCP 400 was based on the more liberal standard that the statements in one document are not inconsistent with those in the other.[161] Thus, a document checker who insisted on inter-documentary mirror image compliance violates the UCP's own standard of examination.

Fourth, mirror image examination is singularly damaging to the trustworthiness of the LOC undertaking when used by bad faith bankers or applicants to avoid the formers' failure of reimbursement and the latters' losses from a bad bargain. Accordingly, bad faith bankers resorted to mirror image examination to reject an otherwise complying tender of documents to prevent the loss caused by the lack of reimbursement by an insolvent applicant. To validate such bad faith practices in the name of strict compliance tips the contractual balance sharply in favor of applicants and against beneficiaries. It also undermines the indispensable trust among the correspondent banks.

As noted earlier, the roles and functions of correspondent banks are inherently interchangeable. Where roles and functions are so easily switched, retaliation is never out of the question and the fear of retaliation adds to the prevailing uncertainty. Moreover, if the issuing bank is deemed to have a right to raise such mirror image hypertechnicalities against the beneficiary or confirming bank, why should such a right be denied to the issuer's applicant in its refusal to reimburse the issuing bank that honored the LOC?

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[159] *See id.* at 320–21 n.65 and accompanying text.

[160] *Id.* at 321.

[161] Article 15 of UCP 400 states:

> Banks must examine all documents with reasonable care to ascertain that they appear on their face to be in accordance with the terms and conditions of the credit. Documents which appear on their face to be inconsistent with one another will be considered as not appearing on their face to be in accordance with the terms and conditions of the credit.

UCP 400 art. 15 (1983).

H. The Issuing Bank's Discretion to Approach the Applicant for a Waiver of Discrepancies

A sharp division of opinion existed between large "money center" and smaller inland banks in the United States on the acceptability of the issuing banks' approach to the applicant. The opposing camps agreed that the distrust felt by beneficiaries and many money center bankers on the one hand, and by inland issuing banks and their applicants on the other, had to be overcome. They also agreed that the principle of independent and neutral checking of documents by the banks had to be preserved, but did not agree on what the issuing bank could say about the nature of the discrepancy to the applicant or when it could be said.

One of the lawyers of the Working Group proposed a combination of rights and duties based on the following principles: first, the issuing bank that approached its applicant for a waiver was expected to act as a fiduciary for both the beneficiary and the applicant. Second, the issuing bank's fiduciary duties stemmed from being allowed to utilize *its sole judgment* on whether to approach the applicant and what to disclose about the discrepancies and when. This fiduciary duty was to be discharged reasonably and reasonableness would determine the timing of the approach based upon considerations, such as the curability of the discrepancy and the time it would take to cure it. The result was Article 14(b) and (c) of UCP 500, which in relevant part stated:

> b. Upon receipt of the documents the Issuing Bank and/or Confirming Bank, if any, or a Nominated Bank acting on their behalf, must determine on the basis of the documents alone whether or not they appear on their face to be in compliance with the terms and conditions of the Credit . . . .
>
> c. If the Issuing Bank determines that the documents appear on their face not to be in compliance with the terms and conditions of the Credit, it may in its sole judgment approach the Applicant for a waiver of the discrepancy(ies).

I. Consequences of the Judicial Mirror Image Compliance: Costly Defensive Practices

The uncertainty of the judicial standard of strict compliance and the likelihood of confirming banks being saddled with the risk of not being reimbursed as a result of bad faith discrepancies caused a large number of banks to adopt highly defensive examination practices. Some confirming banks refused to confirm foreign irrevocable credits without full pre-payment and waiver of discrepancies. Negotiating banks were unwilling to negotiate beneficiaries' drafts without specifying their recourse against the beneficiary. Others were only willing to act as collecting agents and not as negotiating banks for beneficiaries.

The same was true with confirming and negotiating banks, which instructed their document checkers to reject any questionable tender and to list as many discrepancies as possible for submission by the issuing bank so that it obtained a waiver of all possible discrepancies from its applicant. A growing number of issuing banks inserted clauses in their application agreements that authorized their payment and reimbursement regardless of discrepancies. Not surprisingly, document checkers also increased their reliance on bank counsel for everyday documentary compliance decisions, frequently replacing sensible banking practices with hypertechnical legal excuses for non-acceptance or payment of the LOCs in anticipation of possible lawsuits.[162]

VIII. THE UCP 500'S RESPONSE TO BAD FAITH DISCREPANCIES: THE INTERNATIONAL STANDARD BANKING PRACTICE

UCP 500's response to the proliferation of bad faith discrepancies encouraged by the mirror image version of strict compliance was provided by Article 13(a), which in relevant part stated:

> Banks must examine all documents stipulated in the Credit with reasonable care, to ascertain whether or not they appear, on their face, to be in compliance with the terms and conditions of the Credit. Compliance of the stipulated documents on their face with the terms and conditions of the Credit, shall be determined

[162] In July 1987, *Letter of Credit Update* published a survey of documentary compliance practices in the United States. Bankers were asked what percentage of documents presented by the beneficiaries or beneficiaries' banks contained discrepancies. *See Reader Survey Brings Out Reactions to Minor Discrepancies*, 3 LETTER OF CREDIT UPDATE 13, 14 (1987); *see also* James E. Byrne, *Letters of Credit*, 43 BUS. LAW. 1353, 1355–56 (1988); *Beginning a Series on Discrepancies: Five Timely Steps*, 1 LETTER OF CREDIT UPDATE 10 (1985); *L/C Update Trends, Issues & Allerts*, 3 LETTER OF CREDIT UPDATE 2, ¶ 2 (1987); *Chase Looks at Discrepancies*, 3 LETTER OF CREDIT UPDATE 15 (1987). The majority of the respondents indicated that 90% of the documents initially tendered contained discrepancies. A similar survey conducted by this writer in the 1970s among representative bankers of major financial centers produced estimates in the same range. *See* Kozolchyk, *Letters of Credit*, *supra* note 151, at 14, 149. While most perceived discrepancies were eventually cured or waived (estimating that the number of incurable tenders was no more than 1%), the high rate of widespread initial rejection was responsible for high transactional costs. SITPRO, a British international trade facilitation entity, estimated in 1985 that the annual cost to English exporters of correcting LOC discrepancies was approximately 50 million pounds. SITPRO, LETTER OF CREDIT MANAGEMENT AND CONTROL 1 (1985). The high rate of rejection and cure also caused higher operational costs for LOC banks whose review and correction of documents continued to be highly labor intensive. The highest operational cost of all, however, was the distrust fueled by the perception that the irrevocable confirmed LOC was no longer the reliable means of payment and finance it was a generation earlier. A bank could no longer take for granted its correspondent's cooperation, good faith and reasonableness.

> by international standard banking practice as reflected in these Articles.[163]

A question raised by lawyers and judges alike throughout the LOC world was: where do we find such a standard practice? The first such compilation was prepared in 1996 by the above mentioned USCIB, the Mexican Bankers' Association, and the National Law Center for Inter-American Free Trade. It was labeled *Standard Banking Practice for the Examination of Letter of Credit Documents* (SBPED).[164]

The SBPED reflected the requirements of UCP 500, but as a harmonized set only for the United States' and Mexican checking practices. A worldwide harmonization of practices came about in 2002 when most of the other national association members of the ICC summarized the most widely observed documentary examination practices into what was named the International Standard Banking Practice (ICC Publication 645).

IX. FACTORS THAT DETERMINE DOCUMENTARY CHECKING PRACTICES

A. Extrinsic Factors

The volume of daily examinations of LOC documents could be as high as 20 LOC presentations per day in a money center bank and a handful per day in inland banks. This factor alone was responsible for a more distant or closer relationship between the document checker, the beneficiary or the beneficiary's bank, and last but not least, the applicant.

Thus, the directive of Article 16(b) of UCP 400 to the document checker to establish compliance "*on the basis of the documents alone*" resonated more naturally with a document checker of a money center bank than with his inland bank colleague.[165] The last time I visited the document checking shop of the Manufacturers Hanover Bank in lower Manhattan, one the busiest LOC checking departments in the United States at that time, I must have been the only non-document checker present in a hall that housed dozens of checkers, their eyes glued solely to their sets of documents and their respective LOCs. By contrast, the atmosphere in the three inland banks I visited was quite different. Document checkers were usually also in charge of advising, issuing, or confirming LOCs. They were much fewer in number than those in the money center banks and their LOC applicants or beneficiaries could easily access them. In two of these three banks, the document checkers also advised their applicants on how to draw the

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[163] UCP 500 art. 13(a).

[164] *See* Boris Kozolchyk, *Foreword* to U.S. COUNCIL ON INT'L BANKING, INC., STANDARD BANKING PRACTICE FOR THE EXAMINATION OF LETTER OF CREDIT DOCUMENTS (1996).

[165] UCP 400 art. 16(b) (emphasis added).

terms and conditions of an LOC in a manner in which they were protected from a fraudulent beneficiary. Clearly, these inland bankers were not the isolated paymasters envisaged by Bernard Wheble's Article 13 of the 1962 revision, which made the applicant responsible for precise instructions on "the documents against which payment, acceptance or negotiation is to be made"[166] and led to a practice of accepting tenders that, albeit in compliance with stated instructions, did not make much sense to an experienced applicant or document checker.

B. Intrinsic Factors: Archetypal Bad and Good Faith Bankers

The most important intrinsic factors in the viability of document checking practices are the checker's knowledge of the LOC business, his skill, and his integrity.

1. Bad Faith Bankers

As we discussed earlier, the mirror image version of document examination provides an easy cover for bad faith practices and for the temptation to use such practices by invoking hypertechnical reasons not to pay. This temptation is not exclusive to applicant-buyers. It also affects the document checker who finds out that his applicant is unable or unwilling to reimburse him.

2. Honest, but Selfish Bankers

The selfish document checker acts honestly when he detects a discrepancy that on its face is serious enough to warrant rejection. But he is selfish when he decides not to approach the applicant for a waiver of a discrepancy that in his judgment the applicant would be likely to waive because it might expose him to possible risks. He is aware that Article 14 of UCP 500 allows him "in his sole judgment (to) approach the applicant for a waiver of the discrepancy."[167] But he is also aware that there are some risks inherent in this approach, although these are risks that an archetypal reasonable document checker would be willing to assume, as illustrated in the practice commentary by Vincent Maulella, one of the United States' most respected LOC document checkers.[168]

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[166] INT'L CHAMBERS OF COMMERCE, UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS, UCP No. 222, art. 13 (1962) [hereinafter UCP 222] ("All Instructions to issue, confirm, or advise a credit must state precisely the documents against which payment, acceptance or negotiation is to be made.").

[167] UCP 500 art. 14(c).

[168] Vincent M. Maulella, *UCP Art 16 Proposal on Notifying the Applicant*, 7 LETTER OF CREDIT UPDATE 6, 6–9 (1991).

3. A Reasonable Document Checker

In making the decision to approach the applicant for a waiver, Maulella's archetypal banker would have acted reasonably because he would take into consideration not only the interests of his client-applicant, but also those of the beneficiary or "other" party in the LOC transaction. Contrary to the bad faith document checker, the archetypal reasonable document checker's highest duty is to the integrity and reliability of the LOC promise: as a knowledgeable, trusted paymaster, and critical participant in the nuclear LOC transaction, he would try to find ways to pay a beneficiary who tendered documents that in the eyes of other reasonable document checkers should have been acceptable to their applicants, and, if not acceptable, could have been rejected by them in a timely manner.

As noted earlier, a reasonable document checking practice belongs to the family of fair practices, but the latter encompasses more market participants than does the former by including not only the actual participants in the transaction, but also third parties likely to be affected by it.

X. SUMMARY AND CONCLUSION

The first group of questions posed in the introductory section of this article pertained to the elements of a viable LOC practice: 1) How did this practice come about and what were its nuclear elements? 2) Why were some practices and their mutations viable and others were not? The second set of questions pertained to the most appropriate drafters of these practices: 3) Who were they, and how helpful were lawyers as drafters or co-drafters?

In answer to the first question, we should keep in mind that the reason for the LOC was to replace unreliable promises of payment made by distant buyers who were often unknown to their sellers. When issued as an irrevocable, primary, and independent promise by banks of known solvency, the LOC provided the reliability sought by seller-beneficiaries and holders in due course of the drafts. Accordingly, the first nuclear element of the LOC promise was the issuing and confirming banks' promises to accept or pay the seller-beneficiary's draft when accompanied by specified documents. Transactionally speaking, this firm promise was an initial giving of something of value without receiving *immediate* comparable value from the beneficiary. In fact, the beneficiary could have ignored the issuance of the LOC without incurring any liability to the issuing bank. However, this initial giving by the issuing bank cemented the trustworthiness of the LOC transaction for all the subsequent participants.[169]

[169] On the pioneering validation of firm promises in the BGB, see KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 14, chs. XI, XII. On the validation of a firm promise to accept a draft despite the absence of past consideration in the English common law, see the discussion of Lord Mansfield's Pillans decision in KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 14, ch. XXI(G)(2).

The second nuclear element of the LOC promise was the beneficiary's tender of the set of documents specified in the LOC. A crucial feature of this tender was that the documents had independent value; independent, that is, from the value of the goods to which they referred. This value was measured by their acceptability to document checkers as in compliance with the LOC requirements and by providing, in the case of the negotiable ocean bill of lading, the symbolic "key" with which to obtain the goods shipped. Since this second nuclear element was predicated upon trust, each of the nuclear participants had to act honestly and reasonably: the beneficiary was trusted to make a good faith tender of documents that would meet the requirements of the LOC and the reasonable expectations of the issuing bank and its applicant, the document checker was trusted to exercise reasonable care and good faith in his examination of the documents, and the applicant was trusted by the issuing bank to act in good faith when reimbursing it and doing so in a reasonably timely manner.

The answer to the second question then is that for the LOC nuclear practice to be viable, its elements must be part of a balance between selfish (profitable) and altruistic promises and performances that is acceptable to the participants in the transaction, including banks as well as merchants, and their intermediaries, including carriers and insurers. This balance, initiated by the altruistic giving of a firm commitment by the issuing bank, can produce not only standard practices or the practices acceptable to the regular or everyday participants in the transaction, but also best practices. These practices are the ones that reflect not only the interests of regular participants, but also protect third parties from discriminatory or unfair practices, such as the one that excluded freight forwarders who did not belong to an arbitrarily selected organization.

Examples of nuclear practices that lost or could have lost their viability as a result of the disruption of an agreed upon balance abound. Consider, for example, the mutation introduced by Article 10(a)(i) of UCP 400, which allowed an irrevocable LOC to promise "to pay or that payment will be made . . . ." This mutation upset the acceptable balance of a nuclear LOC promise that must be certain, documentary, and independent. One of the questionnaires I circulated prior to the drafting of UCP 500 asked whether banks would be willing to confirm LOCs that contained words to the effect that the issuer "would see to it or procure that payment would be made." Not surprisingly, there were no willing confirmers of such a promise.

The question about the most appropriate drafters of standard and best practices and about the role of lawyers as co-drafters was also answered by the UCP 500 experience. Clearly, the principal drafters of commercial and financial practices are its *boni viri*, the most experienced, knowledgeable, and respected practitioners: the Wilbert Wards, Frank Sauters, Bernard Whebles, Charles del Bustos, and Vincent Maulellas of the banking world, whose courses of dealing are capable of creating viable usages of trade because of their cost effectiveness, honesty, reasonableness, and fairness.

However, the UCP 500 experience also showed that lawyers thoroughly familiar with LOC practices have much to contribute to the drafting of rules based on these practices. Their role is made possible not only by their familiarity with banking practices and the law applicable to them, but also by their mastery of the logic of the reasonable.[170] The understanding of the transactional facts and their legal implications, as well as the mastery of the logic of the reasonable, enabled the lawyers who participated in the drafting of UCP 500 to act as devil's advocates testing the legality, reasonableness, and fairness of existing or proposed practices. It also enabled them to draft rules that harmonized the opposing groups of bankers, such as large money-center banks and smaller inland banks, with respect to the practice of approaching the applicant for his waiver of discrepancies. It was a lawyer's understanding of the fiduciary duties the law imposes upon a party entrusted with decisions that could seriously affect the interests of the entrusters and their clients that made the wording of UCP 500 Article 14(c) acceptable.[171] It also made possible the viability of the new practice to this day. Among these practices were self-help remedies, such as preclusion and abandonment of goods, when the issuing or confirming banks failed to pay or rejected the documents in a timely and reasonable manner.

What can be learned from the comparison of Roman secured lending and contemporary LOC bankers' practices? The first lesson is the importance of equality among the participants in the practice. The equality I am referring to pertains not necessarily to the parties' economic or political bargaining power; it refers to the equality of their transactional functions. The Roman secured lenders' attempt to create viable extra-judicial practices that would facilitate the quickest repayment of their loans and/or the easiest and cheapest way to acquire the property of their borrowers was doomed by both inequalities. The second of these inequalities was the subordination of the borrowers (small farmers and tenants) to their landowners-creditors' directions on the functions assigned to them by the lenders. This dual inequality was responsible for the one-sidedness, harshness, and corruption evidenced by the secured lending practices and especially by sale and acquisition of collateral practices. Eventually, these practices led to contradictory rules and legal invertebration, and to Constantine's decision to invalidate them as "captious" and "harsh" practices deserving to have their memory abolished.

And while it is true that the largest and busiest participants in a commercial or financial practice are often its most influential drafters, their influence is usually tempered by the interchangeability of their functions. Unlike the subordinated and fixed duties of the Roman small farmers and tenant-borrowers, during a typical business day of a small LOC banker, he would act as an issuer of an LOC that would be confirmed, negotiated, or paid by a much larger correspondent bank and vice versa. Such an interchangeability of functions requires a modicum of reasonableness from all of the participants in the LOC transaction because all these participants are potential "others" in the eyes of their correspondents and whatever they reasonably expect for themselves, they must also expect for the others in whose shoes they may find themselves at any time.

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170 *See* KOZOLCHYK, COMMERCIAL CONTRACTS, *supra* note 14, ch. II § 2(B).
171 *See id.* § VII(H).

The second lesson is a corollary of the first: the larger the number of trades or professions involved in drafting a common practice, the larger are the bargaining and functional inequalities, and the harder is the task of drafting and the greater the need for legal participation. At NLCIFT, we learned this lesson while drafting the practices for the carriage of goods by truck among Canada, the United States, and Mexico.[172] Quite often, lawyers had to mediate between the opposing interests of shippers (small and large) and then between shippers and carriers (small and large). And if this were not hard enough, the interests of the insurers for the above groups also had to be satisfied. This lesson suggests that participants in the same trade or profession should be involved in the first attempt at drafting commercial and financial practices. And even when a multi-trade or profession is attempted as it was with NASTRAPS, it is much easier to agree on viable multi-sector or professional practices when their respective practices have been agreed upon. The importance of functional sectoral or professional equality highlights the role of a neutral host, such as the ICC or the NLCIFT for the drafting of the practices. Among the most important functions of such an entity is establishing the transactional facts, including the most accurate terminology possible and a catalogue of the most pressing disputes and issues. It also emphasizes the importance of furthering cross-sectoral equality of bargaining by educational and training efforts of those with the least knowledge and experience. For example, at NLCIFT we are planning to train micro and small borrowers in the use of real life line-of-credit secured financing with the help of bankers and law and business school graduates. At the same time, accountants will help borrowers develop reliable financial statements acceptable to bankers, and bankers will develop manuals of best practices for secured lending. These educational and training efforts should contribute to the birth of new viable standards and best practices of secured lending.

There are many more lessons to be learned from what has been discussed, but time and space only allow for a third lesson. Underlying all the lessons learned in this article is the universality and permanence of Lord Mansfield's dictum, which I have paraphrased proverbially as "a fair price calls for a fair warranty." No viable commercial or financial practice can ignore this dictum. But what is fair is not the result of a mathematical or even algebraic calculus; it is the result of honesty and reasonableness. In fact, I must re-emphasize the importance of Karl Llewellyn's definition of commercial good faith as including: honesty, reasonableness, and fairness. And this good faith can have no better guardian than a commercial lawyer who understands the facts of a practice as well as its governing law and its economic reason for being.

Regretfully, there are too many lawyers who view their role, when drafting or approving commercial and financial practices, as that of shielding their commercial or banking clients from liability at all costs. Consider, for example, the responsibility of a lawyer who is aware that his client sold goods, services, or

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172 NATIONAL LAW CENTER FOR INTER-AMERICAN FREE TRADE, NORTH AMERICAN STANDARD TRANSPORTATION PRACTICES: A GUIDE TO TRUCK TRANSPORTATION (Gary T. Doyle ed., 1998).

commercial paper (including the thousands who not long ago sold or brokered the sale of "sub-prime" mortgage-backed securities) that were intrinsically worthless. Assume that this lawyer was aware that the worthless item was sold as if it had considerable intrinsic value. Should not such a lawyer have to bear the same responsibility of his dishonest, bad faith client? If he is not willing to be the guardian of the legality, reasonableness, and good faith of a practice whose legal clothing he supplies or approves, who will?