



Ohio Legislative Service Commission

122nd House Bill Analysis

H.B. 338

122nd General Assembly
(As Introduced)

Reps. Callender, Womer Benjamin, Garcia, Batchelder, Clancy, Gardner, Wise, Amstutz, Buchy, Harris, Tiberi

- Revises the Letter of Credit Law by adopting Revised Article 5 of the Uniform Commercial Code--Letters of Credit.
- Makes substantive and conforming changes to Article 9--Secured Transactions and other provisions of the Uniform Commercial Code.

CONTENT AND OPERATION

Overview and scope

Existing Chapter 1305. of the Revised Code governs the rights and duties of parties to letters of credit. Generally, the purpose of a letter of credit is to substitute a financial institution's credit for that of its customers in domestic and foreign commercial transactions. A letter of credit provides "a practical method of financing in the common situation where a buyer in one location desires to purchase goods from a seller in another and each party desires to protect himself as fully as possible." Typically, "a bank that issues a letter of credit undertakes that it will pay any draft drawn and negotiated pursuant to its terms, thus merely selling its credit. In other words, a letter of credit ordinarily engages the credit of the issuer in support of an indebtedness of the customer to the beneficiary." (23 O Jur 3d, Credit Cards and Letters of Credit §§7 and 8.)

Under the bill, "letter of credit" means a definite undertaking, in compliance with the bill's formal requirements, by an issuer to a beneficiary at the request or for the account of an applicant or, in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or delivery of an item of value (sec. 1305.01(A) (10)). The bill proposes to revise the law governing letters of credit by adopting Revised Article 5--Letters of Credit of the Uniform Commercial Code approved by The American Law Institute and National Conference of Commissioners on Uniform State Laws in 1995. According to the Prefatory Note accompanying the 1995 Official Text of Revised Article 5, the goals of the proposed law are (1) to conform the law to current practices and customs, (2) to accommodate new forms of letters of credit and new technology, particularly the use of electronic media, (3) to maintain letters of credit as an inexpensive and efficient means of facilitating domestic and international trade, and (4) to provide a means of resolving conflicts between "reported decisions." The bill proposes the adoption of new Chapter 1305., and makes changes to existing laws that apply to letters of credit such as the Secured Transactions Law (Chapter 1309.) and other provisions of Ohio's Uniform Commercial Code (secs. 1301.05 and 1302.56).

The analysis categorizes the changes proposed by Revised Article 5 by subject matter, as follows: (1) general provisions, (2) issuance of a letter of credit, (3) rights and duties of issuers, confirmers, beneficiaries, and applicants, (4) transferability; the rights of a successor beneficiary; and assignability, and (5) enforcement: statute of limitations, choice of law, and subrogation. The sections are characterized as either "based on current law" or as a "new provision." The characterization of a provision as "based on current law" means that the subject matter proposed is addressed in some manner by current law. A "new provision" addresses subject matter that is not included in current law. The designations are intended to identify subject matter that can be compared with provisions in current law and to highlight subject matter that would be new to the Letter of Credit Law.

The bill also makes conforming and substantive changes to Article 9--Secured Transactions (Chapter 1309. of the Revised Code). The analysis outlines and briefly describes the sections of Chapter 1309. that are affected by the bill and characterizes each section in the manner described above.

Finally, the analysis discusses the effective date of the bill's provisions and the application of those provisions to letters of credit issued before that date.

Revised Article 5

General provisions

1305.01 Includes definitions for purposes of the Letter of Credit Law (Chapter 1305.). The definitions include: adviser, applicant, beneficiary, confirmer, dishonor, document, good faith, honor, issuer, letter of credit, nominated person, presentation, presenter, record, and successor of a beneficiary. Also, specifies that "accept" and "acceptance" are to have the same meanings as under the Negotiable Instruments Law (sec. 1303.46) and "value" is to mean the same as under the Negotiable Instruments and the Bank Deposits and Collections Laws (secs. 1303.33 and 1304.21). Additional general definitions and principles of construction and interpretation are to be supplied by the General Provisions that apply to Commercial Transactions Law (Chapter 1301.). (New provision.)

1305.02 Provides for the application of Article 5 and rights and obligations arising out of letter of credit transactions. (Based on current law.)

1305.03 Specifies that a letter of credit, confirmation, advice, transfer, amendment, or cancellation may be issued in any form that is a record and authenticated by a signature or by agreement between the parties or the standard practice of the parties as provided by the bill. (Based on current law.)

1305.04 Specifies that consideration is not required to issue, amend, transfer, or cancel a letter of credit, advice, or confirmation. (Based on current law.)

Issuance of a letter of credit

1305.05 Provides for the issuance, amendment, and revocability of a letter of credit. Specifies when a letter of credit is considered issued and provides for the expiration of a letter of credit. (New provision.)

Rights and duties of issuers, confirmers, beneficiaries, and applicants

1305.07 Sets forth the rights and duties of an issuer after presentment of a letter of credit. Requires an issuer to honor a presentation provided that the letter of credit on its face strictly complies with the standards and conditions of the letter of credit, unless otherwise agreed with an applicant. Provides that an issuer's acceptance of a letter of credit is subject to the bill's provisions dealing with forgery and material fraud and the successor of a beneficiary's rights and duties. Defines "presentation" to mean the delivery of a document to an issuer or nominated person for honor or giving of value under a letter of credit, and "applicant" to mean, in part, a person at whose request or for whose account a letter of credit is issued (sec. 1305.01(A)(2) and (12)). (New provision.)

1305.06 Specifies the rights and duties of a confirmer, nominated person, or an adviser, and also the rights and obligations of a person who notifies a transferee beneficiary of the terms of a letter of credit, confirmation, amendment, or advice. (Based on current law.)

Fraud or forgery

1305.08 Sets forth the rights of an issuer or applicant if a required document is forged or materially fraudulent or if honoring a presentment of a letter of credit would facilitate a material fraud by the beneficiary on the issuer or applicant, including the right of a court to temporarily or permanently enjoin the issuer from honoring the presentment of a letter of credit or to grant similar relief to an applicant. Makes a conforming change in another provision of Ohio's Uniform Commercial Code (sec. 1302.56) to specify that the nonconformity of goods does not excuse payment, unless the enforcement of a letter of credit is enjoined under the provisions addressing fraud or forgery. (Based on current law.)

1305.09 Specifies that in addition to warranties arising under Negotiable Instruments, Bank Deposits and Collections, Warehouse Receipts and Bills of Lading, or Investment Securities Laws, a beneficiary of a letter of credit warrants that there is no fraud or forgery of a kind described in the bill and that the drawing of a letter of credit does not violate any agreement with the applicant or any other agreement intended to be augmented by the letter of credit. (Based on current law.)

Transferability; the rights of a successor of a beneficiary; and assignability

1305.11 Provides that, except as is provided by the bill's provision dealing with the rights of a successor of a beneficiary, and unless a letter of credit provides otherwise, a letter of credit may not be transferred. Also, permits an issuer to refuse to recognize or carry out a transfer, if the letter of credit provides for transferability and if: (1) the transfer would violate applicable law, or (2) the transferor or transferee fails to comply with any requirement that is stated in the letter of credit, or the requirement is imposed by the issuer and within the standard of practice as set forth by the bill or reasonable under the circumstances. (Based on current law.)

1305.12 Sets forth the rights and duties of a successor of a beneficiary to consent to amendments, sign and present documents, and receive payment or other items of value. Also, sets forth the rights of an issuer or beneficiary if a

successor of a beneficiary is named. (New provision.)

1305.13 Sets forth the right of a beneficiary to assign its right to part or all of the proceeds of a letter of credit, provided that the assignment meets specified requirements. Defines "proceeds of a letter of credit" to mean the cash, check, accepted draft, or other item of value paid or delivered upon honor or giving of value by the issuer or any nominated person under the letter of credit. Also, specifies the rights of issuers, nominated persons, and transferee beneficiaries with regard to the assignment of a beneficiary's right to proceeds. (Based on current law.)

Enforcement: wrongful dishonor, statute of limitations, choice of law, and subrogation

1305.10 Provides for the rights of a beneficiary, successor, or nominated person if an issuer wrongfully dishonors or repudiates its obligation to pay money under a letter of credit before presentation, including providing for damage claims, interest, attorney's fees, and other litigation expenses. (Based on current law.)

1305.14 Provides that an action to enforce a right or obligation arising under the bill's provisions must be commenced within one year after the expiration date of the letter of credit or one year after the cause of action. (New provision.)

1305.15 Deals with choice of law issues concerning letters of credit, which include consideration of provisions in the letter of credit and the effect of rules of custom or practice. Also, makes a change in another section of Ohio's Uniform Commercial Code (sec. 1301.05) to reflect that choice of law considerations as to letters of credit are to be governed by proposed section 1305.15. (New provision.)

1305.16 Specifies subrogation rights of issuers, applicants, and nominated persons. (New provision.)

Revised Article 9

In addition to the revision of Article 5, the bill proposes conforming and substantive changes to the provisions of Article 9-Secured Transactions (Chapter 1309. of the Revised Code). The changes generally address the protection of the right to proceeds of a letter of credit as against other creditors.

1309.01 Specifies definitions of "letter of credit" and "proceeds of a letter of credit" that are to apply in the Secured Transactions Law, based on the bill's definition of these terms in its revision of Chapter 1305. (New provision.)

1309.03 Deals with the perfection of security interests in the right to proceeds of a letter of credit. (New provision.)

1309.04 Specifies that the Secured Transactions Law (Chapter 1309.) does not apply to a transfer of an interest in a letter of credit other than the rights to proceeds of a letter of credit. (New provision.)

1309.23 States that a security interest in the right to proceeds of a letter of credit may be perfected only by the secured party taking possession of the letter of credit. (New provision.)

1309.24 States that a security interest in the right to proceeds of a letter of credit that is assigned may be perfected by the secured party taking possession of the letter of credit, and eliminates the provision providing for perfection of advices of credit. (Based on current law.)

Effective date

(Sections 3, 4, and 5)

The bill states that it becomes effective on July 1, 1998. The bill further provides that it does not apply to a transaction, event, obligation, or duty arising out of or associated with a letter of credit issued before July 1, 1998, and also provides that a transaction arising out of or in association with a letter of credit issued before that date and the rights, obligations, and interests flowing from that transaction are governed by the law that existed before July 1, 1998.

HISTORY

ACTION DATE JOURNAL ENTRY

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