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Banking - Wyoming Adopts the Rule of Strict Compliance with Terms Contained in a Letter of Credit - Security State Bank of Basin v. Basin Petroleum Services, Inc.

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BANKING—Wyoming Adopts the Rule of Strict Compliance with Terms Contained in a Letter of Credit. *Security State Bank of Basin v. Basin Petroleum Services, Inc.*, 713 P.2d 1170 (Wyo. 1986).

On November 12, 1982, Basin Petroleum Services, Inc. (Basin) contracted to manufacture hay baling equipment for Round Bale Rail, Inc. (RBRI). The agreement required RBRI to provide Basin with a letter of credit from a bank, guaranteeing payment for the equipment. On November 18, 1982, Security State Bank of Basin (Bank) issued a letter of credit in favor of Basin.¹

The Bank conditionally agreed to pay Basin for purchase orders which were not paid by RBRI. One of several conditions was that the Bank "must have a copy of each purchase order submitted by RBRI to Basin prior to production commencing on any new machinery."²

Over the next four months, Basin manufactured baling equipment for RBRI under four separate purchase orders. The purchase orders did not strictly comply with the requirements of the letter of credit. Basin failed to provide the Bank with either the third or fourth purchase order.³ Basin made no demand for payment of any of the purchase orders because the Bank loaned funds to RBRI to pay Basin. On June 30, 1983, Basin presented a fifth purchase order dated May 3, 1983, and demanded payment from the Bank under that purchase order. The Bank refused to honor Basin's demand, claiming Basin had not strictly complied with the requirement that a copy of the purchase order be sent to the Bank before commencing production of the equipment.⁴ Basin sued to recover under the letter of credit.⁵

The trial court found that an issuing bank can demand strict compliance with a letter of credit's terms. However, it also ruled that the Bank was estopped from demanding strict compliance on the fifth purchase order because it did not object to the lack of compliance by the first four purchase orders.⁶

On appeal, the Wyoming Supreme Court reversed, in a 3-2 decision. The court upheld the rule that strict compliance with a letter of credit's terms is necessary to obligate the issuing bank to pay the demand. It also held that Basin could not claim estoppel because Basin knew that payment was conditioned on the Bank's receiving a copy of the purchase order before beginning production of the equipment. In addition, Basin presented no evidence that it had changed its position in reliance on the Bank's past waiver of strict compliance.⁷

1. *Security State Bank of Basin v. Basin Petroleum Serv., Inc.*, 713 P.2d 1170, 1170-71 (Wyo. 1986).

2. *Id.* at 1171.

3. *Id.* at 1173.

4. *Id.* at 1171. The Bank also claimed that the purchase order did not refer to the letter of credit. This was not an issue because the purchase order was not timely presented to the Bank.

5. *Id.*

6. *Id.*

7. *Id.* at 1172.

This casenote will review the commercial usage of letters of credit. It will discuss the reasoning of courts adopting either the strict or the substantial compliance standard. The two standards will be compared, and the effect each standard has on letters of credit will be addressed. This casenote will not discuss estoppel, a defense to wrongful dishonor of a demand for payment.⁸

BACKGROUND

A letter of credit is "an engagement by a bank or other person made at the request of a customer . . . that the issu[ing bank] will honor . . . demands for payment upon compliance with the conditions specified in the credit."⁹ A letter of credit involves three parties:¹⁰ a customer,¹¹ an issuing bank,¹² and a beneficiary. A customer is a "buyer or other person who causes an issu[ing bank] to issue a credit."¹³ An issuing bank is a "bank or other person issuing the credit."¹⁴ A beneficiary is a person who can demand payment under the letter of credit.¹⁵

A letter of credit normally involves three distinct agreements. First, the customer and beneficiary enter into a contract underlying the letter of credit. Second, the customer and issuing bank contract for the issuance of the letter of credit. That contract governs the terms of the letter and how the customer will reimburse the issuing bank for payments made under the letter. Last, the issuing bank issues the letter of credit. The letter of credit obligates the issuing bank to pay the beneficiary when a demand is made and when accompanied by other documents required by the letter.¹⁶

There are two types of letters of credit. The classic letter contemplates that the issuing bank will pay when the beneficiary complies with the letter's terms. The standby letter contemplates that the issuer will pay only when the customer fails to pay the beneficiary in the underlying contract.¹⁷ The letter in *Security State Bank of Basin v. Basin Petroleum Services, Inc.* was a standby letter of credit.¹⁸

8. See generally *U.S. Indus. v. Second New Haven Bank*, 462 F. Supp. 662 (D. Conn. 1978) (discussing the beneficiary's right to invoke estoppel when an issuing bank represents that documents comply but later refuses to pay the beneficiary because the documents do not strictly comply).

9. WYO. STAT. § 34-21-503(a)(i) (1977); U.C.C. § 5-103(1)(a), 2A U.L.A. 229 (1977).

10. Harfield, *The Increasing Domestic Use of the Letter of Credit*, 4 U.C.C. L.J. 251, 257 (1972).

11. *Id.* at 258. Harfield refers to the customer as the account party throughout the article.

12. *Id.* Harfield refers to the issuing bank as the issuer in the article.

13. WYO. STAT. § 34-21-503(a)(vii) (1977); U.C.C. § 5-103(g), 2A U.L.A. 229 (1977).

14. WYO. STAT. § 34-21-503(a)(iii) (1977); U.C.C. § 5-103(c), 2A U.L.A. 229 (1977). The statute and uniform law actually define an "issuer." The casenote author will call the "issuer" an "issuing bank" throughout this casenote because most cases involve a bank as the issuer of a letter of credit.

15. WYO. STAT. § 34-21-503(a)(iv) (1977); U.C.C. § 5-103(d), 2A U.L.A. 229 (1977).

16. Venizelos, *S.A. v. Chase Manhattan Bank*, 425 F.2d 461, 464-65 (2d Cir. 1970).

17. Harfield, *supra* note 10, at 258.

18. 713 P.2d 1170, 1171 (Wyo. 1986). The letter of credit stated, "If RBRI fails to pay Basin under the terms of their separate agreement . . . Security Bank will remit to Basin the amount of that purchase order."

A letter of credit facilitates financing of an underlying transaction between a beneficiary and a customer whose credit rating is unknown or questioned by the beneficiary.¹⁹ The credit rating of the issuing bank substitutes for that of the customer. The collection and litigation costs shift from the beneficiary to the customer.²⁰ Issuing banks charge a nominal fee for issuing letters of credit.²¹ The letter of credit is a widely accepted credit tool because payment to the beneficiary is independent from his performance on the underlying contract. Consequently, the beneficiary is paid when he complies with the letter's terms.²²

In most jurisdictions, letters of credit are governed by Article 5 of the Uniform Commercial Code (U.C.C.).²³ Wyoming has adopted Article 5 of the U.C.C. in sections 34-21-501 to -517 of the Wyoming Statutes.²⁴ Section 34-21-509 defines an issuing bank's obligation to its customer. The issuing bank must examine documents and ascertain that on their face they comply with the letter's terms.²⁵ The issuing bank's duty is limited to that examination for compliance.²⁶

Section 34-21-514 defines the issuing bank's duty to the beneficiary. Subsection (a) states, "An issu[ing bank] must honor a . . . demand for payment which complies with the terms of the letter of credit, regardless of whether the goods or documents conform to the underlying contract . . . between the customer and the beneficiary."²⁷ This section recognizes the independence between the letter of credit and the underlying transaction.²⁸ The issuing bank's duty is to honor demands for payment solely

19. Dolan, *Strict Compliance with Letters of Credit: Striking a Fair Balance*, 102 *BANKING L.J.* 18, 26 (1985). Dolan refers to the customer as the account party throughout the article.

20. *Id.* The beneficiary is usually a seller. The customer is usually a buyer. In a normal contract, the seller delivers performance and waits for payment. If the buyer does not pay, the seller bears the cost of collection and litigation. In a letter of credit transaction, the seller delivers documents to the issuing bank and is paid. If goods or services are not delivered or accepted, the buyer bears the cost of collection and litigation to have his funds returned.

21. The casenote author was a banker for fifteen years. His experience is that issuing banks charge a fee ranging from one-quarter to one and one-half percent of the amount of the letter of credit.

22. *Dovenmuehle, Inc. v. East Bank of Colo. Springs*, 38 *Colo. App.* 507, 563 P.2d 24, 28 (1977).

23. 7 R. ANDERSON, *UNIFORM COMMERCIAL CODE* § 5-102:2 (3d ed. 1985). Anderson notes that Alabama, Arizona, Missouri, and New York have modified U.C.C. § 5-102 from the official code. Their versions read that, unless otherwise agreed, this article does not apply to a letter of credit or a credit if 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 by any subsequent Congress of the International Chamber of Commerce. See *ALA. CODE* § 7-5-102(4) (1975); *ARIZ. REV. STAT. ANN.* § 47-5102(D) (1986); *MO. ANN. STAT.* § 400.5-102(4) (Vernon 1965); *N.Y. U.C.C. LAW* § 5-102(4) (McKinney 1963).

24. *WYO. STAT.* §§ 34-21-501 to -517 (1977); *U.C.C.* §§ 5-101 to -117, 2A *U.L.A.* 221-79 (1977).

25. *WYO. STAT.* § 34-21-509(b) (1977); *U.C.C.* § 5-109(2), 2A *U.L.A.* 246 (1977).

26. *U.C.C.* § 5-109, comment 2, 2A *U.L.A.* 247 (1977). The comment indicates the standard of performance can be modified by agreement if not manifestly unreasonable. Wyoming did not adopt the U.C.C.'s official comment when it enacted the U.C.C. See 1961 *Wyo. Sess. Laws* ch. 219.

27. *WYO. STAT.* § 34-21-514(a) (1977); *U.C.C.* § 5-114(1), 2A *U.L.A.* 259 (1977).

28. *U.C.C.* § 5-114, comment 1, 2A *U.L.A.* 260 (1977).

on the basis that the documents comply with the letter's terms. The U.C.C. recognizes the importance of preserving both the letter's independent character and the reliance placed on it by a beneficiary.²⁹

Neither section, however, defines "compliance." With no defined standard of compliance, courts have decided if documents comply. From those decisions, two standards have evolved. Strict compliance limits compliance to instances in which the documents precisely match the terms in the letter of credit. Substantial compliance is less rigid. Courts adopting that standard have found compliance when it is reasonably justified by the facts of the case.

Strict Compliance

A majority of courts follow the rule of strict compliance. They focus on the certainty this standard gives to letter of credit parties. Once an issuing bank finds conformity between the documents and the letter's terms, payment to the beneficiary is due. The customer must then reimburse the issuing bank.

In *Courtaulds North America, Inc. v. North Carolina National Bank*,³⁰ the Fourth Circuit considered whether an invoice describing "imported acrylic yarn" met the letter of credit's requirement of "100% acrylic yarn."³¹ The beneficiary contended that the documents complied because packing slips attached to the invoices disclosed that cartons were marked "100% acrylic."³² The court ruled that the issuing bank had no duty to scrutinize documents not required by the letter of credit. It upheld the strict compliance standard and denied payment to the beneficiary.³³ The court stated that the issuing bank should not be involved in disputes between the customer and the beneficiary. The issuing bank's only concern should be with the documents.³⁴ By sticking to the strict requirements of the letter, the issuing bank could avoid a potential claim by its customer for wrongful payment. The only remaining claim would be the beneficiary's claim for wrongful dishonor.³⁵ By adopting the standard of strict compliance, the *Courtaulds* court, as a matter of law, eliminated the second claim.

Several years after the *Courtaulds* decision, the Third Circuit, in *Insurance Co. of North America v. Heritage Bank*,³⁶ decided whether a beneficiary's payment demand was wrongfully dishonored. The beneficiary had posted an appeal bond on behalf of the customers. The bond was issued in reliance on the letter of credit. The beneficiary included an affidavit stating merely that its liability was still outstanding under the bond. The

29. U.C.C. § 5-114, comment 2, 2A U.L.A. 321 (1977).

30. 528 F.2d 802 (5th Cir. 1975).

31. *Id.* at 803.

32. *Id.* at 806.

33. *Id.*

34. *Id.* at 805.

35. *Id.* at 806.

36. 595 F.2d 171 (3d Cir. 1979).

letter of credit required "evidence" that the customers had not performed under the bond.³⁷ The court upheld the strict compliance standard, "fear[ing] that the sacred cow of equity [might] trample the tender vines of letter-of-credit law."³⁸

The court rejected a less-than-strict standard of compliance because the issuing bank's burden would be greater than that for which it had bargained.³⁹ The court reasoned that issuing banks issue letters of credit partly because of their certainty. Under strict compliance, an issuing bank's obligation is clearly defined within the text of the letter of credit. The court feared that adopting a less-than-strict standard would create uncertainty about the issuing bank's duty to pay. Issuing banks would be reluctant to assume the risk of litigation which an uncertain standard creates. That reluctance would doom the commercial viability of the letter of credit.⁴⁰

In a declaratory judgment action brought by an issuing bank, the Iowa Supreme Court, in *First National Bank of Council Bluffs v. Rosebud Housing Authority*,⁴¹ adopted the strict compliance standard. The court required the issuing bank to pay the beneficiary even though the bank knew the complying documents presented were invalid as to the underlying contract.⁴² The court cited the *Heritage Bank* rationale that the certainty provided by the strict standard is critical to the continued use of the letter of credit.⁴³

In *Beyene v. Irving Trust Co.*,⁴⁴ the Second Circuit denied payment to a beneficiary. Irving Trust, a "confirming bank,"⁴⁵ refused to pay because a bill of lading stated the buyer was "Soran" instead of "Sofan." In upholding strict compliance, the court indicated that the standard's certainty protects a customer just as it protects an issuing bank. It stated that the misspelling was consequential. The customer could not be assured he would receive the goods under his contract with the beneficiary. The record indicated the customer had not even been notified the goods arrived.⁴⁶

The courts upholding the strict compliance standard have favored the certainty the standard gives to each party. The beneficiary is assured of payment. The issuing bank's duty is limited to comparing documents with

37. *Id.* at 172.

38. *Id.* at 175 (quoting Harfield, *Code, Customs and Conscience in Letter-of-Credit Law*, 4 U.C.C. L.J. 7, 11 (1971-1972)).

39. *Id.* at 175-76.

40. *Id.* at 176.

41. 291 N.W.2d 41 (Iowa 1980).

42. *Id.* at 43.

43. *Id.* at 45.

44. 762 F.2d 4 (2d Cir. 1985).

45. WYO. STAT. § 34-21-503(a)(vi) (1977) defines a confirming bank as one which promises that either it will honor a letter of credit issued by another issuing bank or that the letter will be honored by the issuing bank or a third bank. See also U.C.C. § 5-103(1)(f), 2A U.L.A. 230 (1977).

46. *Beyene v. Irving Trust Co.*, 762 F.2d 6, 7 (2d Cir. 1985).

the terms of the letter of credit. Hence, the issuing bank is freed from litigation. The customer receives some evidence that the beneficiary has performed on the underlying contract before payment is due.

Substantial Compliance

Courts adopting the substantial compliance standard have looked beyond the four corners of a letter of credit to determine compliance. They have found compliance when it is reasonably justified by the facts and circumstances of each case.

*Banco Espanol de Credito v. State Street Bank and Trust Co.*⁴⁷ is the principal case adopting the substantial compliance standard. The First Circuit considered whether an inspection certificate referring to an "order-stock-sheet" complied with the letter's requirement that the certificate refer to an "order."⁴⁸ The customer originally had not required that the goods be inspected. Later, the parties agreed to an inspection, and the letter of credit was modified to require the inspection certificate.⁴⁹

The court held that the beneficiary was entitled to payment. It found that the inspection certificate could not assure the customer of the quality of his goods. That assurance could only be gained through the faith the customer placed in the inspector. As a result, the defect in the inspection certificate was considered meaningless. That, coupled with the confusion caused by the customer's sending both orders and stock-sheets, convinced the court that compliance should be found.⁵⁰

The court, in *Banco Espanol*, feared that allowing a buyer's challenge to an inspection would preclude transactions requiring inspections. The court found that the inspector had acted reasonably in comparing the goods to the only documents which were available for comparison.⁵¹ The court balanced the rigid standard of material terms in a letter of credit with the flexibility required for insignificant terms.⁵² It concluded that international business dealings would be enhanced as a result of its decision.⁵³

In *First National Bank of Atlanta v. Wynne*,⁵⁴ the Georgia Supreme Court dealt with the issue of whether a draft conformed to a letter of credit although the draft did not indicate the required letter of credit number.⁵⁵ The court found the variance was immaterial. Because the original letter of credit was included with the draft,⁵⁶ the court also found the issuing bank could not be misled to its detriment. It held that in cases where

47. 385 F.2d 230 (1st Cir. 1967).

48. *Id.* at 232.

49. *Id.* at 231-32.

50. *Id.* at 235-37.

51. *Id.* at 237.

52. *Id.* at 234.

53. *See id.* at 237.

54. 149 Ga. App. 811, 256 S.E.2d 383 (1978).

55. *Id.*, 256 S.E.2d at 385.

56. *Id.*, 256 S.E.2d at 386. Also included was an amended letter of credit.

documents substantially comply and the issuing bank cannot be misled to its detriment, compliance would be found.⁵⁷ The court cited the reasoning of *Banco Espanol* to support its decision.⁵⁸

The Illinois Appellate Court, in *First Arlington National Bank v. Stathis*,⁵⁹ considered which standard of compliance would be adopted in Illinois. The issuing bank requested a declaratory judgment to determine if it was obligated to pay the beneficiary. The letter of credit required the beneficiary's statement that demand, under the acceleration clause of a note, had been made on the note makers. Copies of the demand letters were to be attached to the statement.⁶⁰ The issuing bank argued that the statement failed to comply because it only stated a threat of acceleration.⁶¹ The court found the issuing bank could have reasonably determined, by reading the statement and demand letters together, that acceleration had occurred.⁶² The court considered the *Courtaulds* strict compliance standard and the *Banco Espanol* substantial compliance standard.⁶³ The court adopted the substantial compliance standard, noting that the issuing bank would not lose its right to reimbursement from the customer.⁶⁴

The courts adopting the substantial compliance standard consider what is reasonable under the facts of each case to compel a finding of compliance. This contrasts sharply with the strict standard, which rules, as a matter of law, that compliance is dictated by a letter of credit's terms. The certainty of the strict standard conflicts with the uncertainty of the substantial compliance standard. *Security State Bank of Basin v. Basin Petroleum Services, Inc.*⁶⁵ gave the Wyoming Supreme Court its first opportunity to compare the standards.

THE PRINCIPAL CASE

The Wyoming Supreme Court adopted the majority rule of strict compliance with a letter of credit's terms.⁶⁶ The court relied on *First National Bank of Council Bluffs v. Rosebud Housing Authority*⁶⁷ to support its decision.⁶⁸ *Rosebud* stressed the certainty that the strict standard pro-

57. *Id.*, 256 S.E.2d at 386-87.

58. *Id.*, 256 S.E.2d at 387.

59. 90 Ill. App. 3d 802, 413 N.E.2d 1288 (1980).

60. *Id.*, 413 N.E.2d at 1297.

61. *Id.*, 413 N.E.2d at 1298.

62. *Id.*, 413 N.E.2d at 1299.

63. *Id.*, 413 N.E.2d at 1298.

64. *Id.*, 413 N.E.2d at 1299. U.C.C. § 5-114(3), 2A U.L.A. 259 (1977), requires a customer to reimburse an issuing bank immediately after a demand for payment is honored. See Wyo. STAT. § 34-21-514(c) (1977).

65. 713 P.2d 1170 (Wyo. 1986).

66. *Security State Bank of Basin v. Basin Petroleum Serv., Inc.*, 713 P.2d 1170 (Wyo. 1986).

67. 291 N.W.2d 41 (Iowa 1980).

68. *Security State Bank*, 713 P.2d at 1172 (quoting *Insurance Co. of N. Am. v. Heritage Bank*, 595 F.2d 171, 176 (3d Cir. 1979)). The Wyoming Supreme Court also questionably cited *Tosco Corp. v. Federal Deposit Ins. Corp.*, 723 F.2d 1241 (6th Cir. 1983) and *Mount*

vides.⁶⁹ By relying on *Rosebud*, the court recognized that a less-than-strict standard discourages issuing banks from issuing letters of credit because of the inherent, higher risk of litigation.⁷⁰

The court rejected the substantial compliance standard adopted in *First National Bank of Atlanta v. Wynne*⁷¹ and *First Arlington National Bank v. Stathis*.⁷² The court acknowledged that those courts balanced the rigid compliance standard of letters of credit with the need for flexibility in commercial transactions. It refused to adopt substantial compliance because the uncertainty of that standard defeats the need for predictability in commercial transactions.⁷³

The court found that estoppel, a defense to strict compliance, did not apply in this case. The court found that Basin knew payment under the letter of credit was conditioned on receipt by the Bank of a copy of each purchase order. In addition, Basin provided no evidence that it had changed its position because of reliance on the Bank's prior handling of documents.⁷⁴

Justice Cardine, joined by Justice Rose, in his dissenting opinion, agreed with the trial court that substantial compliance was found. Without discussion, he adopted that standard and found that the beneficiary should be paid.⁷⁵ He also stated that the Bank should be estopped from demanding strict compliance.⁷⁶ He reasoned that the Bank knew everything about the first four purchase orders. It had loaned money to RBRI to pay for those purchases and had been in contact with Basin regarding those purchases. The Bank would have been in no better position had it insisted on strict compliance.⁷⁷

Prospect State Bank v. Marine Midland Bank, 121 Ill. App. 3d 295, 459 N.E.2d 979 (1983), as additional authority for the strict compliance rule.

Tosco dealt with the compliance question when a draft had a small "l" instead of a capital "L," the word "number" was abbreviated, and the issuing bank's location was improperly added. The court noted that Tennessee, the Federal court's site, did not adhere to the strict compliance rule. It went on to state that the defects were so small that the issuing bank could not have been misled to its detriment. Consequently, the issuing bank was entitled to reimbursement from the customer. This holding does not support the strict compliance standard.

The *Mount Prospect* court was unsure what standard was applicable in Illinois because another Illinois appellate court, in *First Arlington Nat'l Bank v. Stathis*, 90 Ill. App. 3d 802, 413 N.E.2d 1288 (1980), had previously adopted the substantial compliance standard. The court in *Mount Prospect* held that even if the standard was substantial compliance, the deviation was so great that compliance could not be found. This case is doubtful authority for strict compliance.

69. *Rosebud*, 291 N.W.2d at 45 (quoting *Insurance Co. of N. Am. v. Heritage Bank*, 595 F.2d 171, 176 (3d Cir. 1979)).

70. *Security State Bank*, 713 P.2d at 1172.

71. 149 Ga. App. 811, 256 S.E.2d 383 (1979).

72. 90 Ill. App. 3d 802, 413 N.E.2d 1288 (1980).

73. *Security State Bank*, 713 P.2d at 1172.

74. *Id.*

75. *Id.* at 1174.

76. *Id.*

77. *Id.* at 1173.

ANALYSIS

The Wyoming Supreme Court, in *Security State Bank*,⁷⁸ wisely adopted the strict compliance standard. The uncertainty of substantial compliance undermines the continued use of the letter of credit. Conversely, the certainty of the strict standard assures the letter of credit's future. The strict standard, too, requires the parties to solve potential problems up front, eliminating the courts' involvement in commercial dealings.

The substantial compliance standard undermines the viability of the letter of credit; it invites litigation. *First Arlington* invited a lawsuit by adopting substantial compliance. That court reasoned that the issuing bank had the right to be reimbursed by the customer under the U.C.C.⁷⁹ As pointed out in *Courtaulds*, issuing banks do not want involvement in disputes between customers and beneficiaries. Their only concern is with the documents.⁸⁰ Litigation is expensive. If issuing banks are confronted with litigation, they will raise the fee for issuing letters of credit. That will increase the cost of transactions using letters of credit, negating one of their principal values. Because our society values low transaction costs, that result is undesirable.

Courts adopting the substantial standard determine compliance on the basis of reasonableness under the facts of each case. Until a court makes its decision, the parties are uncertain about their rights and duties. The parties, however, choose a letter of credit principally due to its certainty.

The beneficiary's assurance of payment unravels when a court takes the compliance standard out of the hands of the parties who agreed to the required terms. The beneficiary must wait for a decision which costs both time and money. The substantial compliance standard, which helped the beneficiary in *First Arlington*, now haunts all potential beneficiaries. Because of the uncertainty of payment created by the substantial compliance standard, beneficiaries will be reluctant to use letters of credit. Commercial activity once supported by letters of credit will suffer a blow.

The uncertainty of the substantial compliance standard forces out the issuing bankers as parties to letters of credit. *Heritage Bank* was right when it said banks may become reluctant to issue letters of credit.⁸¹ Issuing banks have limited expertise. They cannot possibly be "reasonable" in every letter of credit transaction. The vast array of transactions⁸² using letters of credit precludes any business from meeting the "reasonable"

78. 713 P.2d 1170 (Wyo. 1986).

79. *First Arlington Nat'l Bank v. Stathis*, 90 Ill. App. 3d 802, 413 N.E.2d 1288, 1299 (1980).

80. *Courtaulds N. Am., Inc. v. North Carolina Nat'l Bank*, 528 F.2d 802, 805 (5th Cir. 1975).

81. *Insurance Co. of N. Am. v. Heritage Bank*, 595 F.2d 171, 176 (3d Cir. 1979).

82. Harfield, *supra* note 10, at 252. Some examples of transactions using letters of credit are construction contracts, corporate consolidations, issues of commercial paper, bid and performance bonds, escrows, stock transfers, and leases of real and personal property.

standard. Without the credit rating of issuing banks, letters of credit and their underlying transactions are forever gone. The *Banco Espanol* court completely overlooked issuing banks as critical parties to letter of credit transactions. That court needlessly complicated letter of credit law by focusing on the equities between the parties to the underlying contract.⁸³

The customer negotiates the letter of credit's terms with the beneficiary. Documentary compliance with those terms gives the customer evidence that the beneficiary has performed as required by the letter. Because of the uncertainty of the substantial compliance standard, that evidence has a diminished value to the customer. The court in *Beyene* could have found compliance when "Soran" was named instead of "Sofan."⁸⁴ A "reasonable" explanation for that mistake is that the letters "r" and "f" are contiguous on the typewriter; the typist slipped. That customer had no evidence. He was not even notified his goods had arrived. A customer will not agree to use a letter of credit if he has to pay for performance which is not evidenced although required by the terms of the letter of credit.

The substantial compliance standard breeds uncertainty. On the other hand, the strict compliance standard adopted in *Security State Bank* enhances the parties' confidence in letters of credit because of the certainty it provides. The parties can rely on the letter's terms to enforce their rights and limit their duties. Those rights and duties can be negotiated by the parties, without need for judicial intervention.

The strict standard gives a beneficiary the right to payment by merely submitting required documents. This is true even if the documents are defective in the underlying contract. This is precisely what occurred in *Rosebud*.⁸⁵ The beneficiary's assured payment is made, and the agreement is fulfilled.

The strict standard limits the issuing banks' duty to comparing documents with letter of credit terms. This limited duty ends their fear of involvement in litigation between customers and beneficiaries. The *Wynne* court failed to adequately consider this point when it stated that the missing letter of credit number was immaterial and that the issuing bank could not be misled to its detriment.⁸⁶ Granted, an issuing bank should be able to recognize the document it issued instead of a numbered reference to that document. The problem is where to draw the line. The strict standard draws a razor-sharp line because documents must comply precisely with the letter of credit's terms.

83. *Banco Espanol de Credito v. State Street Bank & Trust Co.*, 385 F.2d 230, 235-37 (1st Cir. 1967).

84. *Beyene v. Irving Trust Co.*, 762 F.2d 4, 6 (2d Cir. 1985).

85. *First Nat'l Bank of Council Bluffs v. Rosebud Housing Auth.*, 291 N.W.2d 41, 45 (Iowa 1980). The court held that the issuing bank must pay the beneficiary even though the bank knew the documents had been modified in the underlying contract to the letter of credit.

86. *First Nat'l Bank of Atlanta v. Wynne*, 149 Ga. App. 811, 256 S.E.2d 383, 386-87 (1978).

The *Security State Bank* holding provides a clear test for all banks to use in determining compliance. This is important because beneficiaries may require a "confirming bank" to assume the primary obligation to pay⁸⁷ under a letter of credit issued by a Wyoming issuing bank. Wyoming financial institutions are small by national standards. Large financial institutions have large capital accounts. Their credit rating, accordingly, has greater acceptance. Out-of-state confirming banks will more readily agree to confirm letters of credit with this clear test. Consequently, transactions underwritten by Wyoming issuing banks will be more widely accepted.

The strict compliance standard assures the customer that his evidence of performance by the beneficiary will be satisfied. He negotiates for that evidence in exchange for immediate payment to the beneficiary once the evidence is produced. The customer in *Beyene* received the strict standard protection he sought. It saved him from paying for goods with no ability to claim them.⁸⁸ The customer, because of his confidence in the letter of credit, has greater access to commercial transactions.

The strict standard is certain in its application. Beneficiaries are paid merely by presenting documents which match the letter of credit's terms. Issuing banks have only the ministerial duty of laying the documents next to the letter of credit to determine if they conform.⁸⁹ Customers must reimburse issuing banks only when documents precisely conform. Every party receives exactly what was agreed.

The certainty of the strict compliance standard requires rigidity in its application. Parties must, therefore, consider potential problems before the letter of credit is issued if the protection they desire is to be included in its terms. This should present little difficulty since the parties are likely to be sophisticated in business dealings.⁹⁰

A beneficiary can negotiate terms to protect himself from being unable to satisfy its conditions. He can limit required documents to only those within his exclusive control.⁹¹ He can request a time frame for demand which will allow him to cure defects before the expiration of the letter of credit. He can request that demand be made at a confirming bank, which will provide a convenient location for him to substitute documents if defects exist.⁹² If the beneficiary in *First Arlington* or in *Banco Espanol* had taken these steps, litigation threatening the certainty of payment

87. WYO. STAT. § 34-21-507(b) (1977) states that a confirming bank becomes directly obligated as though it were the issuing bank. See U.C.C. § 5-107(2), 2A U.L.A. 240 (1977).

88. *Beyene*, 762 F.2d 4 (2d Cir. 1985). Because the bill of lading had the customer's name improperly spelled, a shipper would hesitate to deliver goods without more than just the customer's explanation of the misspelling.

89. *Fidelity Nat'l Bank of S. Miami v. Dade County*, 371 So. 2d 545, 548 (Fla. Dist. Ct. App. 1979).

90. *Kelly-Springfield Tire Co. v. Dakota Northwestern Bank*, 321 N.W.2d 516, 520 (N.D. 1982).

91. Dolan, *supra* note 19, at 28.

92. *Id.* at 28-29.

would have been unnecessary. The beneficiary can refuse to begin performing on the underlying contract until the letter of credit's terms are acceptable to him.

An issuing bank may have limited expertise in many transactions. It can insist that a confirming bank with more expertise or an experienced third party decide compliance. That type of condition can be included in a letter's terms.

A customer, like the one in *Banco Espanol*, may have a particular concern about the quality of goods. He can arrange a personal inspection or require random sampling that meets certain pre-established criteria. The sampling may be done personally or by using independent parties. All these conditions can be embodied in the letter of credit.

Letters of credit cannot solve all the problems that arise in commercial transactions. If, however, the parties provide solutions to potential problems, letters of credit can be effectively used. Later problems can be solved by modifying⁹³ the letter. The strict compliance standard adopted in *Security State Bank* requires this planning. The reward to the parties in the form of increased commercial activity is, however, well worth the cogent planning.

CONCLUSION

The Wyoming Supreme Court wisely adopted the standard of strict compliance with terms contained in a letter of credit. The strict standard provides certainty as to the rights and duties of each party. The beneficiary is assured of payment. The issuing bank's duty is limited to comparing documents with the letter's terms. The customer is protected from paying until evidence of the beneficiary's performance is secured. The letter of credit can be put to use by creative parties to finance countless commercial deals not yet conceived.

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93. WYO. STAT. § 34-21-506 (1977) provides for modification of a letter of credit. Subsection (a) limits modification of an "irrevocable" letter to be effective against the customer only if he consents. The same is true for a beneficiary. Subsection (b) allows an issuing bank to modify a "revocable" letter without consent of either the customer or the beneficiary. See U.C.C. §§ 5-106(2), -(3), 2A U.L.A. 238 (1977).