Gulf South Bank & Trust Company v. Holden: A Warning to Bankers Honoring Letters of Credit

Tracy L. Howard
NOTES

_Gulf South Bank & Trust Company v. Holden:_ A Warning to Bankers Honoring Letters of Credit

I. INTRODUCTION

In _Gulf South Bank & Trust Co. v. Holden_, the Louisiana Fourth Circuit Court of Appeal held that a bank which paid on a letter of credit was not entitled to recover reimbursement from its customer where the documents presented did not strictly comply with the terms of the letter of credit agreement. Specifically, the court refused to allow the bank to recover on a promissory note executed to secure the issuance of the letter of credit. By its ruling, the court of appeal reversed the trial court which had rendered a judgment in favor of the bank. The appellate court's rationale in so holding was based on two factors: (1) Gulf South Bank and Trust (hereinafter GSBT) breached the terms of the credit agreement by funding without complying precisely with all of its requirements; and (2) GSBT paid on the letter of credit after the term of the agreement had expired.

Eric Holden was one of five members of Deeks Limited (hereinafter Deeks), a limited partnership, which sought to invest in Contessa Vali Thoroughbred Syndicate (hereinafter Syndicate). Deeks was one of fifteen investors in Syndicate, each of whom was required to invest $20,000. Pursuant to this enterprise, Deeks sought the issuance of a $20,000 letter of credit from GSBT. The bank complied with the request and issued the letter on December 11, 1984. According to GSBT, the letter of credit was secured by a $4,000 promissory note from each member of Deeks. Eric Holden's note was dated December 21, 1982, almost two years prior to the issuance of the credit. GSBT also issued the Syndicate a $300,000 line of credit which was secured not only by the

1. 562 So. 2d 1132 (La. App. 4th Cir. 1990).
2. The letter of credit provided that a request to GSBT for payment would be honored on sight when "... accompanied by an affidavit signed by an officer of the holder of this Letter of Credit certifying that (i) a default exists under any loan of Contessa Vali Thoroughbred Syndicate, a Louisiana Partnership in Commendam, due such holder which this Letter of Credit may secure." Id. at 1133.
3. Id. at 1132.
Deeks letter of credit but letters from the fourteen other investors. On December 26, 1985, GSBT called the letter of credit and applied the funds to Syndicate's loan. At the time the letter of credit was called, Syndicate had borrowed $295,000 against the $300,000 credit line established with GSBT.

Although GSBT received payment on the promissory notes of four members of Deeks, Holden refused to pay, claiming that the bank breached the contract for lack of consideration. The court of appeal agreed that Holden was not responsible to pay the note. It grounded its holding not on whether Holden had a defense to payment but on factors pertaining to the letter of credit agreement. In any event, the effect of the decision was to grant Holden a $4,000 windfall which in turn caused the bank a $4,000 loss plus interest.

The Holden opinion raises a significant question as to the standard of compliance Louisiana courts require banks to satisfy pursuant to payment on letters of credit, particularly in wrongful honor cases. The decision on its face suggests that a bank which pays on a letter of credit, despite minor discrepancies between the documents presented and the credit agreement requirements, will have no right of reimbursement from its customers. Stated differently, Holden indicates that banks will be held to a strict compliance standard in those cases in which it chooses to pay on a letter of credit. This case is troublesome, however, because the court seemed to get tied up in letter of credit law and perhaps missed the central issue the suit raised: whether Holden, as an obligor on a promissory note, had any defense of payment to GSBT.

This note will evaluate the holding and rationale of Holden by considering several factors. First, this note will present an overview of the essential aspects of the letter of credit arrangement and will suggest that the facts in Holden present an anomaly vis-à-vis the typical letter of credit arrangement. Second, this note will focus specifically on the two issues the court deemed decisive for its holding: (1) the timeliness of the payment on the letter; and (2) the nature of compliance required pursuant to such payment. Third, this note will address whether unjust enrichment may have provided an additional basis on which GSBT could have recovered. Fourth, the case of Scott v. Bank of Coushatta will be considered in order to show that this case, in conjunction with Holden, places a strict duty on a bank to exercise the utmost caution in its dealings with customers. Finally, in light of the stringent compliance


5. 512 So. 2d 356 (La. 1987).
standards Holden sets forth, this note will propose several guidelines to protect banks from the problems this case presents for banking activities.

II. Precepts of the Letter of Credit Arrangement

General Precepts

The letter of credit is a useful financing mechanism which provides the credit of a third party, generally a bank, as an independent assurance of payment to another party. A letter of credit is “an engagement by a bank or other person made by the request of a customer . . . that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit.” This arrangement normally consists of at least three parties: (1) the customer or buyer who causes an issuer to issue a credit; (2) an issuer who issues the credit; and (3) the beneficiary of a credit who is entitled under the terms of the agreement to draw or demand payment.

One of the significant features of the letter of credit arrangement is that each of the contracts between the respective parties is independent of the others. This principle is critical to the successful function of the letter of credit. Thus, if the beneficiary presents documents that con-

7. La. R.S. 10:5-103(1)(a) (1983). Although the statute requires “compliance,” there is no statutory reference to the standard of compliance. The nature of the standard has become a question for the courts and varies not only from case to case but from jurisdiction to jurisdiction. The Uniform Commercial Code (UCC) is a matter of state law and thus each jurisdiction interprets the compliance standard independently from other jurisdictions. Furthermore, federal courts that hear letter of credit cases under diversity jurisdiction are bound to apply state law pursuant to the Erie rule; cf. Erie Railroad Co. v. Tompkins, 304 U.S. 64, 58 S. Ct. 817 (1938); see Hotchkiss, Strict Compliance in Letter-of-Credit Law: How Uniform is the Uniform Commercial Code?, 23 U.C.C. L.J. 288, 289 (1991) [hereinafter Hotchkiss]; Task Force on the Study of UCC Article 5, An Examination of U.C.C. Article 5 (Letters of Credit), 45 Bus. Law. 1521, 1531 (1990).
9. La. R.S. 10:5-103(1)(c) (1983). In addition to the issuer, oftentimes there is a confirming bank which honors a letter of credit already issued by another bank and engages that the letter of credit will be honored by the issuer or a third bank. La. R.S. 10:5-103(1)(f) (1983); see also Leon, supra note 6, at 436.
form to the terms of the letter of credit agreement, the bank is under an independent duty to pay despite any problems which may or may not exist in the underlying contract between the beneficiary and customer.\textsuperscript{12}

The independence principle has particular application to what is called a "guarantee" or "standby" letter of credit, the kind found in \textit{Holden}. This type of credit arrangement is used in situations in which one party seeks to protect itself from another party's inability to perform. Professor Leon aptly describes the nature of the "standby" agreement:

Because a standby letter of credit is payable upon the default of a party to perform its obligation, this type of credit is in the nature of a loan from the issuer to the customer, and a guarantee from the issuer to the beneficiary. It is, however, legally distinguishable from a guarantee and because of the independence principle, it actually offers the beneficiary more security than a guarantee.\textsuperscript{13}

The duty the bank owes its customer is to examine the documents presented so as to ascertain whether on their face, they comply with the terms of the credit.\textsuperscript{14} The banker must use "care" under the applicable UCC provision\textsuperscript{15} and must use "reasonable care" under the UCP.\textsuperscript{16} The bank, however, assumes no liability for the genuineness,


\begin{quote}
An issuer must honor a draft or demand for payment which complies with the terms of the relevant credit regardless of whether the goods or documents conform to the underlying contract between the customer and the beneficiary.
\end{quote}

The independence principle is also found in Article 3 of the Uniform Customs and Practices for Documentary Credits (UCP) which states:

\begin{quote}
Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the credit.
\end{quote}

Parties to a letter of credit may subject their agreement to the UCP rules adopted by the International Chamber of Commerce (1983 revision). See, e.g., \textit{First Nat'l Bank v. Carmouche}, 515 So. 2d 785, 787 n.2 (La. 1987). These rules apply only to documentary letters of credit issued by banks, will be binding on parties only to the extent they agree to be bound, and may be used by courts as suppletive rules in contract resolution disputes; see Hawkland & Holland, UCC Series § 5-102:07 (1986); Leon, supra note 6, at 439.

\textsuperscript{13} Leon, supra note 6, at 443 (footnote omitted).

\textsuperscript{14} La. R.S. 10:5-109(2) (1983).

\textsuperscript{15} Id.

\textsuperscript{16} UCP art. 15 (rev. 1983).
falsification, or effect of any document which appears on its face to be regular.\textsuperscript{17} The bank, as well as other parties to the arrangement, does have an additional duty to exercise good faith in the performance and enforcement of every contract.\textsuperscript{18}

\textit{Application of Precepts to Holden}

The facts in \textit{Holden} are distinguishable from typical cases in which there are at least three different parties: issuer, customer, and beneficiary.\textsuperscript{19} In \textit{Holden}, GSBT reacquired the letter of credit it had issued to Syndicate, although the facts of the case fail to suggest a link as to how GSBT actually received it. GSBT, from a functional standpoint, actually became both the issuer and beneficiary (at least its transferee), since the credit was used to secure the loan to Syndicate.\textsuperscript{20}

It would seem that the policies favoring strict compliance in a case where the issuer pays a third party to the detriment of the customer are inapposite to the facts presented in \textit{Holden}. Here, all the bank had done, functionally, was to exercise a right of set off against the Syndicate loan. Because GSBT owed a debt to Syndicate (obligation to pay on the letter of credit) and Syndicate owed a debt to GSBT (obligation to pay on the loan), the bank became both obligor and obligee. Thus, although in a technical sense, one might view GSBT as having paid on the letter of credit, practically, by a mere paper transaction, the bank set off the debt Syndicate owed by funding its account with the amount of the letter of credit.\textsuperscript{21} There would seem to be little justification for

\begin{itemize}
    \item \textsuperscript{17} La. R.S. 10:5-109(2) (1983).
    \item \textsuperscript{19} E.g., First Nat'l Bank v. Carmouche, 515 So. 2d 785 (La. 1987); this case actually involved four parties: an issuing bank, a customer, a beneficiary, and a draft endorsee.
    \item \textsuperscript{20} The bank promised that it would not call the note unless it had to pay on the letter of credit. Why the parties went the route of acquiring a letter of credit to ensure the loan to Syndicate is unclear. It would seem that Syndicate could have simply gone to the bank and requested a loan to be secured by other collateral or individual promissory notes such as the one Holden signed.
    \item \textsuperscript{21} La. R.S. 6:316(C) (Supp. 1991) gives banks the privilege of set off. It states in Section C:
      In the event that the depositor should default under any loan, extension of credit or other direct or indirect obligation of any nature and kind whatsoever in favor of the depository bank, the bank shall have the right to apply any and all funds that the depositor then has on deposit with the bank or on which the bank has taken a security interest under Chapter 9 of the Louisiana Commercial Laws (R.S. 10:9-101, et seq.) towards the payment of the depositor's indebtedness or obligations, whether such payment satisfies the indebtedness or obligations in whole or in part. The exercise of the bank's remedies under this Subsection shall not affect any other rights and remedies available to the bank.
\end{itemize}
Holden to acquire a $4,000 windfall on a promissory note simply because GSBT applied a letter of credit, which it held as security, to Syndicate’s debt. Holden was not prejudiced by such an action.

The court’s excursion into letter of credit law, however, misses the decisive issue in the case, namely, whether Holden had a defense to payment on the promissory note. Ostensibly, Holden would be able to argue that the bank paid on the letter without presenting to itself the necessary affidavits the agreement required. Yet, because Holden was an independent party in the contract with GSBT on the promissory note, he should have had to prove whether the bank’s failure to comply strictly with the terms of the agreement constituted a breach to such an extent that it effectively extinguished his obligation to pay the note.

The fourth circuit skirted the issue by stating, “[W]e are not bound by a theory of the case.” This, however, would seem to have been the pivotal issue and should have warranted a significant portion of the court’s discussion. Nevertheless, because the court chose to analyze the problem by focusing on letter of credit law, the following analysis will address both reasons on which the court denied GSBT reimbursement.

III. TIMELY HONORED DRAFT

The court of appeal in Holden denied GSBT reimbursement on the grounds that it paid on the letter of credit after the agreement had terminated. The agreement stated in pertinent part:

This letter may be drafted against, in full, without being accompanied by the Affidavit referred to above from December 11, 1984 until January 11, 1985 if this Letter of Credit is not renewed by January 11, 1985 for a period of one (1) year expiring January 11, 1986, in the face amount of $20,000.00 and in a form acceptable to the beneficiary, its transferees or assigns.

GSBT argued that the language allowed an additional one year extension in the term. The fourth circuit disagreed. The court stated:

There is nothing in the record to show that the letter of credit was renewed by Deeks Limited or that the Contessa Vali Syn-

following the depositor’s default.

This statute contemplates the bank’s right of set off by applying funds on deposit to debts owed by a depositor. Admittedly, although a standby letter of credit backed only by a contingent promissory note is not in fact an insurable deposit within the meaning of the Federal Deposit Insurance Act (Federal Deposit Ins. Corp. v. Philadelphia Gear Corp., 476 U.S. 426, 106 S. Ct. 1931 (1986)), this does not change the practical effect of what GSBT has done by a mere paper transaction.


23. Id. (emphasis added).
icate as beneficiary of the letter of credit approved the extension as required by the quoted provision. The request letter unequivocally seeks issuance of a letter of credit limited to a term of January 13, 1984 through January 11, 1985. Gulf South could not unilaterally extend or vary the term of the letter of credit.24

Louisiana statutory provisions do not specifically address the liability of an issuer who pays after the term has expired, although in such a situation the issue of good faith may arise.25 The only "time requirement" focuses on the duty of the issuer to pay a draft or demand within a reasonable time.26 The circumstances in Holden, however, do not indicate that GSBT breached this particular duty; the question raised in Holden was whether the payment occurred within the time frame of the agreement. Once the letter of credit agreement expired, the duty of the issuer to pay, in this case GSBT, terminated.27

The problem presented in Holden involves contractual interpretation rather than statutory application. The letter of credit agreement could certainly have been construed in favor of GSBT. The conditional clause, "if this Letter of Credit is not renewed by January 11, 1985,"28 could have been read only to limit the bank's option of not having to use an accompanying affidavit after January 11, 1985. The clause does not itself answer whether an extension was contemplated by the parties. The court opined that nothing in the record showed that the letter of credit was renewed.29 Arguably, however, the commercial relationship between Syndicate and GSBT implicitly extended the letter of credit at least to the term of the loan arrangement with Syndicate. This would seem to be the case both as a matter of logic and commercial function. Otherwise, GSBT would have been unsecured for $20,000 of the Syndicate's loan as of January 11, 1985.

Additionally, the fourth circuit noted that GSBT could not unilaterally extend the term of the letter of credit.30 This conclusion seems

24. Id.
26. La. R.S. 10:1-204, 5-112 (1983); see also UCP article 16(c) which requires the bank to examine and determine whether to pay documents within a "reasonable time." This duty has been interpreted strictly in several jurisdictions: FDIC v. Vogel, 437 F. Supp. 660 (E.D. Wis. 1977); The Bazaar, Inc. v. Exchange Nat'l Bank of Chicago, 168 Ill. App. 3d 811, 523 N.E.2d 57 (Ill. App. 1st Dist. 1988); Waidmann v. Mercantile Trust Co. Nat'l Ass'n, 711 S.W.2d 907 (Mo. Ct. App. 1986). In other jurisdictions, however, this duty has been minimized so as to exonerate the issuer: People's State Bank of Clay County v. Gulf Oil, 446 N.E.2d 1358 (Ind. Ct. App. 1st Dist. 1983).
29. Id.
30. Id.
somewhat simplistic. The agreement stated that any renewal needed to be in a "form acceptable to the beneficiary, its transferees or assigns." As noted previously, from a functional standpoint, the bank was not only the issuer but also the beneficiary or, at a minimum, the beneficiary's transferee. This is because Syndicate gave GSBT the letter of credit as security on the loan from the bank. The court, however, never addressed this problem. Instead, in an almost mechanical fashion, the court applied a strict compliance standard which logically required the bank to give itself permission to approve the extension.

In short, considering the unusual situation presented, in which the bank was both the holder and the issuer of the letter of credit, the court's refusal to allow GSBT reimbursement for untimely payment is dubious. The opinion, by doing so, focuses too much time on letter of credit technicalities while completely ignoring commercial actuality.

IV. WRONGFUL HONOR

Holden represents a case of wrongful honor and is distinguishable from cases involving wrongful dishonor. This distinction extends further than merely stating that in the former situation the bank pays whereas in the latter situation it does not; some courts apply varying standards of compliance depending on whether the case is one of wrongful honor or wrongful dishonor.32

31. Id.

Some jurisdictions, on the other hand, have opted for a lesser, substantial compliance standard even in wrongful honor cases. See Hotchkiss, supra note 7, at 294 n.21. See, e.g., First Nat'l Bank of Atlanta v. Wynne, 149 Ga. App. 811, 256 S.E.2d 383 (1979);
Wrongful Honor—A Bifurcated Standard or Strict Compliance?

A wrongful honor suit normally arises after an issuer bank has paid a beneficiary on a letter of credit despite the customer’s desire that the issuer withhold payment for some reason. Issuers often will procure the customer’s funds or other collateral and will merely debit the customer’s account after it has made payment of the letter. The customer’s ultimate argument against the issuer is an allegation of a breach of a Louisiana Revised Statutes 10:5-109 duty.

Early on, strict compliance was adopted as the standard in wrongful honor cases. In *Equitable Trust Co. v. Dawson Partners, Ltd.*,\(^1\) Dawson Partners purchased 3,000 kilos of vanilla beans, using a letter of credit for payment. The letter required the seller to present a quality certificate issued by two experts. Equitable Trust paid when the seller presented a quality certificate signed by one expert. The court held the bank to a strict compliance standard thus denying the bank reimbursement.

This harsh approach has been modified significantly by some jurisdictions in cases involving wrongful honor. These courts have held that when there is minor noncompliance in the demand for payment by the beneficiary and the issuer pays despite the noncompliance, the issuer is still entitled to reimbursement from its customer.

For example, in *Transamerica Delaval, Inc. v. Citibank*,\(^3\) the underlying contract called for Transamerica to sell diesel power generators...
to Electrical Work and Maintenance (EWM). A Citibank subsidiary issued a "letter of guaranty" to Transamerica (its customer) in favor of EWM for $2,809,833. A second bank took over the subsidiary's rights and liabilities. Disagreements arose between Transamerica and EWM, and after Transamerica refused to extend the letter of credit, Citibank paid on the letter. Citibank reimbursed itself from Transamerica's account and Transamerica then sued Citibank to recover the amount. It argued that Citibank was not entitled to reimbursement because the demand by EWM did not technically comply with the letter of credit agreement. The court, however, applied a lesser, "bifurcated standard" and held that substantial compliance was sufficient to exonerate Citibank from any liability to its customer.

This case illustrates a clear departure from the strict compliance test set forth in Dawson Partners. Transamerica, and other cases like it,6 suggest that, at least in some jurisdictions, courts are willing to apply a lesser compliance standard in wrongful honor cases than would be applied in wrongful dishonor situations. White and Summers state:

The case [Transamerica] is representative of many other cases in which customer sues the issuer for wrongful honor. It is representative first because the customer loses; the customer almost always loses. It is representative secondly because the court adopts a more generous standard of measuring the bank's acts vis a vis the customer than might have been applied vis a vis the beneficiary if the bank had chosen to dishonor.7

Wrongful Honor—The Louisiana Standard

In Holden, the court denied GSBT reimbursement because it failed to comply strictly with the terms of the letter of agreement by paying on the letter without the requisite attached affidavit certifying that Syndicate had defaulted on its loan to the bank.8 One might have expected, based on cases like Transamerica, that the fourth circuit would have exonerated the bank so as to allow it reimbursement. The court, however, clearly rejected any "bifurcated" or "substantial compliance" standard in the event of wrongful honor. The court based its ruling squarely on First National Bank v. Carmouche.9

---

37. White & Summers, supra note 27, at 863.
38. Gulf South Bank & Trust Co. v. Holden, 562 So. 2d 1132, 1133 (La. App. 4th Cir. 1990). The court noted that the bank is under a strict statutory duty to examine the documents with care for compliance with the terms of the letter of credit pursuant to La. R.S. 10:5-109(2).
39. 515 So. 2d 785 (La. 1987).
In *First National Bank*, the bank brought suit against the customer to collect funds expended in paying a letter of credit. The customer alleged that the bank was in bad faith because it paid the letter of credit despite indications that its customer might not have owed the money. The court held that the bank’s obligation to pay was independent of any contractual problems that may have existed between its customer and the beneficiary. Pursuant to its analysis, the court addressed the question of compliance and commented that “[t]he bank is under a strict statutory duty to examine the documents with care” prior to payment on a letter of credit. The decision in *First National Bank*, however, turned more on the issue of the independence of the contract between the issuer and the beneficiary than on the issue of strict or substantial compliance.

A similar conclusion regarding the nature of compliance in wrongful honor cases was reached in *Philadelphia Gear Corp. v. Central Bank*. The United States Fifth Circuit, applying Louisiana law, stated that any documentation necessary to support payment under a documentary letter of credit must conform exactly to the requirements of the credit arrangement.

It would appear after *Holden* that the doctrine of strict compliance has become well-settled in Louisiana in wrongful honor cases. The *Holden* court, however, failed to explain why this is the appropriate standard. In *Bank of Cochin Ltd. v. Manufacturers Hanover Trust*, for example, the United States District Court set forth a significant policy reason why a lesser “substantial” compliance standard should be the rule in wrongful honor cases. It stated that such a standard is,

> designed to permit the bank to retain flexibility in dealing with simultaneous customer pressure to reject and beneficiary pressure to accept. This discretion ostensibly preserves the bank’s ministerial function of dealing solely with documents and the insulation of the letter of credit from performance problems. . . .

Notwithstanding this policy argument, Louisiana has opted to return to the strict standard first set forth in *Dawson Partners*. The question then becomes whether the issuer is entitled to any reimbursement if it fails to conform strictly to the credit agreement requirements.

**Reimbursement**

Louisiana law provides that if an issuer has duly honored a draft or demand for payment on a letter of credit, the issuer is entitled to

---

40. Id. at 788.
41. 717 F.2d 230 (5th Cir. 1983).
42. 612 F. Supp. 1533 (S.D.N.Y. 1982).
43. Id. at 1539.
immediate reimbursement of any payment made under the credit. The problem arises, however, when the issuer has honored a draft without fulfilling the "strict compliance" standard.

Louisiana courts have uniformly embraced the position that reimbursement is not recoverable by the issuer if it honors payment on the basis of noncomplying documents. For example, in Holden, GSBT failed to comply with the terms of the letter of credit by not attaching a required affidavit to the demand for payment. The court admitted that such an act might have been viewed as absurd given the fact that GSBT was both the holder of the letter and the Syndicate's creditor. Nevertheless, the court refused the bank reimbursement.

The same principle was espoused both in First National Bank v. Carmouche and Philadelphia Gear Corp. v. Central Bank. For example, in First National Bank, the Louisiana Supreme Court stated:

"The bank is under a strict statutory duty to examine the documents with care, La. R.S. 10:5-109(2), and cannot seek reimbursement from the customer if the documents are not in proper compliance with the terms of the letter." 47

The rationale for refusing the issuer reimbursement is difficult to understand when the customer has not actually been prejudiced. Eric Holden, for example, got exactly what he was entitled to. He executed a promissory note in return for the bank's issuance of a letter of credit in favor of Syndicate. Allowing Holden to seize upon a technical detail in order to escape from liability on his promissory note to GSBT seems unduly harsh. When a customer receives exactly what he bargained for and then is allowed, as it were, to reimburse the bank and then receive the reimbursement back, it amounts to nothing less than a windfall. 48

It should be recalled that the factual situation in Holden is not typical of normal letter of credit arrangements, given the fact that GSBT held the letter of credit as security for the debt of Syndicate in whose favor the letter was originally issued. The fourth circuit failed to take this into consideration. The application of a strict compliance standard under these circumstances, resulting in a denial of reimbursement to GSBT, does not further the policies behind the application of the rule in otherwise normal circumstances. Even in a typical letter of credit arrangement, some academic authorities suggest that banks should rarely

45. 515 So. 2d 785 (La. 1987).
46. 717 F.2d 230 (5th Cir. 1983).
47. First National Bank, 515 So. 2d at 788 (emphasis added).
be refused reimbursement. As a matter of policy, if all of the essential requirements of a letter of credit are complied with, the integrity of the transaction should not be challenged on technical or inconsequential reasons. In particular, Louisiana courts should strike a balance between the integrity of letter of credit transactions and the requirement of their fluidity if the objective of increased dealings to the mutual satisfaction of all interested parties is to be enhanced.

V. UNJUST ENRICHMENT

After Holden, it seems evident that Louisiana law requires strict compliance, pursuant to payment on a letter of credit, as a basis for the right of reimbursement. One issue, however, that neither the parties nor the court raised, was whether an issuer that fails to comply technically with the requirements of the letter of credit may recover its payment under a theory of unjust enrichment; this question arises, particularly in a case like Holden where the customer received a windfall at the bank's expense.

The Doctrine of Unjust Enrichment

The Louisiana Civil Code appears to provide some statutory basis for the action of unjust enrichment. Article 2055 states in pertinent part:

Equity, as intended in the preceding articles, is based on the principles that no one is allowed to take unfair advantage of another and that no one is allowed to enrich himself unjustly at the expense of another.

49. White and Summers state:

For several reasons we believe it should be an unusual case in which the customer successfully recovers from the issuing bank for wrongful honor. In the usual case the bank's bias and its selfish interest run exclusively toward dishonor. In the normal case the issuer's most obvious and intense interest will be in its customer as against a diffuse and remote interest in the integrity of the letter of credit system. If we are to preserve the independence principle and bolster the utility of letters of credit, the law must encourage banks to act in a relatively disinterested way, namely to pay. Moreover, one should have some sympathy for the bank in this position. The bank earns only a small fee, has a limited amount of time to make a decision and, at least when it acts in good faith, courts should be sympathetic to its judgment about beneficiary's compliance with the credit.

Id. at 863 (footnote omitted).


Some commentators, however, have suggested that Louisiana Civil Code article 2055 (formerly articles 1964, 1965 and 1966) provides a cause of action only when there has been a contract because the article is located in Title IV, entitled "Conventional Obligations or Contracts." This requirement certainly would be satisfied by the factual situation in Holden, where a contract existed between Holden and GSBT.

The landmark decision regarding the action for unjust enrichment was Minyard v. Curtis Products, Inc. This decision set forth five requirements necessary to recover under this cause of action: (1) an enrichment; (2) an impoverishment; (3) a connection between the enrichment and impoverishment; (4) an absence of justification for the enrichment and impoverishment; and (5) an absence of a remedy provided by law. Since the Minyard decision, these requirements have become well-settled as a basis of any recovery for unjust enrichment. Further, all five requirements must be satisfied due to the fact that Louisiana law is fundamentally hostile to this cause of action.

The fourth requirement, an absence of justification for the enrichment and impoverishment, of an action for unjust enrichment is probably the most stringent. The law does not allow recovery for any unjust enrichment, rather, only the unjust enrichment for which there is no justification in law or contract. Tate further states, "The action can only be used in the case of unjust enrichments without legal justification; and then only if no other practical remedy is available by which the impoverishment might be or might reasonably have been avoided."

Application to Holden

Although GSBT conceivably could have met four of the five requirements necessary to set forth a cause of action for unjust enrichment, the fourth element cited above would have presented a significant prob-

53. 251 La. 624, 205 So. 2d 422 (1967).
56. Edmonston, 289 So. 2d at 122.
57. Tate, supra note 52, at 904 (emphasis added).
lem. This is true in two respects: (1) Louisiana Revised Statute 10:5-114(3) suggests that reimbursement is allowed only when a bank has duly honored a letter of credit; and (2) the limited number of Louisiana cases prior to Holden that pertain to wrongful honor suggest that reimbursement will only be allowed if the issuer strictly complies with the stipulations of the credit agreement. Thus, the Holden court most likely would have reasoned that any denial of reimbursement, despite the windfall to the customer, is justified under the present state of law in Louisiana. Hence, dura lex sed lex.

VI. Scott v. Bank of Coushatta: A Red Flag for Bankers

The Facts and Holding

The problem that Holden raises for banks is no doubt enhanced by the case Scott v. Bank of Coushatta. In Scott, customers (the Scotts) brought an action against the bank demanding cancellation of a mortgage on their property. They had used the property as collateral for a promissory note (dated August 4, 1980), executed for their son pursuant to the purchase of a car. Approximately one year later (August 18, 1981), the son obtained a new loan from the bank to purchase a truck. He forged the signatures of his parents to the note without their permission, and the bank, unaware of the son's act at the time, treated the new note as a novation, thus extinguishing the former obligation of the Scotts. The Scotts sometime later received notice from the bank that the new note was due. They then filed suit against the bank demanding cancellation of the mortgage on their property and seeking damages.

The trial court held that the Scotts could not be held liable on the former note and that the second note had the effect of cancelling the previous obligation. The court of appeal reversed. It held that the latter note was a renewal of the former one and that the Scotts still owed the obligation evidenced by the former note.

The Louisiana Supreme Court reversed. The court stated that when the bank marked "paid" on the former note, it evidenced an intent to release the debtor. Hence, it construed the later note as a "novation." The effect of the novation, from the bank's standpoint, was to give the Scotts a windfall for the balance remaining on the first note and to cause the bank to suffer a loss.

58. 512 So. 2d 356 (La. 1987).
59. The facts indicate that Mrs. Scott signed both her name and Mr. Scott's name to the promissory note. She did so with Mr. Scott's permission. The effect of their signatures, however, made them liable on the note in the event their son failed to fulfill his obligation to make payments on the car.
Although the bank argued that the later note had been entered into by error and hence should have resulted in a vitiation of consent on its part, the court held that the bank’s inexcusable neglect precluded it from successfully rescinding the novation. The negligence, according to the court, was due to the bank’s failure to check pertinent signature cards of the Scotts which were on file and which would have put the bank on notice that the forged signatures were in fact not the Scotts’.

In a persuasive dissenting opinion, Justice Dennis argued that such a ruling “breaks with precedents establishing an inexcusable error rule and can only result in requiring bankers to take extreme precautions that will impose unnecessary costs of time, inconvenience and expense on honest, reasonable bank customers.” Dennis argued that the bank in this case was not guilty of inexcusable error or gross fault. The bank was guilty only of very slight negligence. He concluded that because the bank was merely trying to avoid a loss whereas the customer was seeking a windfall, the bank should not be barred from rescinding the later obligation because of its error induced by the Scotts’ son.

Implications of Scott

The result in Scott is analogous to the decision in Holden. In both cases, there were contracts, very slight negligence (if any in Holden), and a refusal by the respective courts to allow the banks recovery on their loss. The dissenting opinion by Dennis in Scott raises some of the same troublesome implications found in the Holden decision. For example, if a bank, as in Holden, is held to a strict compliance standard in wrongful honor cases, particularly when it has exercised good faith in the transaction, such a rigid standard will force banks to exercise precautions not customary in ordinary business. These additional precautions will in turn increase delay, inconvenience, and overhead costs for the bank, which ultimately will be passed on to bank customers.

Despite the harshness of both Holden and Scott, these cases, nevertheless, represent the status of the law in Louisiana and serve as strong warnings to banks to exercise extreme caution in their banking practices.

VII. Guidelines for Banks in Light of Holden

In light of the strict requirements placed on banks in letter of credit agreements, several guidelines are suggested to help banks alleviate some

61. Scott, 512 So. 2d at 361.
62. Id. at 365 (Dennis, J., dissenting).
63. Id.
64. Id.
65. Id. at 366 (Dennis, J., dissenting).
of the potential problems prior to entering such agreements. First, banks should attempt to acquire adequate security to ensure a customer's performance in the event that the bank has to pay on the letter of credit. Promissory notes by themselves are less than adequate as evidenced by Holden. Funds on hand are by far the best.66

Second, the bank should endeavor to secure a comprehensive reimbursement agreement from its customer prior to entering a letter of credit arrangement. It is doubtful that a bank can secure an agreement that would exculpate it from any action it might take. For example, in Overseas Trading Corp. v. Irving Trust Co.,67 the letter of credit provided for absolute discretion by the issuer, and the customer agreed to reimburse the bank despite the documents being insufficient, defective, or even forgeries.68 Although Louisiana Revised Statutes 10:5-109 does not necessarily preclude such an agreement,69 10:1-102(3) regarding disclaimers of "good faith, diligence, reasonableness, and care" might invalidate it.70 Thus, although broad exculpatory agreements may be problematic, clauses of more limited application should withstand the test of 10:1-102(3). Consequently, an issuer acting reasonably in paying a draft arguably should be protected by such a clause.71

Third, if the issuing bank pays a beneficiary because the customer has failed in some way to honor its underlying contract with the beneficiary, the bank's right of reimbursement should be enforceable through the doctrine of subrogation. Although some cases have held that such an action violates the notion of independence by interfering with the underlying contract between customer and beneficiary,72 Hawkland and Holland suggest that this is incorrect.73 They espouse the position that in the absence of agreements between the issuer and customer that would allow it to pursue the customer after paying the beneficiary, "the issuing bank ought to be put in the same position that the beneficiary occupied with regard to the right to pursue the customer."74

Finally, the safest guideline for a bank to follow is to examine carefully any documents or papers pursuant to payment on a letter of credit. The law now requires strict compliance, even in wrongful honor

---

66. White & Summers, supra note 27, at 865.
68. Id. at 74; see also White & Summers, supra note 27, at 865 n.9.
69. One could conceivably argue that the clause "unless otherwise agreed" in La. R.S. 10:5-109(1) allows for such a broad disclaimer.
70. White & Summers, supra note 27, at 865; see also Hawkland & Holland, UCC Series § 5-114:13 (1986).
71. White & Summers, supra note 27, at 865.
74. Id.
situations. *Holden* thus serves as a strong warning and incentive for banks to exercise extreme precaution when paying on a letter of credit. After *Holden*, a bank cannot merely wink at the credit when paying.

*Tracy L. Howard*