Letters of Credit: ISP98 Forms, UCC Article 5, UCP, Draw Procedures and More

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Today’s faculty features:

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Letters of Credit: Understanding the ISP98 Forms, UCC Article 5, UCP, Draw Procedures and More

Drafting Commercial vs. Standby, Conditional vs. Unconditional, Limited Term vs. "Evergreen" and Transfer Provisions

Jacob Manning is a partner at Dinsmore & Shohl, and advises clients in a variety of business transactions, both domestic and cross-border, in contracts, sales of goods, distributorships and licensing, construction, vendor and services. He also advises on commercial fraud.

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Walter (Buddy) Baker is a Vice President in the Investment Banking Division of Goldman Sachs & Co. and has over 40 years of experience in international trade finance. An author of numerous articles and books on letters of credit and related topics, he is actively involved in projects to standardize national and international practices around letters of credit.

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I. Definitions
II. Types of LCs—commercial vs. standby
III. Collateral and other bank requirements for issuance
IV. LC laws and rules
   A. UCC Article 5
   B. International Standby Practices 1998 (ISP98)
   C. Uniform Customs and Practice for Documentary Credits (UCP)
   D. Standard forms
V. Deal-specific concerns
   A. Conditional vs. unconditional
   B. Limited (typically one year) term vs. evergreen
   C. Transferability
VI. Draw procedures
VII. Bankruptcy considerations
VIII. Alternative credit enhancements
I. DEFINITIONS

- **Letter of Credit**
  - Bank undertakes to pay a named beneficiary upon the timely presentation of complying documents

- **“Applicant”** applies to **“Issuer”** (bank) which issues the LC to **“Beneficiary”**

- **“Beneficiary”** presents complying documents to Issuer (or **“Confirmer,”** or **“Nominated Bank”**)

- Issuer and confirmer must **“honor”** a complying presentation and pay Beneficiary or **“dishonor”** a non-complying presentation
I. DEFINITIONS

- **Buyer/Applicant**
- **Seller/Beneficiary**
- **Contract**
- **3 parties**
  - 3 independent contracts
- **Letter of Credit Application & Reimbursement Agreement**
- **Buyer’s Bank/Issuer**
- **Letter of Credit**
I. DEFINITIONS

- **Nominated Bank**
  - Issuing Bank may authorize another bank to receive documents and pay Beneficiary
  - Nominated Bank is not authorized to confirm the letter of credit and may not pay until it examines documents and determines that they comply with the LC requirements
  - Nominated Bank obtains reimbursement from Issuing Bank

- **Negotiating Bank**
  - Issuing bank may authorize another bank to purchase documents from the Beneficiary (usually at a discount)
I. DEFINITIONS

- **Advising Bank**
  - Issuing bank may utilize another bank to notify the Beneficiary that the letter of credit has been issued or amended
  - No intrinsic authorization to pay Beneficiary or seek reimbursement

- **Confirmation**
  - If Seller is unfamiliar with Buyer’s Bank or cannot trust the letter of credit practice or law in the country where Buyer’s Bank is located, the Buyer’s Bank may authorize a local bank to confirm the letter of credit
  - Confirming Bank in effect issues a parallel letter of credit to Beneficiary and seeks reimbursement from Buyer’s Bank
I. DEFINITIONS

- **Confirmation**—Two Additional Obligations
II. TYPES OF LCs

- **Commercial Letter of Credit**
  - Bank undertakes to pay to Seller the purchase price of the goods upon receipt of Seller’s invoice or other documents evidencing Seller’s right to payment of the purchase price.
  - Other documents may be transport, insurance, customs, inspection, etc.
II. TYPES OF LCs

- **Standby Letter of Credit**
  - Obligations are the same: Bank undertakes to pay upon the timely presentation of complying documents.
  - Often used in transactions other than the sale of goods.
  - Beneficiary typically presents a demand with a statement that Applicant is obligated to pay Beneficiary the stated amount.
III. BANK REQUIREMENTS

- Collateral and other bank requirements
  - Application
  - Reimbursement agreement
  - For the vast majority of applicants (with the exception of investment-grade companies), the issuing bank will require 100% collateral, exclusive of applicable fees
  - Fees for LCs typically range, like loan spreads
  - Standby LC fees typically payable quarterly; commercial LC fees are charged as you go
IV. LETTER OF CREDIT LAWS & RULES

- United States
  - Uniform Commercial Code, Article 5
- United Nations Convention on Independent Guarantees and Standby Letters of Credit
- People’s Republic of China (New Statute)
  - The Provisions of the Supreme People’s Court on Several Issues Concerning the Trial of Disputes over Letters of Credit (the LC Judicial Interpretations)
- Uniform Customs and Practice for Documentary Credits ("UCP600") (ICC Publication No. 600)
  - International Standard Banking Practice for the Examination of Documents Under Documentary Credits ("ISBP") (ICC Publication No. 745)
- International Standby Practices ("ISP98") (ICC Pub. No. 590)
Scope (Article 5-103)

- “This article applies to letters of credit and to certain rights and obligations arising out of transactions involving letters of credit.”
  - Article 5 does not attempt to cover all rights and obligations
  - UCP600 or ISP98 may still apply by reference
  - Does not apply to “guarantees”
- “With the exception of . . . [certain Sections] . . . the effect of this Article may be varied by agreement or by a provision stated or incorporated by reference in an undertaking.”
  - General disclaimer of liabilities is not sufficient.

UCC ARTICLE 5
Independence Principle (5-103(d))

“Rights and obligations of an issuer to a beneficiary or a nominated person under a letter of credit are independent of the existence, performance, or nonperformance of a contract or arrangement out of which the letter of credit arises or which underlies it, including contracts or arrangements between the issuer and the applicant and between the applicant and the beneficiary.”

- Distinguish “guarantees”
- Exception for the defense of a fraudulent drawing
- Reverse of the independence principle is not true
Formal Requirements (5-102(10) & 5-104)

- Record (includes SWIFT transmissions)
- Authenticated
  - By a signature or
  - In accordance with an agreement of the parties or standard practice
- Definite undertaking by an issuer to a beneficiary at the request of an applicant to honor a documentary presentation by payment or delivery of an item of value
APPLICATION OF THE UCP TO STANDBY CREDITS

- All Credits
  - Expiry
  - Time allowed for document examination
  - Parts of the procedure for refusal
  - Confirmation
  - Force majeure

- Commercial Only
  - Transport docs
  - Acceptance and negotiation of drafts
  - Parts of the procedure for refusal
  - Insurance
  - Partial shipments
  - Installment shipments
  - Late presentation
  - Partial transfers
  - Assignment of proceeds
- Continuing problem with lawsuits involving standbys
- UCP reflects commercial LC practice
  - standby practice sometimes differs (e.g., Articles 17 (Force Majeure), 41 (Installment Drawings), 43 (Late Presentation), & 48 (Transfers))
  - many practices are not covered in the UCP
- Sometimes UCP is unclear (or wrong)
- URDG too vague

**WHY WAS THE ISP CREATED?**
<table>
<thead>
<tr>
<th></th>
<th>UCP600</th>
<th>ISP98</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Force majeure</strong></td>
<td>LC expires nonetheless</td>
<td>Expiry extended 30 days after bank re-opens</td>
</tr>
<tr>
<td><strong>Consistency of documents</strong></td>
<td>Data in documents must not conflict</td>
<td>Documents need not be consistent</td>
</tr>
<tr>
<td><strong>Time allowed for dishonor</strong></td>
<td>5 banking days</td>
<td>&lt;4 days = reasonable</td>
</tr>
<tr>
<td></td>
<td></td>
<td>&gt;7 days = unreasonable</td>
</tr>
<tr>
<td><strong>Original documents</strong></td>
<td>“In __ copies” means one original of each document</td>
<td>“Copies” means copies</td>
</tr>
<tr>
<td><strong>Transport documents</strong></td>
<td>Extensive, detailed requirements</td>
<td>Treated like “other” documents</td>
</tr>
<tr>
<td><strong>Disposition of documents</strong></td>
<td>Strict requirements</td>
<td>No requirements</td>
</tr>
<tr>
<td><strong>Deemed acceptance of amendments</strong></td>
<td>If documents comply w/ amended terms</td>
<td>If documents will not comply w/o amendment</td>
</tr>
<tr>
<td><strong>Transfer</strong></td>
<td>One time but multiple partial transfers allowed</td>
<td>Multiple times but always in entirety</td>
</tr>
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**UCP VS. ISP**
Form 1: Model Standby Incorporating Annexed Form of Payment Demand with Statement
Form 2: Model Standby Providing for Extension and Incorporating Annexed Form of Payment Demand with Alternative Non-Extension Statement
Form 3: Model Standby Providing for Reduction and Incorporating Annexed Form of Reduction Demand
Form 4: Model Standby Providing for Transfer and Incorporating Annexed Form of Transfer Demand
Form 5: Simplified Demand Only Standby
Form 6: Model Counter Standby with Annexed Form of Local Bank Undertaking
Form 7: Model Standby Requiring Confirmation
Form 8: Model Confirmation of Standby
Form 11.1: Model Government Standby (U.S.)
[name and address of beneficiary] [date of issuance]

Issuance. At the request and for the account of [name and address of applicant] (“Applicant”),¹ we [name and address of issuer at place of issuance] (“Issuer”) issue this irrevocable² standby letter of credit number [reference number] (“Standby”)³ in favour of [name and address of beneficiary] (“Beneficiary”)⁴ in the maximum aggregate amount⁵ of [currency/amount].

Undertaking. Issuer undertakes to Beneficiary⁶ to pay⁷ Beneficiary’s demand for payment in the currency and for an amount available under this Standby⁸ and in the form of the Annexed Payment Demand completed as indicated⁹ and presented¹⁰ to Issuer at the following place for presentation: [address of place for presentation],¹¹ on or before the expiration date.¹²

Expiration. The expiration date of this Standby is [date].¹³

[Payment. Payment against a complying presentation shall be made within 3 business days¹⁴ after presentation at the place for presentation or by wire transfer to a duly requested account of Beneficiary. An advice of such payment shall be sent to Beneficiary’s above-stated address.]¹⁵

[Drawing. Partial and multiple drawings are permitted.]¹⁶

[Reduction. Any payment made under this Standby shall reduce the amount available under it.]¹⁷

ISP98. This Standby is issued subject to the International Standby Practices 1998 (ISP98) (International Chamber of Commerce Publication No. 590).¹⁸

[Communications. Communications other than demands may be made to Issuer by telephone, telefax, or SWIFT message, to the following: [numbers/addresses]. Beneficiary requests for amendment of this Standby, including amendment to reflect a change in Beneficiary’s address, should be made to Applicant, who may then request Issuer to issue the desired amendment.]²⁰

[Issuer’s name]

[signature] __________________________
Authorized Signature
Annexed Payment Demand

[INSERT DATE]\(^{21}\)

[name and address of Issuer or other addressee at place of presentation as stated in standby]\(^{22}\)

Re: Standby Letter of Credit No. [reference number], dated [date], issued by [Issuer’s name] (“Standby”)\(^{23}\)

The undersigned Beneficiary demands payment of [INSERT CURRENCY/AMOUNT] under the Standby.\(^{24}\)

Beneficiary states\(^{25}\) that Applicant\(^{26}\) is obligated\(^{27}\) to pay to Beneficiary the amount demanded[, which amount is due and unpaid\(^{28}\)] under[ or in connection with] the agreement\(^{29}\) between Beneficiary and Applicant\(^{30}\) titled [agreement title] and dated [date].

[Beneficiary further states that the proceeds\(^{31}\) from this demand will be used to satisfy\(^{32}\) the above-identified obligations and that Beneficiary will account to Applicant\(^{33}\) for any proceeds that are not so used.]

Beneficiary requests that payment be made by wire transfer to an account of Beneficiary as follows: [INSERT NAME, ADDRESS, AND ROUTING NUMBER OF BENEFICIARY’S BANK, AND NAME AND NUMBER OF BENEFICIARY’S ACCOUNT].\(^{34}\)

[Beneficiary’s name and address]\(^{35}\)

By its authorized officer:

[INSERT ORIGINAL SIGNATURE]\(^{36}\)

[INSERT TYPED/PRINTED NAME AND TITLE]
Extension. The expiration date of this Standby shall be automatically\(^2\) extended\(^3\) for successive one year periods, unless Issuer notifies Beneficiary by registered mail or other receipted means of delivery sent\(^4\) to Beneficiary’s above-stated address [\(30\)]\(^5\) or more days before the then current expiration date that Issuer elects not to extend the expiration date.\(^6\) The expiration date is not subject to automatic extension beyond [\(\text{date}\)]\(^7\), and any pending automatic one-year extension shall be ineffective beyond that date.\(^7\) [The expiration date may also be extended in accordance with the terms of an amendment issued by Issuer to which Beneficiary consents and in accordance with ISP98 rules on closure of the place for presentation on the expiration date.\(^8\)]

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Beneficiary states that

[INSERT ONE OF THE FOLLOWING ALTERNATIVE STATEMENTS\(^10\):]

Applicant is obligated to pay to Beneficiary the amount demanded[, which amount is due and unpaid] under[ or in connection with] the agreement between Beneficiary and Applicant titled [agreement title] and dated [\(\text{date}\)].\(^11\) [Beneficiary further states that the proceeds from this demand will be used to satisfy the above-identified obligations and that Beneficiary will account to Applicant for any proceeds that are not so used.]

or\(^12\)

the Standby is set to expire fewer than [\(30\)] days from the date hereof, because Issuer has given a notice of non-extension of the Standby,\(^13\) and\(^14\) the amount demanded is required as cash collateral to secure the unmatured or contingent obligations of Applicant under[ or in connection with] the agreement between Beneficiary and Applicant titled [agreement title] and dated [\(\text{date}\)]. Beneficiary further states that the proceeds from this demand will be used to secure\(^15\) the above-identified obligations and then to satisfy them as they become absolute and due and that Beneficiary will account to Applicant\(^16\) for any proceeds that are not so used.]
Reduction. Any payment made under this Standby shall reduce the amount available under it. Also, the amount available under this Standby shall be automatically reduced\(^1\) in accordance with the terms of Beneficiary’s reduction demand(s)\(^2\) in the form of the Annexed Reduction Demand completed as indicated and presented to Issuer at the above-stated place for presentation.\(^3\)

... Annexed Reduction Demand

[INSERT DATE]

[name and address of Issuer or other addressee at place of presentation as stated in standby]

Re: Standby Letter of Credit No. [reference number], dated [date], issued by [Issuer’s name] (“Standby”)

The undersigned Beneficiary demands\(^4\) reduction of the amount available under the Standby to the maximum aggregate of [INSERT CURRENCY/AMOUNT]).

Beneficiary states that this Demand for Reduction is based on Beneficiary’s determination regarding the maximum amount of standby support required to be provided to Beneficiary by Applicant under[ or in connection with] the agreement between Beneficiary and Applicant titled [agreement title] and dated [date].\(^5\)

Beneficiary’s demand and statements are made as of the date hereof.

[Beneficiary’s name and address]

By its authorized officer:

[INSERT ORIGINAL SIGNATURE]

[INSERT Typed/Printed Name and Title]\(^6\)
Transfer.\textsuperscript{1} This Standby is transferable.\textsuperscript{2} Beneficiary’s drawing rights under this Standby shall be transferred in their entirety by presentation of a demand\textsuperscript{3} in the form of the Annexed Transfer Demand completed as indicated \textit{together with this Standby}\textsuperscript{4} to Issuer at the above-stated place for presentation. Upon presentation\textsuperscript{5} of a complying demand for transfer, the person identified as the transferee shall become the Beneficiary, whose name and address \textit{and duly provided bank account information for any requested payment by wire transfer of funds} shall be substituted for that of the transferor on any demands, requests, or consents then or thereafter required or permitted to be made by Beneficiary.\textsuperscript{5} Subject to compliance with applicable law\textsuperscript{7} and receipt of its customary or agreed transfer fees\textsuperscript{8}, Issuer must acknowledge and shall effect the demanded transfer\textsuperscript{9} and shall issue its advice of transfer to the [transferor and \textit{transferee}]\textsuperscript{10}.

Annexed Transfer Demand

[INSERT DATE]

[\textit{name and address of Issuer or other addressee at place of presentation as stated in standby}]

Re: Standby Letter of Credit No. [\textit{reference number}], dated [\textit{date}], issued by [\textit{Issuer’s name}] (“Standby”)

The undersigned Beneficiary demands\textsuperscript{11} transfer of drawing rights in their entirety, including rights to demand further payment, \textit{reduction, cancellation}, and transfer\textsuperscript{12} under the Standby and rights to give or withhold consent to any pending or future amendment or cancellation, to the following person at the following address: [INSERT NAME AND ADDRESS OF THAT PERSON]

[\textit{and with the following bank account for payment by wire transfer of funds to that person} [INSERT NAME, ADDRESS, AND ROUTING NUMBER OF THAT PERSON’S BANK AND NAME AND NUMBER OF THAT PERSON’S ACCOUNT]].

Beneficiary states that the above-identified person is the transferee, from and after the effective date stated below, of all of Beneficiary’s rights that are supported by the Standby \textit{and Beneficiary’s related obligations} under\textit{[ or in connection with]} the agreement between Beneficiary and Applicant titled [\textit{agreement title}] and dated [\textit{date}].\textsuperscript{13}

Beneficiary further states that there are no outstanding demands by Beneficiary for any other transfer or for any payment, \textit{or for any reduction or cancellation} under the Standby. Beneficiary agrees to make no such demands or requests while this demand is outstanding.

[\textit{Accompanying this demand is the Standby}]\textsuperscript{14}

Please effect the demanded transfer \textit{as of the following effective date: [INSERT DATE]}\textsuperscript{15} \textit{by marking and delivering the Standby or by delivering a replacement to the above-identified person as the transferee beneficiary and then notify the undersigned thereof.}

[\textit{Also accompanying this demand is Issuer’s transfer fee of an amount equal to [percentage amount]% of the amount of the standby to be transferred but not to exceed [currency/amount]}]

[\textit{Beneficiary’s name and address}]

By its authorized officer:

[INSERT ORIGINAL SIGNATURE]

[INSERT TYPED/PRINTED NAME AND TITLE]\textsuperscript{16}
[name and address of beneficiary] [date of issuance]

On the application of [name and address of applicant], we, [name and address of issuer], issue in your favour this standby letter of credit No. [number] subject to the International Standby Practices 1998 (ISP98) (ICC Publication No. 590)¹ in the amount of [currency/amount], payable² against presentation of your demand³ to us at [address of place for presentation]⁴ on or before [date].⁵

[Issuer’s name]
[signature] ___________________.
Authorized Signature

FORM 5: MINIMUM CONTENT

This is a counter standby³ letter of credit supporting Beneficiary’s issuance of its separate [local bank] undertaking⁴ in the form of the Annexed Local Undertaking⁵[ to be issued on or before [date]].⁶

Issuer undertakes to Beneficiary to pay Beneficiary’s demand that includes⁷ Beneficiary’s statement⁸ that Beneficiary issued its Local Undertaking as provided in the Counter Standby and has received [and honoured] a complying demand under its Local Undertaking in the amount hereby demanded from Issuer, if Beneficiary’s demand is presented to Issuer on or before the expiration date either as an originally signed paper document at Issuer’s above-stated address or as an authenticated SWIFT message sent to Issuer’s SWIFT address [SWIFT code] from Beneficiary’s SWIFT address [SWIFT code].⁹

FORM 6: COUNTER-STANDBY
[name and address of beneficiary or nominated person or both] [date of issuance]

Issuance. At the request and for the account of [name and address of applicant] ("Applicant"), we [name and address of issuer at place of issuance] ("Issuer") issue this irrevocable standby letter of credit number [reference number] ("Standby") in favour of [name and address of beneficiary] ("Beneficiary") in the maximum aggregate amount of [currency/amount].

Expiration. The expiration date of this Standby is [date].

Nomination. Issuer nominates [name and address of nominated person] to advise and confirm this Standby. Confirmation required. If the nominated person does not issue its confirmation on or before [date], then this Standby shall be automatically cancelled. 

Presentations. If the nominated person issues its confirmation to Beneficiary, then all presentations must be made to the nominated person ("Confirmers") at a place of presentation stated in its confirmation ("Confirmation"). Presentations by Beneficiary to Issuer shall not affect Issuer's obligations under this Standby and may be disregarded by Issuer, whether or not this Standby is confirmed.

Undertaking. Issuer undertakes to Beneficiary and to Confirmers that Issuer shall honour this Standby by reimbursing Confirmers for Confirmers' payment if Confirmers rightfully honours a presentation made under its Confirmation if the document(s) presented to Confirmers on or before the above-stated expiration date are promptly forwarded by Confirmers to Issuer for examination by Issuer, and if the forwarded documents include the following: Beneficiary's demand that (i) identifies this Standby (by the name and address of the Issuer and of the Applicant and reference number for this Standby, as shown above) and identifies the Confirmation (by the name and address of the Confirmers and reference number for the Confirmation), (ii) is dated and signed by Beneficiary, and (iii) states that Applicant is obligated to pay to Beneficiary the amount demanded under the agreement between Beneficiary and Applicant titled [agreement title] and dated [date]. This is Issuer's only undertaking. Issuer disclaims any obligation based on Issuer's dishonour of its obligations.

[Charges. Beneficiary shall be solely responsible for payment of Confirmers' fees and charges under or in connection with its Confirmation. Issuer disclaims for itself and Applicant any responsibility for Confirmers' fees, costs, or other charges under ISP98 Rule 8.02 or otherwise.]

[Communications. Communications other than documents forwarded by Confirmers may be made to Issuer by telephone, telefax, or SWIFT message, to the following: numbers/ addresses. Confirmers/nominated person should promptly communicate to Issuer whether, when, and how it advises and confirms this Standby. Beneficiary requests for amendment of this Standby, including amendment to reflect a change in Beneficiary's address, should be made to Applicant, who may then request Issuer to issue the desired amendment subject to Confirmers' consent.]

[Issuer's name]

[signature] ______________________

Authorized Signature
FORM 8: CONFIRMATION

[Form 8: Confirmation]

[Name and address of beneficiary as stated in standby] [Date of issuance]

We [Name and address of confirmer at place of issuance] (“Confirmer”) issue this irrevocable confirmation number [Reference number] (“Confirmation”) in favour of [Name and address of beneficiary] (“Beneficiary”) in the maximum aggregate amount of [Currency/amount]. Confirmer is nominated to issue this Confirmation under standby letter of credit number [Reference number] (“Standby”) issued by [Name of standby issuer and its address at place of standby issuance] (“Issuer”) on the application of [Name and address of applicant] (“Applicant”).

Confirmer undertakes to Beneficiary to pay Beneficiary’s demand for payment in the currency and for an amount available under this Confirmation that (i) identifies this Confirmation (by the name and address of the Confirmer and reference number for this Confirmation, as shown above) and identifies the Standby (by the name and address of the Issuer and of the Applicant and reference number for the Standby, as shown above), (ii) is presented to Confirmer at the following place for presentation to Confirmer: [Address of place for presentation], on or before the expiration date, (iii) is dated and signed by Beneficiary, and (iv) states that Applicant is obligated to pay to Beneficiary the amount demanded under the agreement between Beneficiary and Applicant titled [Agreement title] and dated [Date].

The expiration date of this Confirmation is [Date].

Confirmer’s undertakings to Beneficiary are limited to presentations made to Confirmer under this Confirmation. Confirmer disclaims responsibility under ISP98 Rule 2.01 or otherwise for any presentation Beneficiary makes to Issuer.

All of Confirmer’s obligations under this Confirmation shall terminate automatically upon Beneficiary’s making a presentation to Issuer under the Standby unless such presentation is made (i) through Confirmer or otherwise with Confirmer’s express consent or (ii) to enforce a presentation wrongfully dishonoured by Confirmer.

[This Confirmation shall be automatically cancelled on [Date] if Confirmer has not received before that date Beneficiary’s payment of Confirmer’s fees and charges for issuing this Confirmation, as follows: [Currency/amount], and either payment or satisfactory assurance of payment of Confirmer’s other fees and charges in connection with this Confirmation, as follows: [Description of other fees and charges].]

This Confirmation is issued subject to the International Standby Practices 1998 (ISP98) (International Chamber of Commerce Publication No. 590).

[Communications to Confirmer about this Confirmation other than demands may be made by telephone, telefax, or SWIFT message, to the following: [Numbers/addresses]. Beneficiary requests for amendment of this Confirmation, including amendment to reflect a change in Beneficiary’s address, should be made to the Issuer’s Applicant, who may then request issuance of the desired amendment of the Standby and this Confirmation.]

[Confirmer’s name]
[Signature]
Authorized Signature
[name and address of beneficiary] [date of issuance]

Issuance. At the request and for the account of [name and address of applicant] (“Applicant”), we [name and address of issuer at place of issuance] (“Issuer”) issue this irrevocable independent standby letter of credit number [reference number] (“Standby”) in favor of [name and address of beneficiary] (“Beneficiary”) in the maximum aggregate amount of USD [amount].

Undertaking. Issuer undertakes to Beneficiary to pay Beneficiary’s demand for payment for an amount available under this Standby and in the form of Annex A (Payment Demand) [or Annex B (Payment Demand after Notice of Non-extension)] completed as indicated and presented to Issuer at the following place for presentation: [address of place for presentation], at or before the close of business on the expiration date.

Overdrawing. If a demand exceeds the amount available, but the presentation otherwise complies, Issuer undertakes to pay the amount available.

Expiration. The expiration date of this Standby is [specific calendar date, e.g., the date one year after issuance date].

Automatic Extension. The expiration date of this Standby shall be automatically extended for successive one-year periods, unless [30] or more calendar days before the then current expiration date Issuer gives written notice to Beneficiary that Issuer elects not to extend the expiration date. Issuer’s written notice must be sent [by registered, certified, or priority express mail or nationally recognized overnight courier] to Beneficiary’s above-stated address [and to the attention of [office, officer, or other attention party]] or, alternatively, be received by Beneficiary’s attention party [30] or more calendar days before the then current expiration date. The expiration date is not subject to automatic extension beyond [specific calendar date, e.g., the date five years after issuance date], and any pending automatic one-year extension shall be ineffective beyond that date.

Payment. Payment against a complying presentation shall be made within three business days after presentation at the place for presentation or by wire transfer to a duly requested account of Beneficiary.

ISP98. This Standby is issued subject to the International Standby Practices 1998 (ISP98) (International Chamber of Commerce Publication No. 590).

Issuer’s Charges and Fees. Issuer’s charges and fees for issuing, amending, or honoring this Standby are for Applicant’s account and shall not be deducted from any payment Issuer makes under this Standby. [Issuer undertakes to Beneficiary to pay the charges and fees of any bank nominated in this Standby to advise [and confirm] this Standby for acting on such nomination.]

[Communications. Communications other than demands may be made to Issuer in the manner and at the place for presentation and also as follows: [addresses for mailed, couriered, telephone, telex, or electronic communications] Communications other than for notices of non-extension may be made to Beneficiary at Beneficiary’s above-stated address and also as follows: [addresses for mailed, couriered, telephone, telex, or electronic communications].]

[Issuer’s name]  
[signature]  
Authorized Signature
Annex A: Payment Demand

[INSERT DATE]

[name and address of Issuer or other addressee at place of presentation as stated in standby]

Re: Standby Letter of Credit No. [reference number], dated [date], issued by [Issuer’s name] (“Standby”).

The undersigned Beneficiary demands payment of USD [INSERT AMOUNT] under the Standby.

Beneficiary states that Applicant is obligated to pay to Beneficiary the amount demanded as provided in [the contract, regulation, or other document that identifies the underlying obligations to the government beneficiary].

Beneficiary requests that payment be made by wire transfer to an account of Beneficiary as follows: [INSERT NAME, ADDRESS, AND ROUTING NUMBER OF BENEFICIARY’S BANK, AND NAME AND NUMBER OF BENEFICIARY’S ACCOUNT].

[Beneficiary’s name and address]
By its authorized officer:
[INSERT ORIGINAL SIGNATURE]
[INSERT TYPED/PRINTED NAME AND TITLE]
[Annex B: Payment Demand after Notice of Non-extension]

[INSERT DATE]

[name and address of Issuer or other addressee at place of presentation as stated in standby]

Re: Standby Letter of Credit No. [reference number], dated [date], issued by [Issuer’s name] ("Standby").

The undersigned Beneficiary demands payment of USD [INSERT AMOUNT] under the Standby.

Beneficiary states that the Standby is set to expire fewer than [30] days from the date hereof because Issuer has given a notice of non-extension of the Standby[, no retraction of the non-extension notice or satisfactory replacement standby has been timely received,] and the amount demanded is required to secure the obligations of Applicant as provided in [the contract, regulation or other document that identifies the underlying obligations to the government beneficiary].

Beneficiary requests that payment be made by wire transfer to an account of Beneficiary as follows: [INSERT NAME, ADDRESS, AND ROUTING NUMBER OF BENEFICIARY’S BANK, AND NAME AND NUMBER OF BENEFICIARY’S ACCOUNT].

[Beneficiary’s name and address]

By its authorized officer:

[INSERT ORIGINAL SIGNATURE]

[INSERT TYPED/PRINTED NAME AND TITLE]
Annex C: Demand for Change of Beneficiary’s Address

[INSERT DATE]

[name and address of Issuer or other addressee at place of presentation as stated in standby]

Re: Standby Letter of Credit No. [reference number], dated [date], issued by [Issuer’s name] (“Standby”).

The undersigned Beneficiary demands that its address for sending all communications related to the Standby be changed from [INSERT PRIOR ADDRESS] to [INSERT NEW ADDRESS], effective on the later of Issuer’s receipt or [INSERT DATE].

[Beneficiary’s name and address]

By its authorized officer:

[INSERT ORIGINAL SIGNATURE]

[INSERT TYPED/PRINTED NAME AND TITLE]
V. DEAL SPECIFIC CONCERNS
A. CONDITIONAL VS. UNCONDITIONAL

- **Nondocumentary Conditions** (UCC 5-108(g))
  - “If an undertaking constituting a letter of credit under Section 5-102(a)(10) contains nondocumentary conditions, an issuer shall disregard the nondocumentary conditions and treat them as if they were not stated.”
  - Examples:
    - “Shipment must not be made on vessels more than 15 years old”
    - An award by a “duly-appointed arbitrator”
    - Differing certifications depending on the nature of default
  - Exception (where condition is central to issuer’s obligation):
    - Example: where issuer is required to determine whether Beneficiary performed or Applicant defaulted
V. DEAL SPECIFIC CONCERNS

A. CONDITIONAL VS. UNCONDITIONAL

- **Preclusion Rule** (UCC 5-108)
  - Issuer shall honor a presentation that appears on its face to comply with the terms and conditions of the letter of credit
  - "(c) Except as otherwise provided in subsection (d), an issuer is precluded from asserting as a basis for dishonor any discrepancy if timely notice is not given, or any discrepancy not stated in the notice if timely notice is given."
  - Exceptions for fraud, forgery, or expiration
Expiration Dates (UCC 5-106(c) & (d))

“(c) If there is no stated expiration date or other provision that determines its duration, a letter of credit expires one year after its stated date of issuance or, if none is stated, after the date on which it is issued.”

“(d) A letter of credit that states that it is perpetual expires five years after its stated date of issuance, or, if none is stated, after the date on which it is issued.”
Example

Golden West Refining Co. v. SunTrust Bank, 538 F.3d 1233 (9th Cir. 2008)

- “This letter of credit shall expire one year from the date hereof provided however, that it shall be deemed automatically renewed without amendment for additional one year periods from the present or any future expiration date hereof, unless at least 30 days prior to any such date(s), [Beneficiary] shall have sent [Issuing] Bank notice by certified mail, return receipt requested, or overnight courier service that [Beneficiary] elects not to require this letter of credit renewed for any such additional period.”

- When does the letter of credit expire?
Example (continued)

Courts hold that

- Because the letter of credit did not use the word, “perpetual” the five-year expiration date does not apply
- Because the Beneficiary may terminate, the letter of credit had an expiration

Issues

- Letters of credit are intended to be obligations of limited duration
- Over-emphasis on the word, “perpetual” instead of provisions’ effect
- UCC Section 5-106(d) is a non-variable provision

V. DEAL SPECIFIC CONCERNS

B. LIMITED TERM VS. EVERGREEN
Perpetual Letter of Credit (example no. 2)

“Perpetual Irrevocable Letter of Credit”

“The issuing bank understands that this perpetual irrevocable letter of credit posted in lieu of a wage bond may only be terminated with the approval of the [Beneficiary] . . . .”
EVERGREEN LETTERS OF CREDIT

- Contain language that says the expiration date automatically extends unless the bank sends notice of non-extension
- Commonly, extension is one year at a time
- Notice of non-extension must be sent a specified amount of time in advance, often 30 or 60 days
- Upon receipt of a notice of non-extension, the beneficiary is usually entitled to draw for the full balance of the LC
- No notice is sent of extension

*Evergreen clauses do create problems that might be avoided by issuing LCs with expiries that match the underlying agreements and/or by using amendments to extend expiry as necessary*
Transfer of Letter of Credit (UCC 5-112)

- “Except as otherwise provided in Section 5-113, unless a letter of credit provides that it is transferable, the right of a beneficiary to draw or otherwise demand performance under a letter of credit may not be transferred.”

- Provisions of letter of credit regarding who may draw are treated like documents and an attempted drawing by a transferee beneficiary without approval may be discrepant.
VI. DRAW PROCEDURES

- **Strict Compliance** (UCC 5-108)
  
  
  “(a) Except as otherwise provided in Section 5-109, an issuer shall honor a presentation that, as determined by the standard practice referred to in subsection (e), appears on its face strictly to comply with the terms and conditions of the letter of credit. Except as otherwise provided in Section 5-113 and unless otherwise agreed with the applicant, an issuer shall dishonor a presentation that does not appear so to comply.”
Strict Compliance (continued)

- Importantly, “strict compliance” is according to standard practice
- What is strict compliance depends on the item
  - Description of goods must be exact
  - Contents of documents not required for presentation need not be considered
  - Invoice for an amount in excess in the amount available under the letter of credit may be dishonored as discrepant or may be honored for the amount available
VI. DRAW PROCEDURES

- **Strict Compliance** (examples)
  - Discrepancies among documents
    - Letter of credit requires documents to indicate shipment date. Bill of lading indicates loading on one date and inspection certificates another.
    - Held: noncomplying.
  - Minor discrepancies
    - Letter of credit requires Beneficiary’s draft to state: “Drawn under NEMNB Credit No. 18506” but draft only says “No. 18506”.
    - Held: complying.
VI. DRAW PROCEDURES

- **Strict Compliance** (examples)
  - Minor discrepancy
    - Beneficiary’s draft was to indicate letter of credit number “G-0391” but said “GO391”
    - Held: complying
  - Minor discrepancies
    - Draft was to state “Drawn under Bank of Clarksville Letter of Credit Number 105” but instead stated “drawn under Bank of Clarksville, Clarksville, Tennessee letter of Credit No. 105”
    - Held: complying
VI. DRAW PROCEDURES

- **Examination of Documents** (5-108)
  - Bank has reasonable time not to exceed seven business days to examine documents to honor or give notice of discrepancies
    - Lesser of reasonable time or seven business days
    - Must give notice without delay
  - Contrast with UCP600 Article 14 (five banking days)
  - May seek waiver from Applicant
VI. DRAW PROCEDURES

- **Fraud and Forgery** (5-109)
  - Main contribution Article 5 makes to letter of credit law and practice
  - Presentation is made that is complying on its face but which would work a material fraud by the Beneficiary on the Issuer or Applicant
  - Issuer shall honor if presentation is made by Nominated Person, Confirmer, holder in due course, or assignee of Issuer’s or Nominated Person’s deferred obligation (in good faith, given value)
  - Issuer may honor in any other case if acting in good faith
Fraud and Forgery (continued)

- Practical for Issuer to honor in close cases even if Applicant claims fraud, since Issuer may be liable for wrongful dishonor
- Applicant may apply for an injunction preventing honor
- Standard for obtaining an injunction is necessarily high and must be supported by evidence that Applicant is likely to show fraud
- Breach of contract is normally not sufficient

VI. DRAW PROCEDURES
VI. DRAW PROCEDURES

- Remedies under the UCC
  - 5-115 (one year statute of limitations)
  - 5-111 (attorney’s fees and litigation expenses—including expert witness fees—must be awarded to prevailing party)
  - 5-108 (Issuer’s observance of standard practice is an issue for the Court, not the jury)
  - 5-111 (wrongful dishonor entitles Beneficiary to specific performance, incidental damages, interest, attorney’s fees, and costs; no need to mitigate damages)
  - 5-111 (wrongful honor entitles Applicant to same damages, but must mitigate)
LC draws are usually not prevented by bankruptcy

- 11 USC Section 541 creates an estate upon filing, which consists of “all legal and equitable interests of the debtor in property.”

- “The letter of credit is an independent third party obligation [of the issuer bank], and the proceeds are not the debtor’s property even if ... secured by the debtor’s property.” Keene Corp. v. Acstar Ins. Co., 162 B.R. 935 (S.D.N.Y. 1994)

- Most draws on LCs are not subject to the preference statute [11 USC Section 547(b)]. In re M.J. Sales & Distr. Co., Inc., 25 B.R. 608, 615 (Bk. SDNY 1982); but see, In re Air Conditioning, Inc. of Stuart, 845 F.2d 293, 299 (11th Cir. 1988).
Surety vs. LOCs

- Surety bonds
  - Conditioned upon principal’s default
  - Bond terms may give option to perform
  - Surety has principal’s & surety defenses

- LOCs
  - Independence principle
  - Strict compliance (time/form)

[Absent fraud or forgery, the issuer’s duty is merely to examine the documents and to honor if they comply ...]

See, Trans Meridian etc. v. Empresa Nacional etc., 829 F.2d 949, 956 (9th Cir. 1987)
## Surety vs. LOCs

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Letters of Credit: Understanding the ISP98 Forms, UCC Article 5, UCP, Draw Procedures and More
Drafting Commercial vs. Standby, Conditional vs. Unconditional, Limited Term vs. "Evergreen" and Transfer Provisions

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