



WORKING WITH LETTERS OF CREDIT

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Document Handouts – Examples ^(M)

- » L/C Contract Clause
- » Documentary L/C
- » Standby L/C
- » Draw Certificate
- » Sight Draft
- » Commercial Invoice
- » Bill of Lading

Presentation Overview (M)

- » What are Letters of Credit, and How Are They Used?
- » Types of Credits – Documentary vs Standby
- » Basic Elements of Credits
- » Governing Law and Rules – UCP600 vs ISP98
- » Document Requirements
- » Presentment and Honor/Dishonor
- » Enforcement and Fraud Issues
- » Practice issues

What are Letters of Credit, and How Are They Used? (M)

Basic Letter of Credit Concepts

- L/C = a contract between a bank (“issuer”) and a beneficiary to pay specified sum against presentment of conforming documents, coupled with a contract between an account party (or “applicant”) and issuer to reimburse issuer against draws by beneficiary
- L/C = two (some say three) independent contracts that are separately performed and enforced
- Fundamental commercial mechanism for non face-to-face trading: (i) substitutes a known, nearby party in seller’s home city for a distant, unknown buyer, and (ii) substitutes presentment of trustworthy documents that can be examined for actions that are hard to confirm
- Beneficiary presents documents to issuing bank, bank examines documents and either accepts documents and if documents are acceptable pays beneficiary (honors presentment), or rejects (dishonors) and returns documents to beneficiary
- Beneficiary relies on credit rating of issuer, rather than applicant

What are Letters of Credit, and How Are They Used? (G)

L/C arrangement consists of two separate and independent contractual relationships:

- » Letter of Credit - Issuer/Beneficiary – Issuer issues credit to beneficiary, pays beneficiary if documents presented are in order, dishonors and returns documents if not
- » Reimbursement or Indemnification Agreement - Applicant/Issuer – Issuer issues credit on applicant's behalf, reviews documents and if in order, pays beneficiary; applicant reimburses issuer for payment and costs

What are Letters of Credit, and How Are They Used? (G)

Reimbursement or Indemnification Agreement

- » Contract separate from the L/C, between Buyer (applicant) and Issuer (bank)
- » States applicant's obligation to reimburse issuer in the event of draw
- » Usually Reimbursement Agreement requires account party to post collateral in liquid form, CD or other cash instrument, or to assign accounts
- » Exculpatory provisions and indemnity, provides issuer may rely on conforming documents presented, not liable for honoring presentment if documents appear bona fide

What are Letters of Credit, and How Are They Used? (G)

Typical Use – Sales Transaction (Documentary L/C):

- Seller and Buyer in different cities or countries, or buyer has weak credit
- Seller and Buyer enter a sales contract (note sales contract is separate from the credit – may be a purchase order, single shipment sale contract, or longer term supply or distribution agreement)
- Seller must manage risk of getting paid before it acquires, manufactures or ships goods
- Buyer must manage risk of Seller's performance, make sure conforming goods are shipped in good condition with necessary documentation for import
- Sale contract term calling for Buyer to open a credit with a trusted bank for benefit of Seller, upon which Seller may draw, usually upon shipment of goods and presentment of required documents

OCEAN BILL OF LADING (K)

SHIPPER
(Seller/Exporter)

**CARRIER
(ORIGIN
FACILITY)**

1. CARRIER PICKS UP GOODS AT
ORIGIN

2. SHIPPER PAYS FREIGHT AND
COSTS TO CARRIER (IF B/L IS
FREIGHT PREPAID)

3. CARRIER ISSUES BILL OF
LADING (B/L) TO SHIPPER

5. SHIPPER SENDS B/L TO
CONSIGNEE (OR TO BANK
IF THERE IS L/C)

CONSIGNEE
(Buyer/Importer)



4. CARRIER
MOVES
GOODS

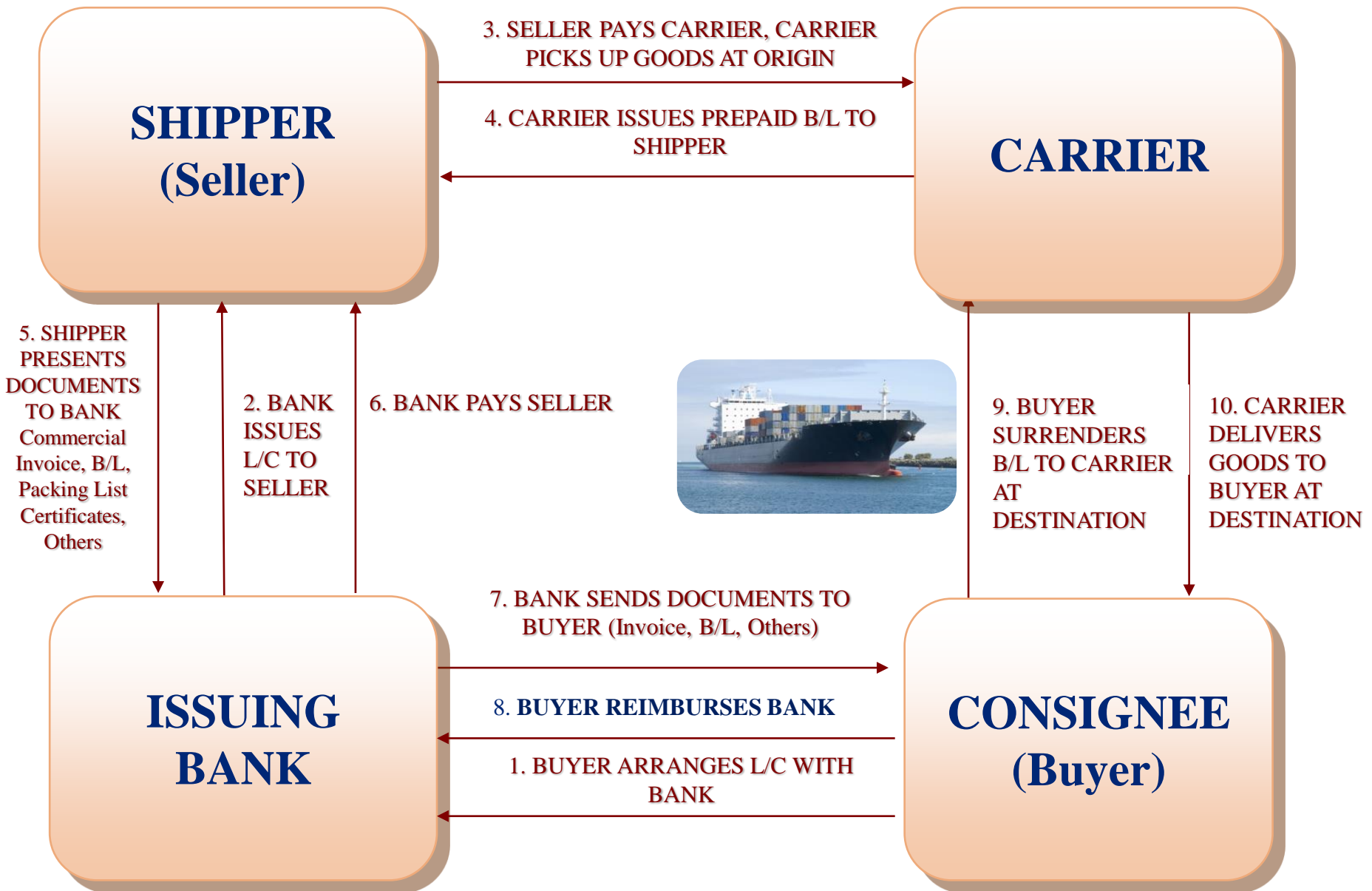
6. CONSIGNEE SURRENDERS B/L
TO CARRIER AT DESTINATION

7. CARRIER RELEASES GOODS TO
CONSIGNEE AT DESTINATION

8. CONSIGNEE PAYS
FREIGHT/COSTS \$ TO CARRIER
(IF B/L NOT FREIGHT PREPAID)

**CARRIER
(DESTINATION
FACILITY)**

DOCUMENTARY LETTER OF CREDIT (M)



What are Letters of Credit, and How Are They Used? ^(G)

Typical Use – Guarantee of Payment (Standby L/C)

- » Seller of land or building wants to be sure buyer has the purchase funds available and will pay at closing
- » Manufacturer wants to be sure dealer will pay for goods shipped on regular basis
- » Purchaser of commodities on long-term supply contract (grain, chemicals, electric power, coal, natural gas) wants protection from a strong financial institution credit against possible supplier default
- » Parties may use a standby credit that can be drawn if party owing the payments or obligation fails to perform timely

What are Letters of Credit, and How Are They Used? (G)

Distinguish L/Cs from similar demand instruments and mechanisms

- Bank Guaranty
- Collection Instructions
- Escrow

What are Letters of Credit, and How Are They Used? ^(G)

Distinguish L/C from Bank Guaranty

- » Bank guarantees beneficiary to pay on demand an amount owing to beneficiary (usually Seller) by its account party (usually Buyer)
- » No documents specified
- » Guaranty is less formal instrument, usually issued quickly to support a simple, low-risk commercial transaction step, e.g., release of cargo by carrier at destination where original negotiable bill of lading is lost or did not arrive on time
- » Usually does not have an expiry date
- » May not have a cap on amount
- » Governed by Uniform Rules for Demand Guarantees (URDG758)
- » Bank contractually obligated to the Seller

What are Letters of Credit, and How Are They Used? (G)

Distinguish L/C from Collection Instruction

- » Collection Instruction (now rarely used) is issued by Seller to a bank at the Buyer's location; Seller sends original negotiable title document, e.g., ocean carrier's bill of lading (B/L) to instructed bank for release to Buyer "against payment" or "against acceptance"
- » If release against payment, bank will give Buyer the B/L (entitling Buyer to receive goods from carrier) upon bank's receipt of Buyer's payment of amount specified in the Instruction
- » If release against acceptance, bank will give Buyer the B/L against execution of a locally enforceable acceptance document obligating Buyer to pay
- » Collection Instruments usually governed by ICC Uniform Rules for Collections (URC522)
- » Bank is not contractually obligated to the Buyer

What are Letters of Credit, and How Are They Used? (G)

Distinguish L/C from Escrow

- » Escrow agent is a neutral agent for two or more parties that agrees to accept, hold and deliver documents or funds deposited into escrow account by the parties
- » Escrow instructions are contingent upon escrow agent's receipt of all described documents and funds by a certain date; if all received, escrow distributes as instructed; if not escrow returns all items to original depositing party
- » Escrow agent does not have first party obligation to pay its own funds to any party; escrow agent's credit rating is irrelevant

Types of Credits – Documentary vs Standby (J)

Documentary Credit

- Intended as the actual payment mechanism for a transaction
- Parties expect to draw against L/C as goods are shipped or delivered
- Usually specifies multiple commercial documents mostly from third parties, always including a Commercial Invoice and shipping document (typically a Negotiable Bill of Lading or other Title Document), may include inspection certificate, packing list, certificate of origin, others
- Documents may be complex and lengthy, e.g., project cargo purchase order, packing list and shipping documents might be over 1,000 pages of technical documents and specifications
- May cover series of related shipments or installment payments, with multiple draws
- May be revolving credit e.g., bank issues documentary L/C for \$50M, revolving twice, meaning each time it is drawn down fully it reinstates back to full \$50M for subsequent draws

»

Types of Credits – Documentary vs Standby (J)

Standby Credit

- » Specifies simple, Seller-generated documents, usually no commercial documents, just demand for payment, plus (sometimes) a sight draft or time draft
- » Used as guaranty of payment, not intended to be drawn unless buyer fails to pay
- » Often used as additional credit support in structured finance or project finance transactions
- » Use for credit enhancement in long-term supply agreements, e.g., in power purchase or fuel supply agreement, supplier may have to post an L/C during the term to protect buyer against market risks from seller default
- » Substitutes financial institution credit rating for that of supplier; provides liquidity to buyer in case of dispute

Basic Elements of Credits (J)

Parties to L/C

- » *Applicant or Account Party* – party owing a payment or performance obligation - usually a Buyer, Consignee or Importer
- » *Beneficiary* – party owed a payment or performance obligation - usually a Seller, Shipper or Exporter
- » *Issuer* – usually Seller's bank, or well-known neutral bank acceptable to Seller – typically Seller wants a bank it can readily sue and enforce award against locally if there is a wrongful dishonor
- » *Confirming Bank* – if L/C issued at Buyer's end, Seller may require that a local bank at Seller's end "confirm" the credit – the confirming bank is legally obligated to beneficiary to honor presentment of conforming documents and make payment
- » *Advising Bank* – services the L/C at Seller's end as Issuer's agent, reviews documents presented, but not legally obligated to beneficiary to honor L/C

Basic Elements of Credits (J)

Confirming vs Advising Bank

- » Beneficiary might not trust applicant's bank, especially if it is foreign or not well known
- » Confirmation places confirming bank in same position as issuer, obligated to the beneficiary; beneficiary can sue non-performing confirming bank locally instead of proceeding against issuer abroad
- » If issuer is well known international bank, and submits to local jurisdiction at beneficiary's location, confirmation may not be needed
- » Advising bank is usually selected by issuer to handle local receipt and examination of documents;
- » Advising bank is agent for issuer, not liable to beneficiary for wrongful dishonor.

Basic Elements of Credits ^(M)

Procedure – Sale Contract provisions requiring the L/C:

- » The sale contract or other agreement to be supported by the L/C specifies terms, conditions and credit amount for the L/C
- » Sometimes the contract attaches a proposed form for the credit – this is usually futile because the issuing bank will use its own form
- » More effective is an exhibit containing the list of documents with detailed specifications, if any, and/or form of the draw certificate; these can be incorporated into the issuing bank's standard form of L/C
- » Usually sale contract provision will specify expiry date (or “evergreen” clause for automatic extensions of expiry date), criteria for the issuing bank (locality, credit rating, where presentment can be made); may require local confirming bank, may specify that multiple draws are allowed and that L/C is transferable, will state terms on which draws can be made by beneficiary (usually (i) breach of payment obligation or (ii) L/C is expiring and has not been replaced, may include (iii) buyer credit downgrade or bankruptcy)

Basic Elements of Credits

Procedure – Negotiating the L/C with the Issuing Bank:

- » The issuing bank will forward a draft of the credit for parties to review and negotiate
- » Banks can be very inflexible and stubborn about certain terms
- » Banks understandably do not want to have document specifications that are vague or ambiguous
- » Final credit will be issued by bank; may be signed original counterpart but now under “SWIFT” rules (discussed below) it can be electronic version marked “Original”

Basic Elements of Credits

Key Documentary and Standby Elements are the Same

1. Basic statement of undertaking between issuer and beneficiary, i.e. irrevocable credit f/b/o beneficiary
2. Amount of credit stated; may be multiple draws
3. Description of documents to be presented
4. Place and method for presentment
5. Expiry time, date/place
 1. “Expires at our counters at 5:00 PM, prevailing U.S. Eastern Time”
 2. Evergreen clause – “This credit will automatically be extended for an additional one (1) year unless we have notified you in writing thirty (30) days prior to the next expiry date that the credit will not be extended.”
6. May be transferable if so stated
7. May have automatic reduction or cancellation provisions
8. Governing law and rules

Basic Elements of Credits

Lawyer must be familiar with:

- » SWIFT - Society for Worldwide Interbank Financial Telecommunication – includes set of rules and abbreviations for L/Cs. SWIFT terms and abbreviations are now often used in L/Cs but SWIFT rules do not govern enforcement of L/C unless expressly incorporated therein
- » INCOTERMS – List of standard international sales contract price delivery terms, e.g. EXW, FOB, FAS, CIP (or CIF), CPT (or C&F), DAF, DDP – Note: These apply between buyer (account party) and seller (beneficiary) but do not govern or affect the enforcement of the L/C.
- » UCC Articles 3 and 7 — Commercial Paper, Negotiable Instruments (Bills of Lading, Warehouse Receipts)
- » Chartering Terms – e.g., SSHINC, AGWWPWOG
- » Everything Else – You have to know what you don't know

Basic Elements of Credits

- » L/Cs are always “irrevocable” but have an expiration date
- » Note – L/Cs are NOT UNCONDITIONAL – contract terms that call for Buyer to furnish an “irrevocable and unconditional” L/C create problems
- » L/C usually states beneficiary can draw full amount if L/C is about to expire and has not been extended or replaced
- » L/C sometimes allows beneficiary to draw down the L/C and hold cash as security if applicant becomes bankrupt or experiences a credit downgrade
- » Applicant’s obligation to maintain L/C, and the expiry date, is often set as 98 days after the last payment is made on any obligation – this protects against bankruptcy preference clawback

Basic Elements of Credits

Automatic reduction or cancellation clauses

- » L/C may have a provision stating the amount of the credit will automatically be reduced from \$X to \$Y on a given date, or upon presentment of an instruction from beneficiary, sometimes on presentment of a specific document by applicant proving a condition has been satisfied
- » This mechanism is used where the risk secured by a standby credit declines over the term, e.g. commodity supply agreement where remaining market risk declines as fewer months or years remain
- » Note that L/C cannot be automatically increased unless account party amends the reimbursement agreement with issuer and provided additional collateral or pledged balances
- » Issuer can only act on a document instruction from parties; cannot effect reduction based on external event or satisfaction of condition

Governing Law and Rules – UCP600 and ISP98

- » Choice of Law – invariably issuer selects applicable law; may be issuer's location but frequently for US credits choice is New York law
- » Parties are free to contract around code provisions
- » US Uniform Commercial Code Article 5 governs L/Cs, but is only a “gap filler” to extent parties do not expressly address issues in the L/C contract
- » Parties also always incorporate a set of governing rules
- » Trumping rules – express provision in L/C will supersede inconsistent incorporated governing rules and UCC; incorporated governing rules will supersede inconsistent provision of UCC

Governing Law and Rules – UCP600 and ISP98

Uniform Commercial Code (“UCC”)

- The UCC has been adopted (with minimal variation) in all 50 states as governing law for commercial sales and trades.
- Article 5 governs letters of credit and provides for considerable concession to other “rules of custom or practice.”

Uniform Customs and Practice for Documentary Credits (“UCP 600”)

- Model rules developed by the International Chamber of Commerce in 1933; widely cited standard practice throughout the world. The current version, UCP 600, was issued in 2007.
- UCP 600 is a uniform set of terms, rules, customs and practices for Letters of Credit comprised of 38 separate articles.
- UCP is used in 175 countries around the world with varying levels of formality. Notable adoptees include the state of New York and the United Kingdom.

International Standby Practices (“ISP 98”)

- These model rules were developed in the 1990s by the Institute of International Banking Law & Practice (and Prof. James Byrne of George Mason Law School) and are widely cited as common practice for standby credits.

Governing Law and Rules – UCP600 and ISP98

- » Default to UCC
 - Unless otherwise specified in the contract, the standard UCC terms will apply to the Letter of Credit in as adopted by the relevant jurisdiction. §5-116(b); NY UCC § 5-102(4) – if UCP applies, UCP supersedes UCC
- » Electing an Alternate Forum §5-116(a)
 - To successfully elect a jurisdiction, the parties must do so explicitly in writing that is “signed or otherwise authenticated” by them.
 - Jurisdiction need not relate to the transaction. (New York is a commonly used jurisdiction across the globe.)
- » Electing an Alternate Choice Law §5-116(c)
 - Like jurisdiction, to successfully elect a governing law, the parties must do so explicitly in writing that is “signed or otherwise authenticated” by them.
 - The parties may be “governed” by any rules of custom or practice to which the Letter of Credit references.
 - The UCP is explicitly identified as an alternate source of law in the text of the UCC.
 - The elected law still governs in the event of a conflict between the UCC and the UPC 600, or alternate source of law. §5-116(c) (iii)

Governing Law and Rules – UCP600 and ISP98

L/Cs invariably governed by set of governing rules designated by parties:

- » Documentary L/Cs – Uniform Customs and Practices (UCP600)
- » Standby L/Cs – International Standby Practices (ISP98) or UCP600
- » Note – UCP600 can be used to govern both standby and documentary L/Cs, but ISP98 does not work for documentary credits
- » UCP600 and ISP98 are in use worldwide
- » Note – rarely, some banks still use UCP500 older version

Governing Law and Rules – UCP600 and ISP98

Some differences between UCP600 and ISP98 :

- » Procedural and timing differences
- » ISP98 automatically extends expiry date for draw if issuer is closed; UCP600 does not
- » UCP obligates issuer to review documents for consistency, but ISP98 does not – consistency is not an issue with a standby credit
- » External differences – UCP is mentioned in some states' UCC provisions, with UCP to trump inconsistent UCC provisions
- » Other differences

Governing Law and Rules – UCP600 and ISP98

Standby L/Cs - Choice between UCP600 and ISP98

- » Standby L/Cs can be governed by UCP600
- » UCP600 is not ideal for standby credits (discuss differences)
- » Some issuers, especially outside the USA, cling to UCP600 for standbys
- » Many government and corporate procurement RFP/Tender rules also require UCP600 for standbys
- » General reason is that issuers, government tendering authorities have just been using UCP since 1930s, are not aware of ISP98, do not understand its benefits or the limitations of UCP for standbys

Elements of Governing Rules

- Defines obligations of issuer, beneficiary and account party
- Basic rules for contents of L/Cs
- Procedural rules for presentment, examination and honor/dishonor of documents
- Rules for document contents
- Timing rules
- Transferability rules

Non-Documentary Conditions

- Under both UCP600 and ISP98, non-documentary items are disregarded by issuer
- E.g., a condition that beneficiary may draw if applicant is in default on sales contract is disregarded, or a condition that beneficiary may draw if applicant's stock price drops below \$X or if applicant becomes bankrupt is unenforceable by beneficiary
- Issuer is not required to investigate external circumstances, conditions or events; issuer's only duty is to examine documents presented to see if they match those described in the L/C
- Parties may structure a draw so that beneficiary can present a document stating that a circumstance has occurred as a condition of a draw, e.g., (i) a common standby requirement for draw is that beneficiary presents a certificate signed by an officer stating that applicant is in default under the sale contract, and beneficiary is entitled to draw \$X, or (ii) beneficiary could present an officer's certificate attaching a copy of a newspaper showing published NYSE stock closing price below \$X.

Governing Law and Rules – UCP600 and ISP98 (M)

- Draws - default rule – under both UCP and ISP multiple draws allowed unless L/C expressly says single draw only
- Procedural rules for presentment, examination and honor/dishonor of documents
- Rules for document contents
- Interpretation – e.g., “approximately” means +/- 10%

Timing rules

- L/C may specify how many days issue has to examine documents
- Under UCP600, 5 banking days maximum time
- Under ISP98, reasonable time is not less than 3 days; more than 7 days is unreasonable

Governing Law and Rules – UCP600 and ISP98 ^(J)

Lost Credit Original Counterpart

- » Beware of ISP98 Rule 3.12(a) which states issuer is not obligated to replace a lost original credit; usually issuer will reissue, or may check with account party to get permission to re-issue
- » This happens more often than you would think; L/Cs are put away in files and misplaced, and when beneficiary wants to draw years later it cannot be found
- » Draft around this rule – state that issuer will replace a lost original credit upon reasonable request; or state that a copy of the credit may be presented with draws, rather than the original counterpart

Governing Law and Rules – UCP600 and ISP98 (J)

Transferability Rules

- » Default rule – L/C not transferable unless the L/C states it is transferable (UCP Art. 38; ISP98 Rule 6); L/C usually transferable only in whole not in part
- » Transferable credit usually has form of transfer certificate attached, to be completed by beneficiary; beneficiary may have to indemnify issuer
- » Transfer certificate states rule with respect to post-transfer amendments

Document Requirements – Documentary Credit (G)

Typical documents to be presented for Documentary L/C:

- » Commercial invoice (always required)
- » Shipping Document – usually clean on-board negotiable bill of lading (almost always B/L, but sometimes Dock Receipt or Forwarder's Cargo Receipt instead)
- » Packing List (usually)
- » Certificate of Insurance
- » Certificate of Origin
- » Surveyor's Certificate (less common)
- » Others

Note a “draft” is often delivered to issuer with presentment but is not a document to be examined. Also many L/Cs require that the original counterpart of the L/C be presented upon drawing.

Some documents prove beneficiary's compliance with contract shipping requirements; others needed for customs and import

Document Requirements – Documentary Credit ^(G)

Commercial invoice – UCP600 Art. 18

- Issued by Seller (usually the beneficiary on the L/C)
- Must be made out in name of applicant
- Must describe the goods exactly, type, model, quantity, matching description in the credit
- States purchase price in same currency as the credit
- Need not be signed, unless L/C requires signature

Document Requirements – Documentary Credit ^(K)

Bill of Lading – Title/Proof of Receipt by Carrier in Good Order

- » B/L is issued and signed by CARRIER to SHIPPER; SHIPPER forwards or delivers B/L to CONSIGNEE
- » Negotiable – B/L (see example) must be consigned “TO ORDER” (in the “CONSIGNEE” box on front. Distinguish from direct consigned of “straight” B/L or a sea waybill. Negotiable B/L is a title document; goods may be sold by negotiation of B/L by endorsement
- » Clean – B/L must show goods loaded to vessel with no noted damage or short count
- » On-Board – goods must be aboard vessel; carrier will not issue B/L until goods fully loaded
- » B/L describes goods, must match but may be less specific than Invoice. If goods in containers or boxes, B/L may recite “Said to Contain (STC)” or “Shipper Load and Count” (SLC or SLSC)

Document Requirements – Documentary Credit ^(K)

Bill of Lading Alternatives (Rarely Used)– Title/Proof of Receipt by Carrier in Good Order

- » Dock Receipt – issued by Carrier upon arrival of goods at its terminal at the port – this is usually NOT negotiable and thus not suitable for L/C. but sometimes is used for on-the-water inventory financing
- » Forwarder's Cargo Receipt – same as Carrier's Dock Receipt but issued by Freight Forwarder (not a carrier) – very rarely negotiable

Document Requirements – Documentary Credit (K)

Packing List

- List of goods shipped
- May be lengthy and have specific technical descriptions of articles
- Must generally match Commercial Invoice

Document Requirements – Documentary Credit ^(K)

Certificate of Origin

- » Buyer's (account party's) sale contract may specify that goods must be of origin of certain country, e.g., USA, to comply with RFP requirement, also to avoid issues with trade embargoes
- » Certificate is issued by authority in country of origin; may be Chamber of Commerce
- » In USA, C/O is issued usually by a City Chamber of Commerce with appropriate credentials.

Document Requirements (K)

Certificate of Insurance

- » Sometimes provided in CIF transactions
- » Names consignee (account party) as insured
- » Waiver of subrogation
- » Sometimes requires underwriter to meet credit rating standard
 - may be S&P, Moody's, often uses A.M. Best rating

Document Requirements – Documentary Credit (K)

Surveyor's Certificate

- » Used with large shipments of articles and commodities to assure proper quantity and quality of goods delivered and loaded to vessel
- » Surveyor is neutral professional engineer (e.g., Lloyds, SGS Logistics) that contracts with account party (buyer) to be present at origin and load port to be sure correct item is shipped in correct amount and condition, certifies compliance with contract specs
- » E.g., on shipment of grain, surveyor would test and inspect the grain as it arrives at the port and is loaded into vessel to be sure it is the right type of grain (hard winter wheat, millet, etc.), meets applicable inspection standard (may be USDA grade), and that agreed quantity is loaded
- » Surveyor may determine load quantity from load lines data of vessel, meters or feet of displacement and draft

Document Requirements – Documentary Credit (K)

Other documents

- » Proof of payment of export duty
- » Tax certificate
- » Supplier's OEM warranty document
- » Infinite variety of others
- » Documents must be described with reasonable precision in L/C

Document Requirements – Standby Credit ^(M)

Draw Certificate

- » Should be only document presented to draw against a standby, although often a draft is presented and sometimes the L/C requires presentment of the original counterpart of the L/C as well
- » Signed by designated beneficiary party, may require officer's signature
- » May require a statement that the draw does not exceed the remaining amount on the credit
- » "Suicide Credit" - Presents demand and amount only, with no representation of existence of breach or condition regarding underlying contract obligation
- » Typically account party prefers to avoid "suicide credit" and require beneficiary to recite that specific breach or draw conditions have occurred – adds a disincentive for beneficiary to make a precipitous or bad faith draw

Document Requirements - Draft

Draft

- » Negotiable draft governed by UCC Art. 3
- » Commercial paper theory is that the issuer “buys” the draft by paying beneficiary, and “sells” the draft to the account party
- » Time draft vs sight draft
- » Why use time drafts?
- » Why use drafts at all on a standby credit?
- » Draft is commercial paper, and negotiable by endorsement – does endorsement defeat the entire purpose of a credit by making beneficiary accept endorser’s liability to issuer if account party becomes bankrupt or defaults on the reimbursement agreement?

Presentment and Honor

Document Presentment

- » L/C states where, how and when documents are presented to issuer by beneficiary
- » “...at our counters in New York not later than 5:00 PM prevailing Eastern Time on the Expiry Date, or if the Expiry Date is a Saturday, Sunday or holiday, on the next following business day.”
- » Beneficiary delivers hardcopy of required documents, with correct number of originals and copies (Note L/C rule – document stamped “ORIGINAL” is treated as such
- » Electronic presentment – see eUCP rules

Presentment and Honor

- » Documents must match what L/C text requires
 - Commercial invoice must match exactly, including commodity description and quantity, parties' names, addresses, whatever is written in the L/C itself
 - Bill of Lading must match closely but some leeway allowed in description of goods (e.g., "STC acceptable"); number of B/L originals is critical, must meet L/C specification on negotiability, clean, on-board etc.
 - Other documents – less rigid standard; but may not be materially inconsistent; number of originals critical
 - Photocopy stamped "Original" is deemed original counterpart
 - Read UCP600 requirements carefully as to commercial documents

Presentment and Honor

- » Documents and draw certificates must match what L/C text requires
 - Read UCP600 and ISP98 carefully as to draw certificates
 - An L/C with a poorly-drafted payment certificate description may be impossible to negotiate. Example: Standby L/C requires presentment of “certificate reading exactly as follows: Beneficiary is entitled to draw \$_____ pursuant to XYZ Sale Contract.” Note – the if the amount is filled in, the certificate no longer matches the L/C text exactly.
 - Avoid using words like “exactly as follows,” avoid quotation marks around description of document

Presentment and Honor

- » Issuer has no duty to verify or investigate conformity of goods with Sale Contract specifications; Issuer only required to see if documents literally match
 - Issuer not required to know if mismatched commodity description is the same item (e.g. peanuts vs ground nuts)
 - Issuer is required to know legal terms (e.g., must be able to tell if a carrier's bill of lading is “negotiable” or “clean”)
- » Shipment of non-conforming goods or even apparent fraud by Seller is not a basis for Issuer to refuse to honor L/C if documents match
 - Seller may obtain court injunction if fraud exists
 - Bank may dishonor if clear evidence of fraud

Presentment and Honor ^(M)

- » L/Cs usually require Seller to present documents at Issuer's counters in a specified office (may be NYC) – originals of documents and original counterpart of L/C usually must be physically presented, not faxed – be careful of logistics problem on last day before expiration
- » Modern practice allows documents to be presented by electronic transmission with originals to follow by overnight express delivery (UPS, FedEx)

Enforcement and Fraud Issues ^(G)

- » Uniform Customs and Practice for Documentary Credits (UCP)
 - UCP is only binding in a letter of credit, if the parties to the contract expressly incorporate the UCP.
- » Time Limits
 - Bank has a reasonable time, not to exceed five days following receipt of documents, to refuse or accept (UCP600, art 14(b)).
- » Right to Refuse Documents
 - Bank must give the presenter of documents immediate notice, and state all discrepancies to refuse the documents (UCP600, art 16(c)(ii)). UCP provides the Bank with one opportunity to identify all discrepancies.
 - UCP is silent in many areas (such as fraud and forgery, which is the main basis for refusing payment under a letter of credit).
 - The area of law surrounding the basis and circumstances for non-payment of a letter of credit has historically been one of substantial discussion and domestic case law.
- » Bank's Standard to Verify Documents
 - Examine the face of the documents with reasonable care as determined by international banking practice (see UCP600, art 14(a)).
- » Bank's Liability
 - UCP releases banks from the liability of checking the authenticity and accuracy of presented documents (see UCP600, art 34).

Enforcement and Fraud Issues ^(G)

» Independence Principle

- Independence principle stands for the idea that the bank's obligation to pay under a letter of credit is independent of the underlying sales transaction.
- Bank looks at only two things when deciding whether to make payment to the seller under a letter of credit:
 - The terms and conditions of the letter of credit.
 - The documents presented by the seller (beneficiary).
- If the documents presented by the seller comply with the terms and conditions of the letter of credit, the bank must make payment to the seller.
- The bank does not look beyond the face of the documents. It cannot consider extra documentary issues such as:
 - The sales contract or any changes to it.
 - The quality or condition of the goods.
 - Disputes between the buyer and seller.
 - The buyer's relationship with the bank including its ability to reimburse the bank.

» Strict Compliance Principle

- The strict compliance principle demands that the documents presented by the seller (beneficiary) agree exactly with the terms and conditions of the letter of credit (see UCP 600, art. 14.)

Enforcement and Fraud Issues ^(G)

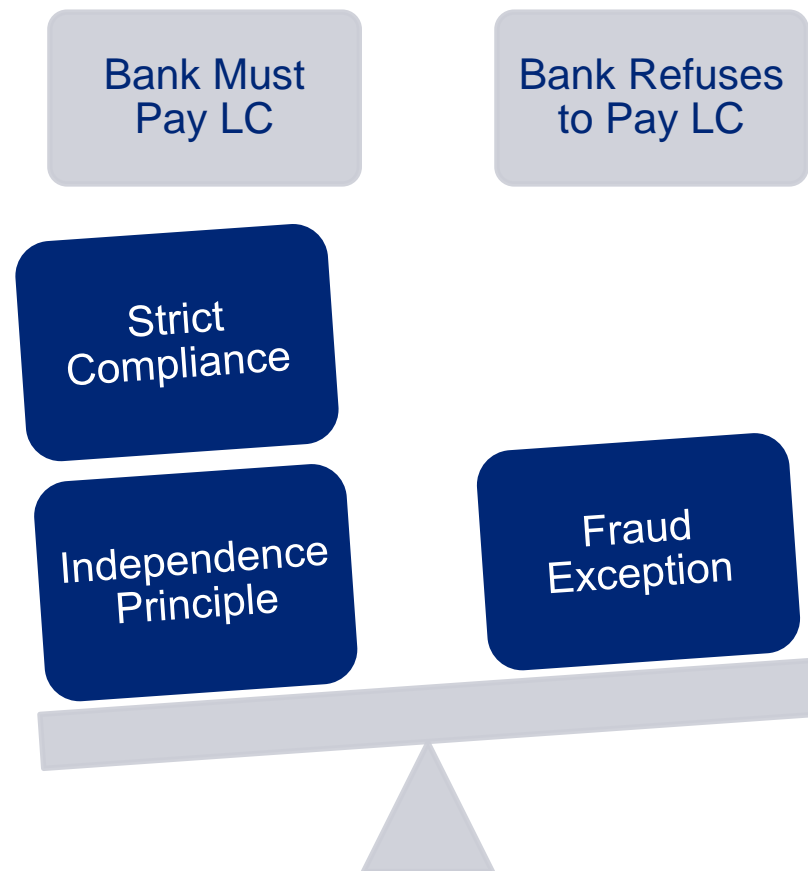
» Disclaimer on Effectiveness of Documents

- “A bank assumes no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any document, or for the general or particular conditions stipulated in a document or superimposed thereon; nor does it assume any liability or responsibility for the description, quantity, weight, quality, condition, packing, delivery, value or existence of the goods, services or other performance represented by any document, or for the good faith or acts or omissions, solvency, performance or standing of the consignor, the carrier, the forwarder, the consignee or the insurer of the goods or any other person.” (See UCP600 art. 34).

Enforcement and Fraud Issues ^(G)

There is one exception to the independence principle. The bank can refuse to make payment on conforming documents when the bank discovers fraud in the presented documents. Even then, however, the fraud must be clearly evident on the face of the documents. If the bank only suspects fraud, or needs to conduct an investigation to uncover the fraud, it cannot refuse to make payment.

No Article that addresses fraud under UCP. Fraud exception is founded in case law under the common law. For instance, U.S. courts have recognized the “material fraud” concept under Article 5 of the UCC. ICC Banking Commission opined that a bank is liable if it is involved in fraud, or if it fails to exercise reasonable care, or if it has knowledge of fraud before paying the credit and fraud is obvious to the bank. (ICC Opinion, 1980-81 No. 399).



Practice Issues (M)

- » Restate Cardinal Rule – L/C is set of independent contracts distinct from the underlying sale contract or other contract that it secures
- » Breach of underlying contract does not affect draws or enforceability of the L/C, unless L/C permits a draw upon presentment of a certificate from beneficiary stating there is a breach

Contract clauses

- » What information to include
 - Parties, confirmation requirement
 - Amount, number of draws, expiry date
 - Any automatic reduction clauses, transferability
 - Describe documents
 - What Rules apply (UCP600 or ISP98)
- » Credit rating requirement for issuer
 - Typically S&P “A” or Moody’s A
 - Some pushback on rating in wake of subprime crisis
 - Can link rating to best of listed SSFIs

Practice Issues

- » Problematic draw certificate provisions – examples
- » Drafting issues - examples

Reading & Reference Materials

- » Cases and Materials:
 - *The Law of Letters of Credit*, John F. Dolan
- » Other Reference Material:
 - Model International Sales Contracts – ICC, others



Thank You!