

Standby Letter of Credit Rules and Practices Misunderstood or Little Understood by Applicants and Beneficiaries¹

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INTRODUCTION

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INTRODUCTION

This article explores some² rules, practices, or practice pointers dealing with standby letters of credit that may not be obvious or readily understood by applicants and beneficiaries. It is not written for letter of credit bankers or their attorneys; although it may stimulate discussion and comments from or among them. Nor does this article deal with commercial letter of credit practices except insofar as they implicate standby practices. In those situations, unless there is a dispute leading to litigation, applicants and beneficiaries usually seek assistance, not from lawyers, but from experienced letter of credit bankers, international factors, freight forwarders, document preparation services, trained export-import staff, or other trade specialists.

Standby letters of credit frequently involve negotiated, complex agreements and larger dollar amounts where lawyers tend to be more involved. Examples include standbys supporting or securing municipal bond issues, construction contracts, subdivision and municipal improvements, commercial real estate leases, equipment leases, cable installations, reinsurance requirements of nonadmitted reinsurers, power purchase contracts, SWAP agreements, securitizations, self-insured retention amounts in insurance

fronting arrangements, indemnification obligations for surety bonds, supersedeas bonds to stay execution of a judgment pending an appeal, prejudgment attachments bonds, government contracts or privileges, clearing obligations of brokers and dealers, advance payment guarantees, and open account sales.³

Most corporate applicants and beneficiaries are inexperienced in commercial letter of credit practices. Those practices, however, can affect standby letters of credit. Commercial letter of credit customs and practice carry over and are applied to standby letters of credit because standby letters of credit evolved from and have many characteristics in common with commercial letters of credit. Commercial letter of credit customs and practice were established well before standby letters of credit gained usage and popularity.⁴ Until 1998, when the International Standby Practices or “ISP”⁵ was promulgated, almost all letters of credit were issued subject to the Uniform Customs and Practice for Documentary Credits (the UCP).⁶ The UCP is specifically geared to examining documents presented in international trade such as drafts, bills of lading, other types of shipping documents, insurance certificates, inspection certificates, commercial invoices, and packing lists. The UCP also provides for the “negotiation” of drafts and documents presented to banks other than issuers that are “nominated” in letters of credit to purchase and present the drafts and documents. Both of these situations—live commercial documents and negotiation of drafts and documents—are seldom relevant to or found in standby letter of credit practice.

The UCP governs standby letters of credit to the extent that its articles are applicable.⁷ The UCP does not explain when and how its articles should be applied to standby letters of credit. Most lawyers and their clients do not have a working knowledge of the articles of the UCP or the written⁸ and unwritten standard customs and practice of banks that regularly issue, confirm, or advise letters of credit and examine and negotiate or accept documents presented under letters of credit. Even preparing a draft to be presented under a standby letter of credit can present challenges for those who do not have a working knowledge of how banks expect drafts to be worded and presented. Yet every regime that governs letters of credit provides that standard banking practices or international standard banking practices are to be used to determine

whether documentary presentations and other aspects of letter of credit transactions are proper and compliant.⁹

Much of the lack of familiarity with or transparency of standby letter of credit practices has been overcome by the International Standby Practices, or ISP. The ISP's rules specifically address standby letter of credit practice separate and apart from commercial letter of credit practice. The ISP's rules are well written and for the most part are clear, even-handed, and straightforward. They avoid significant pitfalls of using the UCP in standby letters of credit, such as presentation of stale documents,¹⁰ installment drawings,¹¹ force majeure,¹² and the requirement that documents and data in documents be consistent.¹³ Unfortunately, the UCP is still used in almost half of the standby letters of credit issued in this country and probably in more than half issued by foreign banks in other countries. Additionally, even the ISP's rules are not all-encompassing. Resort to standard banking practices outside the ISP, caselaw, and the UCC is necessary to fill in the gaps. Finally, there are several rules or provisions of the ISP, the UCP or the UCC that govern standby letters of credit that lawyers and their letter of credit applicant or beneficiary clients may not be familiar with, overlook, or miscomprehend their import. Many letter of credit customs, practices and rules are counterintuitive and cannot be predicted by resort to simple contract law principles or even other articles of the UCC.¹⁴

Letter of credit bankers have a distinct advantage when it comes to knowing the rules, customs, and practices that govern or define letter of credit transactions. Letter of credit activity in this country is concentrated in a handful of large banks, allowing them to capitalize on their expertise.¹⁵ Those banks issue, advise, confirm, negotiate, and examine documents presented on hundreds of letters of credit every day. They have well-trained employees, some with 20 years or more of experience in letter of credit banking. Letter of credit bankers regularly attend internal staff meetings to discuss letter of credit developments and occurrences, control risk, and refine practices. Their attorneys are well-versed in letter of credit rules and law; have carefully prepared and reviewed the bank's letter of credit forms, agreements, and procedures; and are available to advise their bank clients on letter of credit problems and issues as they arise. Letter of credit bankers attend and participate in letter of credit conferences presented by experts and specialists

from other major banks, the IIBLP, the IFSA,¹⁶ the ICC, the USCIB,¹⁷ and private trade specialists. They take letter of credit training courses, tutorials, and exams to become certified documentary credit specialists (CDCSs).¹⁸ They subscribe to and review letter of credit publications such as the IIBLP's *Documentary Credit World* or the ICC's *DC Insight*. Finally, standard letter of credit practices used to supplement applicable letter of credit regimes are based on what letter of credit banks themselves do on a regular basis.¹⁹

The purpose of this article to assist the attorney who does not specialize in or often deal with letters of credit, and their corporate applicants and beneficiaries, in understanding certain standby letter of credit practices, rules, and drafting points that are relevant but perhaps not widely known or understood by standby letter of credit corporate applicants and beneficiaries. Any particular standby transaction should, of course, involve hands-on advice by competent counsel. This article discusses the following eight topics involving standby practices:

- (1) elimination of the use of drafts in standbys;
- (2) endorsements of drafts presented under standbys;
- (3) confirmations of standby letters of credit issued by nonlocal banks;
- (4) the effect of the issuing bank's payment of a draw by an imposter presenting forged documents;
- (5) the ISP vs. the UCP in standbys;
- (6) beneficiary accountability for windfall draws;
- (7) FDIC repudiation and disaffirmance of standby letters of credit; and
- (8) enjoining foreign beneficiaries that are issuers of counter-guarantees.

1. Standby letters of credit should specify demands for payment rather than drafts to effect draws.

At the most recent Annual Letter of Credit of Survey,²⁰ which was attended primarily by letter of credit bankers, both Prof. James Byrne²¹ and Dan Taylor²² commented that drafts are not necessary and should not be used for standby letters of credit or even straight

(non-negotiable) commercial letters of credit. James Barnes, one of the architects of the revised Article 5 and the ISP as well as counsel to the IFSA, remarked that for over the past two decades he has prepared and drafted standby letters of credit to omit where possible the use drafts to be presented to effect draws. Yet in practice drafts are specified by and used to effect draws under the vast majority of standby letters of credit.²³

Drafts are used and appropriate for negotiable commercial letters of credit because the draft and accompanying documents are “purchased” by the negotiating bank nominated in the credit. In those cases, the draft is endorsed over by the drawer to the negotiating bank together with the documents presented. Like a holder in due course, the negotiating bank has the right to be paid by the issuer or confirmer notwithstanding that the beneficiary has defrauded the applicant in some material aspect of the documents presented or in the underlying transaction which the letter of credit supports.²⁴

Negotiation has no relevance to “straight” credits, and almost all standby letters of credit are straight credits. A straight credit is one that is payable only to the named beneficiary (or a transferee of the named beneficiary if the letter of credit is transferable). A straight letter of credit does not “nominate” another bank to “negotiate” or purchase drafts and accompanying documents presented by the beneficiary to effect a draw. Although standby letters of credit frequently nominate another bank to confirm the credit,²⁵ payments of draws under confirmed letters of credit are without recourse to the beneficiary if the issuer does not pay.²⁶

Only the beneficiary may request or demand payment from the issuer of a straight letter of credit upon presentation of conforming documents, including any draft. If a letter of credit is not negotiable,²⁷ there is no reason for the letter of credit to require a draft to effect a draw; a simple demand signed by the beneficiary, preferably in a form attached as an exhibit to the letter of credit, can operate to specify the date, the amount of the draw, identification of the letter of credit, the reason for the draw,²⁸ and to whom and to what bank account the draw proceeds should be wired.²⁹

Is there any reason not to use a draft in a standby letter of credit? Yes. Applicants and sometimes bankers, especially foreign bankers that use the UCP and are steeped in commercial letter of credit customs and practice, will claim or insist that a draft must meet certain minimum, and in some cases, exacting specifications under interna-

tional banking standards. Many, if not most, documentary discrepancies in standby presentations are due to technical deficiencies in the draft presented. Sometimes these technical claimed errors can lead to lawsuits, which are costly and uncertain as to outcome.³⁰ In lawsuits over the formal characteristics of a draft and standard letter of credit banking practice, some courts are unsure of who to believe—the beneficiary’s expert or the applicant’s or issuer’s expert. Bankers or testifying letter of credit experts will seize on some supposed technical defect or nonconformity in a draft to claim that the draft does not strictly comply with the terms of the letter of credit³¹ or international standard banking practice.³²

An Enron letter of credit case illustrates the point.³³ In the BNL Case, about eight months before Enron’s collapse, BNL purchased, without recourse, a 100% participation in a \$39 million standby letter of credit issued by Hypo Bank at the request of Enron to secure obligations of Enron affiliates to construct a power plant. The letter of credit provided for payment against presentation of (1) the beneficiary’s sight draft drawn on Hypo Bank and (2) a default certificate stating that Enron’s affiliates had failed to perform in accordance with specifically identified sections of the engineering, procurement, and construction contract between them and the beneficiary. Following Enron’s bankruptcy, the beneficiary drew the full amount of the letter of credit. Hypo Bank, as issuer, reviewed the initial documents presented, and rejected them due to discrepancies. The beneficiary corrected those discrepancies and presented the corrected documents. Hypo Bank paid the beneficiary and demanded that BNL make good on its 100% participation. BNL refused on various grounds, including that the purported draft presented was nonconforming because (i) it did not adequately identify the drawee, and (ii) it was not negotiable³⁴ because it included payment instructions (address for wiring of funds).³⁵ BNL produced testimony from an Italian banker and an Italian bank-authored commercial letter of credit handbook to support its argument that drafts should contain the full identification of the drawee and should be negotiable and that the one used to effect a draw under this particular letter neither adequately identified the drawee nor was in negotiable form.³⁶ Hypo Bank produced testimony to contest BNL’s characterization of the draft as nonconforming under standard banking practice as well as Hypo Bank’s own practices.³⁷

Judge Gonzalez, the Enron bankruptcy judge, did not decide the issue of the sufficiency of the draft, because Hypo Bank was required to review documents presented on the Enron letter of credit with the same standards and degree of care that it reviewed documents presented to effect draws on its own letters of credit that Hypo Bank had not participated out to other banks. The evidence showed that Hypo Bank met this standard, but the fact that BNL would raise technical issues with the wording of the draft is troubling. A \$39 million claim arguably depended on whether a draft was discrepant because it (a) did not contain the full identification of the drawee bank even though it identified the credit on which it was drawn and was presented to the bank that issued that credit, i.e., the drawee bank, and (b) contained wiring instructions in the draft itself instead of in a transmittal letter. Two experienced letter of credit bankers disagreed with each other as to whether the draft complied with standard banking practices. The Enron letter of credit was a nonnegotiable standby in which the alleged technical deficiencies in the draft should have been given no credence. Unless the letter of credit expressly so provides, a draft presented under a standby letter of credit to the issuing bank and identifying the credit on which it is drawn should be sufficient to warrant honor. A draft that contains wire transfer instructions is still negotiable, and, even if it were not, it could still readily fulfill the function of a draft to effect a draw under a straight standby letter of credit.

2. Issuing banks should not, but frequently will, require the beneficiary's endorsement on drafts presented to effect draws under standbys.

Payment of a draw under a letter of credit by an issuer to a beneficiary is final and without recourse even if the applicant is insolvent or otherwise does not reimburse the issuer.³⁸ That is because letters of credit are obligations of the issuing bank independent of the obligation of the applicant to reimburse the issuer.³⁹ Drafts presented by the beneficiary to the issuer are drawn on the issuer. Once accepted or paid, the issuer discharges its own obligation. Recourse to the beneficiary is inappropriate. In fact, under the UCP, drafts that are drawn on the applicant should not be required or presented to the issuer.⁴⁰ Under these circumstances, no purpose

is served by the beneficiary's endorsing a draft payable to it that is presented to the issuer to obtain payment under a letter of credit that the issuer is obligated to pay without recourse.

Endorsements usually signify recourse liability in the event someone later in the chain of payments does not pay.⁴¹ As noted above, a beneficiary that is properly drawing directly from the issuer does not assume recourse liability to the issuer and therefore should not be required to endorse drafts. Endorsements are not normally called for by standby letters of credit. They are not required for straight credits by the ISP or the UCC.

So where did the requirement or practice of beneficiaries endorsing drafts originate? It comes from the mercantile practice of negotiation of drawings on commercial letters of credit with a nominated bank that purchases or takes the draft and accompanying documents from the beneficiary. In those cases, endorsement of the draft is entirely proper because the negotiating bank wants to (i) be a proper holder of the draft entitled to enforce it against the issuer as a holder in due course, and (ii) have recourse against the beneficiary in the event the issuer or a confirmer does not pay. Unfortunately, the UCP does not distinguish between proper and improper international banking standard practices for standbys and straight credits.

Provided that the standby letter of credit does not require drafts to be endorsed when presented,⁴² and the beneficiary is not directing the proceeds of the drawing to be paid to a third party, a beneficiary of a straight standby letter of credit that requires presentation of a draft should not be asked to endorse it in order to have its draw honored. If it is asked, it can object and argue that the signature of the drawer is all that is required by the standby letter of credit; the issuer does not have recourse to the beneficiary because the issuer is the primary obligor under the letter of credit and draft.⁴³ If the issuer insists that the beneficiary endorse the draft being presented to complete the draw, the beneficiary's doing so should not subject the beneficiary to recourse liability if the applicant does not reimburse the issuer for the draw.⁴⁴ The endorsement is form over substance to satisfy a banking practice under commercial letters of credit that has little relevance to standby practice.

3. Beneficiaries need not always insist that a standby letter of credit be issued or confirmed by a local bank.

The requirement that a local bank issue or confirm a standby letter of credit is not uncommon. Municipalities and other beneficiaries frequently require use of local banks. However, it creates extra burden and expense for contractors and other applicants that have lines of credit with nonlocal banks. If an applicant does not have a line of credit established with a local bank, the applicant will be required to obtain and pay an issuance fee for a letter of credit issued by its own nonlocal bank and then will have to pay a second fee, a confirmation fee, to have a local bank confirm it. It also may unduly restrict the applicant's choice of banks and exclude from use a wide array of creditworthy banks. Money center and large regional banks with an established letter of credit banking business, which are concerned about their reputation, will be more familiar with the integrity of letters of credit and the independence principle and will be less likely than would a local bank to be swayed by pressures from an applicant that wants to avoid payment under a letter of credit based on a disputed occurrence or contract leading to the draw.

Many municipalities and other beneficiaries of letters of credit insist that any letter of credit they require be issued or confirmed by a local bank. This requirement stems from several concerns, most of which are misplaced or can be addressed by appropriate wording in the letter of credit. The primary concern is that, if the issuer does not honor, the beneficiary may have to file suit in a distant and possibly unfriendly forum to obtain enforcement; it will lose "home court" advantage. Other concerns are that it will be difficult or time-consuming to present documents to a distant location, that the documents bear a greater risk of being lost in transit, and that it will take longer to timely correct or cure discrepancies if any are noted by the issuer. Another concern is that a court in a distant forum will apply an unfamiliar law or rule to somehow frustrate the beneficiary's expectation that it is entitled to draw.

Each of these concerns can be addressed by appropriate provisions included in the letter of credit. While most issuing banks will prefer or insist that the state law governing letters of credit they issue be the law of the place of issuance or headquarters of the issuing bank, they will normally consent to jurisdiction and venue in the beneficiary's location for resolving disputes between the beneficia-

ry and the issuer. Should the beneficiary believe that the issuer has wrongfully dishonored the draw under the letter of credit, it will be able to litigate in the same court as it would if the issuer were a local bank. Since the law of letters of credit is fairly uniform in the United States,⁴⁵ and most of the issues that will be of concern will be governed either by the UCP or the ISP (which is the same regardless of which state's law governs the letter of credit), the choice of law of, say, New York instead of Florida or North Dakota to govern a letter of credit should not trouble the beneficiary.⁴⁶

Including a provision requiring a local court for exclusive venue and jurisdiction should satisfy the beneficiary's concern that it will have to file suit in a distant and possibly unfriendly forum. Exclusive venue and jurisdiction clauses in letters of credit are supported by the UCC⁴⁷ and enforced by the courts.⁴⁸

Presentation of documents can be accomplished by courier or, if provided for in the letter of credit, by telefax. For draws on standbys, there is usually no need to present original of the letter of credit⁴⁹ or original documents or documents of any value; frequently, only a demand or a beneficiary signed certificate signed by the beneficiary is necessary to effect a draw. The beneficiary can confirm by telephone that documents were received. Any notice of discrepancies must be given by telecommunications,⁵⁰ not regular mail,⁵¹ thus allowing for their prompt correction. The location and presentation of the documents with an out-of-state issuer should therefore not be a cause for concern for the beneficiary.

If the issuer is located in a foreign country, then the requirement that the letter of credit be confirmed by a United States bank is prudent. The logistics of presentation, the longer turnaround time to correct discrepancies, the possible applicability of the laws of a foreign country and its regulatory authorities, currency exchange risk, and political risk all are legitimate concerns of a beneficiary that are not necessarily overcome by exclusive jurisdiction and venue provisions or even a local or U.S. choice of law provision in the letter of credit.

One should distinguish between a letter of credit issued by a foreign bank from a foreign jurisdiction and a letter of credit issued by the U.S. branch of a foreign bank and governed by U.S. law such as New York law. Under the UCC, a branch is considered a separate bank for letter of credit purposes.⁵² One of the consequences of this is that whatever legal or regulatory constraints

the bank may experience in its home country should not affect the enforceability of the obligations of its U.S. branch under U.S. letter of credit law enforced in U.S. courts. Many foreign banks with U.S. branches are well capitalized; engage, through their U.S. branches, in robust letter of credit business; and are based in countries that are stable economically and politically. A letter of credit issued by the U.S. branch of such a foreign bank should be considered acceptable without confirmation if the letter of credit is governed by U.S. law and the issuer consents to exclusive jurisdiction and venue where the beneficiary is located.

4. If a draw occurs on a letter of credit by a stranger forging the beneficiary's signature on the draw documents, the issuer's undertaking is not discharged and the true beneficiary still has drawing rights.

A little-noticed provision not contained in the original Article 5 and located at the end of § 5-108⁵³ provides that an issuer is discharged from its obligation under the letter of credit “to the extent of its performance under the letter of credit unless the issuer honored a presentation in which a required signature of the beneficiary was forged.” Official Comments 12 and 13 to § 5-108 make clear that this provision is designed to protect the beneficiary, but not the applicant. Official Comment 12 provides that the issuer is entitled to reimbursement from the applicant after honor of a forged or fraudulent drawing if honor was permitted under § 5-109(a). That section gives the issuer the discretion to honor presentations that comply with the terms of the credit, even though the applicant claims that a document may be forged or the drawing fraudulent, and requires the issuer to honor complying but forged or fraudulent draws when the honor is demanded by a nominated bank that is obligated or paid value, a holder in due course of an accepted draft, or an assignee of a deferred payment undertaking, in each case if the nominated bank, holder, or assignee acts in good faith.

Official Comment 13 to § 5-108 indicates that the last clause of § 5-108(i)(5) deals with the special case when the fraud is not committed by the beneficiary, but by a stranger to the transaction who forges the beneficiary's signature. The comment provides that if the issuer pays against documents on which a required signature of the beneficiary is forged, it remains liable to the true beneficiary.

Almost all standby letters of credit are governed by either the UCP or the ISP. Each of those regimes contains an article or rule stating that the issuer is not responsible for the genuineness of documents.⁵⁴ Rather, the issuer is to review the documents to determine whether, “on their face,” they comply with the terms of the credit.⁵⁵ The issuer is arguably justified in honoring a presentation that complies with the requirements of the terms of the credit and thereby having its undertaking under the letter of credit discharged to the extent it pays. If the documents are forged by a stranger to the letter of credit, and the issuer pays the stranger on the basis of facially conforming documents, the UCC provides that the issuer must still pay the true beneficiary if it makes a conforming drawing. The UCC provision is unequivocal on this point and is obviously designed to protect the innocent beneficiary who would otherwise be deprived of its rights under the letter of credit.

An argument can be made that, if a letter of credit incorporates by reference the UCP or the ISP, the credit varies by agreement the result that would otherwise apply under U.C.C. § 5-108(i)(5) if forged beneficiary-signed documents are presented by the forger who obtains payment.⁵⁶ Variation by agreement of Article 5’s provisions is not prohibited except with respect to a handful of sections other than § 5-108(i).⁵⁷ Moreover, § 5-103(c) provides that the terms of Article 5 (other than its nonvariable provisions) can be varied not only by agreement, but by a provision incorporated by reference into the letter of credit. Then, arguably, § 5-108(i)(5) is varied by agreement if the UCP or the ISP is incorporated by reference into the letter of credit to provide in effect that the issuer is discharged to the extent the issuer pays an otherwise conforming presentation made by the stranger forging the beneficiary’s signature.

A similar argument can be made if the term “purportedly” is used to modify the signature requirement of the beneficiary. Under this argument, the draw documents only need to bear a signature “purporting” to be that of the beneficiary or only need to be “purportedly” signed by the beneficiary, even if forged. Most issuing banks do not use the phrase “purportedly signed by” in their letters of credit to describe draw document signature requirements, but a vigilant beneficiary will want to insist that they do not to avoid this argument. The use of the word “purportedly” in letters of credit has been questioned by letter of credit authorities⁵⁸ and does certainly introduce confusion into the analysis of what happens to the

beneficiary's right to draw if a stranger forges the beneficiary's signature and obtains a draw.

The major problem with these arguments is that the letter of credit requires the issuer to treat only the named beneficiary or its due transferee as the beneficiary.⁵⁹ That express term modifies the UCP or the ISP provision on genuineness of documents. More importantly, it is not a matter of whether the person signing the draft or demand for payment is in fact an authorized officer of the beneficiary acting in that capacity. It is a matter of what person or entity receives the draw proceeds. That is not a documentary condition, it is a payment instruction. If the issuer pays a stranger to the letter of credit committing a fraud and not the true beneficiary, the issuer violates an express term of the letter of credit of who the issuer must pay and violates the payment order contained in the draft or demand for payment submitted to effect the draw.⁶⁰ Accordingly, it is not proper to read the UCC, ISP, and UCP provisions that absolve the issuer from responsibility for the genuineness of documents as discharging the issuer's payment obligation to the true beneficiary if the issuer has made payment to a stranger that impersonated the beneficiary through forged draw documents.⁶¹

U.C.C. § 5-108(i)(5) is specific as to what are the consequences to the issuer and the beneficiary when an imposter's documentary presentation containing forged signatures of the beneficiary induces the issuer to pay. Those consequences are reinforced by Official Comments 12 and 13. The drafters of Revised Article 5 were obviously aware that the UCP was being used in almost all letters of credit issued at the time Revised Article 5 was prepared. They could not have intended that UCP 500, Art. 15, which deals with the genuineness of documents, overrides the specific provisions of § 5-108(i)(5). Rather, the two provisions should be read together to the effect, as Official Comments 12 and 13 provide, that the issuer has the right to seek reimbursement from the applicant with which the issuer is in privity, for a forged but facially complying drawing, but the innocent beneficiary is not deprived of its right to draw under the letter of credit. Most reimbursement agreements between the applicant and the issuer will make specifically and unequivocally clear the issuer's right of reimbursement against the applicant in the case of a fraudulent drawing bearing forged signatures.⁶²

The parties to a letter of credit transaction can avoid much, if not all, of the risk of a fraudulent drawing by an imposter posing as the beneficiary by specifying a bank account in the letter of credit to which the proceeds of all draws may or must be paid by the issuer. Assuming that the account is credited upon the issuer's honoring a presentation by an imposter, the imposter gains nothing from its fraud, as the named beneficiary's account receives the proceeds of the fraudulent drawing. If the beneficiary changes bank accounts, the beneficiary should request a formal amendment to the letter of credit to reflect its new bank account information.⁶³

5. Use of the ISP in standbys benefits applicants as well as issuers and beneficiaries.

Since its adoption, the ISP has been rightly described as the regime of choice for standby letters of credit. The ISP should be used in standby letters of credit; the UCP can be a trap for the unwary beneficiary, has many provisions that do not apply to standbys or which, if applied, tend to work counter to the intentions of the parties. This particular admonition may be more widely understood than some of the other practice points raised in this article, but it bears repeating. What is not so widely known is that use of the ISP in standbys also benefits applicants in a number of significant ways. Those benefits are sometimes overlooked. In fact, some are expressing the view that applicants should prefer that the UCP be used in letters of credit issued for their account because, in effect, it may be technically more difficult for the beneficiary to comply with the terms of or standard banking practices governing a UCP credit or may trip an unwary beneficiary not familiar with provisions of the UCP that are inappropriate for standbys.⁶⁴

Almost 50%, by dollar amount, of all standbys issued are governed by the UCP instead of the ISP. Part of the reason that the ISP is not used in almost all standby letters of credit stems from the relative newness of the ISP, which has been around for less than 10 years, while the UCP has been the regime of choice for letters of credit for 80 years. Part of the problem is that the NAIC⁶⁵ and state departments of insurance⁶⁶ have rules or regulations promulgated long before the ISP that require or specify that letters of credit posted in favor of insurance companies for various purposes to be governed by the UCP. Insurance company letters of credit make up a large percentage by dollar amount of all standby letters of

credit issued in the United States.⁶⁷ Part of the problem stems from municipalities requiring the UCP to be used in letters of credit secure obligations owed to the municipality under construction contracts, unrated municipal bond issues, obligations under licenses, and other obligations, primarily because that is the way their forms have always read.

The advantages to using the ISP in standby letters of credit are too numerous to enumerate and explain. The principal ones to beneficiaries and issuers include the following:

1. ISP rules are clear, understandable, precise, and specifically geared to address standby practice and issues.
2. The ISP does not emphasize or deal with specialized examination of documents used in international trade that are largely irrelevant to standby practice.⁶⁸
3. The examination of documents for inconsistency required by the UCP⁶⁹ does not apply; under the ISP, each standby document presented should comply with the terms of the credit,⁷⁰ but data in each standby document presented need not be compared for conflicts with data in other documents or even in the same document unless the standby expressly requires it.⁷¹
4. If the issuer is closed on the last banking day for presentation before the credit expires due to a force majeure event, under the UCP, the beneficiary gets no extra time to present a draw;⁷² under the ISP, the letter of credit expiring is extended for another 30 days from the date the issuer reopens.⁷³
5. Under the ISP, the beneficiary need not be concerned about stale documents.⁷⁴
6. Under the ISP, the beneficiary need not be concerned about installment drawings.⁷⁵

Described below are some of the benefits of using the ISP in letters of credit from the applicant's perspective, some of which are also benefits to beneficiaries, as discussed above. This list is not necessarily exhaustive.

1. ISP rules are clear, understandable, precise, and specifically geared to address standby practice and issues. The

result is that there is less likely to be misunderstandings, disputes, and lawsuits over what was intended.⁷⁶

2. Because the ISP was written exclusively for standbys, it will reduce the cost and time of negotiating and drafting a standby letter of credit. As the footnotes to the above six advantages of using the ISP to issuers and beneficiaries indicate, the parties to a standby will frequently want to exclude or modify the applicability of various provisions of the UCP to avoid their application to standby situations for which they are not intended, designed or well-suited. Using the ISP will avoid the need to take the time, effort, and expense to draft, negotiate, and include the exclusionary and other modified language necessary to tailor a UCP credit to use as a standby in a given situation.
3. Frequently, when UCP standbys are tailored because the ISP is not incorporated, the tailored provisions will end up less favorable to the applicant than the ISP default provisions. A good example is the usual language used in UCP standbys to exclude the applicability of UCP 500, Art. 17 dealing with force majeure events. The tailored provision will usually provide that, if the issuer is closed on the last business day for presentation due to a force majeure event, the letter of credit automatically is extended for another 30 days from the date of reopening of the issuer. Under ISP Rule 3.14(a), the same extension applies, but only if presentation is not made on the last day for presentation because of the force majeure event. If the beneficiary was not in a position to make a presentation on that day, then under ISP Rule 3.14(a) the beneficiary does not receive the benefit of the extension and the letter of credit will be deemed to have expired without a draw. In other words, the ISP rule injects an element of “but for” causation into its force majeure provision extending the expiration date, which the usual UCP formulation does not.⁷⁷
4. The ISP’s safe harbor of three business days to honor⁷⁸ helps the applicant concerned about a fraudulent draw by giving it some time to prepare for and seek an injunction against the draw.⁷⁹ Each extra day that an applicant’s attorney has to obtain relief is important. Anyone who litigates

TROs knows that the time to prepare the necessary pleadings, affidavits, and exhibits and obtain a hearing date from the court is a race against the clock. Under the UCP 500, the time to honor is a reasonable time not to exceed seven business days; there is no safe harbor under the UCP 500 during which the issuer can feel safe in not honoring. The UCP's reasonable time requirement may be fairly short if the documents are simple and straightforward, as they usually are for standbys and the issuer is not busy, is well-staffed, or efficiently processes presentations.⁸⁰ Under the UCP 600, the issuer must honor when it determines that the documents comply, no matter how much time remains in the maximum five-day period under the UCP 600 to honor.⁸¹

5. Under the ISP⁸² and the UCP 600,⁸³ an issuer need not accelerate its examination of documents to give the beneficiary time to correct discrepancies if presentation is made close to the expiration date. Under the UCP 500, that rule is not stated. One recent case decided under the UCP 500 and revised Article 5 clearly implied that issuers do have to speed up their examination and notification of discrepancies to give the beneficiary time to cure.⁸⁴ Authorities have acknowledged the duty UCP 500 credits to speed up examination when expiration is imminent⁸⁵ as have cases decided under Article 5 before its revision.⁸⁶ The rule that makes imminent expiration a factor in the determination of what constitutes a reasonable time to examine and give notice of dishonor under UCP credits disadvantages the issuer, and therefore the applicant who must reimburse if the issuer is precluded from dishonoring.
6. Although the issuer under an ISP credit must return, hold, or dispose of dishonored documents as requested by the presenter, its failure to do so does not impair its dishonor for a valid reason.⁸⁷ In UCP credits, failure to return, hold, or dispose of the documents at the presenter's request violates the UCP and thereby precludes the issuer from relying on documentary discrepancies as a defense to the beneficiary's claim for wrongful dishonor.⁸⁸ If the issuer inadvertently or otherwise fails to return or dispose of a standby presentation as directed by the beneficiary or notify the beneficiary that it is holding those documents

subject to the beneficiary's direction, the issuer may be precluded from dishonor of the drawing if the credit is governed by the UCP. If that happens, then the applicant will be required to reimburse under the terms of most reimbursement agreements. Under the ISP, the applicant will not be so exposed.⁸⁹

7. Under the ISP, a transferable letter of credit cannot be partially transferred.⁹⁰ Under the UCP,⁹¹ it can, thus exposing the applicant to possible multiple draws from different transferee beneficiaries.
8. Under the ISP, a transferable letter of credit can be transferred more than once in its entirety.⁹² Under a UCP credit, a transferable letter of credit may only be transferred once in its entirety.⁹³ While a letter of credit by its terms can override limitations on transfer, in the absence of doing so, ISP letters of credit are better suited to supporting bond offerings, syndications and other financings, where a trustee or agent beneficiary is used. An institutional trustee or corporate or financial agent may assign or transfer its rights and duties to another trustee or agent. Under an ISP governed transferable letter of credit, such transfers can occur without amending the letter of credit to expressly permit the transfer. Such amendments are usually at the expense of the applicant.
9. The ISP has a number of rules governing what documents presented under a standby must contain, what form they must be in, and who must sign them. The UCP distinguishes between commercial invoices, transport documents, insurance documents, and other documents.⁹⁴ Unless the credit specifies the form and content of these other documents, the issuer under a UCP credit may accept them as tendered.

6. Obtaining payment under a standby letter of credit does not immunize the proceeds or the beneficiary from claims that the beneficiary was unjustly enriched or received unreasonable liquidated or otherwise excessive damages.

A letter of credit assures the beneficiary making a nonfraudulent presentation that it will be able to obtain honor against presentation of conforming documents. Under Article 5 of the UCC, an issuer cannot defend against a conforming draw on the ground that

the beneficiary had a duty to mitigate damages.⁹⁵ Although it may have a duty to the applicant under the law governing the underlying agreement and remedies for its breach, the beneficiary is under no duty to the issuer to mitigate damages to reduce the amount it is otherwise entitled to draw. Similarly, in the absence of material fraud, under U.C.C. § 5-109, the applicant cannot enjoin a draw under a letter of credit even though it has a well-founded belief that the draw is excessive, that the beneficiary should mitigate its damages, or that the beneficiary is obtaining a windfall. The general rule for letters of credit is “pay first, litigate later.”⁹⁶

Even if no warranties are violated under U.C.C. § 5-110⁹⁷ and even if the drawing is expressly authorized by the underlying agreement that the letter of credit supports, the proceeds of the draw are not transmuted into something that the beneficiary is entitled to retain if the amount drawn constitutes unreasonable liquidated damages or unjust enrichment or exceeds statutory, regulatory, or public policy limitations. Cases in the context of landlords and municipalities illustrate this point well. What these cases have in common is, first, a recognition of the independence of the letter of credit, so that the right to draw is not interfered with and, second, the right of the applicant to reclaim some or all of the amount drawn if it constitutes or results in unreasonable liquidated damages, a penalty, unjust enrichment, or a violation of legal limits or caps on damages.

In an Eight Circuit Court case⁹⁸ the beneficiary, the City of Papillion, Nebraska (the “City”), drew down the entire amount of a \$250,000 letter of credit posted by the applicant to obtain a license for operating a keno gaming club because the keno club failed to maintain sufficient reserves to assure payment of lottery winners. The keno club’s trustee in bankruptcy claimed that retention of the full amount of the credit constituted unreasonable liquidated damages that had no reasonable connection to any actual damage the City may have suffered. The City argued that the issuing bank’s obligation under a letter of credit was separate and distinct from the underlying obligation for which the credit was issued and therefore the keno club had no right to them. The court quickly disposed of the City’s argument, stating that the independence principle “protects only the *distribution* of the proceeds of the letter of credit... and does not address claims respecting the underlying contract.” Other courts have reached similar results.⁹⁹

Landlords frequently take letters of credit in lieu of security deposits to secure their tenants' lease obligations. While the landlord may draw under the letter of credit in the event that the lease is breached, it may have to account for excess amounts drawn if the draw violates limitations on the amount of damages a landlord can retain for breach of the lease. This is true whether the limitation is imposed by state law¹⁰⁰ or by section 502(b)(6) of the Federal Bankruptcy Code.¹⁰¹

7. Once a bank is in receivership, the FDIC as receiver may reject undrawn standby letters of credit as burdensome contracts.

The FDIC takes the position that, as receiver of an insolvent bank, it can reject the obligations of that bank as the issuer of undrawn letters of credit as burdensome contracts if no default has occurred in the underlying agreement the letter of credit secures at the time the FDIC is appointed as receiver.¹⁰² The FDIC's position is that standby letters of credit are contingent obligations except for those standbys for which a default has occurred on the underlying obligation giving rise to a right to draw at the time the FDIC is appointed as receiver. Generally, contingent obligations do not give rise to provable claims against the FDIC in a receivership or conservatorship of a bank; any claims based upon such obligations lack provable damages because the damages are not fixed and certain as of the date of the appointment of the receiver or conservator.¹⁰³ Accordingly, no provable claims in a receivership or conservatorship can be based on contingent obligations unless the default by the account party or applicant conferring a right to draw under a letter of credit obligation occurred prior to the appointment of the FDIC as receiver or conservator. This is true whether or not the letter of credit obligation of the issuing bank is collateralized to the beneficiary.¹⁰⁴

Several exceptions apply to this rule. Commercial letters of credit might not be viewed as contingent contracts, or, if they are, because of their short duration and payment nature, the FDIC as receiver may allow them to be completed in the interests of commerce and will endeavor to place them with a successor institution or pay them if they in turn are reimbursed by the applicant.¹⁰⁵ Standby letters of credit involved in qualified financial contracts such as swaps, forward contracts, securities contracts, commodi-

ties contracts, repurchase agreements, and foreign exchange contracts, in each case involving capital markets, may receive special treatment.¹⁰⁶ Letters of credit collateralized to the beneficiary, such as municipal entities, where the collateral of the institution was pledged to secure a letter of credit prior to 1989, that have been renewed up through the present, are also exceptions. If the reimbursement obligation to the issuing bank is fully secured, the FDIC may, as a result of concerted lawyering by the beneficiary with the FDIC, in special cases, consent to an agreement or arrangement with the beneficiary whereby the beneficiary directly or indirectly receives payment or access to the collateral, since the result of payment under that circumstance is not to diminish or deplete the assets of the insolvent issuer.¹⁰⁷

The authority of the FDIC to disaffirm undrawn standby letters of credit underscores the importance of the beneficiary's evaluating the solvency and creditworthiness of the issuing bank and approving only creditworthy issuers. Beneficiaries should consider obtaining a provision in the underlying agreement between it and the applicant, requiring the applicant to obtain a substitute or replacement letter of credit with a creditworthy issuer within a certain time (e.g., 30 days) if the original issuer no longer meets certain tests of creditworthiness. If the applicant fails to do so within the time stated, then the beneficiary may draw under the letter of credit before the issuer's financial condition deteriorates further. Use of a downgrade or other credit standards provision requires the beneficiary to monitor the issuer's creditworthiness to determine, before the issuer is in receivership, that the issuer's deteriorated financial condition has triggered the right to demand a replacement letter of credit.

Frequently used barometers of an issuer's financial health include the ratings of the issuer's deposits or the debt rating of its holding company, the issuer's asset size and net worth, and whether, under FDIC guidelines, it is and remains a well-capitalized institution.¹⁰⁸ The requirements to approve a letter of credit of issuing banks for a major insurance company are as follows: (i) the issuing bank should be on the latest NAIC list of approved banks;¹⁰⁹ if the issuing bank is on the NAIC list, it should also have a LACE and BankWatch rating of "C" or better; (ii) if the issuing bank is not on the NAIC list, it must have a Standard and Poor's rating of "A" or better for domestic banks and "AA" or better for foreign

banks; (iii) approved banks must have equity of \$100 million or more; (iv) if the Bank is a foreign Bank, it must be a U.S. branch or agency of the foreign bank; (v) foreign branches of U.S. banks are not acceptable; (vi) the total amount of letters of credit issued by any one bank on behalf of any one account party cannot exceed 5% of the bank's equity; and (vii) the "Total Adjusted Exposure" of any one bank entity to the beneficiary cannot exceed 7.5% of GAAP capital of the beneficiary. This last component, while important to a major insurance company, obviously does not work for smaller beneficiaries. Other criteria can be formulated. Beneficiaries should be concerned about and set standards of creditworthiness for the issuer. Especially for longer-term letters of credit, the beneficiary must monitor the issuer's meeting specified credit standards and, if warranted, require the applicant to replace the issuer of the letter of credit with a suitable substitute issuer when the original issuer's credit rating or level is no longer acceptable.

8. U.S. corporate applicants should not expect U.S. courts to enjoin draws on letters of credit supporting foreign bank guarantees, even if their foreign counterparties engage in sharp practices or alleged fraud when they call upon those bank guarantees.

In order to obtain foreign business, U.S. suppliers and contractors are frequently required to procure a bank guarantee¹¹⁰ in favor of and to secure performance due to foreign purchasers of the U.S. seller's goods or services. Posting of a bank guarantee, sometimes called a counter-guarantee, enables the buyer to pay the seller or contractor in advance or in stages before the contract is fully performed. The bank guarantee is usually issued by a bank located in the buyer's country and is subject to the law of that country. Eager to obtain the business, a U.S. supplier or contractor will turn to its own bank with which it has established a line of credit. Unless its own bank is an international bank with offices in the country of the foreign buyer and is approved by the buyer or the buyer's appropriate government agency to issue bank guarantees in that country,¹¹¹ the supplier or contractor will have to obtain an automatically extendable letter of credit from its U.S. bank issued to a foreign bank approved by the buyer. The letter of credit is then used to obtain and support an independent bank guarantee to the foreign buyer to secure the seller's performance. The U.S. letter of credit can

be drawn upon the issuer's receipt of a certification by the issuer of the bank guarantee that the guarantee has been called by the foreign buyer.¹¹² The seller understands that the foreign buyer will call upon the bank guarantee if the U.S. seller or contractor fails to deliver the contracted for goods or services, fails to timely perform or ship, fails to complete performance, breaches warranties, does not meet specifications, or otherwise fails to perform as agreed or required. Frequently, the U.S. seller or contractor will also have agreed in the underlying contract to foreign choice of law and exclusive venue and arbitration or litigation before tribunals located in the buyer's country.

It is not uncommon for U.S. businesses to find, after the letter of credit and guarantee are in place and performance is completed or nearly completed, that the buyer demands goods, services, and/or other performance or compensation that the U.S. supplier or contractor believes is clearly uncalled for under the underlying contract terms. Foreign buyers may assert numerous claimed deficiencies in the goods and/or materials or work performed by the U.S. supplier or contractor and attach a price tag to their correction or as compensation for amounts far in excess of what the U.S. supplier or contractor deems is reasonably warranted or warranted at all. In other cases, the foreign buyer will simply not release the bank guarantee, which has an unlimited duration, until some consideration is received by the buyer to induce it to do so.

What happens in these circumstances usually follows a pattern: (i) the U.S. supplier or contractor, thinking that it has performed, asks its bank to obtain return and cancellation of its letter of credit; (ii) the U.S. supplier's or contractor's issuing bank tells its customer that it cannot obtain release of the letter of credit until the foreign buyer's bank releases the letter of credit; (iii) the foreign buyer's bank will not release the U.S. bank's letter of credit until its bank guarantee is cancelled by the buyer and returned; and (iv) the foreign buyer tells its U.S. supplier or contractor that it will not release the bank guarantee but instead will draw under it unless the U.S. supplier or contractor renders additional performance, agrees to discount amounts owed, or otherwise compensates the foreign buyer for its asserted claims that the U.S. supplier or contractor thinks are unfounded or overreaching or both.¹¹³

When an applicant-seller seeks judicial relief in this country in the form of an injunction against a draw under the letter of credit

that supports an independent bank guarantee, the applicant faces a number of difficulties and obstacles it must overcome to obtain that relief. Under U.C.C. § 5-109, the applicant must show that material fraud is occurring; an underlying contract dispute is not enough to justify injunctive relief.¹¹⁴ The seller-applicant must also meet judicial requirements for issuing injunctions by showing irreparable harm, no adequate remedy at law, no harm to the public interest, and satisfaction of the balance of the equities test.¹¹⁵ The applicant must also show probable success on the merits.¹¹⁶ The applicant must post a bond or provide other assurances to protect the beneficiary against harm that it will suffer by reason of temporary injunctive relief, such as expiration of the letter of credit.¹¹⁷ Injunctive relief is to be denied if the draw sought to be enjoined is presented by a nominated bank that has paid value, by a holder in due course of a deferred payment undertaking, or by the assignee of an accepted draft.¹¹⁸

In addition to all of these conditions or requirements to obtaining injunctive relief, the applicant must overcome any choice of foreign venue, jurisdiction, arbitration, and law clauses agreed to in the underlying contract. A number of U.S. courts have recognized that they should not be enjoining draws on letters of credit in this country on the basis of fraud allegations that sound like contract disputes. They recognize and give effect to consensual foreign choice of law and forum provisions in contracts performed or deemed performed in a foreign country. U.S. courts will also recognize the rights of the foreign issuer of the independent bank guarantee as an innocent middleman that should be likened to a confirming bank that pays value but is not a party to the underlying contract in dispute.

The *Lloyd's* cases decided in the 1990s upheld English choice of law, jurisdiction, and arbitration in the parties' agreements and denied injunctive relief against draws under letters of credit posted by "Names" who claimed that they were defrauded.¹¹⁹ In these cases, high net worth U.S. individuals, as a condition of becoming "Names," posted letters of credit to secure their obligation to meet their underwriting liability to insurance syndicates to which they subscribed. Significantly, as a condition of becoming a Name, the Name was required to travel to London to execute the pertinent underwriting agreements; consent to English choice of law, exclu-

sive jurisdiction, and venue in England; and agree to arbitrate all claims and disputes in England.

U.S. Names by the hundreds incurred large losses on various Lloyd's insurance syndicates. Many filed suits here alleging fraud, securities violations, breach of fiduciary duty, and other causes of action arising out of the solicitation, selling, and administration of Lloyd's syndicate participations. Some sought to enjoin draws on the letters of credit they posted to secure their obligations to make good on their underwriting obligations. U.S. courts denied injunctive and other relief, primarily on the basis that the applicants had an adequate remedy at law under securities laws of and due process afforded in England pursuant to the terms of the dispute resolution procedures the Names had agreed to as a condition of becoming a Name. The agreements by the Names to litigate their claims exclusively in an English forum under English law were upheld.

In a more recent insurance context, a trilogy of cases involved a Bermuda underwriter and reinsurer in receivership and a small domestic roofing insurer over alleged fraud in the negotiation, underwriting, management, and profit-sharing arrangements between the two companies. The courts responded with mixed results when the U.S. insurer, claiming fraud, sought here to enjoin draws on two letters of credit securing obligations owed to the distressed Bermuda insurer. The Seventh Circuit on the underlying fraud dispute on the merits upheld the parties' choice of law, arbitration, and forum in Bermuda.¹²⁰ The Sixth Circuit denied injunctive relief with respect to a Comerica Bank letter of credit posted by the U.S. insurer to the Bermuda company on the ground that monetary damages alone that the U.S. insurer might suffer if the Bermuda insurer drew on the letter of credit were not enough to warrant injunctive relief.¹²¹ The Ninth Circuit upheld injunctive relief against a draw under a Bank of America letter of credit, disagreeing with the Sixth Circuit on the monetary damages issue and distinguishing the Seventh Circuit decision on the grounds that (i) the forum selection clause in the underlying agreement was not so broad as to preclude injunctive relief against a bank issuer not a party to that agreement, and (ii) injunctive relief maintained the status quo until the underlying dispute on the merits could be resolved in Bermuda as required by the Seventh Circuit.¹²²

Except for the Ninth Circuit decision described above, these insurance cases show that courts in this country are reluctant to

overturn international dispute resolution provisions negotiated at arms length between business parties. Judicial deference to party dispute resolution choices comes across even more clearly in the cases discussed below, which involve letters of credit that support independent bank guarantees for overseas sales or services. In those cases, courts have generally upheld the right of the foreign issuer of a bank guarantee to draw under a letter of credit supporting its bank guarantee when that guarantee has been called, notwithstanding protests by the U.S. applicant that it has performed and the demand on the bank guarantee is unjustified. The courts uphold the right of the counterguarantor to draw on the basis of one and usually two or more of the following rationales: (i) the counterguarantor is an innocent financial intermediary not a party to the alleged fraud,¹²³ (ii) the parties agreed to litigate their disputes overseas, (iii) the dispute is primarily a contractual one not involving material fraud, and (iv) public policy favors upholding the integrity of letters of credit in international business transactions negotiated at arms length.

In a Fifth Circuit case,¹²⁴ the district court issued a preliminary injunction prohibiting an Ecuadorian oil company from demanding payment on a letter of guarantee issued by the Ecuadorian branch office of a bank whose main office was in the United States, prohibiting the Ecuadorian branch office from demanding payment on a letter of credit issued by a different bank located in the United States supporting the guarantee, and prohibiting the United States bank from honoring any such demand on the letter of credit. The injunction was reversed on appeal based on the provisions in the underlying contract that required that all claims of the buyer be submitted to a designated Ecuadorian court for resolution under the laws of Ecuador. The court was also concerned about maintaining the integrity of international letters of credit and troubled by the jurisdictional reach of lower court's order.

In a First Circuit case,¹²⁵ Foxboro elected to provide a bank guarantee, which was issued by Saudi American Bank (Samba) to Arab American Oil Co. (Aramco) to secure Foxboro's obligation to supply process control systems for a refinery in Saudi Arabia. The Samba guarantee was itself secured by a letter of credit issued by Citibank on Foxboro's behalf. The court noted that this "four-way" security is a typical commercial arrangement for American contractors doing business in the Middle East. After 11 months

of negotiation over post-termination obligations, Aramco made a demand on the Samba bank guarantee, and Samba, in turn, made a demand on the Citibank letter of credit. Foxboro sought a temporary restraining order to prevent a draw under the letter of credit and bank guarantee, alleging fraud. The district court granted a restraining order and preliminary injunction. The First Circuit reversed on the ground that arbitration chosen by the parties in Saudi Arabia gave Foxboro an adequate remedy at law. The parties contracted to be bound by Saudi Arabian law and to use Saudi Arabian arbitration in resolving disputes between them, which the court found provided Foxboro with an adequate remedy at law.

In a case decided by the District Court for the District of Columbia,¹²⁶ the American supplier (AEG) had its bank (First American) issue two letters of credit to the National Bank of Kuwait (NBK) to secure NBK's issuance of a performance bond to insure delivery of ordered electric equipment. AEG sought to enjoin draws on the two letters of credit after demand was made by Salem on the NBK bank guarantee. AEG alleged that

- (1) it supplied the electrical equipment ordered,
- (2) the equipment was fully tested and after installation was operating,
- (3) the work was accepted and completed,
- (4) the one-year warranty period had run two years before the draw under the bank guarantee, and
- (5) Salem should have released the letters of credit long ago, but it had consistently but improperly refused to do so when requested.

Under the terms of the bank guarantee arrangement, neither AEG nor its bank (First American) could cancel the letters of credit. The court refused to grant injunctive relief even though Salem did not contest the absence of valid reasons for its call on the bond. Because arbitration was available in Kuwait, the court found that an adequate remedy at law existed. Because the injunction restrained NBK as bank guarantee issuer, rather than Salem as bank guarantee beneficiary, from drawing on the letter of credit, the court remarked that a showing of probable success on the merits could not be made in the absence of a showing of collusion between NBK and Salem.¹²⁷ The court also found that the public interest

warranted denying injunctive relief because AEG knowingly gave up procedural protections to gain the business opportunity, AEG failed to take legal action to secure release of the bank guarantee and letters of credit because of its asserted completion of its contract obligations, and there was a vital public interest against issuance of relief that undermines international arrangements negotiated at arms length and secured by irrevocable letters of credit.

In a North Carolina district court case,¹²⁸ the French purchaser of road construction equipment gave notice of its intent to draw on a letter of credit posted in lieu of a 10% performance bond after it encountered numerous problems of compliance such as customs clearance, lack of steering axles, lack of warning decals, missing mud flap, electrical circuit problems, and reflectors and lights that did not comply with European standards. The letter of credit required a statement that the asphalt plant the beneficiary had purchased did not meet the specifications set out in the contract. The applicant sought to enjoin the draw on the letter of credit on the ground that it had substantially and satisfactorily performed its obligations. The court denied injunctive relief on the following grounds:

- (i) the applicant's claim of irreparable harm from having to litigate in France was spurious because the applicant consented to jurisdiction and mediation in France in the underlying sales contract;
- (ii) the beneficiary would be deprived of the benefit of its bargain;
- (iii) the letter of credit was issued as a performance guarantee and it was doubtful that the applicant would succeed in showing that the drawing was unwarranted or fraudulent;
- (iv) the amount of the drawing was limited to 10% of the contract price, so it would not deprive the applicant of the basis of its bargain; and
- (v) the applicant's argument that the beneficiary was using the threat of a draw on the letter of credit to harass and extract services for which it did not contract was rejected because it was a risk knowingly encountered when it gave the standby as part of the agreed upon exchange between the parties.

The result reached in the case appears correct, but unfortunately the court failed to discuss the absence of a showing of material fraud required by U.C.C. § 5-109.

State courts reach similar results. In a case decided by the Alabama Supreme Court,¹²⁹ AmSouth issued a letter of credit at Southern Energy's request to secure a bank guarantee in favor of Deutsche Bank, which in turn issued a performance guarantee in favor of a German company (GBH) based on a construction contract between Southern Energy and GBH. The contract was governed by German law and provided for disputes to be resolved in Germany. Southern Energy obtained an injunction from the trial court. AmSouth moved to modify or dissolve the TRO in order to protect itself from liability to Deutsche Bank. AmSouth argued that it should not be enjoined from paying on its letter of credit, because it provided for payment upon Deutsche Bank's automatic debit of AmSouth's account. AmSouth also asked the court for protections of its "active foreign banking business." The Alabama Supreme Court opted not to decide the case on the basis argued by AmSouth but still overturned the injunction on the ground that Southern Energy had an adequate remedy at law, namely to litigate in Germany as the underlying contract documents required.

The Alabama Supreme Court more recently decided on different grounds to deny injunctive relief on a counter-guarantee case.¹³⁰ The Airport Authority of India (AAI) retained Transact International, Inc. (Transact) to build a cargo-handling facility at the Indira Gandhi International Airport in New Delhi, India. The contract between AAI and Transact included forum selection and choice of law provisions requiring that any disputes related to the contract be resolved in New Delhi according to Indian law. Webb-Stiles Company, Inc. (Webb-Stiles), a U.S. manufacturer of conveyor systems, was one of Transact's subcontractors on the airport project. In connection with the contract, AAI and Transact joined with SouthTrust and the State Bank of India (SBI) in a so-called four-way security arrangement. SBI agreed to guarantee Transact's performance to AAI. In return, SBI required that Transact obtain an irrevocable standby letter of credit in favor of SBI. Webb-Stiles helped Transact obtain the letter of credit from SouthTrust. For five years after the contract was completed, the parties argued over whether further work needed to be performed. Under its terms, the letter of credit was payable by SouthTrust

upon SouthTrust's receipt of a proper demand from SBI. It was undisputed that SBI's demand conformed to the requirements of the letter of credit. AAI drew on the SBI guarantee and SBI drew on the SouthTrust letter of credit. Webb-Stiles sued to enjoin SouthTrust from honoring the letter of credit, claiming that AAI had fraudulently misrepresented its right to make demand against the SBI performance guarantee. After hearing testimony, the trial court found that AAI's cost to remedy any remaining deficiencies under the contract would not exceed \$10,000 and that AAI itself owed Transact \$158,000. As a result, the trial court found AAI's claim that Transact was materially in default under the contract to be fraudulent. Webb-Stiles also asserted that Indian law would deny Webb-Stiles a remedy. The Alabama Supreme Court denied injunctive relief but side-stepped the issue of whether Indian law would deny Webb-Stiles an adequate remedy, instead relying on Webb-Stiles position as surety for Transact with recourse against Transact and therefore an adequate remedy at law against Transact for any amounts Webb-Stiles paid in reimbursement on the SouthTrust letter of credit issued for Transact's benefit. The court, however, cited and emphasized the principles set forth in the Southern Energy Homes case discussed above, including the burden Webb-Stiles faced in disrupting important commercial functions served by international letters of credit.

CONCLUSION

As noted at the outset, letter of credit law and practice is counterintuitive in some cases and *sui generis*. Although highly formal in its structure and the application of rules, it is a practical tool that when properly understood and used can be invaluable to the attorney and businessman. The hope of this article is that by reading through it, nonbankers—applicants and beneficiaries and their attorneys—will have a better understanding of how standby letters of credit work in specific situations and what are some of the drafting and legal points to be mindful of when drafting and using them.

NOTES

1. Various aspects of this article were commented upon by James G. Barnes of Baker & McKenzie LLP, Walter "Buddy" Baker of Atradius, and Fiore "Frank" Petrassi of JPMorgan Chase Bank. Their comments are greatly appreciated. Special thanks go to James Barnes for his editorial review of this article. Special thanks also go to Cori

Brown of Jenner & Block for her assistance. The views expressed in this article are not necessarily those of Jenner & Block LLP.

2. The original, more ambitious scope of this article dealt with 50 standby letter of credit practices or rules misunderstood or little understood by applicants and beneficiaries. The current scope of this article is limited to eight rules and practices involving standby letters of credit.

3. For a more comprehensive listing of the uses of standby letters of credit and citation of decisions involving them, see Dolan, *The Law of Letters of Credit: Commercial and Standby Credits* ¶1.06 (A.S. Pratt 2002).

4. Commercial letters of credit were frequently used in the late 1800s, and their use became widespread after World War I with the growth of international trade. Standby letters of credit acquired use in the 1960s for certain types of financings, such as real estate developments, shipbuilding and Middle East infrastructure projects and gained widespread use and recognition in the 1970s. See Verkuil, *Bank Solvency and Guaranty Letters of Credit*, 25 *Stan. L. Rev.* 716 (May 1973); Dolan, *The Law of Letters of Credit: Commercial and Standby Credits* (A.S. Pratt 2002) ¶¶ 3.05 & 3.06.

5. The ISP was originally drafted by the Institute of International Banking Law & Practice, Inc. (IIBLP) in 1998 and was later adopted by the International Chamber of Commerce as Publication No. 590. It has gained fairly rapid acceptance and is now used as the regime of choice in over half of the \$650 billion face amount of standbys issued by U.S. banks and U.S. branches of foreign banks. See quarterly statistics of letter of credit activity on a bank-by-bank basis collected by the FDIC and published in *Documentary Credit World*.

6. The UCP was started by New York banks (including foreign banks operating in New York) in the 1920s as a statement of customs and practice for examining documentary presentations under letters of credit used in international trade. European banks embraced its rules and the International Chamber of Commerce (ICC) began publishing them. The ICC Banking Commission revises the UCP about every 10 years. The version of the UCP that has been in use since 1994 is the UCP 500, ICC Publication No. 500 (the UCP 500). The UCP 500 was recently revised in ICC Publication No. 600, adopted by the ICC Banking Commission on October 25, 2006, effective July 1, 2007 (the UCP 600). As the ICC guards its copyright, the UCP is not available online. Copies can be purchased from the ICC through its Web site at <http://iccwbo.org>.

7. UCP 500, Art. 1; UCP 600, Art. 1.

8. The UCP 500 is supplemented by the International Standard Banking Practices (ISBP) approved by the ICC Banking Commission in October 2002. The ISBP is a distillation into 200 sections of interpretations of the UCP, written by a specially appointed committee of the ICC Banking Commission after receiving and reviewing national committee comments and dozens of ICC interpretative letters on the UCP. The ISBP will be revised for the UCP 600. Although the ISBP has a statement of general principles, most of its sections deal with commercial letter of credit practice and documents.

9. Under the UCP, the ISP and Article 5 of the Uniform Commercial Code, the performance of documents to the terms of the credit are determined under standard banking practice. UCP 500, Art. 13(a); UCP 600, Art. 2 (definition of "Complying Presentation"); ISP, Rules 1.03(b) and 4.01(b); U.C.C. § 5-108(a), (e).

10. UCP 500, Art. 43; UCP 600, Art. 14(c).

11. UCP 500, Art. 41; UCP 600, Art. 32.

12. UCP 500, Art. 17; UCP 600, Art. 36.

13. UCP 500, Art. 13(a); UCP 600, Art. 14(d).

14. For example, Article 5 of the UCC is the only article of the UCC that defines good faith as “honesty in fact in the conduct or transaction in question” without reference to the observance of reasonable commercial standards of fair dealing. See U.C.C. § 5-102(a)(7). Assignments of proceeds of letters of credit can be used to perfect a security interest in letter of credit rights, but a transfer of drawing rights to the secured party is outside the scope of Article 9 of the UCC. See U.C.C. § 5-114(e) & (f) and Official Comment 4 to U.C.C. § 9-107. A failure to identify a discrepancy on dozens of prior drawings of the same or similar letters of credit does not preclude the issuer from raising that discrepancy, without prior notice, on any subsequent drawing on that or another letter of credit issued to the same beneficiary. See Official Comment 7 to U.C.C. § 5-108. Many other examples could be cited.

15. Although there are over 7,000 banks in the United States, 10 banks account for well over half the dollar amount of all outstanding letters of credit issued by U.S. banks. JPMorgan Chase Bank alone accounts for almost \$100 billion face amount of standbys issued and outstanding as of the end of the third quarter of 2006. See Doc. Credit World (Feb. 2007).

16. International Financial Services Association. The IFSA membership is composed primarily of banks, including the largest U.S. banks and most of the major banks of the world with branches or banking subsidiaries in the United States. IFSA members handle over 98% of the letters of credit issued in the United States and over 98% of the U.S. funds transfer volume. The IFSA represents the international operations of financial services providers with particular emphasis on trade payments involving documentary credits, treasury operations, compliance, and regulatory reporting. The IFSA regularly sponsors and conducts educational programs and conferences on payments, collections, and letters of credit at the regional and national levels.

17. The Banking Committee of the USCIB educates its members and promotes their interests on international trade finance issues, including the UCP 600, documentary collections, and dispute resolution.

18. Becoming a CDCS requires some four to six months of independent study and passing a three-hour examination consisting of 120 multiple choice questions as well as three “in basket” exercises with questions that demonstrate skill in real-world applications of the UCP. The IFSA has a training course and exam for letter of credit personnel to become a Certified Documentary Credit Specialist. The ICC sponsors an online training program and discussion groups called DC Pro. Private trade firms such as Mantissa and Sitpro also offer letter of credit training.

19. U.C.C. § 5-108(e) provides that an issuer shall observe standard practices of financial institutions that regularly issue letters of credit. The ISP rules are to be interpreted as mercantile usage with regard for practice and terminology of banks and businesses in day-to-day transactions and consistency within the worldwide system of banking operations and commerce. ISP Rule 1.03(b) & (c). Compliance of documents presented with the credit terms are determined by international standard banking practices as reflected in the UCP. UCP 500, Art. 13(a). A complying presentation under UCP 600 is one that is in accordance with the terms and conditions of the credit, the applicable UCP articles and international standard banking practice. UCP 600, Art. 2.

20. The Annual Letter of Credit Survey is sponsored by the IIBLP; is held around the world in prominent venues such as Singapore, Shanghai, Vienna, Sweden, Prague, Moscow, Dubai, Hong Kong, and Miami; and attracts as speakers and panelists some of the world’s leading authorities on letters of credit and bank guarantees.

21. Prof. James Byrne is president of the IIBLP and was one of the chief draftsmen of the ISP.

22. Dan Taylor is President of the IFSA and was only one of two United States members of the 11-member ICC Drafting Group responsible for the UCP 600.

23. Frank Petrassi of JPMorganChase, the issuer of the largest dollar volume of standby letters of credit in the United States, indicated that his bank sees drafts specified for drawings in about 90% of standby letters of credit.

24. See § 5-109(a)(1).

25. A confirming bank must be nominated in the letter of credit to act as a confirming bank. U.C.C. § 5-102(a)(4). The confirmer steps into the shoes of the issuer when documents are presented to the confirmer. If the confirmer honors a complying presentation, as it has undertaken to do, it is entitled to reimbursement from the issuer as if the confirmer were the issuer and the issuer the applicant, regardless of whether or not a draft is required to be presented to effect the draw. See U.C.C. § 5-107(a). Under U.C.C. § 5-109(a)(1), a confirming bank that has honored a presentation, but has not yet been reimbursed by the issuer, is entitled to reimbursement notwithstanding discovery of an intervening fraud. This is true even if the letter of credit does not require presentation of a draft to effect a draw and therefore the confirmer does not hold a draft to be presented to the issuer for reimbursement.

26. See U.C.C. § 5-107(a) (confirmer has rights and obligations of an issuer) and U.C.C. § 5-108(i)(3) & (4) (issuer has no right of recourse on draft or in restitution against beneficiary). To be liable on its confirmation, draw documents must be presented to the confirming bank unless the credit or the confirmation otherwise specifies. UCP 600, Art. 8(a); UCP 500, Art. 9(b); ISP Rule 3.04(c). Confirming banks require and expect that when drafts are presented to effect a draw under their confirmation, the draft be drawn on the confirming bank, rather than the issuing bank. Accordingly, when it honors the draft, the confirming bank would not be purchasing or negotiating the draft but discharging it. That, of course, would not affect the confirmer's right of reimbursement from the issuer that arises under the terms of the letter of credit and letter of credit law independent of the draft.

27. The reference to a letter of credit as negotiable is a shorthand way of referring to a letter of credit which authorizes drafts or demands for payment and accompanying documents to be negotiated by the beneficiary to or purchased by a nominated party who may then obtain payment from the issuer or a confirmer upon their presentation. Letters of credit can be made negotiable to parties specifically nominated or named in the letter of credit, such as the beneficiary's bank or a bank near the beneficiary, or they can be made freely negotiable, which means that the documents presented can be negotiated to or purchased by any bank. The usual language inserted in a letter of credit for negotiation of draws is simply a statement that the credit is available by negotiation with a specifically named bank or if freely negotiable, available by negotiation with any bank. Previously, drawings under the credit were also made negotiable by the inclusion of a statement in the credit that the issuer engages with or agrees to make payment to "drawers, endorsers, and bona fide holders of drafts drawn under and in compliance with the terms of the credit." See Dolan, *The Law of Letters of Credit* (A.S. Pratt 2002) ¶1.02[3]. This latter language is now regarded as obsolete.

28. Clean letters of credit, also known as "suicide" letters of credit because of the ease with which they may be drawn and the difficulty of enjoining them, only require a draft to be presented to effect a draw; no reason or certification of an occurrence or default need be stated.

29. ISP Rule 4.16(a) provides that if a separate demand for payment is called for by the letter of credit, it must contain a demand for payment from the beneficiary directed to the issuer or nominated person, a date of the demand, the amount demanded, and the beneficiary's signature. ISP Rule 3.03 also requires identification of the standby

on which demand is made. If a standby fails to specify any required document, ISP-governed credits will be deemed to require a documentary demand for payment. ISP Rule, Rule 4.08.

30. See, e.g., *Continental Cas. Co. v. SouthTrust Bank, N.A.*, 933 So. 2d 337, 58 U.C.C. Rep. Serv. 2d 372 (Ala. 2006) (a draft required by standby letter of credit that omitted an address is not discrepant if the letter of credit does not require that the address be included in the draft; Supreme Court of Alabama reversed lower court to reach this result).

31. U.C.C. § 5-108(a); *BM Electronics Corporations v. LaSalle Bank, N.A.*, 59 U.C.C. Rep. Serv. 2d 280 (N.D. Ill. 2006) (the strict compliance standard applies to letters of credit governed by the UCP 500).

32. As noted earlier, under the UCP, the ISP and the UCC, the conformance of documents to the terms of the credit are determined by resort to standard banking practice. UCP 500, Art. 13(a); UCP 600, Art. 2; ISP, Rules 1.03(b), 4.07(b); U.C.C. § 5-108(a), (e).

33. *In re Enron Corp.*, 292 B.R. 752 (Bankr. S.D. N.Y. 2003) (the “BNL Case”).

34. ISP Rule 4.16(c) provides that a draft need not be in negotiable form. The BNL Case involved a UCP credit.

35. BNL argued in its brief that “[a]s a matter of law, under UCC §§3-104(1)(b) and 3-102(1)(b), it is impossible to call an instrument which is not addressed to anyone a draft, and a draft is what was required by the LOC. BNL also contends that the inclusion of wiring instructions in the middle of the purported draft creates an instrument that was so odd that it would not pass muster in the ‘standard practice of financial institutions that regularly issue letters of credit,’ which is a question of fact to be determined at trial.” Third Supplemental Affidavit of Michael Lampert in Opposition to Plaintiff’s Motion for Summary Judgment, at p. 9 (Jan. 24, 2003). BNL also pointed to New York’s nonuniform version of revised Article 5-108(e), which eliminates the provision that provides for court, as opposed to jury, determination of standard banking practice.

36. BNL submitted the affidavit of Thomas Badolato, head of the letter of credit department of BNL’s New York branch. Badolato stated: “In early December 2001, I was called by BNL senior management to a conference room at BNL and, with no introduction or explanation, shown a telefax of what purported to be a sight draft... I was asked if I saw anything wrong with the document. This was an unusual occurrence and I was a little nervous, not knowing whether the senior executives wanted the draft to be good or bad, so I just scanned it and blurted out ‘It’s not addressed to anyone.’ The defect was so immediately apparent that any junior document checker would have spotted it.” Mr. Badolato went on to testify that his “job is to know that documents on their face comply with stipulated conditions in accordance with international standard banking practice.” *Enron Corp.*, 292 B.R. at 779.

37. Hypo Bank introduced testimony of Antoinette Wynn, the head of the letter of credit department of Hypo Bank’s New York branch. Her testimony was that the draft was in sufficient form for honor and not discrepant. As noted in the text, neither a form of the draft nor specifications of what it should contain were stated in the credit.

38. U.C.C. § 5-108(i)(3) (issuer that honors presentation is precluded from asserting a right of recourse on a draft under U.C.C. § 3-415); see also U.C.C. § 3-415(c) (if a draft is accepted by a bank after an endorsement is made, the liability of the endorser under § 3-415(a) is discharged). The statement in the text also assumes that the draw is otherwise proper and does not violate the warranties under U.C.C. § 5-110.

39. U.C.C. § 5-103(d); UCP 500, Art. 3; UCP 600, Art. 4; ISP Rule 1.06(c).

40. UCP 600, Art. 6(c); ISBP, Sec. 56.

41. See U.C.C. § 3-415(a) (if an instrument is dishonored, an endorser is obliged to pay the amount due on the instrument according to the terms of the instrument at the time it was endorsed).

42. It would be an unusual non-negotiable standby letter of credit that expressly required drafts to be presented by the beneficiary duly endorsed.

43. European and other non-U.S. issuing banks may insist on endorsement of drafts presented to them even on straight or standby letters of credit. They can point to ISBP, Sec. 51 which provides that “drafts must be endorsed if necessary” as well as their long-standing custom and practice of requiring endorsements. The beneficiary should argue that endorsement is not necessary for standby presentations, but that argument might not carry weight with non-U.S. issuers or even some U.S. issuers.

44. See footnote 37.

45. All 50 states have adopted revised Article 5 of the UCC. Except for a handful of states that have modified the mandatory attorney’s fees provision of § 5-111(e), the court vs. jury determination of standard banking practice under § 5-108(e), and the definition of good faith in § 5-102(a)(7), Article 5 is substantially the same among all the states. New York has not adopted the mandatory attorney’s fees provision of U.C.C. § 5-111(e).

46. Several major banks, including Citibank and JPMorganChase, have their letter of credit operations located in Florida. However, their standby letters of credit prescribe New York law to govern. An advantage of using New York law is that it has a well-developed body of letter of credit law as opposed to a state such as North Dakota. The outcome of a letter of credit case decided under New York law therefore may be more predictable and closer to the expectations of the parties.

47. U.C.C. § 5-116(a) & (e) give the parties the right to choose the governing law and the forum for settling disputes arising out of the letter of credit.

48. Courts have upheld choice of forum and jurisdiction even in international letter of credit transactions where there is very little relation to the forum state. See *Banco Nacional De Mexico, S.A. v. Societe Generale*, 34 A.D.3d 124, 820 N.Y.S.2d 588, 60 U.C.C. Rep. Serv. 2d 1248 (1st Dep’t 2006) (even though issuer, confirming bank, and beneficiary were located elsewhere, court enforced exclusive jurisdiction of New York court chosen in letter of credit to secure construction of power plant in Mexico).

49. See ISP Rule 9.05 (retention of standby after the right to receive payment does not preserve any rights). It is not uncommon for a bank negotiating documents under commercial letters of credit to require presentation of the original of the letter of credit together with draw documents. The bank to which the draw is presented will endorse the amount of the payment on the reverse of the letter of credit so any subsequent bank to which the beneficiary may make another partial drawing under the same letter of credit can ascertain the amount that has already been drawn to determine availability.

50. UCP 600, Art. 16(d); UCP 500, Art. 14(d)(i); ISP Rule 5.01(b)(i).

51. See, e.g., *Datapoint Corp. v. M & I Bank of Hilldale*, 665 F. Supp. 722, 4 U.C.C. Rep. Serv. 2d 829 (W.D. Wis. 1987) (issuer that finds discrepancy on draft on the last day for presentation must give notice by telecommunication that day to enable the beneficiary to correct the discrepancy and represent; mailing notice of the discrepancy insufficient). This case is cited with approval in Official Comment 4 to U.C.C. § 5-108.

52. U.C.C. § 5-116(b).

53. U.C.C. § 5-108(i)(5).

54. UCP 500, Art. 15; UCP 600, Art. 34; ISP, Rule 1.08(b).

55. UCP 500, Art. 13(a); UCP 600, Art. 14(a); ISP, Rule 4.01(b).

56. ISP Rule 4.13 deals with the responsibility of an issuer or other person honoring a presentation identifying the beneficiary. Subsection (a) provides that the issuer or other person honoring a presentation has no duty to the applicant to ascertain the identity of any person making a presentation. The implication is that the issuer or other person honoring a presentation is not relieved of its duties to the beneficiary. Subsection (b) indicates that the issuer's obligation under the standby is fulfilled if the payment is made to the named beneficiary, to its transferee, to a successor by operation of law, to an account stated in the standby or in a cover instruction from the beneficiary. Again, the implication is that unless the true beneficiary or its transferee or successor receives payment or payment is made as instructed by it, the issuer or other person honoring a presentation is still under obligation to the true beneficiary.

57. See § 5-103(c).

58. James G. Barnes of Baker & McKenzie LLP, one of the chief architects of Revised Article 5 and the ISP, presented a position paper at the IIBLP's Letter of Credit Law Summit in October of 2003 on the use of the word "purportedly" to describe signature requirements in documents presented under letters of credit. He comments: "A surprising number of LCs, particularly standbys, require 'purportedly' signed documents. Some bankers and lawyers think it is customary and/or desirable to draft LCs to call for, e.g., a 'statement purportedly signed by the beneficiary stating that....' It is a truism that bankers expect reimbursement for honoring documents that purport to be what they are not. It is customary and appropriate for issuers to say in reimbursement agreements that they are entitled to reimbursement for 'purported' drawings under the LC, etc. The UCC, and ISP98 (and arguably UCP500) say as much. However, this is not a precise or benign way to indicate that documents presented under an LC are examined 'on their face.' It is not customary or appropriate to say in an LC that the issuer will honor documents that only appear or purport to be signed (or issued, genuine, original, etc.). It's unnecessary to preserve the issuer's right to reimbursement after honoring forged documents. It's endless—'purportedly signed by a purported officer of the purported beneficiary and purporting to say that...' It's not intended—no issuer or applicant wants forged documents. It confuses everyone's rights and obligations in the event that a draft or demand is purportedly, but not actually, signed by the beneficiary."

59. An argument could also be made that UCP 500, Art. 15, UCP 600, Art. 34 and ISP Rule 1.08(b), as they might affect the beneficiary's rights, is a general disclaimer of liability which is unenforceable against the beneficiary under the last sentence of U.C.C. § 5-103(c). An analysis of the merits of that argument is beyond the scope of this article.

60. An analogy can be made to U.C.C. § 3-404, which covers the situation where a party is induced through use of the mails or otherwise, to issue a payment instrument to an imposter instead of the true payee. In that situation, U.C.C. § 3-404 will allocate the loss to the party so induced if the other parties affected have not participated in the fraud and are not negligent.

61. The text does not mean to say that it would be impossible or unenforceable to draft a letter of credit in such a manner that the beneficiary assumes the risk of a draw by an imposter using forged documents. The point is that incorporation of the UCP or ISP into the credit or the use of the word "purportedly" alone is probably not enough to reach that result. The letter of credit would have to explicitly state that the beneficiary bears the risk if the issuer pays an imposter on a draw based on forged documents.

62. For example, the terms of Citibank's standard Agreement for Standby Letter of Credit protects Citibank against presentations by an imposter in at least four different ways. It provides that the applicant's obligation to reimburse and indemnify "is unqualified, irrevocable and payable in the manner and method provided for under this Agreement irrespective of... (v) any Draft, or other document presented under the Credit being forged, fraudulent, invalid or insufficient or any statement therein being

untrue or inaccurate... (vii)... payment against any Draft, certificate or other document which appeared on its face to be signed or presented by the proper party but was in fact signed or presented by a party posing as the proper party..." The Citibank Agreement also provides that "Citibank and any of its correspondents... (iii) shall not be responsible for the identity or authority of any signer or the form, accuracy, genuineness, falsification or legal effect of any Draft, certificate or other document presented under the Credit if such Draft, certificate or other document on its face appears to be in accordance with the terms and conditions of the Credit... (v) may accept or pay as complying with the terms and conditions of the Credit any Draft, certificate or other document appearing on its face (A) substantially to comply with the terms and conditions of the Credit, (B) to be signed or presented by or issued to any... person in whose name the Credit requires or authorizes any Draft, certificate or other document to be signed, presented or issued..."

63. The issuing bank should insure that, in amending the credit, it is dealing with the true beneficiary by using a security or verification procedure.

64. The author participated in a panel discussion on letter of credit issues with treasurers of large corporations in a particular industry where this view was expressed by counsel for one of the largest members present as well as by a former letter of credit banker for a large bank. This view has also been mentioned or commented on at several letter of credit conferences.

65. National Association of Insurance Commissioners. The NAIC is an organization of insurance regulators from the 50 states, the District of Columbia and the five U.S. territories. The NAIC has developed uniform policies regarding a number of areas of insurance regulation, the most notable being the development of uniform financial reporting by insurance companies. It also prescribes the requirements for a qualifying letter of credit that insurance companies should use with offshore reinsurers. See 5 NAIC Model Laws, Regulations and Guidelines 786-1, §11 (Letters of Credit Qualified under Section 9 [Reinsurance]) (Feb. 2007).

66. See New York Department of Insurance Regulation 133. The Office of General Counsel issued an opinion on May 27, 2003, representing the position of the New York State Insurance Department that a standby letter of credit governed by the ISP and not the UCP does not comply with its Regulation 133, which specifies the form and requirements of letters of credit posted for reinsurance to obtain reserves credit and for other purposes. The NY Department of Insurance takes the position that to be compliant with their regulations, the letter of credit must state that it is subject to and governed by the UCP 500.

67. At the Annual Letter of Credit Survey, it was reported that the largest dollar amount of standby letters of credit are issued for insurance and reinsurance purposes. Insurance-related letters of credit are posted as security for obligations of foreign reinsurers that are not admitted in the U.S., so the domestic insurer can obtain credit against reserve requirements. Standby letters of credit are also used to secure indemnity obligations of corporations for their retained liability under fronting agreements with insurers for workmen's compensation, medical insurance, and other forms of self-insured arrangements that require, by state law, an insurance company to provide employee insurance benefits. They are also used to secure indemnity obligations owed to surety companies for issuing performance bonds.

68. See, e.g., ISP Rule 4.20(b) (issuers to examine trade standby documents presented not under the UCP but according to standby practices).

69. UCP 500, Art. 13(a); UCP 600, Art. 14(d). For commercial letters of credit, inconsistency of documents is a discrepancy frequently cited by issuers for dishonor of presentations.

70. ISP Rule 4.01.

71. ISP Rule 4.03.

72. UCP 500, Art. 17; UCP 600, Art. 36. If the draw documents are mailed or delivered and actually received within the four walls of the issuer prior to expiry, a court would be hard-pressed to deny the timeliness of the presentation simply because the letter of credit department of the bank or the bank as a whole was closed due to a force majeure event.

73. UCP 500, Article 17 and UCP 600, Article 36 put the risk on the beneficiary if the issuer is closed due to a force majeure event. As a result, knowledgeable beneficiaries normally require inclusion in a UCP standby letter of credit of an extension provision even more favorable than that contained in ISP Rule 3.14. Recent experience shows the need for modification of the UCP provision; shutdowns of bank issuers can and have occurred as a result of a variety of events such as terrorist acts in New York, hurricanes in Florida, Mississippi and Louisiana, earthquakes in San Francisco, and floods in Chicago.

74. The UCP has a rule that transport documents must be presented within 21 days after shipment. UCP 500, Art. 43(a); UCP 600, Art. 14(c). Most standby letters of credit do not involve presentation of transport documents, so in those cases, this provision would not be a concern. If a standby secures international sales on open account and requires transport documents to be presented showing shipment in order to effect a draw after there is a default in payment, those documents will necessarily be copies, since the originals were acquired by the buyer. In addition, they will undoubtedly be stale because it is only after payment is not made within terms, say 30 days after shipment, that there would be occasion to draw for default on the standby. Most issuers understand this and would not review transport documents in this situation as live documents and would not apply UCP 500, Art. 43(a). This result follows from the qualifying language of the UCP, which states that the articles of the UCP only apply standbys "as applicable." UCP 500, Art. 1; UCP 600, Art. 1. Knowledgeable beneficiaries will normally disclaim the applicability of UCP 500, Art. 43(a) to standbys governed by the UCP.

75. The UCP provides that if a letter of credit specifies installment payments, and if an installment is not drawn, the remainder of the credit ceases to be available. UCP 500, Art. 41; UCP 600, Art. 32. Most knowledgeable standby beneficiaries will exclude the applicability of this article to their UCP standby credits.

76. Justice Oliver Wendell Holmes said over 100 years ago, "Better a serious illness than a lawsuit." Those applicants and their lawyers who practice law by misdirection, obfuscation, and ambiguity to entrap the unwary beneficiary by using the UCP instead of the ISP in standby letters of credit have a higher chance of ending up in litigation. If they lose, they pay the issuer's attorney's fees under the application agreement and, in most states, the beneficiary's attorney's fees under U.C.C. § 5-111(e).

77. Another formulation that the author has heard of but not seen is that if the issuer is closed on any of the last 10 business days before expiration due to a force majeure event, even though it may be open on the expiration date, the letter of credit expiration date is automatically extended.

78. ISP Rule 5.01(a)(i).

79. The applicant has no assurance that the issuer will give the applicant the full three business days to obtain a TRO, but it is easier for an applicant concerned about a fraudulent draw to persuade an issuer to wait before honoring at least two or three business days while a TRO is being prepared and sought if the issuer knows, because of the ISP's three-day safe harbor, that it will not be subject to liability for failing to honor within that time.

80. See, e.g., *Datapoint Corp. v. M & I Bank of Hilldale*, 665 F. Supp. 722, 4 U.C.C. Rep. Serv. 2d 829 (W.D. Wis. 1987) (issuer that finds discrepancy on draft on the last day for presentation must give notice by telecommunication that day to enable the

beneficiary to correct the discrepancy and re-present; mailing notice of the discrepancy insufficient). This case is cited with approval in Official Comment 4 to U.C.C. § 5-108.

81. UCP 600, Art. 15(a).

82. ISP Rule 5.01(a)(ii).

83. UCP 600, Art. 14(b).

84. *DBJJJ, Inc. v. National City Bank*, No. BC 276543 (Los Angeles Superior Court, Dec. 28, 2006) (discussed at 2007 Annual Letter of Credit Survey 167 (IIBLP) and full text set forth at 2007 Annual Letter of Credit Survey 266 (IIBLP)). The case is a remand of a prior appeal which rejected the argument made by the issuer that it acted in accordance with standard banking practice and the IFSA's position paper titled "Standard Banking Practice for the Examination of Documents." The IFSA position paper takes the view that under standard banking practice, when the issuer requests the applicant for a waiver of discrepancies, the issuer has a full seven business days to dishonor and give notice of discrepancies. See *DBJJJ, Inc. v. National City Bank*, 123 Cal. App. 4th 530, 19 Cal. Rptr. 3d 904, 55 U.C.C. Rep. Serv. 2d 126 (2d Dist. 2004). In rejecting that argument, the court quoted from the Official Comments to U.C.C. § 5-108: "Section 5-108(a) balances the need of the issuer for time to examine the documents against the possibility that the examiner (at the urging of the applicant or for fear that it will not be reimbursed) will take excessive time to search for defects. What is a 'reasonable time' is not extended to accommodate an issuer's procuring a waiver from the applicant. See Article 14c of the UCP... Examiners must note that the seven-day period is not a safe harbor. The time within which the [issuing bank] must give notice is the lesser of a reasonable time or seven business days. Where there are few documents... the reasonable time would be less than seven days."

85. See Dolan, *The Law of Letters of Credit: Commercial and Standby Credits* ¶6.06[1][b] (A.S. Pratt 2002).

86. See, e.g., *Rhode Island Hosp. Trust Nat. Bank v. Eastern General Contractors, Inc.*, 674 A.2d 1227, 29 U.C.C. Rep. Serv. 2d 960, 56 A.L.R.5th 917 (R.I. 1996); *Hellenic Republic v. Standard Chartered Bank*, 219 A.D.2d 498, 631 N.Y.S.2d 320, 29 U.C.C. Rep. Serv. 2d 308 (1st Dep't 1995); but see *Banco General Runinahui, S.A. v. Citibank Intern.*, 97 F.3d 480, 30 U.C.C. Rep. Serv. 2d 1163 (11th Cir. 1996).

87. ISP Rule 5.07. Revised Article 5 of the UCC also does not provide for preclusion if the issuer fails to return or dispose of documents presented. Compare U.C.C. § 5-108(c) (preclusion applies to discrepancies not noted) with § 5-108(h) (issuer must return or hold documents presented at the disposal of the presenter, but does not provide for preclusion if issuer fails to do so).

88. UCP 500, Arts. 14(d)(ii) and 14(e).

89. Normally documents presented under a standby consist of a beneficiary's demand or a certificate and a draft. These documents have no worth; they do not control shipped goods. The draft drawn on the issuer has no value if not honored. In most presentations under standbys there is no point in requiring return of these documents and certainly no point in penalizing the issuer if, through inadvertence, it fails to return them or notify the beneficiary that it is holding them at the disposal of the beneficiary.

90. ISP Rule 6.02(b)(ii).

91. UCP 600, Art. 38; UCP 500, Art. 48.

92. ISP Rule 6.02(b)(i).

93. UCP 600, Art. 38; UCP 500, Art. 48(g).

94. UCP 600, Art. 14(f); UCP 500, Art. 21.

95. U.C.C. § 5-111(a) and Official Comment 1 thereto; *Eakin v. Continental Illinois Nat. Bank and Trust Co. of Chicago*, 875 F.2d 114, 8 U.C.C. Rep. Serv. 2d 422

(7th Cir. 1989); *Hamilton Bank, N.A. v. Kookmin Bank*, 44 F. Supp. 2d 653, 38 U.C.C. Rep. Serv. 2d 930 (S.D. N.Y. 1999), *aff'd in part, vacated in part on other grounds*, 245 F.3d 82, 44 U.C.C. Rep. Serv. 2d 269 (2d Cir. 2001); *Colorado Nat. Bank of Denver v. Board of County Com'rs of Routt County*, 634 P.2d 32, 31 U.C.C. Rep. Serv. 1681 (Colo. 1981); *5 East 59th Street Holding Co., LLC v. Farmers and Merchants Bank of Eatonton, Ga.*, 30 A.D.3d 183, 816 N.Y.S.2d 68 (1st Dep't 2006); *Carlson v. Branch Banking and Trust Co.*, 123 N.C. App. 306, 473 S.E.2d 631 (1996); *Perry v. Carolina Builders Corp.*, 128 N.C. App. 143, 493 S.E.2d 814 (1997). In *Balboa Ins. Co. v. Coastal Bank*, 42 U.C.C. Rep. Serv. 1716 (S.D. Ga. 1986), the court noted that the issuer was "obligated to provide hassle-free payment on drafts" even though the drafts demanded an amount greater than what was necessary to indemnify the beneficiary.

96. *Eakin*, 875 F.2d 114; *In re Sabratek Corp.*, 257 B.R. 732, 45 Collier Bankr. Cas. 2d (MB) 1223 (Bankr. D. Del. 2000).

97. U.C.C. § 5-110 provides that if its presentation is honored, the beneficiary warrants to the issuer and the applicant that there is no fraud or forgery involved in the draw and that it does not violate any underlying agreement supported by the letter of credit.

98. *In re Papio Keno Club, Inc.*, 262 F.3d 725, 45 U.C.C. Rep. Serv. 2d 1146 (8th Cir. 2001).

99. See, e.g., *In re Graham Square, Inc.*, 126 F.3d 823, 31 Bankr. Ct. Dec. (CRR) 739, Bankr. L. Rep. (CCH) P 77507, 33 U.C.C. Rep. Serv. 2d 883, 1997 FED App. 0289P (6th Cir. 1997) (beneficiary could not retain amount drawn from letter of credit that represented an unreasonable commitment fee penalty for not closing a loan); *Telenois, Inc. v. Village of Schaumburg*, 256 Ill. App. 3d 897, 195 Ill. Dec. 117, 628 N.E.2d 581, 23 U.C.C. Rep. Serv. 2d 862 (1st Dist. 1993) (village drew the entire amount of a \$100,000 letter of credit posted to secure cable television conversions after applicant timely completed 99% of all installations; court found that the draw constituted a penalty and required disgorgement of the proceeds).

100. *In re Onecast Media, Inc.*, 439 F.3d 558, 46 Bankr. Ct. Dec. (CRR) 14, 55 Collier Bankr. Cas. 2d (MB) 1178, Bankr. L. Rep. (CCH) P 80464 (9th Cir. 2006) ("There is no issue concerning the bank's performance under the letter of credit... What is at issue here is simply the controversy between the Landlord and the Trustee over how much of the funds held by the Landlord it is entitled to retain"); *In re Builders Transport, Inc.*, 471 F.3d 1178, 47 Bankr. Ct. Dec. (CRR) 122, Bankr. L. Rep. (CCH) P 70793 (11th Cir. 2006), *cert. denied*, 127 S. Ct. 2112, 167 L. Ed. 2d 814 (U.S. 2007) (court noted that the doctrine of independence protects only the right of a beneficiary to draw upon a letter of credit; once the proceeds of a letter of credit have been drawn down, the underlying contracts become pertinent in determining which parties have a right to those proceeds; the proceeds of the letter of credit are not protected by the doctrine of independence).

101. Section 502(b)(6) of the Bankruptcy Code limits the amount a landlord can recover from the estate of a bankrupt tenant for future rent under a rejected lease to the lesser of (i) actual damages, or (ii) the greater of (a) one year's rent or (b) 15% of the rent due for the unexpired lease term. If the limitation applies, courts do not allow the landlord to escape the limitation simply because some or all of the amount obtained by the landlord in excess of the cap represents proceeds of a draw under a letter of credit. See *In re PPI Enterprises (U.S.), Inc.*, 324 F.3d 197, 41 Bankr. Ct. Dec. (CRR) 16, 49 Collier Bankr. Cas. 2d (MB) 1749, Bankr. L. Rep. (CCH) P 78824 (3d Cir. 2003); *In re AB Liquidating Corp.*, 416 F.3d 961, 44 Bankr. Ct. Dec. (CRR) 278, 54 Collier Bankr. Cas. 2d (MB) 955, Bankr. L. Rep. (CCH) P 80321 (9th Cir. 2005) (rent damages capped, regardless of whether damages were recovered from cash security deposit or letter of credit); *In re Mayan Networks Corp.*, 306 B.R. 295, 42 Bankr. Ct. Dec. (CRR) 196, 52 Collier Bankr. Cas. 2d (MB) 815, 53 U.C.C. Rep. Serv. 2d 105 (B.A.P. 9th Cir. 2004). *In re Stonebridge Technologies, Inc.*, 430 F.3d 260, 45 Bankr. Ct. Dec. (CRR)

166, *Bankr. L. Rep. (CCH) P 80389* (5th Cir. 2005), the use of a letter of credit posted as security to a landlord did help the landlord avoid the § 502(b)(6) cap because the landlord did not file a claim in the bankruptcy proceedings of the tenant. The court read the cap as applying only to the amount of the claim allowable against the debtor.

102. See FDIC Statement of Policy regarding Treatment of Collateralized Letters of Credit after Appointment of the FDIC as Conservator or Receiver, 60 Fed. Reg. 27976, May 26, 1995, effective May 19, 1995 (FDIC Policy Statement).

103. FDIC Statement of Policy regarding Treatment of Collateralized Letters of Credit after Appointment of the FDIC as Conservator or Receiver, 60 Fed. Reg. 27976, May 26, 1995, effective May 19, 1995 (FDIC Policy Statement). The FDIC's position is based on 12 U.S.C.A. 1821(e)(3), a part of the Financial Institutions Regulatory Reform and Enforcement Act (FIRREA). This provision grants the FDIC as receiver or conservator the authority to repudiate or disaffirm burdensome contracts or contracts that it determines will hinder the orderly administration of the estate. The claim of the party whose contract is disaffirmed or repudiated is measured as of the date of appointment of the receiver or conservator and is limited to direct compensatory damages provable as of that date. In a standby letter of credit context this means that if the underlying obligation which the letter of credit secures is itself not in default at the time of appointment of the FDIC as receiver, the beneficiary cannot prove that it has incurred direct noncontingent damages as of that time. This provision of FIRREA changes the result that existed prior to its adoption under cases such as *First Empire Bank-New York v. Federal Deposit Ins. Corp.*, 572 F.2d 1361 (9th Cir. 1978). See Dolan, *The Law of Letters of Credit: Commercial and Standby Credits* (A.S. Pratt 2002) ¶12.02[1][a]; cf. *Del E. Webb McQueen Development Corp. v. Resolution Trust Corp.*, 69 F.3d 355, 27 U.C.C. Rep. Serv. 2d 1386 (9th Cir. 1995) (under FSLIC regulations, claim contingent at time of appointment of receiver was not provable against RTC).

104. FDIC Policy Statement.

105. At the 2006 Annual Letter of Credit Survey held in Miami, a representative of the FDIC explained how this procedure was being used to handle commercial letters of credit issued by Hamilton Bank, N.A., an insolvent Florida bank for which the FDIC was acting as receiver. See also *First Empire Bank-New York v. Federal Deposit Ins. Corp.*, 572 F.2d 1361 (9th Cir. 1978).

106. See 12 U.S.C.A. 1821(e)(8).

107. Since the FDIC's right to repudiate or disaffirm burdensome contracts is discretionary, the beneficiary will want to propose an arrangement with the FDIC that either allows access to the underlying collateral via subrogation or assignment or by which the FDIC honors a subsequent draw under the letter of credit and simultaneously reimburses itself from the collateral posted by the applicant. The FDIC will undoubtedly want to insure that all other obligations owed to the insolvent bank by the applicant are paid from the collateral before consenting to its use to reimburse the FDIC for claims on account of the standby letter of credit.

108. FDIC regulations define a well-capitalized bank as one that: (i) has a total risk-based capital ratio of 10.0% or greater; (ii) has a Tier 1 risk-based capital ratio of 6.0% or greater; (iii) has a leverage ratio of 5.0% or greater; and (iv) is not subject to any written agreement, order, capital directive, or prompt corrective action directive issued by the FDIC with a banking regulatory authority to meet and maintain a specific capital level. See 12 CFR § 325.103.

109. The NAIC's Securities Valuation Office publishes an "approved banks" list for U.S. insurance companies.

110. Bank guarantees are sometimes called demand guarantees, independent bank guarantees, unconditional guarantees, simple demand guarantees, or first demand

guarantees. A bank guarantee is in some respects the European equivalent of a standby letter of credit. Although the UNCITRAL Convention on Independent Guarantees and Stand-By Letters of Credit has not been ratified by any major country, it sets forth a number of principles applicable to bank guarantees parallel to those applicable to letters of credit. Like letters of credit, the payment undertaking under a bank guarantee is regarded as independent of determination of performance of the underlying obligation the guarantee supports, the guarantee is usually issued by a bank and payment after the beneficiary makes demand on the guarantee is not normally subject to injunction in the absence of a showing of fraud. Bank guarantees and the law governing them are not as clear as U.S. law and the ISP governing standby letters of credit, although the ICC in 1992 promulgated a regime to govern bank guarantees called the Uniform Rules for Demand Guarantees, ICC Publication No. 458 (the URDG). Bank guarantees differ from standby letters of credit in that bank guarantees may not have an expiration date, may be subject to termination upon the occurrence of an event, and payment is normally triggered by a simple demand. The wording of demand guarantees can vary and in some cases the issuer of a demand guarantee may not regard it as totally independent of the underlying obligation that it supports.

111. Using a foreign branch of a U.S. bank that issues a letter of credit to support the foreign branch bank guarantee may save the U.S. applicant from paying a substantial additional bank guarantee fee, as there is essentially only one credit risk for which to compensate the issuer. Some foreign counterparties may insist on a non-U.S. bank or a foreign state bank to issue the guarantee to avoid U.S. jurisdiction over the issuer of the independent bank guarantee, thus making it more difficult for the U.S. applicant to obtain injunctive relief. See, e.g., *Enterprise Intern., Inc. v. Corporacion Estatal Petrolera Ecuatoriana*, 762 F.2d 464, 41 U.C.C. Rep. Serv. 1388 (5th Cir. 1985) (discussed *infra*).

112. Because the letter of credit is issued cross-border to another bank, its issuance to the buyer's bank will normally be communicated through SWIFT. To draw under a letter of credit supporting a bank guarantee, the beneficiary bank can certify through a SWIFT message to the issuing bank that its bank guarantee has been called. See ISP Rule 3.06(b). No paper documentation is required. Under the ISP, the documents used to demand payment under the foreign independent bank guarantee are not relevant to a draw under the letter of credit supporting the bank guarantee. See ISP Rule 4.21, which deals with requests to issue separate undertakings.

113. See, e.g., *American Export Group Intern. Services, Inc. v. Salem M. AL-NISF Elec. Co.*, W.L.L., 661 F. Supp. 759 (D.D.C. 1987) (discussed *infra*).

114. See Official Comment 1 to U.C.C. § 5-109 and cases cited therein.

115. U.C.C. § 5-109(b)(3).

116. U.C.C. § 5-109(b)(4).

117. U.C.C. § 5-109(b)(2).

118. U.C.C. § 5-109(a)(1).

119. See, e.g., *Roby v. Corporation of Lloyd's*, 996 F.2d 1353, Fed. Sec. L. Rep. (CCH) P 97458, R.I.C.O. Bus. Disp. Guide (CCH) P 8307 (2d Cir. 1993); *Bonny v. Society of Lloyd's*, 3 F.3d 156, Fed. Sec. L. Rep. (CCH) P 97688 (7th Cir. 1993); *Richards v. Lloyd's of London*, 107 F.3d 1422, Fed. Sec. L. Rep. (CCH) P 99425 (9th Cir. 1997), opinion withdrawn and superseded on reh'g, 135 F.3d 1289, Fed. Sec. L. Rep. (CCH) P 90134, R.I.C.O. Bus. Disp. Guide (CCH) P 9495 (9th Cir. 1998); *Leslie v. Lloyd's of London*, 1994 WL 873350 (S.D. Tex. 1994), *aff'd*, 85 F.3d 625, 29 U.C.C. Rep. Serv. 2d 971 (5th Cir. 1996).

120. *American Patriot Ins. Agency, Inc. v. Mutual Risk Management, Ltd.*, 364 F.3d 884 (7th Cir. 2004). The court noted that charging fraud does not overcome the forum selection clause in the parties' agreement as the charge still relates to the contract

giving rise to the charge of fraud. The same could be said of letter of credit disputes that arise out of the underlying contract.

121. *Hendricks v. Comerica Bank*, 122 Fed. Appx. 820, 2004 FED App. 0179N (6th Cir. 2004), cert. denied, 546 U.S. 976, 126 S. Ct. 545, 163 L. Ed. 2d 459 (2005) (unpublished).

122. *Hendricks v. Bank of America, N.A.*, 408 F.3d 1127 (9th Cir. 2005). The fact that the beneficiary was insolvent and did not contest the fraud allegations in the trial court played a role in the Ninth Circuit's upholding the preliminary injunction. The case is therefore distinguishable from cases discussed below.

123. A U.S. applicant undoubtedly has a better chance of enjoining a draw under its bank's letter of credit if there is no independent guarantee interposed between the letter of credit beneficiary and the overseas party accused of fraud. See, e.g., *Mid-America Tire, Inc. v. PTZ Trading Ltd.*, 95 Ohio St. 3d 367, 2002-Ohio-2427, 768 N.E.2d 619, 47 U.C.C. Rep. Serv. 2d 853 (2002). This case involved requested injunctive relief for fraud against a draw under a letter of credit on basis that the European seller sold the applicant tires without disclosure that they were blemished or gray market snow tires. The Ohio Supreme Court held that the parties' foreign choice of law and forum did not provide an adequate remedy at law because there were multiple defendants and it would be hard to track them down and include them in one action. The case has been regarded as a close case on the issue of whether the type of fraud necessary to enjoin a draw under a letter of credit was sufficiently shown.

124. *Enterprise Intern.*, 762 F.2d 464.

125. *Foxboro Co. v. Arabian American Oil Co.*, 805 F.2d 34, 2 U.C.C. Rep. Serv. 2d 1012 (1st Cir. 1986).

126. *American Export*, 661 F. Supp. 759.

127. In the Iranian letter of credit injunction cases that were filed at the time of the Islamic Revolution in Iran beginning in 1979, some courts may have felt that the issuer of the counter-guarantee as beneficiary of U.S. bank letters of credit acted in collusion with Iranian beneficiaries of the counter-guarantees and the new government of Iran to trigger draws on U.S. bank letters of credit. Yet, even in many of these cases, courts denied injunctive relief because the prerequisites for injunctive relief had not been met. See Dolan, *The Law of Letters of Credit: Commercial and Standby Credits* (A.S. Pratt 2002) ¶7.04[4][e].

128. *In re Irrevocable Standby Letter of Credit No. SE444393W*, 336 F. Supp. 2d 578 (M.D. N.C. 2004).

129. *Southern Energy Homes, Inc. v. AmSouth Bank of Alabama*, 709 So. 2d 1180, 35 U.C.C. Rep. Serv. 2d 250 (Ala. 1998).

130. *SouthTrust Bank of Alabama, N.A. v. Webb-Stiles Co., Inc.*, 931 So. 2d 706, 58 U.C.C. Rep. Serv. 2d 60 (Ala. 2005).