Legal Issues, Practices and Practicalities for Letters of Credit (Particularly in Commercial Leases), and a Sample Letter of Credit With Commentary

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When negotiating a prospective business transaction, one party may doubt the credit of another party. As a common technique to solve that problem, the party with dubious credit (in this context, an “Account Party”) may give the skeptical party (a “Beneficiary”) a standby letter of credit (an “L/C”) to back Account Party’s performance. For example, when a commercial landlord (a “Landlord”) wants security under a commercial lease (a “Lease”), the tenant under that Lease (the “Tenant”) will often, as Account Party, deliver an L/C to Landlord, as Beneficiary.

An L/C will be issued by a creditworthy third party, typically but not necessarily a bank (the “Issuer”). If the Lease or other transaction ever goes into default, Beneficiary can submit a sight draft to Issuer, requesting Issuer to pay the amount specified in the sight draft, up to the amount of the L/C. This is called "drawing upon" the L/C. Beneficiary can use the proceeds of the draw to cure Account Party’s default.

Issuer will look to Account Party to reimburse any payments Issuer makes under the L/C. Toward that end, Account Party and Issuer will enter into an agreement (a “Reimbursement Agreement”) where Issuer agrees to issue the L/C for a fee, and Account Party agrees to reimburse Issuer for any drawings under the L/C, with interest. The Reimbursement Agreement may actually appear in (or tie to) a larger revolving credit agreement between Account Party (or its parent company) and Issuer.

If Account Party never defaults, then Beneficiary never draws upon the L/C, and eventually returns it, consents to its cancellation, or lets it expire without being drawn upon.

When Account Party delivers an L/C in a Lease or other transactional context, typically neither party anticipates that Beneficiary will ever draw upon the L/C—this is a "standby" L/C.¹

This article discusses several issues, some specific to commercial space leasing, that arise whenever any Beneficiary accepts a standby L/C to back an obligation.² This article concludes by offering a model L/C, suitable to back Tenant’s obligations under a Lease or almost any other obligation that might require credit enhancement.³

This article and model L/C mostly focus on Beneficiary’s agenda. Because an L/C is a fairly standard document, the model L/C could also be used, with care, when acting for Issuer⁴ or Account Party.⁵ This model L/C was not intended for use as a documentary L/C.

Substantive Comments

Drawing Conditions. If possible, the L/C should not require Beneficiary to provide any certification, prior notice, or third-party verification to draw upon the L/C. As an extreme example of language that Beneficiary should reject out of hand, an optimistic Account Party once actually proposed to the author, as an exercise in fantasy and creativity, that any Drawing Documentation must include this statement:

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Beneficiary represents, warrants, and certifies, under penalty of perjury, that: (a) Account Party has defaulted in performing these obligations under the ___________ dated __________ between Account Party and Beneficiary (the “Agreement”): ______________; (b) such default was not excused by any failure or nonperformance by Beneficiary under the Agreement; (c) Beneficiary has properly given notice of Account Party’s default to Account Party and all other parties entitled to such notice, at the addresses shown and in the forms attached as Exhibits hereto, all in full compliance with Lease requirements; (d) after the giving of such notice, any and all cure periods under the Lease have expired; (e) Beneficiary has given Account Party and _____ a copy of the form of this certification and notice that Beneficiary intends to submit this Drawing Documentation; and (f) at least ____ business days has elapsed since such notice.

Pre-Existing Debt. An L/C delivered to back pre-existing debt may raise issues in Account Party’s insolvency or bankruptcy. Avoid accepting an L/C under those circumstances, at least not without fully considering bankruptcy issues. In some instances, the parties can structure the transaction to minimize these issues.

Negotiation of L/C Forms. To Beneficiary, the purpose of an L/C is usually to provide cash-equivalent security. Beneficiary should not readily agree to bear even “small risks” in the name of compromise and accommodation. The L/C should remain airtight notwithstanding any negotiated changes, so Beneficiary always has the equivalent of a cash deposit, at least until L/C expiry.

Industry Standard Practices for L/Cs

In 1998, the International Chamber of Commerce released a set of standards designed specifically for standby L/Cs, the International Standby Practices (“ISP98”), offering a more tailored alternative to the earlier Uniform Customs and Practice for Documentary Credits, International Chamber of Commerce Publication No. 600 (the “UCP”), which relate to L/Cs generally. ISP98 has achieved significant and growing acceptance in the world of standby L/Cs, but has not fully displaced UCP. Attorneys who handle far more L/C work than the author have advised informally that as of 2008 about two-thirds of standby L/Cs, by face amount, use ISP98 rather than UCP. That fact, and the author’s careful reading of ISP98, convinced the author to use UCP rather than ISP98 for this model L/C. Footnotes in the model L/C highlight some consequences of that choice.

In addition to those consequences, ISP98 eliminates the need for some language commonly seen in L/Cs, and includes these noteworthy provisions:

- **Issuer’s Funds.** Some L/Cs say Issuer must pay from its own funds. ISP98 § 1.10(a)(iv) eliminates any need for this statement.

- **Irrevocable/Unconditional.** Many L/Cs insert the word “irrevocably” to modify Issuer’s agreement to pay. ISP98 eliminates the need for that word. ISP98 § 1.06(a). Similarly, ISP98 §§ 1.06(a) and 1.10(a) eliminate the need for an L/C to say it is “irrevocable and unconditional.”
• **Bad Amendments.** Some L/Cs include a statement like this, often just before the signature: "If any amendment adversely affects Beneficiary, it shall not become effective without Beneficiary’s written consent." ISP98 §§ 1.06(b) and 2.06(c) eliminate the need for any such statement. ISP98 § 7.01 gives similar protection for any L/C cancellation. Therefore this model L/C doesn’t mention these points.

• **Partial Transfer.** ISP98 § 6.02(b) says any L/C “may not be partially transferred,” eliminating the need for any such restriction in the L/C.

• **Closed Office.** If Issuer’s office for presentation of the L/C is closed on the last business day when Beneficiary can present the L/C, then the L/C will automatically remain in effect until 30 days after the office reopens. ISP98 § 3.14(a). Issuer need not, however, notify Beneficiary of the reopening.

If an L/C “worked” for UCP, then switching to ISP98 requires no significant changes to (though it allows minor deletions from) the L/C text. As the main change, one must replace references to UCP with references to ISP98. Nothing in ISP98 requires any magic language that a well written UCP L/C would not already contain. ISP98 may matter more in administering, drawing upon, and otherwise living with L/Cs after issuance. ISP98 was designed specifically for standby L/Cs. Thus, for a standby L/C, it makes more sense to use ISP98 than UCP.

**Points Not Covered**

This model L/C seeks to achieve minimalism and simplicity, consistent with the usual goal of keeping any L/C as short and simple as possible. Any party to an L/C transaction, or its counsel, can readily think of ways to complicate and lengthen any document, including any L/C, sometimes based on the circumstances of a particular transaction and other times driven by personal taste or bad experiences. Here are some examples of nonstandard provisions that the parties may want to add to an L/C for a particular transaction or to address particular concerns.

**Changes in Amount.** The parties may want to build into the L/C future reductions in its face amount. In a Lease, for example, the required security might drop over time.\(^{12}\) Beneficiary will want to assure that this reduction takes place in a way that does not imperil Beneficiary’s security if problems arise. This entire issue is best addressed in the underlying documentation (e.g., the Lease) between the parties. That documentation should allow Account Party to amend the L/C to reduce its amount, but each amendment should still require Beneficiary’s formal written consent. This way, Beneficiary can protect itself against “stealth” L/C reductions that no longer should occur, for which Account Party failed to satisfy all conditions, or for which Beneficiary failed to pay enough attention.

**Special Protections.** Beneficiary may worry about some risks that an L/C creates, and might want to mitigate them by adding additional (nonstandard) provisions to the L/C or the underlying contract documents. These risks might include the possibilities of: (a) an injunction or temporary restraining order preventing a draw upon the L/C; (b) Issuer’s insolvency or closure; (c) Account Party’s insolvency; and (d) Account Party’s payment of the L/C-backed obligation, after which Beneficiary releases the L/C, after which Account Party files bankruptcy and its estate seeks to claw back the payment. Provisions to address these risks have traditionally not appeared in L/Cs, and hence this model L/C does not include them. Counsel could craft them as appropriate or desired in particular cases. The author can provide sample language.
Multiple Beneficiaries. If multiple parties have an interest in the proceeds of an L/C, they must agree how to protect their respective interests. As a common example in commercial real estate transactions, Landlord's mortgage lender ("Lender") may want to control the drawing process and proceeds of an L/C that replaced a cash security deposit, particularly a large cash security deposit. Restrictions on assignability of L/Cs, the requirements for perfection of a security interest, Lender's general need to protect its security, Tenant's concerns about the use of the L/C and its proceeds, and the practical mechanics of any L/C create a rather robust three-party agenda among Tenant, Landlord, and Lender. Full and proper resolution of that agenda can require a complex and sophisticated (and tedious) three-party agreement, a matter beyond the scope of this article.\(^13\)

Notice of Transfer. Although a Beneficiary cannot transfer an L/C easily,\(^14\) this model L/C solves that problem by saying Beneficiary can freely transfer the L/C upon notice to Issuer, provided that Issuer can legally do business with the transferee.\(^15\) Should Beneficiary also notify Account Party of the transfer? If so, that point belongs in the Lease or other underlying agreement, not the L/C.

Lost L/C. As a fundamental expectation in commercial real estate transactions, Beneficiary must present an original L/C to draw upon it.\(^16\) If Beneficiary cannot locate the original, Beneficiary loses.\(^17\) The original L/C therefore matters far more than an original promissory note.\(^18\) Widespread awareness of the importance of original L/Cs means that any Beneficiary is typically very careful about storing and tracking original L/Cs. The requirement for an original also facilitates the reliable transfer and collateral assignment of L/Cs, and the reliable perfection of security interests in L/Cs. But it also creates a huge pitfall for any Beneficiary.

A Beneficiary concerned about this pitfall could propose language in the L/C to address it. For example, Beneficiary might try to remove any requirement to deliver the original L/C when drawing upon it. Any such proposal would not be market standard, at least in commercial real estate, but Issuers do sometimes agree to it.\(^19\)

Without going as far as entirely removing the requirement for an original, this language (similar to the procedures for lost notes or lost cashier's checks) might help mitigate a Beneficiary's concern:

(a) Reissuance Package. At Beneficiary's request at any time before the Expiry Date or whenever this L/C requires Beneficiary to deliver to Issuer the original of this L/C (the "Original"), Beneficiary may deliver the following to Issuer (collectively, a "Reissuance Package"):  

(1) Status of Original. Either (i) if the Original has been damaged or mutilated, then the damaged or mutilated Original, or (ii) if the Original has been lost, misplaced, or destroyed, then Beneficiary's certification to that effect;

(2) Indemnity. Beneficiary's indemnity in ordinary and customary form against any claims or drawings that may be made against Issuer on account of the Original, expiring 60 days after the then-current Expiry Date (the "Indemnity"); and

(3) Bond. Unless Beneficiary's credit is reasonably satisfactory to Issuer, a bond or other security for the Indemnity.\(^20\)
(b) Effect of Reissuance Package. After Beneficiary delivers a Reissuance Package to Issuer:

(1) Drawing. If Beneficiary is otherwise entitled to draw upon the L/C, then Beneficiary may do so as if Beneficiary had submitted the Original; and

(2) Replacement Original. Issuer shall, upon request (except to the extent that Beneficiary simultaneously draws upon the L/C), reissue the Original simultaneously with receipt of, and in exchange for, the Reissuance Package. Any such reissued Original shall be deemed the Original L/C for all purposes.

Nonconforming Draw. General principles of entropy may cause: (a) any Beneficiary to wait until the last minute to draw upon an L/C; (b) that last-minute drawing to be defective, because drawing an L/C can turn out to be more difficult than Beneficiary expected; and (c) Beneficiary to lose out as a result, because Beneficiary does not have time for a "do over." To respond to that possibility, one could add the following language, which can help a Beneficiary, but is utterly nonstandard:

If (a) Beneficiary attempts to draw upon this L/C during the last ____ Banking Days before the Expiry Date and (b) Beneficiary’s Drawing Documentation is for any reason incomplete, ineffective, defective, or incorrect, or incorrectly presented, then the Expiry Date shall automatically be extended (but only once) until the date ____ Banking Days after Issuer first notified Beneficiary of occurrence of (b), including a reasonably detailed explanation of all deficiencies.

Effect of Nonrenewal. This L/C includes “evergreen” language, so that the expiry date automatically renews every year. That structure has become quite common, eliminating the need to require annual renewals and the attendant risk of the Issuer's forgetting to monitor the renewals. But this structure also creates evidentiary issues: Beneficiary cannot easily prove (or satisfy itself) the L/C remains in effect after the stated initial expiry date. The model L/C accompanying this article includes language to require Issuer to confirm the current expiry date of the L/C from time to time.21 One could also provide the following nonstandard language, to eliminate the remaining traps of accepting an evergreen L/C:

Effective upon Issuer’s dispatch or Beneficiary’s receipt of any Nonrenewal Notice, Beneficiary shall automatically be deemed to have validly presented to Issuer fully conforming Drawing Documentation for the entire amount of this L/C. Issuer shall then, both before and after the Expiry Date:

(a) Obligation to Pay. Be irrevocably and unconditionally obligated to pay the entire amount of this L/C to Beneficiary;

(b) L/C Proceeds. Hold the proceeds of such deemed draw solely for Beneficiary’s benefit, pending Beneficiary's written directions on disbursement, and promptly comply with such written directions;

(c) Required Documents. Be entitled to require, simultaneously with such disbursement (solely to complete Issuer’s files), that
Beneficiary present either (i) Drawing Documentation in the form that this L/C would otherwise require; or (ii) the original of this L/C and Beneficiary’s consent to its cancellation.

**Deemed Draw at Expiry.** Beneficiary may want the L/C to say that if the L/C expires and has not been drawn upon, then Beneficiary will be deemed automatically to have drawn upon the L/C the moment before it expired (basically the same concept as the preceding comment suggests, and much like the treatment of exchange-traded options). This is a perfectly reasonable and appropriate way to eliminate the biggest pitfall in accepting any L/C – the risk that it will expire without being drawn upon when it should have been. Such measures rarely appear, though. Along similar lines, and just as rare, the L/C might obligate Issuer to remind Beneficiary 30 days before the L/C expires that it is about to expire (for example, because of the impending outside expiry date of an evergreen L/C). Failure to deliver the reminder notice would extend the expiry date.22

**Transfer Fees.** Issuer will typically expect to collect a transfer fee if Beneficiary ever transfers the L/C (for example, if Landlord sells or refinances the building). Beneficiary will want Account Party to bear this fee. If Account Party is willing to do so (perhaps subject to some limit on frequency), then the Lease or other underlying agreement would incorporate that concept and let Beneficiary draw upon the L/C if Account Party does not pay. As an alternative, Beneficiary might insist that Issuer address all fees in the reimbursement agreement with Account Party, and leave Beneficiary out of it. In that case, Beneficiary might request this language in the L/C:

Issuer shall look solely to Account Party to pay any fee for any transfer of this L/C. Such payment is not a condition to any transfer.

**Some Issues to Consider**

Beneficiary and its counsel will want to think about these issues when Beneficiary accepts an L/C.

**Escrow.** Try not to place any L/C in escrow. If a dispute arises about the underlying transaction, Account Party may try to direct the escrowee (sometimes called escrow agent) not to draw upon the L/C. In that case, the escrowee may “freeze” while the L/C expires. On the other hand, one can probably eliminate this risk through appropriate drafting in the escrow documentation, with a suitable acknowledgment from the escrowee and all other parties. One could also provide for a “deemed draw” upon expiry, as suggested above.

**Expiry.** The “expiry date” (not “expiration date” in L/C jargon) of any L/C should be at least 30 days, preferably up to 90 days, after the last day by which Account Party must perform the obligation that the L/C backs. Give Beneficiary some time to draw upon the L/C if necessary – twice, if necessary, just in case the first draw fails. Depending on the circumstances, Beneficiary might need some time to calculate Tenant’s final rent bill under the Lease, or Tenant’s last rent check might bounce. Beneficiary will not want to feel pressured during that process, and Account Party will not want Beneficiary to “jump the gun” and submit a sight draft under the L/C. The L/C expiry date should give Beneficiary enough time to pull together a final bill that Landlord knows will be reliably final and confirm that any other loose ends have been fully tied up.

**Signing Procedures.** Make the drawing procedures particularly simple and direct so they don’t create issues. For example, rather than require a joint venture Beneficiary/Landlord to sign drawing documents, state instead that any designated venturer may sign them. Make the documentation requirements as simple – just a sight draft and the L/C, without a drawing certificate or third-party evidence of anything.
The more flexible the L/C is about who may sign draw documentation, and what documents must accompany that documentation, the easier and quicker the L/C will be to draw upon if the need ever arises. This may make a great deal of difference when any Beneficiary actually tries to draw upon the L/C, often a few days before the expiry date. On the other hand, the easier an L/C is to draw upon, the more one must consider the risk of fraudulent diversion of the proceeds. As a fraud prevention measure, the L/C might designate exactly how Issuer must disburse the proceeds of any draw.23

Beneficiary’s Address. If Issuer ever sends any Nonrenewal Notice, or other notice, Issuer will send it to Beneficiary at the address stated in the L/C. Beneficiary must know when it has received such a notice, and act upon it. If Beneficiary is a large organization, any such notice may get lost. Therefore, Beneficiary’s address should include information that will help prevent this from happening. Particularly for a long-term L/C, Beneficiary should avoid having L/C notices go to specific individuals. Instead, the address of the notice recipient should refer to a position, such as “Attention: Director of West Coast Leasing,” and an identification number for the particular lease or contract.24 The L/C might also require any notices to go to two or more recipients (with a copy to counsel). If any notice recipient relocates, the parties must remember to correct the L/C notice address and make appropriate mail forwarding arrangements (and then remember to renew those arrangements when they expire). This concern becomes even more important than usual for notices under an evergreen L/C, with the risk of early (and unexpected) nonrenewal.

Other Documentation.

Anyone using this model L/C should also consider these documentation issues for the overall transaction, including items and exhibits they need to attach to the L/C.

Underlying Obligation. An L/C merely secures an underlying obligation. The underlying documentation (e.g., the Lease) should clearly describe that underlying obligation and clearly allow the L/C beneficiary to draw upon the L/C under appropriate circumstances25 without satisfying burdensome conditions or drawing requirements. The author can provide standard contract language for use of an L/C to support any obligation. Some of these provisions are non-obvious. To avoid bankruptcy risks relating to Account Party, Beneficiary would in theory prefer a “direct pay” L/C, so that Beneficiary never accepts payment directly from Account Party, but instead only from Issuer, even if Account Party would otherwise pay the obligation in the ordinary course without a default.

Additional Exhibits to L/C. One could attach to any L/C exhibits setting forth the required forms of certain additional ancillary documents. Those could include: (a) drawing certificate, which would require Beneficiary to certify the circumstances that entitle Beneficiary to draw upon the L/C; and (b) termination certificate. This model L/C omits a form of drawing certificate because a Beneficiary should try to reject the entire concept of any drawing certificate. This model L/C omits a form of termination certificate because it rarely causes trouble. If anyone wants to include a termination certificate, they certainly can. It just creates some extra work and offers an easy opportunity to complicate and lengthen any document unnecessarily. Sample termination certificates are available from the author. One might argue that even the two exhibits attached to this model L/C are not crucial and not worth the time they might take to prepare and negotiate.

Where’s the L/C? Determine how best to hold the L/C (for example, in a vault). Establish a clear written record of who received the L/C after closing, and who will monitor it. Distribute that written record to everyone who might need to find the L/C. File a copy in each place where someone might look for the L/C.
Reimbursement Agreement. Issuer will, of course, want to make sure that its Reimbursement Agreement is in place before Issuer issues an L/C. To the extent that the expiry date of an L/C does not coincide with the expiration/termination date of Account Party’s revolving credit agreement, Issuer may find itself in a somewhat awkward position if an L/C remains outstanding at that point. When the credit agreement expires, it should require Account Party to cash collateralize any open L/Cs, or arrange replacement L/Cs from the new revolving lender. The credit agreement might also excuse Issuer from issuing any L/C whose expiry date postdates the termination date of the credit agreement.

Other Reimbursement Obligations. The Reimbursement Agreement between Issuer and Account Party does not exhaust the reimbursement issues that lurk behind any L/C. If Account Party reimburses Issuer for a draw, should Account Party have any rights against anyone else? For example, if Account Party constitutes only one of several partners of Tenant, should the other partners agree to reimburse some share of any reimbursement payment Account Party might make to Issuer? Are those partners creditworthy? Should the reimbursement obligation come from the other partners’ ultimate owners or principals? And how should the partnership agreement treat any payments Account Party makes to Issuer, and any reimbursements of those payments? Does Account Party (if not actually Tenant) want any right to participate in negotiations that might precede a draw upon the L/C? The parties should negotiate and sign appropriate documents on these issues when Account Party obtains the L/C and gives it to Beneficiary.

Noncompliant L/C. The Lease might say that Landlord may accept an L/C that doesn’t fully meet Landlord’s requirements, with Tenant obligated to fix it quickly. If Tenant does not, then Landlord can draw. Such provisions may save time and trouble during the L/C issuance process for a closing. If Landlord accepts a noncompliant L/C, then Landlord must remember to follow through and fix it, often easier in theory than practice.

Tickler File Entry. Place reminders of any upcoming expiry date(s) on a calendar and in an appropriate “tickler” file. Remind the client to do the same, preferably in writing. Allocate this responsibility in an unambiguous way, to avoid claims that counsel agreed to monitor the upcoming expiry date and the need to draw upon the L/C (unless counsel intends to assume such responsibility, usually inadvisable).

[On Letterhead or L/C Letterhead of Issuer.]

FORM LETTER OF CREDIT

Date: __________, 200__

__________________________ (“Beneficiary”)

__________________________

__________________________

Attention: __________________

L/C No.: ___________________

Ladies and Gentlemen:

___________ (“Issuer”) establishes in favor of Beneficiary the irrevocable Letter of Credit numbered as identified above (as validly amended from time to time, the “L/C”) for an aggregate amount of $_______, expiring at __:00 p.m. on _______ or, if such day is not a Banking Day, then the next succeeding Banking Day (such date, as extended from time to time, the “Expiry Date”). “Banking Day”
means a weekday except a weekday when commercial banks in _____________ are authorized or required to close.

Issuer authorizes Beneficiary to draw upon Issuer for the account of _______ (the “Account Party”), under the terms and conditions of this L/C.

Funds under this L/C are available by presenting the following documentation (the “Drawing Documentation”): [(a) the original L/C and (b)] a signed sight draft [substantially] in the form of Exhibit A, with blanks filled in and bracketed items provided as appropriate. No other evidence of authority, certificate, or documentation is required.

Beneficiary must present Drawing Documentation at Issuer’s office at ____________ on or before the Expiry Date by personal presentation, courier or messenger service, or by fax to (___) ___-____. Issuer may change its fax number by written notice to Beneficiary identifying this L/C by number. [After any fax presentation, but not as a condition to its effectiveness, Beneficiary shall with reasonable promptness deliver original Drawing Documentation by any other means.] Issuer will on request issue a receipt for Drawing Documentation.

Issuer agrees, irrespective of any claim by any other person, to honor drafts drawn under and in conformity with this L/C, within the maximum amount of this L/C, presented to Issuer on or before the Expiry Date, provided Issuer also receives (on or before the Expiry Date) any other Drawing Documentation this L/C requires. Issuer shall pay this L/C [only] by [check or wire transfer] [wire transfer to this account: ________________] [check payable to the order of Beneficiary and delivered to ________________].

If Beneficiary presents proper Drawing Documentation to Issuer on or before the Expiry Date, then Issuer shall pay under this L/C at or before the following time (the “Payment Deadline”): (a) if presentment is made at or before noon of any Banking Day, then the close of such Banking Day; and (b) otherwise, the close of the next Banking Day. Issuer waives any right to delay payment beyond the Payment Deadline.

Issuer shall have no duty [or right] to inquire into the validity of or basis for any draw under this L/C or any Drawing Documentation. Issuer waives any defense based on fraud or any claim of fraud.

Issuer may from time to time transfer this L/C to any transferee (the “Transferee”), provided that such transfer does not violate any legal requirement that governs Issuer. Beneficiary or Transferee shall consummate such transfer by delivering to Issuer the original L/C and a Transfer Notice [substantially] in the form of Exhibit B, signed by Beneficiary, designating Transferee. Upon any transfer: (a) all
references to Beneficiary shall automatically refer to Transferee, who may then exercise all rights of Beneficiary; and (b) if requested, Issuer shall promptly reissue or amend this L/C (simultaneously with the surrender of this L/C to Issuer) in favor of Transferee as Beneficiary.

Any notice to Beneficiary shall be in writing and delivered by hand (or by overnight delivery service such as FedEx), with proof of delivery, at the above address. [As a condition to the effectiveness of any notice, Issuer shall deliver a copy of it, by the same means, to: __________.] Beneficiary may change any notice address by written notice to Issuer.

This L/C is subject to: (a) International Standby Practices, ISP98, International Chamber of Commerce Publication No. 590 ("ISP98"); and (b) to the extent not inconsistent with ISP98, the law of the State of [New York].

Very truly yours,

[Issuer Signature]

EXHIBIT A

FORM OF SIGHT DRAFT

[Beneficiary Letterhead]

TO:
[Name and Address of Issuer]

SIGHT DRAFT

AT SIGHT, pay to the Order of ______________, the sum of ______________ United States Dollars ($______________). Drawn under [Issuer] Letter of Credit No. ______________ dated ______________.

[Beneficiary directs Issuer to pay the proceeds of this Sight Draft solely to this account of Beneficiary 41: _________________.]

[Name and signature block, with Beneficiary signature.]

Date: ________________

EXHIBIT B

FORM OF TRANSFER NOTICE

[Beneficiary Letterhead]

TO:
[Name and Address of Issuer]
("Issuer")

TRANSFER NOTICE

By signing below, the undersigned, Beneficiary (the "Beneficiary") under Issuer’s Letter of Credit No. ________________ dated ________________ (as amended, the "L/C"), transfers the L/C to this transferee (the "Transferee").

[Transferee Name and Address]

Beneficiary: (a) encloses the original L/C; (b) directs Issuer to reissue or amend the L/C in favor of Transferee as Beneficiary; and (c) represents and warrants Beneficiary has made no assignment, encumbrance, or transfer of the L/C remaining in effect.

[Name and signature block, with Beneficiary signature.]
Date: ________________

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1 In contrast, import/export transactions use "documentary" L/Cs, where everyone expects Beneficiary to draw upon the L/C in the ordinary course.
2 The possibility of a Tenant bankruptcy can create thorny issues in this area – at least if the L/C exceeds a year's rent – but those issues lie beyond this article. The author will soon publish an article discussing only those issues.
3 Because of the "independence principle" of L/Cs, a standby L/C should require relatively little customizing regardless of the transaction for which the parties use it. Any L/C should simply confirm Issuer's unconditional promise to pay Beneficiary if Beneficiary presents a compliant sight draft. Everything transaction-specific belongs elsewhere.
4 Issuer cares less about the form of the L/C than about the form of the Reimbursement Agreement. Issuer should be willing to issue any L/C at all so long as: (a) it's just an L/C and not, for example, also an agreement to build a house or to dance a jig; (b) the form of L/C and its drawing requirements match Issuer's operating procedures; (c) the drawing conditions are simple and clear enough so Issuer can reliably honor or dishonor a sight draft without liability to either Beneficiary or Account Party; and (d) Issuer is comfortable with Account Party's credit and the airtight nature and reliability of the Reimbursement Agreement. Issuer can and must treat the issuance of the L/C as an unconditional commitment to make a loan to Account Party at an unpredictable future moment—tomorrow, the next day, five years from now, whenever Beneficiary draws upon the L/C (at any time before expiry), whether or not Account Party remains creditworthy at that moment or Issuer otherwise still wants to make such a loan. If the conditions listed earlier in this footnote are satisfied, the substantive terms and conditions of the L/C merely determine the timing of Issuer's loan disbursement. Thus, if Account Party tries to blame Issuer for introducing off-
market complexities or conditions into an L/C, Beneficiary should often take Account Party’s claims with a bushel of salt.

5 For a Lease, Account Party would be Tenant. Account Party might also consist of Tenant’s principals or, in the “New Economy” or dotcom world, the venture capitalists that backed Tenant. This article treats the whole group as Account Party, disregarding any issues within the group. Any Account Party wants to defer, frustrate, and complicate any L/C draw. This article offers plenty of clues for how to do that. A careful Beneficiary will try to reject Account Party’s proposals, regardless of how rational, reasonable, earnest, and well thought through they may sound.

6 If Account Party were subject to bankruptcy proceedings, any such notice to Account Party would violate the automatic stay. This does not limit the grounds on which Beneficiary should object to almost every line of the proposed language.

7 Beneficiary and its counsel know that Account Party wants notice and a waiting period so Account Party can try to enjoin or otherwise prevent Issuer from honoring Beneficiary’s draw upon the L/C.

8 Uniform Commercial Code Article 5 also governs L/Cs.

9 ISP98 can be read in well under an hour. Unlike UCP, ISP98 is written in ordinary and straightforward English.

10 ISP98 also contains many other noteworthy provisions. Anyone who works with standby L/Cs should buy and read ISP98. It is available at modest cost from its issuer, the International Chamber of Commerce, www.iccbooksusa.com (search for “Standby”).

11 This verbiage may, however, make Beneficiaries more comfortable. It does no harm.

12 Tenant may, for example, worry about Landlord credit issues near the end of the term. Even part way through the term, Tenant can reasonably argue that Landlord’s credit exposure has diminished over time, entitling Tenant to reduce the amount of the L/C. Having Lender hold the L/C can help solve this problem, if accompanied by appropriate protections.

13 For a sample agreement, see II COMMERCIAL LEASING 1009 (New York State Bar Association, 2004, Joshua Stein, ed.). An updated version of that agreement with commentary is in publication and available from the author upon request. As a ‘lite” solution to this problem, Landlord might give Lender the original L/C and a signed drawing certificate.

14 ISP98 § 6.02(a) states that a standby L/C “is not transferable unless it so states.”

15 For example, anti-money-laundering law and the USA PATRIOT Act prohibit certain financial institutions (all likely Issuers) from doing business with certain persons.

16 If Issuer has amended the L/C, the same requirements apply to any amendments.

17 ISP98 provides, for example: “If an original standby is lost, stolen, mutilated, or destroyed, the issuer need not replace it or waive any requirement that the original be presented under the standby.” ISP98 § 3.12(a).

18 Mortgage lenders routinely misplace, destroy, or lose most promissory notes. Historically, this has produced no adverse effect, but this may change in response to the present foreclosure crisis and judicial efforts to slow down foreclosures.

19 Not requiring an original of the L/C may raise its own issue. For example, Beneficiary will want to prevent a fraudulent draw upon the L/C. As one solution, the L/C might specify the exact account into which Issuer will fund the proceeds of any draw. That might leave open the risk that someone could improperly request an amendment of the L/C to change the account number – a risk that might increase if that person didn’t need to deliver the original L/C to obtain an amendment.

20 Consider deleting clause (3), at least as long as Beneficiary has not transferred the L/C. Any requirement for a bond will be expensive and create issues if Beneficiary actually needs to deliver a Reissuance Package.

21 If Issuer fails to provide the confirmation, Beneficiary would want the right to draw upon the L/C. The Lease or other underlying agreement would need to cover this point.

22 In a transaction the author handled in the second half of 2008, Beneficiary requested such comfort. With difficulty, Account Party eventually convinced Issuer to agree to provide a reminder notice before the outside expiry date. While the parties spent time and legal fees dealing with this and other similar creative issues, the stock market and commercial real estate market began their collapse. Account Party decided not to proceed at all. In perfect hindsight, Beneficiary might have done better by taking the less-sophisticated L/C that Account Party offered, dropping this and all other creative and cutting-edge issues, and just closing the deal.

23 Looking ahead, fraud-related issues like these may attract more attention from all parties to business transactions than in the past.

24 To avoid issues, the L/C should state that any notice will not be effective unless it contains all the required information.

25 Beneficiary would want those circumstances to include: (a) an Event of Default under the Lease or other agreement; (b) Issuer downgrade; (c) Issuer’s failing to maintain an office in a particular place where the L/C can be
(D) Account Party’s failing to pay any cost of transferring or reissuing the L/C when necessary; (e) other possible impairment of the L/C; (f) Account Party’s or possibly some other person’s (e.g., a guarantor’s) bankruptcy (or similar event); and (g) upcoming L/C expiry (e.g., within 60 days) unless Account Party has satisfactorily renewed or replaced the L/C. Before Beneficiary draws upon the L/C, Account Party will seek notice and opportunity to cure for all the above circumstances, except perhaps (g). Beneficiary should resist, but should agree to release the L/C proceeds if Account Party somehow cures the problem and restores the L/C after Beneficiary drew upon the L/C.

In some cases, Beneficiary may want to be a party to the Reimbursement Agreement, or at least receive copies of notices under the Reimbursement Agreement or related revolving credit agreement. This might allow Beneficiary to monitor any possible problems involving Account Party. It might also demonstrate that lawyers can always come up with a reason to justify practically anything.

This assumes the absence of a credit crisis at that particular moment. If Account Party anticipates needing to replace an L/C for this type of reason, the underlying document (e.g., the Lease) will need to give Account Party that right.

See Joshua Stein, After the Closing: A Legal Tragedy That Didn’t Need to Be, ABA Prob. & Prop. J. (November/December 2001), at 54. Another version of this article appears as Chapter 16 of Joshua Stein, A Practical Guide to Real Estate Practice (2001).

This model L/C should be used only by attorneys familiar with L/C procedures and admitted to practice in the jurisdiction whose law will govern this L/C. Any such attorney may obtain an editable version of this model L/C from the author. The author provides no assurances regarding the enforceability or sufficiency of this model L/C, either generally or for specific transactions.

Issuers often write L/Cs in the first person plural, drifting into and out of the third person. Consistent use of the third person seems more appropriate.

ISP98 makes this word unnecessary, but Beneficiaries like it.

Almost every L/C requires Beneficiary to deliver the original L/C when drawing. Without such a requirement, one would want to add a statement like: “The original of the L/C need not be presented.” Although this approach would simplify Beneficiary’s life, it is off market and may create some additional potential for confusion or even fraud. See also the further introductory comments about lost L/Cs.

Unlike ordinary contract law, L/C practice typically does not tolerate “substantial compliance.” Issuer may favor the standard of “strict compliance,” which governs L/C practice absent agreement otherwise. As a compromise, the L/C could say: “Typographical errors shall not constitute discrepancies unless they refer to the date, amount, or identifying number of this L/C.”

ISP98 negates any requirement for any “solemnity, officialization, or any other formality.” ISP98 § 4.12(a). In general, if a signature looks like it complies with the L/C, then ISP98 treats it as compliant. ISP98 § 4.07. This eliminates any need to refer to the “purported” signature of Beneficiary.

At some point soon, Beneficiary will present an L/C by email or by going to a website and typing the L/C number and a password. That point (or any point close to it) has not yet been reached at time of writing. L/C practice favors adherence to market standards and custom—more so than almost any other area of banking or legal practice.

Nothing in the preceding sentence is mandatory. Specificity about payment mechanisms can reduce any possible risk of fraud. Beneficiary may want the right to change payment mechanisms, but this may increase the risk of fraud.

The deadlines in this paragraph seem short but not excessively so. ISP98 § 5.01(a) says Issuer must give notice of dishonor “within a time after presentation of documents which is not unreasonable.” Three business days meets the test; more than seven does not. ISP98 § 5.01(a)(i). Any notice of dishonor “shall state all discrepancies upon which the [dishonor] is based.” ISP98 § 5.02. Thus, the L/C need not state that requirement.

ISP98 § 3.08 makes this paragraph unnecessary. If Beneficiary might make partial draws, though, Beneficiary might not want to rely on ISP98, and will probably want to see this language. It does no harm.

The preceding sentence is highly nonstandard, but not entirely beyond the realm of L/C practice. ISP98 leaves the matter to whatever law would otherwise govern. ISP98 § 1.05(c).

See earlier comments about not using this word in L/C practice.

Typically any L/C Proceeds go directly to Beneficiary’s account. If Beneficiary or Lender wants the proceeds to go elsewhere, this would require, at a minimum, a document assigning the proceeds. Any such document still might not allow Lender itself to draw upon the L/C. As the introductory comments note, the parties may need a three-party agreement to give Lender enough control over the L/C.