1 Description. This document is a standby letter of credit (an "L/C"), suitable for: (a) leases where a tenant delivers an L/C instead of a security deposit; and (b) loans or other obligations secured by an L/C. This document is prepared from the perspective of Beneficiary. Because an L/C is a fairly standard document, this Model Document could also be used, with care, when acting for the party issuing an L/C (the “Issuer”) or the party that is obtaining the L/C (the “Account Party”). This Model Document is inappropriate for an import-export L/C, where the parties anticipate the L/C will be drawn in the ordinary course by presentment of a bill of

Experience suggests the need, unfortunately, to remind the user that this model document, outline, or checklist comes with no guarantee or warranty; may contain errors or omissions; does not define a minimum standard of practice; has not been approved by, and is not the official position of, any organization; does not estop any person in any negotiation or transaction or otherwise; should be used only where correct in context; does not replace thought, analysis, and use of a range of appropriate precedents; has not been tailored for use in any particular state (except perhaps New York); and is just a model document, outline, or checklist – nothing more. The author disclaims responsibility for any use or misuse of this model document, outline, or checklist. Consent is granted for any attorney to use and adapt for specific transactions, subject to the preceding qualifications.

Issuer’s agenda relates less to the form of the L/C than to 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 a contract to build a house or to dance a jig; (b) the form complies with Issuer’s technical and operating procedures and is written clearly enough so Issuer can decide whether Beneficiary has submitted compliant drawing papers; and (c) Issuer is comfortable with Account Party’s credit and the airtight nature of Account Party’s obligation to reimburse the entire amount of any draw on the L/C. 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 decides to draw the L/C. As long as the foregoing conditions “a” through “c” are satisfied, the substantive terms and conditions of the L/C merely determine the timing of the loan disbursement and since Issuer must be willing to disburse the loan at any time (or else it should not issue the L/C at all) those other terms and conditions don’t matter to Issuer.

Account Party will, however, want to defer, frustrate, and complicate any L/C draw. Techniques to do this can readily be inferred by reading these cover notes and considering the comments here from Account Party’s perspective rather than Beneficiary’s. A careful Beneficiary will try to reject Account Party’s proposals.
lading or other trade documents. Parts of this Model Document can be used when drawing on any standby L/C, or transferring any standby L/C that allows transfer.

2 Points Not Covered. A document of this type could cover the following points, but this Model Document does not cover them. Appropriate provisions are available separately from the author, and can be added in particular cases.

2.1 Changes in Amount. The parties may want to build into the L/C future reductions in its face amount, for example if the L/C backs an obligation to be performed in stages, so that as each stage is performed the L/C is automatically deemed reduced whether or not the parties remember. Beneficiary will want to assure that this takes place in a way that does not imperil Beneficiary’s security if problems arise. This entire issue is best addressed in the underlying contract documentation between the parties, implemented through future amendments of the L/C, each requiring Beneficiary’s formal written consent.

2.2 Special Protections. Beneficiary may be concerned about certain special risks that arise with a letter of credit and can be addressed by adding additional (nonstandard) provisions, including: (a) injunction or TRO preventing draw on L/C; (b) insolvency or closure of Issuer; (c) insolvency of Account Party; and (d) payment by Account Party and release of the L/C, followed by bankruptcy of Account Party and an attempt to claw back the payment.

2.3 Multiple Beneficiaries. If multiple parties have an interest in the proceeds of the letter of credit, they need to agree upon a process to protect their respective interests.

2.4 Notice of Transfer. The L/C is freely transferable upon notice to Issuer. Should Account Party also be entitled to such notice? If so, the point might better be covered in the underlying agreement than in the L/C.

2.5 International Standby Practices. Like most L/C’s, this one is governed by the Uniform Customs and Practice for Documentary Credits, International Chamber of Commerce Publication No. 400 (the “UCP”). Within the last few years, the International Chamber of Commerce has released a new set of standards for standby letters of credit, the International Standby Practices (the “ISP”). In the author’s experience, however, the ISP has not yet achieved any level of industry acceptance. Therefore this L/C does not refer to it. Over time this may change.

2.6 Nonconforming Draw. To deal with a surprisingly common problem, one could add the following language, which is highly desirable but utterly nonstandard:

If (a) Beneficiary attempts to draw on this Letter of Credit during the last 10 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 by 10 Banking Days.
Checklist. Consider the following issues when using this Model Document.

3.1 Escrow. Try not to place a letter of credit in escrow. If a dispute arises, the escrowee may “freeze” while the letter of credit 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.

3.2 Expiry. The “expiry date” (not “expiration date” in L/C jargon) should be at least 30 days, preferably up to 90 days, after the last day by which Account Party must perform the underlying obligation. Give Beneficiary time to draw the L/C. Twice, if necessary, just in case the first time doesn’t work.

3.3 Signing Procedures. If Beneficiary is a complicated or uncertain entity, such as a joint venture, make the drawing procedures (deliver of a bare sight draft and the L/C) particularly simple and direct, so they don’t create issues. For example, rather than provide for the joint venture’s signing the documentation, state instead that any designated corporate venturer may sign it. The more flexible the L/C is about who signs draw documentation, and what documents must accompany that documentation, the easier and quicker it is to draw. This may make a great deal of difference when Beneficiary is actually trying to draw, often a few days before the L/C expires. On the other hand, the easier an L/C is to draw the more one must consider the risk of fraudulent diversion of the proceeds. As a fraud prevention measure, perhaps the L/C should designate exactly how the proceeds will be paid.

4 Other Documentation. This Model Document raises the following concerns relating to other documentation for the transaction, including items and exhibits that need to be attached to this document when using it.

4.1 Instructions. This Model Document includes proposed instructions to be distributed along with the form of L/C. These instructions may be helpful in some cases, or they may be regarded as more trouble and more detail than they’re worth. These instructions are designed to prevent the problems and crises that recur most often when accepting L/C’s.

4.2 Underlying Obligation. An L/C merely secures an underlying obligation. The underlying documentation should clearly describe that obligation and clearly permit a draw on the L/C without satisfying burdensome conditions or drawing requirements. The author can provide standard contract language relating to use of an L/C to secure an obligation. Some of these provisions are nonobvious. To avoid bankruptcy risks relating to Account Party, Beneficiary would usually prefer a “direct pay” letter of credit, so that Beneficiary never accepts payment directly from Account Party, but only from Issuer, even if Account Party is paying the obligation in the ordinary course without a default.

4.3 Additional Exhibits to L/C. One could attach as exhibits to the L/C forms of the following related documents: (a) drawing certificate; or (b) termination certificate. Item “a” is omitted here because Beneficiary should reject the entire concept. Item “b” is omitted here because it is rarely troublesome. If any party wants to include a termination certificate, it is certainly not unreasonable to do so, just some extra work. Samples are available from the author.
4.4 Noncompliant L/C. The instructions for this L/C contemplate that Beneficiary may accept a noncompliant L/C, with Account Party obligated to fix it quickly. If Account Party does not, then Beneficiary can draw. Such provisions, if desired, must also be addressed in the underlying agreement between Beneficiary and Account Party. They will tend to save a reasonable amount of time and trouble during the L/C issuance process for the closing. But Beneficiary needs to remember to follow through after the closing, which is often easier in theory than in practice.

4.5 Reimbursement Obligations. In the event of a draw, who should reimburse that draw? Should that person be entitled to contribution? If so, from whom? From anyone's parent company? With what results under any related partnership or LLC documentation? Consider issues of creditworthiness. All documentation on reimbursement and contribution should be negotiated, executed, and delivered when the L/C is delivered to Beneficiary.

4.6 Tickler File Entry. Place appropriate reminders of any upcoming expiry date(s) in your calendar and the firm’s tickler file. Remind the client to do the same, preferably in writing. Allocate this responsibility in an unambiguous way, to avoid claims that it was the responsibility of counsel to remember the upcoming expiry date and the need to draw the L/C (unless counsel intends to assume such responsibility).

4.7 Where’s the L/C? Establish a clear written record of who received the L/C after the closing, and who is responsible for holding it. If counsel will hold the L/C, determine how best to do so (e.g., in a vault) and establish an appropriate written record of exactly where the L/C went.

5 Substantive Comments.

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

5.2 Drawing Conditions. If possible, no certification, prior notice, or third-party verification should be required for Beneficiary to draw upon the L/C. As an extreme example of language that Beneficiary should reject out of hand, here is language that an optimistic Account Party might propose to be included in the sight draft or a separate mandatory drawing certificate:

Beneficiary represents, warrants, and certifies that: (a) Account Party has defaulted in performing the following 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 4 to all parties entitled to such notice, at the addresses shown and in the forms attached as Exhibits hereto, all in full compliance with the requirements of the Agreement; (d) any and all cure periods under the Agreement 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; and (f) a period of at least _____ business days has elapsed since the notice described in clause “e.”

5.3 Drawdown Documentation. This L/C requires that drawdown documentation be “substantially” in the form annexed. Substantial compliance is ordinarily not an element of L/C practice. Issuer may object to it.

5.4 Pre-Existing Debt. An L/C delivered as security for pre-existing debt may face insolvency or bankruptcy challenge. Avoid accepting an L/C under those circumstances, at least not without fully considering bankruptcy issues, some of which can be structured around.

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4 If Account Party were subject to bankruptcy proceedings, any such notice to Account Party would violate the automatic stay. This comment is not intended to limit the grounds on which Beneficiary should object to the suggested language.
INSTRUCTIONS FOR LETTER OF CREDIT

1. Required Form. Please tell your bank to issue this Letter of Credit in exactly the form provided here. Unfortunately, issuers often try to “improve” the form of Letters of Credit, such as by: (a) requiring Beneficiary to deliver some form of drawing certificate; (b) modifying the “evergreen” language; (c) cutting back language that makes it clear Beneficiary need not pay any transfer fees for this Letter of Credit under any circumstances; (d) referring to the agreement between Beneficiary and Account Party; or (e) modifying the “boilerplate” provisions of the Letter of Credit. Most such “improvements” will be unacceptable to Beneficiary. The Letter of Credit will simply need to be reissued. If you direct your bank to issue the Letter of Credit exactly in the form attached, and make it clear they must do so, then in most cases they eventually will. This will save all parties the trouble of having the Letter of Credit reissued or amended.

2. Review of Draft; Noncompliant L/C. Before your bank issues the Letter of Credit, please arrange to have a draft of it faxed to Beneficiary’s counsel, _________, at (212) __________, for review and approval. If the Letter of Credit conforms to the following form of Letter of Credit and is otherwise consistent with transactional requirements, it should be fine. If not, it will need to be modified. In the interests of time, however, Beneficiary may accept a noncomplying Letter of Credit at closing. In such a case, however, Beneficiary will have the right, for 60 days, to require the Letter of Credit to be modified or reissued to comply strictly with the following form (a “Corrective Reissuance”).[5] Beneficiary recommends that the Letter of Credit be issued correctly at closing. If it is, then Beneficiary’s counsel will, upon request, waive in writing Beneficiary’s right to require a Corrective Reissuance.

4. Questions. Any questions regarding the Letter of Credit should be directed to Beneficiary’s counsel, _________, at _________.

[5] This concept would also need to be covered in the underlying agreement between Account Party and Beneficiary.
LETTER OF CREDIT

Date: ___________, 200__

[Name and Address of Beneficiary]
(the “Beneficiary”)

Ladies and Gentlemen:

We establish in favor of Beneficiary our irrevocable and unconditional Letter of Credit No. _______ (the “Letter of Credit”) for an aggregate amount of _______ Dollars ($_______), expiring at __:00 p.m. on _______ (such date, as extended from time to time, the “Expiry Date”).

We authorize Beneficiary to draw on us (the “Issuer”) for the account of _______ (the “Account Party”), under the terms and conditions of this Letter of Credit.

Funds under this Letter of Credit are available by presenting the following documentation (the “Drawing Documentation”): [(a) the original Letter of Credit and (b)] a 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 documents are required.

Drawing Documentation must be presented at Issuer’s office at ______________ on or before the Expiry Date by personal presentation, courier or messenger service, or fax. Presentation by fax shall be effective upon electronic confirmation of transmission as evidenced by a printed report from the sender’s fax machine. After any fax presentation, Beneficiary shall with reasonable promptness transmit original Drawing Documentation by any other means. Issuer will on request issue a receipt for Drawing Documentation.

We agree, irrevocably, and irrespective of any claim by any other person, to honor drafts drawn under and in conformity with this Letter of Credit, within the maximum amount of this Letter of Credit, presented to us on or before the Expiry Date, provided we also receive any other Drawing Documentation this Letter of Credit requires. Our payments under this Letter of Credit shall be made from our own funds[ by check or wire transfer, as Beneficiary shall request in writing] [only by wire transfer to the following bank account: ________________] [only by check payable and delivered to __________________].

If Beneficiary presents proper Drawing Documentation at or before noon of any day other than a day on which all commercial banks in _____________ are authorized or required to be closed (a “Banking Day”) we shall pay on the same Banking Day. If Beneficiary
presents proper Drawing Documentation at any other time, Issuer shall pay on the next Banking Day. Issuer waives any right to delay payment. If the Expiry Date is not a Banking Day, then Drawing Documentation submitted on the next Banking Day shall be deemed timely and compliant.

[Partial drawings are permitted. This Letter of Credit shall, except to the extent reduced thereby, survive any partial drawings.]

Issuer shall have no duty or right to inquire into the validity of or basis for any Drawing Documentation. Issuer waives any defense based upon fraud or any claim of fraud.

[The Expiry Date shall automatically be extended by one year (but never beyond _____ [the “Outside Date”]) unless, on or before the date 90 days before any Expiry Date, Issuer has given Beneficiary notice that the Expiry Date shall not be so extended (a “Nonrenewal Notice”). Issuer shall promptly upon request confirm any such automatic extension of the Expiry Date by issuing an amendment to this Letter of Credit, but such automatic extension shall be effective with or without such confirmation amendment. Issuer need not give any notice of the Outside Date.]

[Effective upon Issuer's dispatch or Beneficiary's receipt of any Nonrenewal Notice, Beneficiary shall be automatically deemed to have validly presented to Issuer fully conforming Drawing Documentation for the entire amount of this Letter of Credit, and Issuer shall: (a) be irrevocably and unconditionally obligated to pay the entire amount of this Letter of Credit to Beneficiary; (b) hold the proceeds of such deemed draw pending Beneficiary’s written direction regarding disbursement; (c) promptly comply with such written directions; and (d) be entitled to require, as a condition to disbursement (whether before or after the Expiry Date that would otherwise apply), that Beneficiary present Drawing Documentation at the time of disbursement in the form that this Letter of Credit would otherwise require.]

[Beneficiary may from time to time transfer this Letter of Credit, in whole but not in part, to any transferee (the “Transferee”). Beneficiary shall make such transfer by delivering to Issuer the original of this Letter of Credit and a Transfer Notice in the form of Exhibit B designating Transferee. Issuer shall promptly reissue or amend this Letter of Credit in favor of Transferee. Issuer shall look solely to Account Party for any payment or fee for such transfer. Such payment is not a condition to transfer. Upon any transfer, all references to Beneficiary shall automatically refer to Transferee, who may then exercise all rights of Beneficiary.]

Any notice to Beneficiary shall be in writing and delivered by hand with receipt acknowledged or by certified mail (return receipt requested) at the address set forth above, or to such other address as Beneficiary may specify by written notice to Issuer. No amendment that adversely affects Beneficiary shall be effective without Beneficiary’s written consent.

This Letter of Credit is subject to and incorporates by reference the Uniform Customs and Practice for Documentary Credits, International Chamber of Commerce Publication No. 400 (the “UCP”) and, to the extent not inconsistent with the UCP, is governed by the
Uniform Commercial Code of the State of [New York] (except Section 5-102(4)). [NOTE: The preceding parenthetical applies in Alabama, Michigan, and New York only.]

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 ______________.

[Name and signature block, with signature or purported signature of Beneficiary]

Date: ______________
FORM OF TRANSFER NOTICE

[Beneficiary Letterhead]

TO:

[Name and Address of Issuer]
(the “Issuer”)

TRANSFER NOTICE

By signing below, the undersigned, Beneficiary (the “Beneficiary”) under Issuer’s Letter of Credit No. ____________ dated ____________ (the “Letter of Credit”), transfers the Letter of Credit to the following transferee (the “Transferee”):

[Transferee Name and Address]

The original Letter of Credit is enclosed. Beneficiary directs Issuer to reissue or amend the Letter of Credit in favor of Transferee as Beneficiary. Beneficiary represents and warrants that Beneficiary has not transferred, assigned, or encumbered the Letter of Credit or any interest in the Letter of Credit, which transfer, assignment, or encumbrance remains in effect.

[Name and signature block, with signature or purported signature of Beneficiary]

Date: ______________