2009 ANNUAL SURVEY OF LETTER OF CREDIT LAW & PRACTICE AMERICAS CONFERENCE SUMMARY (PART 1 OF 2)

By Lisa CHIN*

Edited by Christopher BYRNES**

ANNUAL SURVEY OF LC LAW & PRACTICE

For the 18th consecutive year, the Institute of International Banking Law and Practice (IIBLP) conducted its Americas Annual Survey of LC Law & Practice. Held in Charlotte, North Carolina for the first time, the 2009 conference took place on 26-27 March. The 2009 Americas Annual Survey was co-sponsored and hosted by Bank of America. The event attracted over 65 delegates from Canada, Ireland, and 18 US states.

Led by Americas Annual Survey Co-Chairs Professor James E. BYRNE (IIBLP) and James G. BARNES (Baker & McKenzie), the conference featured 15 additional local, regional, and international experts. Panelists included Michael Evan AVIDON (Moses & Singer LLP); Buddy BAKER; Mel BATOR (Bank of America); Leo CULLEN (Coastline Solutions); Nelson EVERHARDT (Everhardt & Associates); Bob FOUTTS (JP Morgan); Paul GREAVES (Bank of America); George HISERT (Bingham McCutchen LLP); Carter KLEIN (Jenner & Block LLP); Don MATTOX (SunTrust); Dennis NOAH (M&T Bank); Donald SMITH (Norman Technologies); Dan TAYLOR (IFSA); Charnell C. WILLIAMS (Citi); and Jim WILLS (SWIFT).

Additional sponsors of the 2009 Americas Annual Survey included Coastline Solutions and *Documentary Credit World*.

Martin ABRAHAMSON (Bank of America) delivered an opening address to welcome delegates.

Prior to the start of the conference discussions, Professor BYRNE recognized James G. BARNES for whom the 2009 ANNUAL REVIEW OF INTERNATIONAL BANKING LAW & PRACTICE volume is dedicated for his years of service to the letter of credit community.

Hot Topics

To begin this first discussion, each panelist chose a "hot topic" for discussion. Paula GREAVES noted that she is seeing an increase in documents being returned under commercial letters of credit rather than eventually being paid after initial refusal. She emphasized that each party needs to read the LC carefully, no matter what its role is.

Don SMITH stated he is hearing about a rise in "mythical" discrepancies. There has also been a rise in LC-related scams such as efforts to "sell" letters of

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Delegates of the 2009 Americas Annual Survey of LC Law & Practice conference in Charlotte, North Carolina.

credit and "3039" demand guarantees ("3039" refers to a bogus financial guarantee called the "ICC 3039 London Long Form"). SMITH stressed that delegates and their colleagues must prepare themselves to guard against these and related scams.

Professor BYRNE said that he is learning of more frequent instances of scams on banks. There has been an increase in the use of LCs to defraud banks by counter parties.

Bob FOUTTS cited sanctions clauses as his hot topic. These clauses are consuming time and complicating LC transactions. Another panelist anticipates the situation will worsen for banks with more regulations and regulators.

Dan TAYLOR stated that the revision to the Uniform Rules for Demand Guarantees (URDG) is taking shape, qualifying it as a hot topic. He also agrees with FOUTTS' sentiments regarding sanctions clauses.

Dennis NOAH (M&T Bank) has encountered **"push back" from China** whereby Chinese entities have been increasingly reluctant to deal with the US. This appears to be economically motivated rather than politically driven. Many state-owned companies are coping with solvency issues and some are seeking injunctions to avoid payment. Professor BYRNE added that there was no private law 20 years ago in China. In one generation, they formulated a legal system which is an impressive achievement. Challenges remain. Judges are not lawyers and there are very few lawyers in China that understand LCs. BYRNE noted it is common for one party to eventually back down if pressure is applied. There is a clear divide regarding expertise among banks across China. Head offices with more experienced personnel want to avoid reputational risk whereas branches may not see this as a top priority and have less respect for the LC product.

Referencing a recent conversation he had with a senior Chinese banker, NOAH said Chinese banks are

considering whether they need to confirm US credits in light of the financial difficulties many US banks have experienced recently. Chinese institutions are essentially saying: "We're more concerned about your banks than you are with ours."

BYRNE then referred to two cases in the 2009 ANNUAL REVIEW volume involving a similar pattern. In *Jaffe v. Bank of America, N.A.* (abstracted at Apr 2009 DCW 13), an applicant sued the issuer to enjoin honor of a standby. The credit was to cover payment for the construction of a luxury yacht. The beneficiary was not the builder, but instead was a Chinese bank that was to lend funds to the builder. The yacht was never built nor were the funds repaid, so the beneficiary drew on the LC. The applicant accused the beneficiary of fraud and maintained that the Chinese bank was also a party to the fraud. This was a serious allegation to say that a Chinese bank was in collusion with the Chinese boat builder. The injunction was granted.

The same shipyard was involved in *2002 Irrevocable Trust v. Huntington National Bank* (noted in 2009 ANNUAL REVIEW 388). A buyer entered into two contracts with a seller/ joint builder and a Chinese builder to construct two 127-foot luxury motor yachts in China. Two standby LCs were issued in favor of the Chinese builder's bank to guarantee re-payment of funds that were advanced to build the yachts. The buyer terminated both contracts less than six months after signing, alleging that no work had been started on the yachts. The buyer tried to have the credits cancelled, but the beneficiary refused, as it had not been repaid the advance funds. The buyer sought to enjoin the issuer from paying any demands. Similar to the *Jaffe* case, there were allegations that the Chinese bank was a party to the fraud, but it was not joined as a party in the action.

It was noted that in both cases the credits did not run logically to the beneficiary but rather to the beneficiary's lender.

One panelist noted a **rise in LCs where the beneficiary is not the applicant's counter party**, but somebody else. It might be a lender or an entirely different entity. A typical LC is between counter parties and the lender is the assignee of proceeds. There is much confusion regarding how credits should be worded when the two sides are not counter parties. If not properly structured, one might have a kind of surety. The panelist used the example of a lessee's obligation running not to the lessor, but to the lessor's lender. It appears the two have a direct relationship with each other, but they do not. This is not so much a concern for banks, but causes many problems for applicants and beneficiaries as it serves as a transferable letter of credit.

As a beneficiary, one corporate participant indicated she sees this situation a lot, particularly from Korea. The purchase order says the buyer is one party, but the letter of credit is coming from another party. She has to ask her Korean office to determine the obligor party, because she and her company would not otherwise know who it is (probably the ultimate buyer). Sometimes the LC comes from the finance company or a lessee.

One panelist cautioned that warranties arising under US Uniform Commercial Code Article 5 (UCC Art. 5), specifically section 5-110, are to the named applicant.[1] Another panelist added that if there is no contractual relationship between the beneficiary and another party who is unknown, the law implies a separate promise.

A third panelist warned that

1. UCC Art. 5-110(a)(2) states: "If its presentation is honored, the beneficiary warrants to the applicant that the drawing does not violate any agreement between the applicant and beneficiary or any other agreement intended by them to be augmented by the letter of credit."

from a compliance perspective, any beneficiary/seller should be "very afraid" of this scenario, because the US government will carefully scrutinize such matters. Sellers need to know their buyers.

Another problem expressed by the corporate user is that an LC may not cover 100% of the merchandise value. A portion (perhaps 50%) is payable against delivery or when the product is working and requires a document signed by someone unknown to the beneficiary/seller. Others agreed this **trend of partial payments** is growing because of the dismal economy. The buyer is attempting to get financing on the back end. As payment is at the buyer's discretion, it may not occur most of the time. Within a large global company acting as beneficiary/seller, sales representatives may say this is common and have no problem with such an arrangement, but LC specialists will strongly object and may prohibit it.

One participant mentioned he knew of an instance where the LC had an 80%/20% split. The government-controlled applicant had no intention of paying the last 20% as it considered this 20% to be its discount.

How does this compare to the *Jaffe* case? One panelist responded that it depends on where the fraud was considered to have taken place. Another panelist said that he would consider this a UCC Art. 5-110 warranty, but wondered how well that would stand up with a non-US beneficiary.

Would the same result have occurred if this has been a transfer? Panelists commented that there would probably have been a clause in the LC stating not to transfer before checking back with the issuing bank to see if such transfer was acceptable to the new party. Some participants thought the result would have been the same since the first beneficiary's documents are substituted.

Asked one former banker: Are today's bankers experiencing **pressure to do riskier or strange deals**? He recalls from his past some "really creative people" on the sales side of the bank that would try some really unusual deals. From their perspective, they had little concern if the deal went bad down the road because they had already been paid. Another former banker as head of the sales department had the policy that sales reps only got paid their commission when the bank got paid. That philosophy changed the entire dynamic of sales' thinking.

One active banker said that he is starting to see sales that are much riskier in order to capture business. Interestingly, another active banker said the opposite. At his bank, there has been an increase in their sales reps having more knowledge and unwilling to do certain creative deals. They are seeing greater interest in standbys and carefully reviewing them.

Panelists told participants they must recognize that there is an increased regulatory burden. Banks must look carefully at their deployment of assets. Every transaction is going to a risk group for evaluation. One participant has observed an increase in creative deals because liquidity has dried up. Those within banks that are responsible for risk have had to get up to speed. Banks really have to look at deals and ask if they make sense. It is no longer "business as usual" anymore, another experienced banker said. He added his bank is almost reinventing the business. A lot of oversight is being put into place for credit risk and operational risk.

BYRNE informed delegates that Sue Auerbach retired one year ago from the US Office of the Comptroller of the Currency. Since 1995, she had been the OCC attorney primarily responsible for letter of credit and guarantee issues. The Office has just named Sue's replacement, Chris Manthey.

A participant who is an exporter stated that he is seeing that credits are no

longer available in the US. The buyer wants them available with the issuing bank and payment delayed considerably. There have been ongoing problems with sales and operations to be able to cope with significant payment delays.

Returning to the topic of **mythical discrepancies**, one panelist asked what beneficiaries can do when such discrepancies are cited by an inland Chinese branch as opposed to a branch in a large "money center" city. He suggested trying to get a US bank involved in refuting such discrepancies since a US bank may have "more weight". Another question then arises: How does one get the matter elevated to the higher department within the Chinese bank? An experienced banker responded that one must start at the bank's head office with the highest person with whom one has contact and then be referred to others. The concept of "losing face" is still very important in China. Starting at the bottom is much more inefficient. One needs to prepare in advance what to do if they do not get paid.

One panelist stated that he is seeing bad discrepancies and Chinese banks "are not budging". In one instance, there were several unpaid LCs involved. His strategy was to utilize correspondent relationships in the country for assistance. The LCs eventually were paid, But the situation demonstrated to him that local branches do not have as much familiarity with LCs.

A participant who is an exporter mentioned a past experience contesting a discrepancy in which he requested his bank to go "to the top" in Pakistan, but it did not help. He asked Annual Survey delegates: What is the responsibility of a negotiating bank to assist an exporter? One panelist replied that it depends on which bank the exporter is using because each bank has different contacts. Another added that if the bank has a stake in the transaction (an obligation), then the bank would fight the discrepancy. If the bank does not have an obligation, then it might not take a position, although may elect to fight the discrepancy if it wants to support its customer. A third panelist suggested that LC specialists should develop a network of options, possibilities, threats, and strategies and use them in a variety of ways in different situations.

Although much of the discussion referenced China and many situations do relate to China, it was pointed out that mythical discrepancies can happen anywhere.

One banker mentioned an instance at her bank where the issuing bank argued that Vancouver (in the US state of Washington) was not seaport, but a river port, so therefore the bill of lading was discrepant. In fact, Vancouver is considered a seaport. Another dispute had to do with a credit requiring a "full set" of insurance documents. The insurance document presented did not state how many originals were issued, so the issuing bank cited it as a discrepancy. Bankers explained they are getting more push-back of this nature.

Turning to boycott matters, one corporate said that she sometimes sees **boycott language** on the bid or purchase order, but not within the letter of credit itself. If a company's sales reps are not recognizing such language, the company must educate them to detect it. Corporates still have to comply with US laws and one panelist stated that US anti-boycott regulations have not changed much at all the last 5-6 years. Another panelist added that the only things that have really changed are the types of language boycotting countries are trying to slip through.

Sanctions clauses have been in LCs for years and have gone unnoticed in past years. Now, however, new types of lengthy, all-encompassing clauses and are causing problems. These problematic clauses say that bank policies may go beyond the sanctions

and the bank may not pay because of that. One participant indicated his bank is struggling internally whether or not to utilize sanctions clauses. He would rather not include the language. If sanctions language is used, what does a bank do if it receives a request to remove it? If a bank agrees to remove, the vacuum creates a problem because one must ask why the sanctions language was there in the first place.

Panelists explained there are two kinds of sanctions clauses. The first is informative. The other kind is a long narrative statement that may impact the beneficiary's right to get paid at the discretion of the issuing bank and could question the irrevocability of the instrument. Regarding the latter type, the quality of clauses being written by banks is worsening. Experts do not think sanctions clauses are soon going away. Bank lawyers are responsible for these clauses, not operations. One lawyer said there have always been sanctions clauses in promise-to-pay documents declaring that regulations may prevent the obligor from paying, so this concept is not new. This current breed of sanctions clauses in LCs, however, go beyond warnings.

Odd elements of clauses mentioned by bankers: Use of the word "apparent", such as "apparent" violations; a requirement to notify the beneficiary if the issuing bank is about to declare bankruptcy; and a bank's use of one clause in the US and another clause for the rest of the world.

Turning to one point of dispute from the US case *Labarge Pipe & Steel Co. v. First Bank* (Mar 2009 DCW 11), panelists asked Annual Survey delegates: What does the word 'original' mean when the credit requires **the 'original letter of credit'**? If a bank faxed an LC to the beneficiary and released the original to the applicant, and the beneficiary never received what was sent to the applicant, would the fax be considered the original? One participant explained that her bank's policy is to state that the fax is the copy and the original will follow by mail. Another delegate recalled that the matter was considered during the drafting of UCP600 to see if there was a need to define how an original credit is created. It was decided that it has not been a problem so the discussion was dropped. From a lawyer's point of view, one explained that if you fax the LC, then that is the operative instrument unless you state something to the contrary. Another panelist added that banks also need to consider electronic front-end systems. What is the bank delivering to the beneficiary? It needs to tell the beneficiary what it considers the output to be.

Recent ICC Opinions

In **ICC Opinion TA644rev**, a credit was issued specifying details of shipment, such as transport from and to and a latest shipment date, but the credit did not require a transport document which would evidence such details. Applying UCP600 Article 14(h), the shipment details on the credit would be disregarded. However, applying UCP600 Article 14(d), if a required document contained any information that contradicted any of the shipment information in the credit, then that document would be discrepant. Are these two articles contradictory in the way they describe how this situation should be handled? The ICC Banking Commission said no, and stated so in its conclusion to this opinion:

> Where it has been agreed to handle such a transaction, details such as the places, ports, or airports from which the goods are to be shipped from and to and the latest shipment date may be disregarded for the purpose of determining a complying presentation and need not be stated in any other stipulated document presented. However, the data in the other stipulated

documents will still be subject to review under sub-article 14(d) to ensure that any data is not conflicting with the data in the credit. According to sub-article 14(h), banks will deem a non-documentary condition as not stated (on the basis that there is no necessity for the beneficiary to provide any evidence of compliance) and will disregard it. Should the beneficiary, nevertheless, elect to insert such data on any other stipulated document, then it must ensure that the data does not conflict with the data in the credit. The view of the Banking Commission is that sub-article 14(h) is not absolute and is qualified by the content of sub-article 14(d).

This is a change from UCP500. Now, if there is additional information on a required document and that additional information conflicts, then the document is discrepant. When discussed at the ICC Banking Commission meeting, the opinion prompted many comments and much criticism. At the Annual Survey, one panelist explained that if something is considered "not stated" that means it is not there. If it is not there, then there can be no conflict. His fear is that this will eventually extend to documents presented that are not required by the credit. Another panelist reminded participants that this is extra data on a document. Is it possible to call the beneficiary and ask if you can "white out" the conflicting (extra) information on the document?

According to one delegate, European banks find this opinion acceptable but American courts will object to it. The worst aspect of this opinion is that it does not deter non-documentary conditions in a standby, but encourages them. This further demonstrates the value of ISP98. Another delegate expressed agreement with the opinion. He sees the two provisions as different because one deals with a condition, and the other deals with data.

The Annual Survey audience was reminded that during the UCP600 drafting process, three variations of Article 14(d) had been proposed to ICC National Committees. A majority chose the version that is now contained in UCP600. At the time, the US position was that Article 14(d) should have specified "data in a document required by the credit … ."

One banker wondered why a bank would put a condition into a credit without a documentary requirement. While most may simply attribute this to inexperience or carelessness, one banker offered regulatory compliance as a possible explanation. An issuing bank may list the transport from and to details so that the advising bank does not need to go back to the issuing bank to request this information due to the lack of a transport document.

From the corporate perspective, one LC specialist stated her company does not put anything extra in its documents. They ask for non-documentary conditions to be taken out. Now, they are getting discrepancies for conflict when their packing list doesn't total up or match the air waybill by 10 kilograms. Another specialist remarked that this has always been true but that it is just more prevalent now.

Some background was offered to explain how guidelines for non-documentary conditions came about. Concern was expressed in the 1980s about the increasing number of non-documentary conditions in letters of credit. People dealing with guarantees around the world struggle with a similar issue. Is a guarantee independent or a type of contract? So, what should be done with non-documentary conditions? LC specialists dealt with the same problem with UCP500, ISP98, UCC Art. 5, and now with UCP600 for standbys. It is

more of a struggle with commercial LCs. For one LC expert, the result of ICC Opinion TA644rev is not disastrous but its ramifications for standbys are worrisome as it seems to create an open invitation to lawyers and applicants to insert language into UCP600 standbys.

Does ICC Opinion TA672rev help or hurt nominated banks in the event of an injunction?

In **ICC Opinion TA672rev**, a commercial LC was issued available by deferred payment with the confirming bank. The confirming bank incurred the deferred payment undertaking and prepaid the beneficiary. The issuing bank communicated its acceptance of the documents. One day before the maturity date, the issuing bank notified the confirming bank that it would not be effecting payment because it had been served with a judicial order preventing payment. Upon receipt of a faxed copy of the judicial order, the confirming bank noted that the order prevented the issuing bank from paying the beneficiary. The confirming bank reminded the issuing bank of its obligation under UCP600 Article 7(c)[2] and also that the issuing bank had authorized the confirming bank to prepay per Article 12(b).[3]

The ICC Banking Commission noted that local law prevails over the transaction and agreed with the confirming bank that "the issuing bank should seek to resist such an injunction in order to preserve the integrity of its credit and the UCP" by attempting to have the injunction removed by informing the court of the relevant UCP articles and that the confirming bank has paid the beneficiary.

As explained by one panelist, the crux of this Opinion was what the injunction said. It made a difference that the prohibition was against paying the beneficiary rather than the nominated bank. Because of this, the issuing bank is obligated to pay the nominated bank per Article 7(c). The panelist also mentioned that this Opinion referenced ICC Opinion R519.[4] Another panelist added that even under UCP600 this kind of payment is still risky because negotiable instrument laws do not back the nominated bank as a holder in due course. The point was made to the Annual Survey audience that this is not just a matter of rule versus law. Rather, it is a matter of injunctions versus everything else. Injunctions operate outside rules and sometimes even outside laws. Does ICC Opinion TA672rev help or hurt

2. UCP600 Article 7(c) states: "An issuing bank undertakes to reimburse a nominated bank that has honoured or negotiated a complying presentation and forwarded the documents to the issuing bank. Reimbursement for the amount of the complying presentation under a credit available by acceptance or deferred payment is due at maturity, whether or not the nominated bank prepaid or purchased before maturity. An issuing bank's undertaking to reimburse a nominated bank is independent of the issuing bank's undertaking to the beneficiary.

3. UCP600 Article 12(b) states: "By nominating a bank to accept a draft or incur a deferred payment undertaking, an issuing bank authorizes that nominated bank to prepay or purchase a draft accepted or a deferred payment undertaking incurred by that nominated bank.

4. ICC Opinion R519, an unpublished opinion under UCP500, dealt with similar issues and reached the same conclusion. Because the credit in that query was available by acceptance, there was an additional question of whether the ICC recognizes the position of a holder in due course. The ICC Banking Commission responded, "The status of 'holder in due course' comes by virtue of bill of exchange law and not through UCP."

nominated banks in the event of an injunction?

Another panelist advised that if a nominated bank receives notice of an injunction from the issuing bank, the nominated bank should demand a copy of the injunction by fax. Sometimes the injunction just does not exist or it may only cover not allowing the issuing bank to debit the applicant's account, which is different from honoring the LC obligation.

Another panelist noted that every country has negotiable instruments law, whether it is the Geneva Convention (civil law) or the Bills of Exchange Act or the Uniform Commercial Code (common law). A nominated bank needs to inform the court that it is a negotiating bank and the court may lift the injunction. One delegate reminded fellow participants of the 2005 French case, *Crédit Lyonnais v. Canara Bank*, where a time draft was not honored due to a fraud.

ICC Opinion TA677rev deals with clauses in credits stating that documents presented must be correct on first presentation and no correction of documents is allowed. The ICC Banking Commission stated that a clause, which stated that the documents must not evidence any corrections, is "one that the beneficiary would have to abide by, unless the credit was subsequently amended to refuse the condition, and a nominated bank would be required to refuse documents that contained any corrections." However, the other requirement that documents must be correct on the first presentation "represent bad practice, and issuing banks should refrain from including such terms and conditions in their credit."

If the beneficiary has one chance to present complying documents and no corrections are allowed, panelists stated such a clause puts a huge burden on the nominated bank. Another panelist noted that such a clause is different than one stating that documents bearing corrections are not permitted.

In **ICC Opinion TA658**, an issuing bank had refused a set of documents due to an incorrect LC number on the bill of lading (one character was different). The query asked if this was a valid discrepancy, particularly in light of the fact that the issuing bank misquoted the LC number is in its refusal. Also, if a nominated bank sends a revised document after receiving a refusal, does this imply that the nominated bank has accepted the cited discrepancies as valid?

The ICC Banking Commission replied that the incorrect credit number was not a valid reason for refusal. Also, the fact that the nominated bank or beneficiary sends a replacement or corrected document "does not, in itself, signify the nominated bank's or beneficiary's acceptance of the discrepancy."

One panelist stated that in many countries, if you send a replacement document, then you are indicating to issuing bank that you accept the discrepancy. The rationale for that attitude is this: either you originally had a clean document and were now sending a discrepant one, or you are agreeing with their assessment on the discrepancy. Another panelist reminded the audience that the LC number appearing on all documents is required by law in some countries or is customary practice where the examiners do not speak English, as it is part of their marks and numbers.

This Opinion TA658 also referenced Opinion R289.[5] Courts have made the distinction in contracts between terms and conditions. The discrepancy must be material in order not to pay. One delegate stated that a reasonable document checker

5. ICC Opinion R289 stated that the purpose of requiring a credit number on a document "is only to assist in tracing documents should they go astray. "

would come to the conclusion that the incorrect credit number is a typo.

It was pointed out that ISP98 uses a rational approach to this issue in that it suspends the time to honor until the bank figures out the proper standby to check against.[6] Delegates were again reminded that queries to the ICC Banking Commission are answered based solely on the exact specifics contained in the query.

To conclude this panel discussion, one panelist alerted delegates of **DOCDEX Decision No. 271**. The most important of recent DOCDEX decisions in his opinion, it concerns banks that give a release to a carrier and then receive discrepant documents. The panelist contends that since the two transactions are different, the bank can refuse the documents. The beneficiary then has a claim against the carrier. When that occurs, the carrier will claim against the release the bank issued.

Standby Issues & Guarantee Issues

Given the current state of the economy, panelists predict more litigation and disputes in the future. Even within banks, sales and operations personnel desperate to complete deals will likely battle with their bank's in house counsel.

Asked by the panel if they are experiencing more **draws on standbys**, less than half the audience indicated such. One banker remarked that he had seen more draws in 4th quarter 2008 when liquidity problems first emerged. Since then, the number of draws have tapered off. Professor BYRNE reported to Americas Annual Survey delegates that in recent meetings of IIBLP's Regional Advisory Councils (Asia, Europe, Middle East) bankers are seeing more refusals in standbys.

A question was raised about US banks now being able to issue true (accessory) guarantees.[7] Up until recently, it was thought that a bank had to have express authority in its charter or be involved in the transaction (like a steamship guarantee). Otherwise, the answer was no. LC legal experts believe the only practical change in the new rule allowing this is to be able to add **avals** to drafts. BYRNE explained that by adding an aval, a bank is an accommodation endorser of the draft under US law. BYRNE suggested that bank personnel be told not to add their signatures to anything that states "aval" on it. Another panelist added that if banks want to offer this service they need to carefully consider what is involved. Would you handle the draft? Would you hold it or give it back? Where should it be presented at maturity? How would it be reflected on your books?

One former banker stated that at his institution avalized drafts would say "Domiciled at" to indicate where to present it. These days, he says there is some trade in the Miami market handled by forfaiting operations. The avals are obligations of their home country, so they feel comfortable with the country risk. An active banker added that she believes avals are a dying product and that there is little market for them within the United States. Some interest remains in Latin America, but even there the aval market is drying up. Another banker stated that his bank had done many of these for shoes in the 1970s and would send the avalized drafts

6. ISP98 Rule 3.03(c) states: "If the issuer cannot determine from the face of the document received that it should be processed under a standby or cannot identify the standby to which it relates, presentation is deemed to have been made on the date of identification."

7. US OCC Final Rule Amendments to Part 7 – Bank Activities and Operations (§7.1016 and §7.1017), Federal Register, Vol. 73, No. 80; reprinted at 2009 Annual Review 343.

back in Italy. His bank used to book them as bankers' acceptances. The Italian banks would discount. They are now getting more requests to do this.

One panelist stated that failing to give proper notice of dishonor would be a problem. This is not an old-fashioned guarantee. In the US, it would be the same (no difference between a guarantee and an LC). Another panelist stated that it abolished the effect of the signature on the instrument. One delegate added that collections coming in from Turkey wanted avals. Another delegate cautioned banks to make sure their employees are trained and can recognize these words. He referenced a past situation involving orange juice from Argentina where it was discovered that the bank did not have recourse to the buyer.

The panel then briefly returned to the *Jaffe* and *2002 Irrevocable Trust* cases previously discussed during the Hot Topics panel. In these cases, the judges did not take into account **UCC Art. 5**. Per UCC Art. 5, only beneficiary fraud can excuse the issuer's LC obligation. The lender of the shipbuilder was the beneficiary. The lender did not commit fraud. In *Jaffe*, the court granted relief. In *2002 Irrevocable Trust*, the parties worked out the LC aspect and the case proceeded on substantive issues.

In *Lennar Homes, L.L.C. v. V Ventures, LLC* (Nov/Dec 2008 DCW 22), Lennar Homes had secured an option to purchase real estate by having a standby LC issued in favor of the seller. Lennar failed to close the purchase and V Ventures drew on the standby. Lennar claimed it was not in default because its performance was prevented by a governmental restriction. The US government had determined that the land had been a panther habitat so the purchaser of the real estate was required to acquire "1,100 panther migration units" (a permit) in order to develop the property. Lennar tried to enjoin the issuer from honoring the draw, **claiming LC fraud**. Whose responsibility was it to get the permit? The court decided it was a contract dispute and properly refused injunctive relief.

One banker asked the lawyers present if they believe that most cases where fraud is alleged are really contract disputes. One lawyer said yes; no others responded to the contrary.

In *Foster Poultry Farms, Inc. v. Suntrust Bank* (May 2009 DCW 11), Foster Poultry wished to purchase a chicken processing facility and the seller required that Foster issue four negotiable promissory notes backed by an LC. The LC was syndicated to ten separate financial institutions. Because the promissory notes were transferable, there was a **transfer clause in the LC** stating that the credit was transferable to any successor or assignee that became a holder of the notes. Although the buyer gave the notes to the seller, the buyer did not endorse the notes. The issuer did transfer the credit by re-issuing two separate replacement credits. The terms of the notes allowed them to be "monetized" (converted to cash).

In order to accomplish this, the buyer had to give permission according to the notes. The seller wanted to monetize the notes and use the funds for competition with the buyer. The buyer refused permission to monetize the notes, but the issuer got a legal opinion that stated that endorsement of the notes in blank and their delivery together with the letter of credit would satisfy the transfer clause in the original LC. The issuer, however, failed to re-issue the LCs so it became unclear who could draw on the credits. The buyer sued the issuer, stating that the issuer had a duty of disclosure based on their confidential relationship.

The panelist discussing the case asked what the issuer meant by the transfer clause. The issuer did not have a right

to use confidential information to its own ends in a different transaction. Besides the transfer clause, did the issuer check that the transferee was the new holder of the notes? Is it a non-documentary condition? How does the syndicated agreement come into play when the fronting agent is the one who is negligent? There are a host of warning lessons to banks contained in this case.

Issues in UCP600

This panel began by noting the **rise in exclusions of certain UCP600 articles** without replacing them, particularly portions of UCP600 Articles 14, 15, and 16.[8] Others mentioned UCP600 Articles 10(c)[9] and 10(f)[10] For at least one institution, the bank will not confirm LCs containing these exclusions without specific replacements. Such LCs are primarily coming from countries in Southeast Asia.

Panelists conducted an informal poll of delegate regarding the impact of exclusions. If you exclude an article, then is the opposite situation true? If you exclude an article, then does it means it is not there (leaves a hole)? Most all bankers present thought that exclusion leaves a hole. It was observed that lawyers present would not commit to an opinion. One lawyer did state that this requires an interpretation as to why the clause is being excluded, adding that "once you start trying to guess what the intent of the issuing bank is, you're in trouble."

If a bank excludes UCP600 Article 14(i), could you accept documents presented today and dated tomorrow?[11] Most bankers said yes. One stated that it depended on the content of the document. (For instance, he would certainly never accept an on-board notation dated tomorrow.) Another specialist added that it makes a difference whether it is a commercial LC or a standby LC when subject to UCP600. Under a standby, it does not really matter. For commercial credits, he understands why it would be cause for concern.

One delegate sought clarification regarding whether, when there is a beginning inland point, one could not use "Free on Board" terms but rather must use "Free Carrier" terms because the transport document would be a multimodal bill of lading. One panelist informed delegates that Incoterms are currently being revised and will be finished next year. They will be called Incoterms 3000 with an effective date of 1 January 2011.

The panel next discussed confusion over on board requirements on **transport documents**. There are multiple issues, but the main one relates to the requirement of the vessel name and port of loading with the on board notation on the bill of lading

8. UCP600 Article 14 is "Standard for Examination of Documents." UCP600 Article 15 is "Complying Presentation." UCP600 Article 16 is "Discrepant Documents, Waiver and Notice."

9. UCP600 Article 10(c) states: "The terms and conditions of the original credit (or a credit incorporating previously accepted amendments) will remain in force for the beneficiary until the beneficiary communicates its acceptance to the bank that advised such amendment. The beneficiary should give notification of acceptance or rejection of an amendment. If the beneficiary fails to give such notification, a presentation that complies with the credit and to any not yet accepted amendment will be deemed to be notification of acceptance by the beneficiary of such amendment. As of that moment, the credit will be amended."

10. UCP600 Article 10(f) states: "A provision in an amendment to the effect that the amendment shall enter into force unless rejected by the beneficiary within a certain time shall be disregarded."

11. UCP600 Article 14(i) states: "A document may be dated prior to the issuance date of the credit, but must not be dated later than its date of presentation."

when the place of receipt is different from the port of loading. Although wording changed slightly from UCP500 to UCP600, the requirement remained the same. One panelist believes that this misconception (of the vessel name and port of loading no longer being required) appears to have started in Vietnam and moved across the continent.

Participants were informed that the UCP600 Drafting Group is developing a matrix of transport articles and what is required for each to signify shipment. This will be issued as an educational document in early 2010. For the last 20 years, multimodal transport has been the global standard. When the multimodal article was moved in front of the bill of lading article in UCP600, this helped LC specialists appreciate this.

One panelist stated that if there is no pre-carriage (the multimodal transport is occurring at the end of the journey), then the on board notation must contain the vessel name. Another added that it depends on what type of document one has and whether the multimodal transport occurs at the beginning or end or both. If there is no inland transport at the beginning, then the transport document must have a normal on board notation.

Discussion turned to the terms and conditions of carriage and how these will not be examined. Carriers have started putting some of this language on the front at the top of the signature block. What do you need (or need not) examine? Where does this start and end?

Other transport-related comments regarded whether a bill of lading requires a merchandise description. Panelists indicated no. Does there need to be linkage between the bill of lading and other documents? Delegates were reminded that "linkage" had been addressed in a position paper relating to UCP500 which no longer applies under UCP600.

A delegate then mentioned a scenario regarding merchandise descriptions. On the LC, the merchandise description was given as "hot rolled steel rods". On the bill of lading, it was "hot rolled rods". Panelists agreed that this was not a conflict and therefore, not a discrepancy. Another delegate revised the scenario with the bill of lading showing a more specific description, but the panel still believed there would be no conflict.

One delegate stated that he would not accept a bill of lading without a merchandise description. Others replied that the absence of a merchandise description on a bill of lading is still acceptable under the UCP, although a carrier would likely not issue a bill of lading without a merchandise description.

It was mentioned that the delivery clause on bills of lading is making a "comeback". This cannot be dealt with in UCP because there is no definition in the UCP of a negotiable bill of lading, but is subject to a legal definition. Nonetheless, at least one banker said she is still seeing banks cite this as a discrepancy. The panel recommended that she should ask the bank to show her where in UCP it states that would be a discrepancy. The banker added that some banks are issuing LCs stating that bills of lading cannot show this clause, but this is problematic because the clause may be buried within the terms and conditions.

Regarding use of consolidated shipment clauses, it was pointed out that this is still not a discrepancy.[12] Is it an

12. It must be noted that this is addressed by the International Standard Banking Practices (ISBP) Paragraph 114: "If a bill of lading states that the goods in a container are covered by that bill of lading plus one or more other bills of lading, and the bill of lading states that all bills of lading must be surrendered, or words of similar effect, this means that all the bills of lading related to that container must be presented in order for the container to be released. Such a bill of lading is not acceptable unless all the bills of lading form part of the same presentation under the same credit."

unspoken assumption that when a bill of lading is required, that it must be a negotiable bill of lading? The ICC Banking Commission has said no. A panelist then added that the real definition of a negotiable bill of lading is determined by each country's laws which is why the UCP never dealt with it. The panelist agreed with the strategy of stating in the credit that it is not acceptable because this will gradually force carriers to remove the requirement that a bill of lading be negotiable. Others, however, observed that this could be part of the terms and conditions that banks are not supposed to read. It was mentioned that there have been cases in Singapore where a straight consigned bill of lading was still required for delivery. One delegate noted that the clause states that the carrier may deliver with an original, but the carrier may choose not to do so. If it does choose to do so, then it cannot be sued for misdelivery. The panel agreed.

Another delegate asked if a bank could cite UCP600 Article 14(d) and say that the document conflicts with itself because it is not really a negotiable document. Others responded that some banks are making the argument that regulatory matters are beyond their control so that the force majeure article applies. This is a misapplication of UCP600 Article 36. ■

(Part 2 of the 2009 Americas Annual Survey conference summary will appear in next month's DCW.*)*

2009 ANNUAL SURVEY OF LETTER OF CREDIT LAW & PRACTICE AMERICAS CONFERENCE SUMMARY (PART 2 OF 2)

By Lisa CHIN*
Edited by Christopher BYRNES**

ANNUAL SURVEY OF LC LAW & PRACTICE

(Part 1 of the 2009 Americas Annual Survey conference appeared in the May 2009 DCW *issue at page 18.)*

Impact of the Financial Crisis on LCs

To begin this panel discussion, Professor BYRNE reviewed the US case *Anchor Savings Bank, FSB v. United States* (summarized at Oct. 2008 DCW 13) because "it encapsulates what is happening now." In the 1980s, the US Federal Home Loan Bank Board responsible for certain **regulatory matters** asked Anchor Savings Bank to acquire four failing financial institutions. In return, Anchor was told it could include "supervisory good will" as a capital asset amortized over a 25-to-40 year period to count toward capital requirements. In 1989, the US Financial Institutions Reform, Recovery and Enforcement Act disallowed use of supervisory good will which caused Anchor to become severely undercapitalized. Anchor sued the United States in 1995 for breach of contract and other financial institutions with the same problem also sued.

In a 1996 decision[1], the US Supreme Court ruled that the United States had breached its contract with those financial institutions. Anchor claimed that the breach forced it to sell a subsidiary, the Residential Fund Corporation (RFC), for less than its proper value in 1990 to put toward its capital shortfall. The US argued that Anchor would have had to sell RFC anyway because RFC's operational structure required too much regulatory capital for Anchor (a thrift institution) to own since RFC used letter of credit-backed structures for credit enhancement. The judge determined that Anchor was in the process of transitioning from LCs as a credit enhancement to a senior/subordinate structure for its mortgage-backed securities and held the subordinate securities in its own portfolio. The court determined that RFC could have operated profitably. In 1995, Anchor was awarded over US$382 million in damages.

For BYRNE, this case illustrates that the financial system will never be sound until piecemeal regulation is abandoned in favor of treating products with a similar

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1. *United States v. Winstar Corp.*, 518 U.S. 839 (1996).

function in a similar fashion. This will help deter strategies to avoid or circumvent regulatory schemes.

Dan TAYLOR referenced a recent survey conducted by ICC in which 122 banks in 59 countries responded. The purpose of **"Rethinking Trade Finance 2009: An ICC Global Survey"** was to track letter of credit activity and the impact of the financial crisis. The forthcoming results generated no real surprises.

Among the Survey findings highlighted: 33% of responding banks experienced an increase in demand that they were unable to satisfy from 4Q07 to 4Q08; more than half (52%) experienced increased confirmation requests during the same period; 20% of issuers experienced increased pressure from applicants to refuse documents, usually prompted by "falling commodity prices"; some 40% experienced an increase in the number of spurious or questionable refusals; 30% experienced a jump in claims under standbys and guarantees; 12% experienced an increase in court injunctions; and 40% experienced a decrease in trade credit lines for corporates, while even more (51%) experienced a decrease in trade credit lines for financial institutions.

Overall, there are more stringent credit criteria and capital allocation restrictions. A number of banks are exiting the market. Trade finance has become a very important topic on the global stage and a major subject at G20 meetings. Concerned that Basel II requirements are now inhibiting trade, US federal regulators have elected to postpone its implementation until 1 April 2011.

Another panelist familiar with a new US Government trade agenda have sensed an era of "creeping protectionism". In his opinion, the Obama Administration wants a more rule-based trade agenda along with more social accountability in trade policy. The president also wants to use trade to achieve environmental policy and trade agreements must address frictions between countries. In recent years, this panelist says it has been a real challenge to promote US exports but his hope is that the Obama Administration's approach toward trade will translate into positive help for exports.

Delegates were curious if there is data to explain how the financial crisis has impacted **open account transactions**. One panelist responded that data is hard to come by for open account transactions because they are clean payments. They are not tracked well and not all banks handle open account transactions. One participant stated that logically, if credit lines are down on both LC issuances and confirmations, then the number of LCs will also decrease and the number of open account transactions will rise. Others noted this was logical, but not always true.

Reporting on SWIFT figures, Jim WILLS (SWIFT) stated that MT700 volume was flat from 2001 through 2007. Volume then declined 13% in 2008 and even further during the first two months of 2009. For guarantees and standbys, MT760 message volume in 2008 was up 3% in 2008 and increased further in 2009.

Other **recent LC usage trends** observed and expressed by Americas Annual Survey delegates:

- Small exporters do not want to use LCs as they are considered too expensive and cause payment delays.

- There has been a shift in Asia from open account to LCs for financing purposes.

- Instances of acceptances and discounting for applicants dropped considerably in 4th quarter 2008. In Korea, an applicant wanted 180-day financing, but could not obtain it. The exporter could not absorb the financing costs.

- A perceived reduction in

business from China. "No one wants to approve credit for anyone and when credit is approved, it is taking a very long time."

Trade finance has always been a risky business, noted one delegate, but now she has detected a tremendous spike in **operational risk**, especially from places never seen before. Sales and domestic correspondents are approaching LC specialists with more creative financing solutions. The question becomes: Is this a trade deal or a working capital deal? Banks must be very vigilant about operational risk.

Over the last 50 years, LCs have become increasingly more technical. One cannot find answers in UCP and ISBP for every possible situation, so that is why there are ICC opinions. Even then, bankers noted, they cannot always be sure of the answer. IIBLP intends to create an expedited LC whereby a standard invoice would be part of the LC. This would allow the LC to become a tool of payment. IIBLP is prepared to seek regulatory approval for it to be treated as a commercial LC.

Regarding **compliance matters** against the backdrop of financial crisis, panelist Nelson EVERHARDT offered some thoughts to the audience. Annual Survey delegates were cautioned that US regulators "will not let up" on Bank Secrecy Act (BSA) and Anti-Money Laundering (AML) regulations and expectations. This includes terrorist financing, fraud, scams, reporting of suspicious activity, and "Know Your Customer" (KYC) due diligence efforts. In dismal financial times, certain criminal elements may act if they think bankers are distracted by credit worries and other concerns.

There is a perception that trade is higher risk, but not all aspects of the business are high risk. EVERHARDT urged bankers their institutions need a system to measure risk. It is up to banks to conduct a risk assessment to determine what risks are high and low and put policies in place to address them in practice. He believes that there is insufficient understanding of trade finance by banks' sales forces. There needs to be adequate means to measure, identify, and mitigate the risks. EVERHARDT said that banks don't necessarily have to spend the most on compliance, but to demonstrate to regulators that they are doing the right thing.

One banker stated that he is starting to see higher fees being charged because bankers are "waking up" to compliance costs. He is also witnessing an increase in collateralization. One delegate from a small financial institution remarked that since her bank is not rated, her bank's confirmation fees have doubled or other banks are unwilling to confirm her LCs at all. Another banker replied that larger banks have had to start making tough decisions for whom to provide confirmations since lines are tighter.

No one can deny the high unit cost of regulatory compliance. According to EVERHARDT, BSA/AML matters are the single-most expensive area with which banks have to deal. Some Tier 1 banks have spent US$30-40 million for systems, but are still not in full compliance. Banks, however, cannot take the stance that they are not going to address problems and must appoint people within the bank to review the higher risk transactions.

Troublesome LC Practice Trends

Bankers are seeing more **bankruptcy clauses** in LCs. One bank lawyer maintained that this is problematic from both a bankruptcy standpoint and an LC standpoint. He typically turns down requests to add such clauses in credits, but it is often hard to convince a beneficiary that the clause is a bad idea. Clauses usually mean that if a payment is made from the applicant to the beneficiary in the 90 days prior to a bankruptcy filing, then the LC obligation is resurrected.

An LC payment is not considered preferential. If paid by the applicant, then the beneficiary can draw under the LC and essentially get paid twice. It is also a bad practice for banks since they cannot easily figure out when to take the obligation off their books. When do banks release collateral? Do banks continue to charge fees?

Lawyers referred to these as "clawback" clauses.[2] One solution is to utilize a direct–pay LC to pay down the obligation. The clawback clause would have the credit expiry go beyond the preference period. The issuer would put LC proceeds into an escrow account until the outcome of the bankruptcy proceeding. One clause might define bankruptcy as a force majeure event so that it would extend 30 days past the stated expiry date.

Bankers are understandably concerned if the beneficiary gets paid twice. One lawyer replied that the bankruptcy trustee would require that one of the payments will have to go back, but it will not necessarily be returned to the bank. Furthermore, the bank cannot get reimbursed by the applicant if the applicant is in bankruptcy.

On the trend of very **short time limits for standby payments**, one banker expressed hope that banks could ban together as a group and push back on requirements for same day payment. Some applicants have problems funding that quickly through no fault of their own. One senior banker recalled this from the 1970s when beneficiaries lined up in person at the bank to get paid. Now, this banker just says no to same day payment. Another banker added that same day payment clauses are most common in industrial revenue bond (IRB) payments. For this bank, is a significant challenge because they have 600 IRB payments per month happening at the same time. They try to "push back" if the LC is anything but an IRB.

One bank accepts fax demands because those terms are contained within the LC. This is especially true when the beneficiary wants presentation in a location where the bank is no longer present. Another banker added that he can cope with regular, expected drawings, but has had a problem with "surprise drawings". Bankers recommended being very specific on the place and time of presentation. If presented after that time, the draw will be considered as being presented on the next business day.

Are banks receiving requests to put **credit rating language in LCs** where the issuer would notify the beneficiary if the issuer's rating drops? In addition, are banks seeing language where the issuer has to notify the beneficiary if the issuer is cited for an "apparent" violation of a government regulation? Such requests for what one banker termed "impossible conditions" represent a troublesome trend. Bankers expressed that they would decline to incorporate this language in credits. On IRBs, one banker indicated he sees language stating that if the rating drops, the beneficiary can draw or the applicant must replace it with a bank with a better rating. One lawyer added that credit default swap spreads information belongs not in the credit, but in the underlying agreement under negative events for the issuer. If the spread widens, it is considered a problem but the key here is that it should be kept out of the credit.

Discussed shifted to use of a relationship management application (RMA) where one can make a conscious decision to accept or reject specific transactions. It can be used as a risk management tool. There is a corporate concern about

2. According to itlaw.wikia.com, "a clawback clause is a contract provision that requires a party who has received a benefit to return that benefit due to specially arising conditions."

managing open account risk today. The SWIFT Trade Services Utility (TSU) is a new effort to match up information between buyer and seller.

On the issue of **fluctuation clauses in oil LCs**, many bankers are struggling with means of managing them. Banks need a cap, but customers would prefer not to have one. An attendee stated that his bank absolutely puts a visible cap on its LCs, otherwise it would not issue such a credit. The bank does a mark to market and adds 20%, then tracks it internally. Who will monitor such credits? This is a contested issue within many banks.

Another consideration: If a bank is asked to confirm an LC which does not contain a cap, should the bank put a cap on its confirmation? One banker replied that this is absolutely essential since the confirming bank must book its maximum obligation.

Asked one delegate: Could oil credits be treated similar to foreign exchange letters of credit? The issuer could add a percentage and if the amount gets close to the maximum amount booked, then the issuer could require additional collateral per the reimbursement agreement. For most bankers, the question of who is responsible for monitoring such credits remains. Bankers are convinced they need to keep the monitoring process as simple as possible for trade operations staff.

On the topic of **applicant indemnities**, when do banks use them? One lawyer suggested establishing tight timeframes for bank action, for example. How enforceable are indemnities if the letter of credit is poorly drafted? As these indemnities are enforceable and can shift risk to the applicant, another lawyer said that this should be done as an addendum to the existing agreement.

Some bankers noted they try to avoid use of indemnities. When an indemnity is needed, then one banker indicated preference for the indemnity in the reimbursement agreement so the bank is only dealing with the one document. She agrees with the approach for an addendum to the reimbursement agreement. Another banker disagreed, stating that he prefers to do the indemnity separately in order to show the applicant how important it is and how bad the credit is.

Has there been "brain drain" within the LC industry as experienced personnel retire or are laid off? One specialist believes that banks have unwisely gone too much for functional processing where employees are responsible for narrow areas and specific tasks. When a financial crunch arrives, banks are not able to cope well with the conditions. Veteran bankers recall they did a bit of everything in the past and that is how they learned. This knowledge, they fear, is not being transitioned and they need to find a way to cultivate the learning.

One banker reported seeing strange **expiration date clauses** from state governments in the US. If the transaction goes to litigation and the court decides that the LC was poorly drafted, but the issuing bank has recourse to the applicant, will the risk go back to the applicant? A lawyer reminded delegates that an ambiguous LC will be construed against the issuer. Another lawyer added this problem dates back to the 1980s when bond counsels started drafting financial letters of credit. Such lawyers were great bond counsels, but they were not adequately knowledgeable of LCs. For the same reason, the standard syndicated credit agreement is usually poor due to bond counsel drafting. For many bankers within the audience, these matters demonstrate the value of skilled letter of credit lawyers. Some LC lawyers have worked together and attempted to contact "power beneficiaries" in order to explain to them why certain formats are problematic.

The LC Year in Review

Leo CULLEN (Coastline Solutions) first introduced delegates to **Coastline Solutions**' newest advanced online training programs. ISP Master, written by Professor BYRNE in conjunction with ICC Banking Commission Technical Adviser Gary COLLYER, consists of over 12 hours of online instruction and training on ISP98. Since its release, ISP Master has generated considerable interest within the US as well as from other countries. Its practical training format includes case studies and qualifies Certified Documentary Credit Specialists (CDCS) users for 12 Professional Development Units (PDU). Written by COLLYER, DC Master is advanced training on documentary credit practice with particular focus on areas that are misunderstood or misapplied, as evidenced by ICC Opinions and DOCDEX decisions. This training also earns 12 PDUs for CDCS recertification. These two latest offerings further bolster Coastline Solutions' suite of online training programmes aimed at beginners as well as experienced specialists who need continued education. Coastline Solutions also has a free monthly newsletter which interested parties can sign up for at its website, www.coastlinesolutions.com

Dan TAYLOR (International Financial Services Association) updated the audience on the Certified Documentary Credit Specialist (**CDCS**) program. Currently there are 6,000 CDCS holders around the world, the vast majority of which are based in China. The IFSA and the ifs School of Finance (England) which jointly developed and maintain the CDCS program retain about 65% of the specialists who pass the exam. At the time of the Americas Annual Survey, 2,601 individuals were registered to take the exam around the world in April 2009. It is the largest number ever registered in one year for the annual exam. For 2010, there will be a minor revision to the test to accommodate the new Uniform Rules for Bank-to-Bank Reimbursements under Documentary Credits (URR 725) which was revised in October 2008.

Jim WILLS (SWIFT) recognized the IFSA for its help in the **SWIFT** standards change as well as IIBLP for its assistance. SWIFT does two million cover payments (open account) each day, prompting WILLS to mention that if bankers find it hard getting someone to pay attention to trade, they should reference this figure. Previously, there were unknown parties that were not available to the intermediary bank. However, now there will be transparency. There will be a new MT798 message for corporates. SWIFT is seeking feedback on corporate-to-bank trade messaging. There was a new (second) TSU release in March 2009. The TSU is designed for open account transactions. Banks are members of the TSU and submit information on behalf of their corporates with SWIFT acting as a matching engine. Banks would add this to their product offerings. They have 83 banks in the TSU.

One delegate stated that transparency can be a real problem for regulators as there can be a disguise of the downstream bank. All information may need to start traveling with the other data. WILLS added that the upcoming SWIFT standard change of November 2009 is mandatory; banks must adopt it.

Buddy BAKER explained there was not a great deal new to report regarding the **Basel II** capital adequacy requirements. Basel I had been a very easy computation and Basel II takes a much more sophisticated approach. Banks are expected to use their own internal risk ratings and conduct a statistical analysis of their potential loss. The question of Basel II's impact on LCs is still unanswered and probably will change soon. Costs relating to exposure to

non-US banks will become much higher. Instead of a 20% weighting, it will probably be like a corporate risk. Banks' confirmation fees, however, will be increased as well. At present, there is a great deal of concern at the US Fed whether banks are adequately capitalized and it is not really focused on Basel II. Many European banks have already converted to Basel II in 2008. Within the US, 11 banks currently meet the criteria for mandatory adoption. Others are allowed to move to Basel II on an elective basis. A bank would really only do so if its capital requirement would be less under Basel II than under Basel I. The Bank for International Settlements is already looking at refining Basel II or deciding if there should even be a Basel III. Basel II is heavy on statistical analysis with a 10-year window, but it does not take into account the present financial climate.

Don SMITH reported on the status of the **URDG** redrafting effort. As of March 2009, a new draft to consulting group was due within a few weeks and would then be sent to ICC national committees. SMITH also informed delegates that the ICC Banking Commission is working with International Forfeiting Commission in writing rules for **forfeiting**. They anticipate that it will take 2-3 years to finish such rules. One can find three documents on the IFSA website under committee information for this project.

LC Compliance

Panelists began by suggesting that banks are sometimes confused over what they are required to do under US Anti-Boycott, OFAC, and BSA/AML **compliance requirements**. What can banks handle, what must banks refuse, and what must banks report?

One panelist warned that even if the US Office of Foreign Assets Control (OFAC) permits a bank to return documents and the presenter subsequently deletes the offending information, the bank still cannot pay. It would be a violation since the bank already aware that a prohibited entity was there originally.

Another panelist pointed out that the IFSA has published a best practices model to determine who is an "account relationship" where one has to conduct due diligence. There are requirements to report suspicious activity, but one does not necessarily have to refuse a transaction.

Within banks, it is vital that departments communicate with each other. At one bank, regulators asked during its audit how many Suspicious Activity Reports (SAR) the bank had filed last year. Another area of the bank does the filing, but the Risk Group did not follow up on the status of the filing. Now, the Risk Group monitors filings and reconciles them on a monthly basis.

Delegates were cautioned that changes to OFAC regulations take effect at 12:01am before banks commerce work. Because of this gap, manual checks are needed. One banker mentioned his institution's process of sending out e-mails announcing regulatory updates and requiring manual checking until such time as it can confirmed to staff that the system has been updated.

Other panelists added that banks' due diligence practices for trade should be consistent with what is done regarding wire transfers. Also, banks were reminded that they are responsible for checking all documents for compliance, including collections.

One panelist expressed his opinion that banks should not use **sanction clauses** in letters of credit. If bank must use one, it should keep the clause simple and informative. Others agreed that many within the letter of credit community prefer not to use sanction clauses, however, LC specialists receive "pushback" from others and are compelled to insert sanction clauses. In

certain countries outside the US, sanction clauses do give banks protection which is some US banks have started including them. In some instances, it takes a long time to get the necessary license to pay. In some venues, that is illegal. Banks need to research in which countries these can be used since they are prohibited in some venues. This is why some of the clauses are so complex.

For US banks, there are a host of matters to consider. While a bank which follows US regulations would expect US courts to protect it, a non-US courts may not. If a US bank needs to refuse, is it even allowed to issue its notice of refusal? Is it allowed to hold the documents at the presenter's disposal? If not, would it be precluded? Most sanction clauses do not address all these matters..

Another delegate expressed amazement that most sanction clauses do not deal with court injunctions since there is a much greater chance of experiencing them as opposed to sanctions. This is partly because most LCs do not contain choice of law and choice of forum provisions. Although one can understand why issuers cannot always include a choice of forum, choice of law should be added. Beyond inserting its choice of law into the credit (especially for commercial LCs), what more can an issuer do? Delegates were referred to a letter written by James BARNES to the IFSA regarding mention in LC text of sanctions as a defense against honor.[3] Others added that inserting a choice of law can create problems and might not always be possible due to confirmation or with back-to-back LCs.

For one delegate, there is no substitute for knowing the relevant laws and rules of the jurisdictions in which one does business. For this reason, having a standard clause is a bad idea because it will get skewed and become incomprehensible. Others added that once you have included sanctions language in a credit and subsequently agree to a request to remove it, there is no way of knowing what the deletion implies. As a result, such deletion can be dangerous.

Discussion turned to preclusion clauses in LCs. When one reads an **OFAC** license, the entire license must be read. The license may allow the sale of goods or services, but not allow a US bank to participate in any way. A question-and-answer contained on the OFAC website clarifies that a US bank can be a second advising bank under certain conditions.[4] There needs to be an intermediary bank.

Others emphasized to delegates that US regulators will not let up in this area and OFAC sanctions are going to become even more stringent. The regulators will "dig even deeper" and are carefully scrutinizing SARs. Bankers were advised of the importance of updating their compliance systems immediately. Reporting suspicious activity is the heart of the BSA. Regulators have emphasized that banks should not file an SAR unless it is serious and is truly suspicious behavior. In instances where a third SAR is filed against a customer, banks have stopped business and closed the account so that regulators can check. Further, the wording in SARs needs to be reviewed and banks need to have a centralized area to handle SARs. Also, there will be more "1602" requests.[5] When

3. This letter is reprinted in the 2009 ANNUAL REVIEW OF INTERNATIONAL BANKING LAW & PRACTICE at page 374.

4. See: http://treas.gov/offices/enforcement/ofac/faq/answer.shtml#117 .

5. "1602" refers to Part 1602 (40 CFR 1602) of the US Code of Federal Regulations entitled "Protection of Privacy and Access to Individual Records under the Privacy Act of 1974".

examining a bank, US regulators will be evaluating its risk assessment. If one is not adequately in place, regulators will establish one for the bank and no bank wants to be in this position.

Regarding the pricing of goods, what do regulators expect of banks? It is expected that banks just have to demonstrate that bankers are using their best effort. Bank associates do not need to be pricing experts, but need to know that there are possibilities for under- or over-pricing and how it may lead to money laundering.

Major Commercial LC Cases

Panelist moderator Jim BARNES (Baker & McKenzie) began by pointing out that after revised US Revised UCC Article 5[6] went into effect, the number of US court cases involving letters of credit has dropped. In recent years, the number has been flat. As some cases are settled, others are never reported, and because there is a time lag for reporting of cases, one cannot tell whether there has been more litigation in the last six months. It does appear, however, that fraud injunction actions have increased. The panel then discussed specific recent cases of importance to the US letter of credit community.

In *Lenox Hill Hospital v. American International Group, Inc.* (abstracted at 2009 ANNUAL REVIEW 474), Lenox had obtained a standby LC in favor of Lexington Insurance Company (a subsidiary of American International Group, Inc.) to partially back a malpractice policy issued by Lexington. Lexington issued a loss statement in April 2008 which reported a large increase in claims related to prior policies. Lenox claimed that the loss report numbers were "fabricated" and cancelled the insurance policy. Lenox also sued and sought a preliminary injunction against drawing under the credit, claiming that Lexington was using the false number in order to prepare a draw under the LC because its parent, AIG, was in "dire financial straits." One panelist noted the dispute involved a typical fight regarding whether or not the LC should be enjoined. In this case, the court properly determined there was no LC fraud and therefore should be no injunction.

In *Summit Resource Group, Inc. v. JLM Chemicals, Inc.* (abstracted at 2009 ANNUAL REVIEW 506), Summit had a commercial standby LC issued in favor of JLM backing its payment obligation to purchase three orders of glycine. Some time later, Summit requested that the three purchase orders be cancelled. Because the first order had already shipped, Summit paid for that order. JLM informed Summit by e-mail that the other two orders were cancelled. After that, JLM changed its mind, stating that its suppliers were pressuring JLM to take the orders, so JLM would not consider the remaining two orders as cancelled. Summit, fearing that JLM would draw on the standby for the remaining orders, sought injunctive relief and obtained a temporary restraining order in state court. JLM got this action moved from the state court to the federal court, but the federal trial court issued a preliminary injunction to prevent JLM from drawing on the standby. Panelists stated that this was just a typical breach of contract dispute. There was no mention whatsoever of US Rev. UCC Art. 5 and the court ignored Rev. UCC 5-109.[7] For one

6. Professor Byrne has written a 600-page treatise on US Revised UCC Article 5. As part of a 12-volume Uniform Commercial Code Series published by West Publishing, the Article 5 (Letters of Credit) volume is available from IIBLP.

7. US Revised UCC 5-109 (Fraud and Forgery) states the requirements the applicant has to meet in order for a court to grant an injunction.

attorney on the panel, the case is his candidate for "worst letter of credit case of the year".

Panelists then offered views about what to do when an applicant alleges that fraud has occurred or claims there is an impending fraudulent drawing. What should bankers tell their in-house attorney? There must be coordination between bankers, attorneys, and operations. Banks should remember they have flexibility in hurrying or not hurrying payment. Banks should refrain from advising the applicant on what they should do.

Some bankers added that they strongly recommended that banks do not say "enjoin" to the applicant. Banks need to state that if the documents comply, they will pay. One lawyer asked bankers if they would notify the applicant that a drawing was made if requested to do so. One banker said it would depend on the situation, but that she would first talk to internal counsel.

One bank lawyer stated that he would view this as an attempt to pull the bank into the underlying transaction and recommended that banks resist this as much as possible. Banks should not want to tell the applicant that they will notify it. Such notification mitigates the independence of the LC and signals to the applicant that it is on "borrowed time". As to whether a bank should direct an applicant to US Rev. UCC 5-109, lawyers said a bank can send them to applicable law but do not want it to be construed as giving legal advice. Based on the current financial climate, one lawyer stated he expects to see more cases in the future.

One delegate described a situation in which the applicant requests that the bank delay notifying the beneficiary of the discrepancies in order to give the applicant time to get an injunction. How can the bank act? One panelist replied that the bank needs to act the way it always does. For a bank, this is difficult as it will not be able to look at the documents the same way if it is notified in this manner. The panelist added that banks do have flexibility in terms of time as long as they do not go beyond the rules, however banks do not want to get into trouble by delaying the notice. A bank can examine differently, but you should not delay.

Discussion followed regarding protected parties as described in UCC 5-109(b)(2).[8] One would think that the issuing bank would notify the court that another bank is a protected party. An issuing bank knows it has nominated another bank, but the issuing bank does not know if the other bank has undertaken its nomination. Another panelist added that the nominated bank has to show that not only did it act, but that it did so without the knowledge of the fraud. The issuing bank would not be in a position to know that. The beneficiary is usually not in court because it is out of the jurisdiction. What happens if the beneficiary is involved?

In *Guetzko v. KeyBank Nat'l Assoc.* (summarized at 2009 ANNUAL REVIEW 435), the applicant obtained a standby LC in favor of Tri-County Metropolitan Transportation District of Oregon (buyer) to assure delivery of railcars. The reimbursement obligation was apparently guaranteed by shareholders of the applicant (among others, Mark and Lisa Guetzko). When the beneficiary drew on the LC, guarantors obtained a temporary restraining order and temporary injunction in state court against payment by the issuer. The action was removed from state court to US federal court. The beneficiary claimed that it was the real party in interest (as opposed to the issuer) and was entitled to intervene. The guarantors argued that the

8. The protected parties named in US Rev. UCC 5-109(b)(2) are the "beneficiary, issuer, or nominated person who may be adversely affected".

beneficiary failed to oppose the state action, so its intervention in the federal action was untimely. The Judge rejected this argument and noted that the beneficiary had an interest in the injunction as it would be adversely affected. A case like this prompts questions: Who needs to be served? Who is considered a real party to the case?

The panel also briefed delegates of the Singapore case, *DBS Bank Ltd. v. Carrier Singapore (Pte) Ltd*. This decision is abstracted in this *DCW* issue at page 10.

The next case discussed was *Sadacharamani a/l Govindasamy v. G. Narayanan a/l Gopala Panniker* (summarized at May 2009 DCW 16). Mr. Govindasamy needed a letter of credit but did not have the credit facilities to have one issued. He retained a broker, Mr. Panniker, to find an entity that would be willing to lend its credit facilities. Panniker found one and charged a fee of US$95,000. When this fee was not paid, Panniker sued. The court found in favor of Panniker. Govindasamy sought an injunction to stay the collection of the judgment when Panniker tried to place him into bankruptcy. Govindasamy claimed fraud because, according to his investigation, the letter of credit never existed. The judge was not convinced that the investigation evidenced fraud

and noted the timing of the claim. The court concluded that Govindasamy was trying to avoid the bankruptcy "through the back door and this amount[ed] to abusing the process of [the] court."

In *Uniloy Milacron Inc, v. PNC Bank, N.A.* (abstracted at 2009 ANNUAL REVIEW 511), buyer, MAB, LLC, had a standby LC by PNC Bank in favor of Uniloy, the seller, for the purchase of two plastic bottling machines. The LC required a dated original certificate that Uniloy had not received payment from MAB within 60 days of shipment, copies of unpaid invoices, and copies of bills of lading indicating the shipment date. Uniloy presented documents on the expiry date. On the same day, PNC refused the documents due to the following discrepancies: the certificate was not dated; the serial number shown on one invoice did not match the serial number on the LC; and the merchandise description on the bills of lading did not match the credit description. On the notice, PNC stated that they were in the process of contacting the applicant for waiver, but never did so. MAB was prepared to waive the discrepancies, but PNC refused. When Uniloy re-presented the documents, PNC refused them due to an expired credit. Uniloy then sued PNC. PNC argued that the documents were not in strict compliance, but the court did not believe that the discrepancies were material when the presentation was viewed as a whole and cited a similar decision in the 2000 US case, *Voest-Alpine Trading USA Corp. v. Bank of China*[9]. The court entered partial summary judgment in favor of Uniloy. PNC sought reconsideration because, throughout the trial, both PNC and Uniloy had stated that the credit was subject to UCP500, when in fact, it had been subject to ISP98. The court denied the motion.

As to the undated certification, most bankers would regard this as a discrepancy. One panelist said that lawyers tend to think otherwise, even if it is an express requirement under the credit. Regarding discovery that credit was subject to ISP rather than UCP, the Judge decided the results would have been the same. Panelists suggested the judge may have been annoyed at the bank for this. One lawyer on the panel finds an important lesson regarding the issuer's notice that it was contacting the applicant for waiver, but failure to do so. If this is standard language in a bank's form, then the bank needs to take it out. Another panelist recommended that the internal legal counsel in banks should always consult with trade operations in answering LC questions or preparing defenses.

Turning to the topic of statute of limitations, one panelist said that there is a one year limit in US Rev. UCC Art. 5 for a reason.[10] If one has not been reimbursed, one needs to act before the one-year period elapses. This comment led to a discussion of *Alhadeff v. Meridian on Bainbridge Island, LLC* (abstracted at Feb 2009 DCW 11). Meridian was the developer of condominiums and needed financing. Kitsap Community Federal Credit Union agreed to provide a construction loan if Meridian provided a US$1 million LC in its favor. Meridian arranged for N. Jack Alhadeff to serve as applicant and obtain the LC. Over the next year, the Credit Union provided additional financing and drew the entire

9. Abstracted at 2001 ANNUAL SURVEY OF LETTER OF CREDIT LAW & PRACTICE 273, full text at 390.

10. US Rev. UCC 5-115 (Statute of Limitations) states: "An action to enforce a right or obligation arising under this article must be commenced within one year after the expiration date of the relevant letter of credit or one year after the [claim for relief] [cause of action] accrues, whichever occurs later. A [claim for relief] [cause of action] accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach."

amount of the LC. The Credit Union declared Meridian to be in default on its loan and Meridian defaulted on its agreement with Alhadeff. The Credit Union was the first mortgagee, making it likely that Alhadeff's mortgage would yield nothing. Alhadeff sued the Credit Union for breach of contract, tort, and equitable claims. The Credit Union argued that the claim was barred because it had been filed more than one year after the transaction. The appellate court determined that Alhadeff's claims did not all arise under Rev. UCC Art. 5. One panelist pointed out that this case gives an interpretation of Rev. UCC 5-115. There is some ambiguity regarding how one can interpret it. The panelist explained that the reimbursement agreement is not necessarily subject to the statute of limitations. The IIBLP's written analysis of the case comments on what the appellate court describes as a "four party letter of credit transaction". The comment states: "Hopefully, this new diagnostic tool will not encourage courts to sketch out the relationships between all the parties to the various underlying transactions and the parties to the LCs, such as carriers, inspectors, freight forwarders, etc. If so, we will soon be visited with a 10 party LC. Oh well, the more the merrier."

Panelists next commented on some worrisome aspects of *Capital Investments-USA, Inc. v. KeyBank N.A.* (summarized at Jan 2009 DCW 11), Capital was interested in obtaining a US$41.6 million line of credit to provide LCs to fund commodity purchases. To this end, Capital entered into communications with KeyBank, which included e-mails, commitment letters, and other documents. Ultimately, KeyBank refused to extend the line of credit and issue the LCs. Capital sued KeyBank for breach of contract and negligent misrepresentation. KeyBank argued that it had signed no writing as required by a US state statute (Colorado Credit Agreement Statue of Frauds), which applies to all credit agreements with a principal balance greater than US$25,000. Capital argued that the various communications satisfied the requirement. The court dismissed this, stating that the statute required that the writing actually establish a credit agreement and prohibited implying one. One panelist stated that this case was a breach of contract to issue a letter of credit. It demonstrates that it is dangerous for a bank's sales employees to make certain statements promoting their products.

The panel then discussed *Impex Int'l Corp. v. HSBC Bank USA, N.A.* (abstracted at 2009 ANNUAL REVIEW 446). Impex, as buyer, had HSBC issue a commercial LC subject to UCP500 to pay for textiles to be "on rolls. Each roll to contain 500 yards. Total quantity: 80,000 yards". Three presentations were made to HSBC. On each presentation, in addition to the goods being "on rolls", it was also described as packaged in "bales". On the third presentation only, the documents showed the quantity of goods as exceeding the amount in the LC by 5%. HSBC honored all three presentations. Impex sued HSBC for wrongful honor, claiming that mention of "bales" was inconsistent with "rolls". The court disagreed.

With regard to the 5% excess, the court applied UCP500 Article 39(b) and stated that the quantity exceeded the tolerance permitted.[11] For the first two

11. UCP500 Article 39(b) states: "Unless a Credit stipulates that the quantity of goods must not be exceeded or reduced, a tolerance of 5% more or 5% less will be permissible, always provided that the amount of the drawings does not exceed the amount of the Credit. This tolerance does not apply when the Credit stipulates the quantity in terms of a stated number of packing units or individual items."

presentations, the court found in favor of HSBC, but for the third presentation, found in favor of Impex. One panelist pointed out that what constitutes wrongful dishonor is governed at least in part by the agreement between the issuer and the applicant. One has the ability to put in a reimbursement agreement that you can have a substantial compliance standard. It is interesting that courts are imposing a 100% forfeiture rule, instead of just the difference for damages. According to the statute, it should only be for the extent to which there is breach. Another panelist added that it is also to the extent to which the applicant or the beneficiary has been damaged unless there is a wrongful dishonor, in which case it is 100% of the draw amount. This prompted one banker to ask whether it would be better for a bank to be sued for wrongful honor rather than wrongful dishonor since the damages are different. One panelist replied that a bank should have language in its reimbursement agreement which makes it very difficult for the applicant to mitigate the damages. Do the same principles apply if one is the negotiating bank because it does not have a direct link back to the applicant (only the issuing bank has a direct link back to the applicant)? One panelist replied the same principles do not apply as much; it could also be subject to a different law.

In *Labarge Pipe & Steel Co. v. First Bank* (abstracted at Mar 2009 DCW 11), PVF USA, LLC, the buyer, had a standby LC issued by First Bank in favor of Labarge, the seller, to back payment for its purchase of steel pipe. The credit was subject to UCP400. When issued, First Bank faxed the LC to Labarge with a cover letter stating, "Here is the letter of credit you requested." When Labarge requested an amendment, First Bank faxed the amended credit to Labarge with a cover letter stating, "Here is the revision to the letter of credit you requested." The faxed credit had the handwritten signatures of First Bank's employees.

The LC required presentation of the original letter of credit with any drawing. Labarge relied on the issuance and shipped the pipe. PVF failed pay for the pipe and subsequently filed for bankruptcy. Labarge attempted to locate the original credit and failed. Labarge drew on the LC, presenting the fax and an affidavit stating that the "original letter of credit" was lost or destroyed and indemnified First Bank against

a loss if the original was presented. First Bank refused the documents the same day but failed to state if it was holding the documents at Labarge's disposal or returning them. Three days later, First Bank informed Labarge by phone that it was dishonoring due to the lack of the original credit in the presentation. Labarge sued First Bank for wrongful dishonor, breach of the letter of credit, detrimental reliance, and breach of its good faith obligation. The court agreed with First Bank that the original letter of credit was required, but also determined that First Bank did not provide a proper notice of refusal. One lawyer stated he would be careful of deliberately stalling a notice of refusal. Another panelist stated that this case puts to rest a previous terrible decision, *Philadelphia Gear Corporation v. Central Bank* (1983) [USA], which confused preclusion with estoppel.[12]

One delegate posed the following variation: Supposed the original letter of credit is not required for presentation. When the credit is being cancelled and the beneficiary cannot find the original, is it ok just to take the letter of the beneficiary to agree to cancellation? One panelist replied that there is no special significance to the original unless it is required for transfer or presentment. If it is lost, but not required for presentation, one can get an affidavit from the beneficiary. Another panelist added that it does not matter if the credit is subject to ISP98 or UCP. One banker asserted that it is a real risk to just take a letter as the beneficiary does not want to provide the bank with an indemnity. Another banker recommended to fellow bankers that they should require an indemnity, but county governments are likely unwilling to do so. A bank will want someone to at least cover court costs, especially for an evergreen. One lawyer suggested that banks put in their credit a particular format in the form of an appendix that would be used for cancellation.

In *Joseph Stephens & Company, Inc. v. Cikanek* (summarized at 2009 ANNUAL REVIEW 455), Cikanek was a creditor to Joseph Stephens & Company, Inc. (JSC). Cikanek was awarded a judgment from JSC in arbitration, but JSC failed to pay. Cikanek attempted to seize funds in a JSC bank account. The bank refused, stating that because of an Assignment and Security Agreement, the account funds were collateral for a standby LC covering a lease for JSC's New York office. This agreement allowed the bank to set-off any losses against the account in the event of JSC's default. Cikanek rejected this argument, contending that the right to exercise set-off was "immature" and that the bank had waived this right by failing to assert it to Cikanek when the account was disclosed to him. The court found that because of US UCC Article 9, the bank had automatically perfected its security interest simply by maintaining the account. New York law provides that "a security interest perfected prior to entry of judgment trumps the rights of an unsecured judgment creditor".

12. In this case, the issuing bank did not give a proper advice of refusal when it dishonored drafts. Because of this, the court ruled that "Central Bank was estopped to raise the documents' deficiencies as a defense, the requirement of strict compliance with the terms of letters of credit notwithstanding … . Estoppel was proper because Central's failure either to return the drafts' supporting documentation or to give notice that it was being held at [beneficiary's] disposal violated article 8(f) of I.C.C. Pub. 290, thwarting any attempt to cure the drafts' defects." In reality, because the advice of refusal was insufficient, Central Bank was precluded from claiming that the documents were not in compliance. Interestingly, the court also stated, "It would be a strange rule indeed under which a party could tender drafts containing defects of which it knew and yet attain recovery on the ground it was not advised of them." Strange it may be, but welcome to the world of letters of credit!

Under this law, a depository bank's security interest trumps any other security interest in a deposit account, unless the bank specifically agrees to recognize the other interest.

Open Forum

The Americas Annual Survey concluded with the opportunity for delegates to pose questions to the entire group of panelists.

One participant asked if a **bank fails under bankruptcy**, is the beneficiary considered a general creditor. One panelist stated that one situation is where the bank's portfolio is given to another bank. But, the US Federal Deposit Insurance Corporation (FDIC) could take over the bank altogether. During the savings and loan crisis, another panelist stated that the FDIC did repudiate some LCs.

One banker who previously worked at a bank which failed had heard that the US Fed repudiated all the letters of credit even though 80% were cash-collateralized. When the bank was taken over by another institution, it did not get the portfolio back. Another added that the same situation happened with Hamilton Bank.

Another delegate familiar with these issues explained that if there is a Purchase and Assumption agreement, then the portfolio would move to the acquiring bank. The beneficiary can claim against a receivership estate. A panelist added that the beneficiary winds up a general creditor. Another panelist referenced *FDIC v. Philadelphia Gear Corp.* (1986) [USA] as when the FDIC rules changed.

One lawyer noted that the FDIC has issued some guidelines in this area.[13] It depends on whether or not the letter of credit has been drawn upon. Another lawyer stated that it is no claim rather than a claim for 10 cents on the dollar. The guarantee is a deposit guarantee.

One participant then asked **when an agreement to negotiate actually commences**. One panelist replied that it occurs when the bank agrees to act. A banker stated that there is a beneficiary expectation on the timing. Her bank is taking a much harder look now at this and the agreement. One panelist suggested having a qualified agreement to negotiate with checkboxes. One lawyer viewed this as a silent confirmation with options. One must distinguish between an agreement to advance funds and an agreement to negotiate. Then, one actually has to agree to negotiate. The banker said that the timing is different between an agreement to purchase and a silent confirmation.

Is it considered negotiating if one advances before the drawer bank accepts? One lawyer responded that an agreement to do so is different from actually doing it.

Another participant asked how long a bank should retain **records for evergreen credits**. The consensus answer was that such records must be maintained forever. Expanding on this topic, another delegate asked about the issuing bank's responsibility if the notice of non-extension comes back undeliverable. One banker commented that her bank uses different methods to try to find a beneficiary's new address and keeps the records of these attempts. Another banker suggested that an issuer put language into the credit stating that a beneficiary has a duty to notify the issuer if the beneficiary's address changes. Also, if a bank can demonstrate that it has made a good faith effort to notify the beneficiary and keeps those records forever then that should help convince a judge, if needed. Another participant suggested seeking the applicant's help in trying to locate the beneficiary. ■

13. "Statement of Policy Regarding Treatment of Collateralized Letters of Credit after Appointment of the Federal Deposit Insurance Corporation as Conservator or Receiver", reprinted at 2009 ANNUAL REVIEW 335.