

# Standby Letter of Credit & Bank Guarantee Recent Cases

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# SBLC Cases for Discussion

- Marquette Transportation Finance, LLC v. Soleil Chartered Bank, 2020 WL 122975 (S.D.N.Y.) (wrongful dishonor)
- Tecnicas Reunidas Saudia for Services and Contracting Co., Ltd. v. Korea Development Bank, Queen's Bench – Technology and Construction Court, 2020 EWHC 968 (TCC) (conditions on bank guarantee)
- Lexon Insurance Co. v. FDIC 2020 WL 972708 (E.D.La.) (FDIC repudiation of undrawn LC)
- Granite Re v. NCUA, 956 F.3d 1041 (8th Cir. 2020) (NCUA repudiation of undrawn LC)
- DB NPI Century City, LLC v. Legendary Investors Group No. 1, LLC, 2019 WL 2082039 (Cal.App.) (Payment in full draw on LC)
- ADA-ES, Inc. v. Big Rivers Electric Corp., 2020 WL 3065532 (W.D.Ky.) (Remedy sought for overdraft)
- JR Food Stores, Inc. v. Hartland Constr. Group, LLC & Peoples Bank, 2020 WL 1442889 (W.D. Ky.) (Issuer arbitration)
- Solferini as Trustee of Corradi S.P.A. v. Corradi USA, Inc., 2020 WL 1511315 (W.D. Tx) (Source of payment – issuer or applicant)
- EFLO Energy v. Devon Energy Corporation, 2020 WL 4925741 (W.D.Okla.) (draw in violation of extend or pay period)
- GP3 v. Bank of the West, 2020 WL 3317613 (W.D.Mo.) (UCC 5-109 fraud case)
- Backal Hospitality Group LLC v. 627 West 42nd Retail LLC (N.Y. County Sup. Ct. Aug. 3, 2020) (Return of proceeds)
- Booth Creek Management Corp. v New Executive Group, Ltd., 2020 WL 4760163 (Tex.App.) (Intermediary liability for LC scam)
- U.S. v. Delgado, 2020 WL 4353177 (W.D.Tx.) (Criminal conviction and sentence for LC fraud)
- Washington v. Polis et al., 800 Fed.Appx. 877 (10th Cir. 2020)(Largest LC ever issued)
- Lynch v. Trump, 2019 WL 4643987 (C.D.IL) (LC from property Franklin Roosevelt put in trust)

# Issuer's Right to Verify the Default Notice under the LC Draw Leads to Wrongful Dishonor

- Marquette Transportation Finance, LLC v. Soleil Chartered Bank, 2020 WL 122975 (S.D.N.Y.)
- Summary judgment granted against issuer for wrongful dishonor of otherwise confirming draw on a letter of credit that contained a requirement that a copy of the default notice to the draw documents “shall be subject to verification” by the issuing bank
- Court held that the condition was ambiguous and not binding on the beneficiary.
- Should the court have said that issuer verification is a nondocumentary condition which the issuer should have ignored? See ISP Rule 4.11; UCP Art. 14(h); UCC §5-108(g)
- Should a bank issue or beneficiary accept a letter of credit with such a condition?

# Conditions to Enforce a Bank Guarantee

- *Tecnicas Reunidas Saudia for Services and Contracting Co., Ltd. v. Korea Development Bank*, Queen's Bench – Technology and Construction Court, 2020 EWHC 968 (TCC)
- Advance payment URDG guarantee to secure advances paid by main contractor/beneficiary (Tecnicas) to subcontractor/applicant (Sungchan) for construction project in Saudi Arabia; the subcontractor/applicant abandoned the job.
- Action filed in England to enforce KDB's bank guarantee (via summary judgment).
- The language in the Guarantee provided that it was a condition for any claim or payment made the guarantee that funds or advance payments had to be made into an account of and received by the subcontractor at HSBC.
- KDB argued that instead of being paid to HSBC, the advance payment called for by the Guarantee was made to an account at SABB, a Saudi bank affiliated with HSBC, even though the correct or same account number of the subcontractor at HSBC was used for the transfer to SABB.
- The Court found that payment was made to the subcontractor so that the condition was met.
- Alternatively, the court considered whether the payment condition should be disregarded (URDG-758 Art. 7) as a nondocumentary condition.
- The Court also discussed whether timely notice of refusal was sent by KDB (URDG-758 Art. 24).
- The Court rejected defenses by KDB and upheld the obligation of KDB to pay on its guarantee.

# Beneficiary's LC Claims against the Receiver or Conservator after Issuer Insolvency

- Granite Re v. NCUA, 956 F.3d 1041 (8th Cir. 2020) (letter of credit repudiation due to credit union issuer's conservatorship prior to draw)
- Lexon Insurance Co. v. FDIC, 2020 WL 972708 (E.D.La., appeal to 5<sup>th</sup> Circuit pending)(Letter of credit repudiation due to bank issuer's receivership prior to draw)
- Granite Re v. NCUA, 956 F.3d 1041 (8th Cir. 2020) reversed the lower court holding that 12 U.S.C. Section 1787 limited recovery for a repudiated insolvent issuer's LC to "actual direct compensatory damages...determined as of the date of the appointment of the conservator," which the lower court had interpreted as requiring presentation of a drawing before the conservator was appointed.
- The opinion in Lexon Insurance v. FDIC similarly denied recovery of any amount by a standby beneficiary. The Court opined that "the beneficiary of a valid letter of credit may realize damages prior to the date of the conservatorship as a result of its reliance on that letter of credit."
- What about the FDIC Policy Statement on Collateralized Letters of Credit?
- See 60 Fed. Reg. 27976, May 26, 1995, effective May 19, 1995.  
<https://www.fdic.gov/regulations/laws/rules/5000-3900.html>

# Draw Certificate Stating Draw Pays a Debt

- DB NPI Century City, LLC v. Legendary Investors Group No. 1, LLC, 2019 WL 2082039 (Cal. App., unpubl.)
- LC draw statement for \$841K (the amount of the LC) included a statement that the amount of the draw “covers the unpaid principal indebtedness including principal, interest and all charges and expenses, incurred due to [beneficiary East West Bank] arising out of” loan facilities to applicant.
- Appeals Court held the LC is an independent obligation and does not bar enforcement of the balance of the \$6 million mortgage and note that the LC secured.
- Court also held that the one year statute of limitations of UCC §5-115 did not bar the foreclosure action since that action arose out of the note and mortgage, not the LC.
- Why isn't this a variation of UCC §3-311 payment in full by use of an instrument? (Case doesn't state whether a draft had to be presented to effect a draw as well.)
- Why can't an LC provide for a certificate stating that the draw on it satisfies a particular debt?
- Would it have been better for the applicant to require in the LC that the note it secured be presented marked canceled? Had the applicant tried to have the LC drafted that way the beneficiary bank would probably not have allowed it, at least not prior to foreclosure and realization on collateral.
- Does the issuer take any risk for issuing an LC with payment in full language in the draw certificate?

# Attempt to Recover Overdraw

- ADA-ES, Inc. v. Big Rivers Electric Corp., 2020 WL 3065532 (W.D.Ky.)
- ADA-ES (ADA) posted a letter of credit naming Big Rive Electric as beneficiary (BRE) to secure ADA's delivery and performance of equipment to reduce sulfur emissions
- BRE claimed that the equipment failed emissions tests, withheld \$583,000 in contract payments and drew down the entire LC for \$807,600.
- ADA claimed that Big River drew amounts far in excess of what was due on the LC ADA posted and for purposes other than what BRE stated to the issuer.
- ADA's post-honor claims against BRE included breach of contract, fraud and breach of UCC §5-110 warranties for the overdraw.
- The issuing bank was not a party to the suit.
- The court spent a lot of time trying to determine if the underlying contract put limits on the draw on the letter of credit. No argument was made by ADA that BRE's retaining and then drawing for more than it was damaged, would be a common law breach of the underlying contract.
- The court denied BRE's motion for summary judgment on the counts alleging fraud and breach of UCC's §5-110 warranty. The court also noted that the letter was credit was not "clean" because it required a statement that ADA has been notified of BRE's intent to make a draw because of ADA's failure to meet the faithful performance of the contract. The court equated this statement with a statement that ADA breached the contract, not merely that it was given notice of BRE's intent to draw.

# Issuer Arbitration of Wrongful Dishonor Claim

- JR Food Stores, Inc. v. Hartland Construction Group, LLC & Peoples Bank, 2020 WL 1442889 (W.D. Ky.)
- The Peoples Bank letter of credit supported a contractor's obligations under an AIA construction contract to construct an IGA market. The LC made several references to the AIA contract.
- When a draw request was denied by Peoples Bank on its LC, the beneficiary sought to compel Peoples Bank as well as the contractor to mediate and arbitrate as required by the AIA contract even though People's Bank as issuer of the letter of credit did not sign and was not a party to the AIA contract.
- The court did not require Peoples Bank to be a party to the arbitration, not because it was not a signatory to the AIA contract and not because an LC is an obligation of the issuing bank independent of the underlying contract which it supports, but because the letter of credit contained a provision that stated any disputes arising out of the letter of credit would be commenced and heard in the courts of Kentucky.
- The unfortunate implication of the case, particularly from cases cited by the court, is that had there not been a jurisdiction before courts clause in the LC, the issuer may have been compelled to arbitrate the beneficiary's wrongful dishonor claim.
- The court also stayed the wrongful dishonor claim against Peoples Bank pending the results of the arbitration the plaintiff and its contractor, a sensible decision made in the discretion of the court.



# Attributing Payment Made by Foreign Bank to LC It Issued Rather Than As a Payment from the Applicant's Account

- Solferini as Trustee of Corradi S.P.A. v. Corradi USA, Inc., 2020 WL 1511315 (W.D. Tx).
- The Italian parent of Corradi USA supported a Bank of the West \$800k credit line to Corradi USA by issuing a BNL \$800k LC to Bank of the West.
- Corradi S.P.A. became bankrupt, Bank of the West submitted an \$800k draw request and received an \$800k payment from BNL.
- The trustee for Corradi SPA argued and the court rejected the argument that the payment was not of the issuing bank's own funds but rather from a debit to Corradi SPA's account at BNL.
- The Italian bankruptcy trustee apparently mis-pled its potential UCC 5-110(a) breach of warranty claims and related post-honor subrogation claims.
- The opinion focuses too much on whether the payment was made by the issuer or by the applicant, and too little on whether the applicant's reimbursement obligation was undischarged or converted into a loan.

# Expiration Draw Made Before Expiration of Extend or Draw Period

- EFLO Energy v. Devon Energy Corporation, 2020 WL 4925741 (W.D.Okla.)
- What happens when the beneficiary states to the applicant that it will draw on the letter of credit in two weeks if it is not extended, but then draws \$4.36 Million on the LC only 4 days later instead of waiting the two weeks?
- The beneficiary gets sued for breach of contract and fraud.
- The draw was honored; the court focused on what would be proper damages
- A motion to dismiss was denied, but the court was very skeptical of damages in the amount of the draw, but rather indicated damages for the few days early draw was time and money the applicant spent trying to get an extension for the LC.
- Note: The issuer was not a party to the suit.

# Tutorial on How to Enjoin a Draw on an LC

- GP3 v. Bank of the West, 2020 WL 3317613 (W.D.Mo.)
- In this case a TRO was issued against draw by the supplier and payment by the issuer of a SBLC issued to secure purchase of 38 miles of water pipe for a New Mexico water project.
- The case is a good example of checking off and meeting with proof each of the elements under UCC §5-109 to warrant enjoining a draw on a letter of credit.
- Strong evidence of fraud was produced showing likely success on the merits, including experts showing that pictures of pipe allegedly ready to ship were not from the beneficiary's own lots but were copied from Google webpages of other manufacturers and that the pipe shown in the pictures clearly did not meet the contract specifications required for the N.M. water project
- The applicant also posted a \$21,000,000 bond against draw on LC because the LC had only a 15 day window on which it could be drawn.

# Tenant's Seeking to Recover a Landlord's Draw Due to the Virus

- Backal Hospitality Group LLC v. 627 West 42nd Retail LLC (N.Y. County Sup. Ct. Aug. 3, 2020).
- The Tenant leased a conference center from the beneficiary landlord, had to close its business due to the virus and turned the keys over the landlord.
- The landlord then drew on the tenant's LC which supported the tenant's obligations under the lease.
- The tenant filed mandatory injunction to return to it the letter of credit proceeds or post a bond for them due to virus and surrender of keys.
- The lease was well drafted in favor of the landlord, including anti-waiver clauses and reservation of all rights upon surrender the keys to and/or vacating the premises and terminating the lease.
- In contrast to the GP3 case above, UCC 5-109 was not discussed but should have been. An injunction to return proceeds should be treated at least as difficult to obtain as an injunction against a draw on the letter of credit. Official Comment 5 to UCC §5-109 states that plaintiff's burdens to obtain injunctive relief against a draw on a letter of credit apply to other "similar" forms of action which are intended by the applicant to reach the same result as an injunction.

# Intermediary Caught in Advance LC Fee Scam

- Booth Creek Management Corp. v. New Executive Group, Ltd., 2020 WL 4760163 (Tex.App.)
- Advance LC fee fraud is alive if not well.
- The Booth Creek case involves an intermediary trying to avoid liability for two fake retyped 750 million Euro “discounted” LC’s from a forged SWIFT transcript purportedly issued by BBVA–Spain with no stated purpose.
- The fraudsters supposedly were working with Prince Khalid al Khariff of the Saudi Arabian Royal Family.
- The intermediary company was found complicit or liable.
- When confronted with these types of schemes, the investor target should always seek competent legal and banking advice from those with LC experience.
- If it sounds too good to be true, it is when it comes to LC’s.

## Another LC Scam and Unbelievable LC Cases

- U.S. v. Delgado, 2020 WL 4353177 (W.D.Tx.). Delgado, an attorney, was convicted for participating in a scheme to defraud a Mexican state owned utility by attempting to substitute equipment and supplies to be supplied but not owned by the fraudster group in place of a \$20 million letter of credit, as collateral for \$103 million contract with the utility.
- Washington v. Polis et al., 800 Fed.Appx. 877 (10th Cir. 2020)(unpubl.). Plaintiff filed a purported letter of credit seeking \$4.2 trillion from the federal government. Case was dismissed and dismissal affirmed on appeal. The courts could not discern an identifiable claim.
- Lynch v. Trump, 2019 WL 4643987 (C.D.IL). Plaintiff's proposed amended complaint alleged that, in 1933, an implied trust was created when President Franklin Delano Roosevelt took all of Plaintiff's property and “conveyed it to the Office of the Secretary of the Treasury” for Plaintiff's benefit “during the emergency” and that because Trump and Mnuchin occupy the “Office of the President and Office of the Secretary of the Treasury”, they have fiduciary duties during their occupancies.
- Plaintiff claimed the authority to administer the “BRYON JOHN LYNCH estate”. Plaintiff requested a full accounting of all property “connected to or deprived from” the Estate. Plaintiff also requested that the Secretary of the Treasury issue him a letter of credit “in the amount of the full accounting” and assist Plaintiff in utilizing the letter of credit.

**Thank you**