LETTERS OF CREDIT IN REAL ESTATE TRANSACTIONS

MARILYN C. MALONEY
Liskow & Lewis
1001 Fannin Street
Suite 1800
Houston, TX 77002

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AUTHOR'S BIOGRAPHY

MARILYN C. MALONEY
Liskow & Lewis, A PLC
1001 Fannin Street, Suite 1800
Houston, Texas 77002
713-651-2938
mcmaloney@liskow.com

BIOGRAPHICAL INFORMATION

EDUCATION

B.A., magna cum laude, Louisiana State University, Phi Kappa Phi

J.D., Louisiana State University, Order of the Coif, Louisiana Law Review, Omicron Delta Kappa, Mortar Board

Licensed to practice in Louisiana and Texas

PROFESSIONAL ACTIVITIES AND HONORS

Liskow & Lewis – Founding head of Houston Office 2005-2008; shareholder; former member of Board of Directors and Compensation Committee

American College of Real Estate Lawyers – Fellow; Member of Board of Governors; Former Chair of Programs Committee; Former Chair of Insurance Committee

American College of Commercial Finance Lawyers – Fellow; Member of Board of Regents

Louisiana Law Institute – Chair Emeritus; Member, Mortgage and UCC Drafting Committees

Louisiana Bar Association and Louisiana Bar Foundation – Former Member, Board of Governors

Vice-Chair of the Intellectual Property Committee of the Business Section of the American Bar Association and of *Intellectual Property Deskbook for the Business Lawyer* (3d Ed., 2013)

Listed in Texas' Best Lawyers and Texas Super Lawyers

Recipient, 2013 LSU Law Distinguished Achievement Award

Recipient, 2004 President's Award, Louisiana Bar Foundation

Named One of the Women of the Year for 2004, *New Orleans City Business Magazine*

Who's Who in American Law

LAW RELATED PRESENTATIONS AND PUBLICATIONS:

ABA (American Bar Association); Business Law Section and Real Property, Trust and Estate Law Section

ACREL (American College of Real Estate Lawyers)

Business Law Today (ABA Business Law Section)

Houston Commercial Finance Roundtable

ICSC (International Council of Shopping Centers)

Louisiana Bankers Association

Louisiana Bar Association

Louisiana Mineral Law Institute

LSU Law School

The Business Lawyer (ABA Business Law Section)

Tulane University Law School

South Texas College of Law Annual Real Estate Law Conference

State Bar of Texas: Advanced Real Estate Seminar

State Bar of Texas: Advanced Real Estate Drafting Course

State Bar of Texas: Advanced Real Estate Strategies Course

University of Texas: Mortgage Lending Institute

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I. OVERVIEW OF MATERIALS

Letters of credit can be helpful to developers, investors, buyers, sellers, lenders, landlords, and tenants. This paper will discuss the nature of letters of credit and the law that may govern them and provide tips and suggestions for drafting. In addition, it will review briefly the treatment of letters of credit in bankruptcy and the ability to pledge or assign proceeds of a letter of credit as for security for obligations of the beneficiary.

II. USE OF LETTERS OF CREDIT IN REAL ESTATE TRANSACTIONS

Letters of credit may be used in real estate transactions in many situations. For instance, consider the following possibilities:

A tenant may furnish a letter of credit to its landlord as a portion of its security deposit;

A letter of credit may be used to provide assurances that investments to be made to a joint venture in the future will be funded;

A letter of credit may be used to fund obligations for the purchase price for the acquisition of large tracts;

A letter of credit may be used by a seller or landlord to its buyer or tenant to secure construction or development obligations;

A letter of credit may be used to provide security for payment of bonds issued by tax-exempt entities for construction of low-cost housing or university or hospital facilities;

A letter of credit may be provided by a contractor as security for completion of construction, performance of warranty obligations, and payment of subcontractors and suppliers;

Several builders party to a joint development agreement may provide letters of credit to an escrow agent to insure payment of costs of roads, drainage, and other infrastructure;

A letter of credit may provide security for the payment of indemnification obligations under a purchase and sale agreement;

The holder of a letter of credit may grant a security interest in the proceeds of a letter of credit to secure its own loans.

III. TYPES OF LETTERS OF CREDIT

Since this paper is reviewing the use of letters of credit in real estate transactions, rather than in international sales or construction contracts, it will focus on standby letters of credit rather than documentary letters of credit. While the fundamental principles applicable to the two types of letters of credit are the same, their uses are different.

A. Documentary.

Letters of credit facilitate commerce within and among countries. For instance, a U.S. seller may be unwilling to ship goods to a buyer in another country based solely upon the foreign buyer's agreement to pay. Not only would the seller bear the risk of non-payment, but it also might be required to enforce its rights in the foreign country. The delivery to the seller of a letter of credit as a condition to shipment shifts those risks in favor of the seller. On the other hand, a U.S. buyer of foreign goods would want assurance that goods nominally fulfilling requirements of a purchase order are shipped before it is obligated to pay for the goods. Typically, the documentary letter of credit is payable only on submission of documentation such as shipping receipts, bills of lading, invoices, freight receipts, insurance, and inspection certificates evidencing that the seller has complied with sales contract.

B. Standby.

Standby letters of credit provide a source of payment of an underlying contractual obligation, such as a loan, a lease, an acquisition agreement, or other payment or performance obligation. This paper will focus on the use of standby letters of credit.

C. Differences in function.

There are differences in the function of documentary and standby letters of credit. In the documentary transaction the parties expect to draw upon the letter of credit because it is the method by which the seller is to receive payment for his goods. No default or other action by the buyer is required as a condition for the draw.

In the case of a standby letter of credit, it is typical, although not required, that the letter of credit is drawn only if there is a problem with the transaction or the account party has in some way breached an obligation. For instance, a letter of credit issued to a regulatory agency to ensure environmental remediation may be called upon if the account party defaults in the payment of its obligations. If a letter of credit backs a bond, the letter of credit may be drawn upon only if the bond is called and the bonding agency is required to pay the obligee.

IV. SOURCES OF LAW GOVERNING LETTERS OF CREDIT

There are several laws and customs that may govern a letter of credit.

A. UCC5.

Article 5 of the Texas Business and Commerce Code as currently in effect in Texas was adopted in 1999 at *§ § 5.101-5.118* (hereafter "UCC5"). UCC5 does not limit its application to either documentary or standby letters of credit. When reviewing older letter of credit cases, be aware that there were substantial changes enacted in 1999.

B. ISP98.

The International Chamber of Commerce has adopted International Standby Practices ("ISP98"). This was adopted in 1998 specifically to standardize practices with respect to standby letters of credit. Prior to that adoption, many issuers used UCP, discussed below, for standby as well as for documentary letters of credit.

C. UCP.

The International Chamber of Commerce has adopted Uniform Customs and Practices for Documentary Credits ("UCP"). This was first published in 1933 and was subsequently revised in 1955, 1962, 1974, 1983, 1993, and 2006. The current revision, ICC Publication No. 600, was adopted in 2006. The UCP memorializes customs and practices of issuers of documentary letters of credit. However, it was widely adopted as governing financial letters of credit prior to the adoption of ISP98. While many issuers now use ISP98 for standby letters of credit, some issuers will utilize UCP. As in the case of the adoption of revised UCC5, there were substantial changes between UCP No. 500 (and earlier versions) and the current No. 600. Discussions are beginning regarding the drafting and adoption of a UCP 700. One proposal would remove standby letters of credit from the scope of the UCP.

D. UNCITRAL.

The United Nations Commission on International Trade Law adopted Conventions on Independent Guarantees and Standby Letters of Credit in 1995. This report has been adopted by the General Assembly and has been referred to the member nations who may choose to adopt its principles.

E. Regulatory restrictions.

The issuer of a letter of a letter of credit may be subject to regulatory restrictions such as those of 12 C.F.R. § 7.1016 (approval by the Controller of the Currency for the issuance of letters of credit by national banks); 12 C.F.R. § 208.24 (approval for issuance of standby letters of credit by state banks party to the Federal Reserve System); and 12 C.F.R. § 337.2 (FDIC regulations applicable to insured State non-member banks). Texas state chartered banks and savings associations are subject to provisions of Title 7 of the Texas Administrative Code, particularly Rules §§ 65.1, 65.18, and 77.51.

F. Supplementary provisions.

In considering whether a letter of credit should be governed by ISP98, UCP, UCC5, or a combination, parties should be aware of some of the distinctions between them. ISP98 and UCP are not law but merely customs and usages of trade while UCC5 is part of the statutory law of the applicable state. In most states, the ISP98 or UCP will be used to fill voids in the UCC, and vice versa. For instance, UCC5 §5.116 provides that with certain limitations for unwaivable provisions of UCC5, if the letter of credit adopts rules of custom or practice and those rules governing the liability of an issuer, nominated person, or adviser are in conflict with a provision of UCC5, the adopted rules shall be applied. However, if there is no conflict, both the rules and UCC5 govern. *See*, Official Comment 5 to UCC5 §5.116. ISP98 provides in Rule 1.02(a) that the rules "supplement the applicable law [such as UCC5] to the extent not prohibited by that law."

UCP was drafted primarily for documentary letters of credit and contains extensive provisions for bills of lading, insurance, and other documentation required in international trade transactions that have little or no applicability in the typical standby transaction. ISP98, however, was drafted primarily for standby letters of credit. UCC5 can be applied to both documentary letters of credit and standby letters of credit.

There are too many differences between UCP and ISP98 to identify in a single paper. However, in light of business disruptions from Hurricanes Katrina and Ike, Superstorm Sandy, and other local disasters that might cause banks to be closed for substantial periods of time, beneficiaries should be aware of the different treatment of force majeure events under the two sets of practices. ISP98 provides at Rule 3.14(a) that "If on the last business day for presentation the place for presentation stated in a standby is for any reason closed and presentation is not timely made because of the closure, then the last day for presentation is automatically extended to the day occurring thirty calendar days after the place for presentation re-opens for business, unless the standby otherwise provides." UCP articles 29 and 36 address closure in different fashions. Under article 29 if a presentation is due on any day when the bank is closed for any reason other than those set forth in article 36 (which governs force majeure issues) the presentation is extended to the first following banking day. Article 36 provides that "A bank assumes no liability or responsibility for the consequences arising out of the interruption of its business by Acts of God, riots, civil commotions, insurrections, wars, acts of terrorism, or by any strikes or lockouts or any other causes beyond its control. A bank will not, upon resumption of its business, honour [sic] or negotiate under a credit that expired during such interruption of its business." Although article 36 would relieve the bank of the obligation to honor a draft due to closure for a force majeure event, most issuers will agree to modify this rule. Typical language in a letter of credit governed by UCP to modify the standard rule is "Notwithstanding article 36 of [UCP], if this Letter of Credit expires while we are closed for a reason beyond our control we will honor a presentation under this Letter of Credit provided the presentation is made within 30 days of the resumption of our business." Beneficiaries should examine letters of credit to be governed by UCP to insure that the issuer has agreed to override the provisions of article 36.

V. NATURE OF A STANDBY LETTER OF CREDIT

A. Parties to the transaction.

The parties to a typical standby letter of credit transaction include:

Issuer – the party who issues the letter of credit and agrees to make the payment upon presentation of the specified documents. The issuer is the party upon whose credit worthiness the transaction depends. It should be noted that the issuer's obligation is a simple, unsecured corporate undertaking and is not a FDIC insured obligation, so the reputation and credit rating of the issuer should be examined carefully by the beneficiary.

Account Party or Applicant or Customer – the party who requests the issuance of the letter of credit. In a standby transaction this is the borrower or other obligor who obtains credit or induces another to enter into a transaction or to take or refrain from taking action based upon the letter of credit.

Beneficiary – the party who is entitled to receive the benefits of the letter of credit. In a standby transaction, this may be the lender who required the letter of credit before making a loan or the landlord who requires a security deposit.

Confirmer – a bank or other person that confirms the obligations of the issuer. This person, which may be known to the beneficiary or located in the beneficiary's jurisdiction, or which may have a stronger credit rating than the issuer, supplies additional credit or security to the beneficiary. The confirmer independently undertakes to honor presentations under the issuer's letter of credit. The beneficiary essentially has two obligors.

Adviser – a bank or other person that advises the beneficiary of the existence and terms of the letter of credit but which does not independently undertake any obligations under the letter of credit (other than giving accurate information regarding the credit). The adviser provides convenience but no additional security. The adviser does not undertake to honor drafts.

B. Independent nature of the letter of credit transaction.

The essence of the letter of credit transaction is the independent undertaking of the issuer. This "independence" principle is one of the most cited aspects of letter of credit law.

ISP98 provides in Rule 1.06(a) that it is "an irrevocable, independent, documentary, and binding undertaking." Rule 1.06(c) elaborates on what it means to be an independent undertaking, and clients who agree to furnish letters of credit must be aware of this point. The rule stipulates that enforcement does not depend upon, among other conditions, either the "beneficiary's right to obtain payment from the applicant" or "the issuer's knowledge of performance or breach of any reimbursement agreement or underlying transaction." What this means to the applicant is that a dispute between applicant and beneficiary as to whether conditions for payment have accrued will not authorize the issuer to refuse to honor a presentation that appears to comply with the requirements of the letter of credit.

UCP provides a similar provision in Article 4 and provides that "[a] credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if any reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honour [sic], to negotiate, or to fulfil [sic] any other obligation under the credit is not subject to claims or defences [sic] by the applicant resulting from its relationships with the issuing bank or the beneficiary." Again, what this means to the applicant is that the letter of credit will be (or should be) paid by the bank even if the applicant is in a dispute with the beneficiary over whether there was a default under the underlying deal documents.

This independence principle is the primary difference between a letter of credit and a guaranty or surety bond. In the case of the guaranty or surety bond, the guarantor or surety company has no obligations until there is a default, and it would expect to investigate whether the conditions of its obligations had accrued, including whether there had been an actual default or failure of performance under the underlying contract. The opposite is true in the case of the letter of credit. The issuer only examines whether the conditions for draws have been met. It does not and cannot investigate any provisions of the underlying contract.

This has been recognized in many cases in Texas and elsewhere. *Philipp Bros., Inc. v. Oil Country Specialists, Ltd.*, 787 S.W.2d 38 (Tex. 1990); *CKB & Assocs. v. Moore McCormack Petroleum, Inc.*, 734 S.W.2d 653 (Tex. 1987); *Sava Gumarska in Kemijska Industria D.D. v. Advanced Polymer Scis., Inc.*, 128 S.W.3d 304 (Tex. App.-Dallas, 2004, no pet.); *Synergy Ctr., Ltd. v. Lone Star Franchising, Inc.*, 63 S.W.3d 561 (Tex. App.-Austin 2001, no pet.); *SRS Prods. Co. v. LG Eng'd Co.*, 994 S.W.2d 380 (Tex. App.-Houston [14th Dist.] 1999, no pet.). Although there is a limited ability to refuse to honor a draw (or for an injunction against a draw to be rendered) based upon fraud (discussed at Section X below), cases strongly uphold the independence principle of the letter of credit. As noted in *CKB*, "[t]he very object of a letter of credit is to provide a near foolproof method of placing money in the beneficiary's hands when he complies with the terms of the letter itself. [citations omitted] Parties to a contract may use a letter of credit in order to make certain that contractual disputes wend their way toward resolution with money in the beneficiary's pocket rather than in the pocket of the contracting party." 734 S.W.2d at 655.

For the beneficiary of the letter of credit, the "foolproof" nature of the letter of credit is a benefit. It means that the beneficiary has the upper hand in relation to the applicant. On the other hand, the applicant must understand that it is delivering to the beneficiary leverage that it might not have in the instance of a guaranty or a surety bond. However, even if the letter of credit is paid, as it should be, the applicant may still have rights against the beneficiary under the underlying contract. As noted in *CKB* "[UCC5 § 5-110] recognizes that the beneficiary's immediate right of possession does not preclude dispute over the ultimate retention… . Without this rule, the beneficiary of the letter of credit would be the ultimate arbiter of compliance with the underlying contract and the commercial viability of a letter of credit would be destroyed." *Id.*

C. Documents are important.

The issuer's obligations are limited to those set forth in the letter of credit. Thus, the beneficiary must comply exactly with all terms and conditions of the letter of credit in order to be entitled to draw upon the issuer. UCC5 §5.108(a) provides that the issuer "shall honor a presentation that, as determined by the standard practice [of financial institutions that regularly issue letters of credit], appears on its face strictly to comply with the terms and conditions of the letter of credit" (emphasis supplied). Except in limited instances or as agreed by the account party, the issuer shall dishonor presentations that do not appear so to comply. As a result, the beneficiary must be reasonably comfortable that it will be able to comply strictly with the requirements of the letter of credit and will in fact be able to furnish the documentation or certifications required.

One issue that may arise is the ability of the beneficiary to draw when the condition requires the presentation of a draw and the original of the letter of credit. Would a beneficiary be denied the right to draw in the event the original is lost or destroyed? *Ladenburg Thalmann & Co, Inc. v. Signature Bank*, New York Supreme Court Appellate Division, First Judicial Department (Slip opinion 02224, March 19, 2015) illustrates the problem. This letter of credit required that the beneficiary include "the original of this standby letter of credit, and all amendments, if any, and the operative notice." The beneficiary submitted the original of the letter of credit as well as the original of amendments 1 and 4 through 6. It could not locate the originals of amendments 2 and 3, which apparently provided for interim extensions of the term of the letter of credit. After its initial drawing was dishonored for failure to include all amendments, the beneficiary obtained from the bank's records a copy of amendments 2 and 3 and resubmitted its draw. The issuer dishonored it again. The court eventually approved the draw on several grounds, including the fact that the bank could not be misled as to the existence or terms of the amendments, as they came from its own files. The court noted that the bank did not have to understand the commercial effects of a discrepancy (as it might in a documentary or trade letter of credit in which non-conforming documents were offered). The final reason was that the court found ambiguity as to whether the original letter of credit (only) or the originals of the letter of credit and all amendments had to be presented. However, while this decision finally benefitted the beneficiary, the delay in obtaining the funds was clearly not what the beneficiary expected when it obtained the letter of credit.

D. Reimbursement obligation.

The issuer pays drafts drawn under the letter of credit from its assets. Thus, the issuer must make provisions for recouping payments from its customer, the account party. UCC5 recognizes the issuer's right of reimbursement in §5.108. For instance, this reimbursement obligation may be evidenced by a reimbursement agreement or a letter of credit application or the applicant may agree that any amounts paid under the letter of credit will be deemed advances under an existing revolving credit facility. The issuer, if claiming any security in the property of the account party or guarantor, should insure that all security interests, mortgages, and other rights are perfected at the time of the issuance of the letter of credit.

National banks issuing letters of credit are subject to the requirements of 12 C.F.R. § 7.7016 that the bank either must be fully collateralized or it must have a right of reimbursement from the account party or another person. Texas state chartered banks and savings associations are required to obtain an unqualified reimbursement agreement from the customer. 7 Texas Administrative Code §§ 65.18 and 77.51.

The confirming bank typically has a relationship only with the issuer. Thus, the confirming bank must examine the credit of the issuer, rather than of the beneficiary, in determining its rights of reimbursement and its risk in the transaction. *See, e.g., Dibrell Brothers International S.A. v. Banca Nazionale del Lavoro,* 38 F.3d 1571 (11th Cir. 1994).

E. Subrogation rights.

UCC5 §5.117 specifically grants rights of subrogation after (but not until) the issuer has honored the credit to the same extent as if the issuer were a secondary obligor of the underlying obligation. In addition, the account party that reimburses the issuer is subrogated to its rights against the beneficiary to the same extent as if the account party were a secondary obligor of the obligations owed to the issuer. In both instances, the test is whether a party secondarily liable, such as a guarantor, would have had rights of subrogation.

VI. ISSUES IN DRAFTING LETTERS OF CREDIT

A. The independence principle.

The value to the beneficiary of a letter of credit is that it is independent of the underlying transaction. Thus, it is neither desirable nor acceptable to incorporate the terms or conditions of the underlying contract in the letter of credit. A letter of credit that is intended to permit a creditor to draw when its underlying loan is in default should not be drafted as follows:

> "Issuer hereby agrees to pay upon the occurrence of the Event of Default under that certain Loan Agreement dated January 1, 2015, between beneficiary and account party."

The problem with this formulation is that the issuer would be required to investigate the underlying facts to determine whether an Event of Default has occurred. If the account party wishes the credit support to investigate whether an Event of Default has occurred, it should furnish a guaranty or a surety bond rather than a letter of credit.

Rather than the language quoted above, the letter of credit should be drafted in order to provide for payment upon submission of documentation. For instance, the previous paragraph could be re-drafted to provide:

> "Issuer hereby agrees to pay upon receipt from beneficiary of a certificate to the effect that the account party is in default under that certain Credit Agreement dated January 1, 2015 between beneficiary and account party."

Wichita Eagle & Beacon Publishing Co. v. Pacific National Bank, 493 F.2d. 1285 (9th Cir. 1974) adds an additional reason to avoid incorporation of non-documentary terms. In this case, the court held that an engagement by Pacific National Bank styled as a letter of credit, but which agreed to pay damages in the event that a tenant did not comply with lease obligations, constituted a guaranty rather than a letter of credit. As noted in *Republic Nat'l Bank v. Northwest Nat'l Bank*, 578 S.W.2d 109 (Tex. 1978), modified on other grounds at 578 S.W.2d 109 (Tex. 1979), national banks are not permitted to execute guaranties but are expressly allowed to issue letters of credit. In the view of the *Republic Nat'l Bank* court, the difference between a permissible letter of credit and an impermissible guaranty is that in the case of the first the issuer pays solely upon the presentation of documents, while in the case of the guaranty the bank is required "to undertake actual determinations of fact regarding the underlying obligation." *Id.* at 115. UCC5 § 5.108(g) provides that an issuer shall disregard any non-documentary conditions in a letter of credit and treat them as if they were not stated. If the issuer is to disregard a non-documentary condition, it is uncertain whether the letter of credit must be funded simply by the presentation of a draft, or whether the letter of credit is totally invalid. In *Continental Grain Co. v. Meridien International Bank*, 894 F. Supp. 654 (S.D.N.Y. 1995), a non-documentary condition was deemed disregarded and the issuer was bound to honor the draw.

That the letter of credit relies upon submission of documents, rather than in determination of the correctness of the underlying facts, is one of the greatest potential benefits to the beneficiary and the greatest potential risks to the account party. The issuer of a standby letter of credit is typically directed to pay upon submission of a certificate of the beneficiary to the effect that certain events, such as events of default, have occurred. The issuer should not, and effectively cannot, investigate the truthfulness of the statement. Issuers could find that beneficiaries would not accept letters of credit they issued if they had a reputation for contacting the account party for counsel or advice upon presentation of a draw, rather than simply examining the documents presented for conformity to the requirements of the letter of credit.

For this reason, the account party may require that the letter of credit require the beneficiary to certify that an event (such as an event of default) has occurred and that the beneficiary has given the account party notice of its intent to draw on the letter of credit. If the account party disputes the right of the beneficiary to make the draw it would use that notice period to file suit for an injunction, if necessary (see Section X below). An example of a letter of credit incorporating documentation evidencing notice and demand to the account party is attached at Appendix 1. While such language would benefit the account party, the beneficiary would want just the opposite and would require a "clean" letter of credit that would be paid upon delivery of nothing more than a demand. An example of such a clean letter of credit is attached at Appendix 2.

B. The irrevocable letter of credit.

It is extremely important to a beneficiary that a letter of credit be irrevocable. Under UCP, a letter of credit that does not otherwise provide is deemed to be irrevocable. UCC5 § 5.106(a) provides that a letter of credit is revocable only if it specifically so states. ISP98 specifically provides in Rule 1.06(a) that a standby letter of credit is irrevocable, and it is not necessary to state that.

However, typically a letter of credit will provide in its opening statement:

> "We hereby establish in your favor our irrevocable letter of credit no. _____ in the amount of $_______, effective immediately and expiring ___________."

C. Assignment or transfer.

Under UCC5 § 5.112, ISP98, and UCP, a letter of credit can be transferred only if it so states. This protects the account party who wants to insure that only the specific beneficiary, with whom there is some existing relationship, will draw under the letter of credit and trigger the account party's reimbursement obligation. A typical situation in which a letter of credit provides for transfer is one issued in favor of a trustee for bondholders. Such a letter of credit may provide for transfers as follows:

> "This letter of credit is transferable in its entirety (but not in part) to any transferee who has succeeded you as Trustee under the Indenture and may be successively so transferred. Transfer shall be effected by the presentation to us of this Letter of Credit accompanied by a certificate in the form of Exhibit "_" hereto."

Another common instance in which transferability is important is a letter of credit posted as security for a lessee's lease obligations. Presumably the lease would provide that if the lessor sells the property the lessee would consent to a transfer or would post a replacement letter of credit in favor of the new owner. However, particularly in a large portfolio sale, the burden of policing all of the necessary substitutions could be avoided by providing for automatic transfer of the original letter of credit, using language similar to that provided for the trustee, above.

Even if the beneficiary does not expect to transfer its rights, merger, transfer of assets, failure, bankruptcy, or death may intervene. Problems have also arisen when the letter of credit required certificates by a specific individual or beneficiary, such as a provision that requires for draw under letter of credit:

> "A certificate signed by Joe Blow stating that an Event of Default has occurred under that certain Loan Agreement between Borrower and Joe Blow dated January 1, 1996."

Such a certificate will be impossible to provide upon Joe Blow's death. *See*, *Samuel Rappaport Family Partnership v. Meridian Bank*, 657 A.2d 17 (Penn. Sup. Ct. 1995). Likewise, a provision that would require a certificate by a specific bank subsequently closed by the FDIC would hinder a draw.

UCC5 §5.113 alleviates this problem by permitting the successor of the beneficiary to submit draws. "Successor of a beneficiary" is defined in §5.102(a)(15) as a person "who succeeds to substantially all of the rights of a beneficiary by operation of law, including a corporation with or into which the beneficiary has been merged or consolidated, an administrator, an executor, a personal representative, a trustee in bankruptcy, a debtor in possession, a liquidator, and a receiver." ISP98 Rules 6.11 through 6.14 contain detailed provisions for presentations by "an heir, personal representative, liquidator, trustee, receiver, successor corporation, or similar person who claims to be designated by law to succeed to the interests of a beneficiary." UCP does not directly address this issue. While these provisions of UCC5 and ISP98 do not permit the beneficiary to assign a single contract and a letter of credit securing payment and performance, it does insure that death, merger, bankruptcy, and similar occurrences will not deprive the beneficiary of the intended benefits of the letter of credit.

D. Expiration of letter of credit.

Under Article 42 of UCP, all letters of credit must contain an expiration date. UCC5 §5.106 provides that, unless otherwise stated, a letter of credit will expire one year after its stated date of issuance and a letter of credit which states that it is perpetual expires five years after its date of issuance. Under ISP98 Rule 9.01, a standby must either contain an expiry date "or permit the issuer to terminate the standby upon reasonable prior notice or payment."

If the account party's obligations to the beneficiary are of extended duration it would prefer to have a very long maturity in the corresponding letter of credit. However, capital requirements for letters of credit issued for longer than a one-year period are very onerous, and the issuer would prefer to limit the term, thus reducing its capital requirements and the cost to its customer. Thus, it is not unusual to provide for an "evergreen" letter of credit. A letter of credit with a standard one year maturity could provide as follows:

> "Notwithstanding the expiration date, this letter of credit shall be automatically extended for additional one-year periods from the present and each future expiration date unless the issuer notifies the beneficiary in writing by registered mail at the above address at least 30 days prior to the then current expiration date that it elects not to extend this letter of credit. In the event that the beneficiary is so notified, it may draw the full amount of this letter of credit by presenting its draft at sight prior to the then current expiration date."

Even in cases such as the evergreen, in which the bank can terminate at any annual period, many banks also prefer to include a final maturity date beyond which there would be no extensions. This allows the issuer to clear the expired letter of credit from its books at some period without having to obtain evidence from the beneficiary that the letter of credit was cancelled or released.

The beneficiary must be certain, prior to accepting a letter of credit, that the expiration date (whether a single date or the final maturity date of an evergreen letter of credit) will allow it to collect and present the necessary documentation in a timely fashion. For instance, a letter of credit that requires submission of a certificate to the effect that the account party has defaulted in the payment of a note that is not due until March 1, 2015, should contain a later expiration date that would allow the creditor to assemble the necessary documents and certificates to allow it to draw if payment of the note is not received on its due date.

E. Form of documents.

Unless specifically stipulated, the documents to be submitted in connection with the draw must be originals. *See, e.g., Airlines Reporting Corp. v. Norwest Bank, N.A.*, 529 N.W.2d 449 (Minn. Ct. App. 1995). This is particularly true in documentary letters of credit, in which the actual shipping receipts, invoices, and other documents will be redelivered by the issuer to the account party to permit it to claim the goods from the carrier. However, the parties may agree otherwise, including permitting documents to be delivered by fax or electronic transmission. This is often done in a standby transaction in which only a draft and certificate are required under the letter of credit. In such instances, it is typical for the letter of credit to provide as follows:

> "Funds under this letter of credit are available to you against your draft in the form attached hereto and your certificate in the form attached hereto appropriately completed. Such draft and certificate shall be presented to us either (i) at our office at _________________ (or at any other office in the city and State of New York which may be designated by us by written notice delivered to you) or (ii) if delivered by facsimile, to [fax number] (or to any other facsimile number which may be designated by us by written notice delivered to you); provided that in the event drafts and certificates are presented by facsimile you shall also deliver the original draft and certificate to an expedited delivery courier addressed to us as set forth in (i) above."

UCC5 § 5.104 authorizes letters of credit in any form that is a "record." "Record" is a term used in the Uniform Commercial Code to make it neutral to the use of electronic documents and agreements. It is defined in UCC5 § 5.102 as "information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form." Thus, it would be possible, if the issuer and the beneficiary agreed, for a letter of credit to be issued to the beneficiary without any "hard" or paper copy to be delivered to the beneficiary. However, even an electronic letter of credit issued under UCC5 may still require the production of original documents in order to authorize a draft. The beneficiary should examine those requirements closely to insure that it can produce the proper documentation at the time of the draft.

Often, in connection with the letter of credit documentation, the beneficiary is required to deliver a draft. A draft is in the nature of a check or demand for payment and is more than a simple letter of request. An example of a simple sight draft is attached at Appendix 3.

F. Partial draws.

Although UCC5 is silent on this point, ISP98 Rule 3.08 provides that a standby may be drawn in partial or successive draws unless it provides to the contrary. UCP Article 31 allows partial drawings, but does not stipulate whether this is the default rule or must be reflected in the terms of the letter of credit itself. A letter of credit intended to provide security for payment of amounts that will be due over time, such as monthly interest and principal payments, or providing a means of payment for successive shipments of goods, should clearly so provide. An example of language of this nature is:

> "This amount is available to you by your drafts drawn on us at sight from time to time and accompanied by [applicable documents]. Multiple drawings are permitted."

G. Choice of law.

As noted above, it is possible for a standby credit to be governed by both UCC5 and either ISP98 or UCP. The question then arises as to which state's UCC would control. UCC5 §5.116 allows the parties to choose any jurisdiction, regardless of whether it bears any relation to the transaction. Typically, the issuer will select the law of its main office or the law of a state in which it maintains a substantial commercial presence.

VII. ISSUER'S OBLIGATION TO THE ACCOUNT PARTY

A. Examination of Documents.

The primary obligation of the issuer to its customer, the account party, is to examine with care documents presented with a draw in order to ascertain that they comply with the terms of the credit. UCC5 § 5.108. In so doing, the issuer must act in good faith and must observe general banking usages. Failure to do so may expose it to liability for wrongful honor of drafts. If the issuer has paid a draft that did not conform strictly to the letter of credit, the account party may seek to avoid its reimbursement obligation or otherwise to recover damages against the issuer, based upon its wrongful honor. As noted in Section VIII below, however, if the issuer fails to pay a draft that does conform strictly to the letter of credit, the beneficiary will have claims against the issuer.

B. Modification of Duty of Issuer.

Often the issuer will request a specific agreement from its customer varying or modifying that standard. § 1.302 of the Texas Business and Commerce Code allows provisions to be varied by agreement, except that "obligations of good faith, diligence, reasonableness and care ... may not be disclaimed by agreement. The parties, by agreement, may determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable." UCC5 § 5.108(a) enforces this in providing that "unless otherwise agreed with the applicant, an issuer shall dishonor a presentation that does not appear" to comply with the strict standard. Typical language requested by issuers includes:

> "The Account Party assumes all risks of the acts or omissions of the Beneficiary with respect to its use of the Letter of Credit. Neither the Issuer nor any of its officers or directors shall be liable or responsible for (a) the use which may be made of the Letter of Credit or for any acts or omissions of the Beneficiary in connection therewith; (b) the validity, or genuineness of documents, or of any endorsement(s) thereon, even if such documents should in fact prove to be in any or all respects invalid, fraudulent, or forged; or (c) any other circumstances whatsoever in making or failing to make payment under the Letter of Credit, except only that the Account Party shall have a claim against the Issuer; and the Issuer shall be liable to the Account Party, to the extent, but only to the extent, of any direct, as opposed to consequential, damages suffered by the Account Party which the Account Party proves were caused by (i) the Issuer's willful misconduct or gross negligence in determining whether documents presented under the Letter of Credit comply with the terms thereof or (ii) the Issuer's willful failure to pay under the Letter of Credit after the presentation to it by the Beneficiary of a draft and certificate strictly complying with the terms and conditions of the Letter of Credit. In furtherance and not in limitation of the foregoing, the Issuer may accept documents that appear on their face to be in order, without responsibility for further investigation, regardless of any notice or information to the contrary from any person."

VIII. OBLIGATIONS TO THE BENEFICIARY

A. Pay Upon Submission of Documents.

The primary obligation owed to the beneficiary is to pay upon submission of documents conforming to the terms of the credit. The issuer's obligation is only to determine whether the documents appear to comply on their face; it is not responsible for determining whether the documents are correct or truthful or whether the underlying transaction has in fact been carried out by the parties as required.

The standards of UCC5, ISP98, and UCP vary in language in describing the standard for examination, but all attempt to highlight the independence principle of the letter of credit and to divorce the issuer from examination of the underlying transaction. Article 13 of UCP requires that the issuer examine the documents "with reasonable care to ascertain that they appear on their fact to be in accordance with the terms and conditions of the credit" and elaborates that compliance shall be determined "by international standard banking practice" as reflected in the UCP. UCC5 § 5.108 provides that "an issuer shall honor a presentation that, as determined by [standard practice of financial institutions that regularly issue letters of credit], appears on its face strictly to comply with the terms and conditions of the letter of credit." ISP98 provides extensive rules for examination of draws at Rules 4.01 through 4.15.

B. Strict Compliance.

The issue of what constitutes "strict" compliance has been addressed in several cases. In *New Braunfels National Bank v Odiorne,* 780 S.W.2d 313 (Tex. App.-Austin 1989, writ den.) a letter of credit was issued with the number 86-122-S. The testimony indicated that "86" indicated the year of issuance, "122" indicated the consecutive number assigned to the letter of credit by the bank, and "S" indicated that the letter of credit was a standby credit. The beneficiary submitted a draw request that identified the letter of credit as Number "86-122-5." On that basis, the issuer refused to honor the draft. The court recognized the need for a draw to comply strictly with the terms of the letter of credit, but held that this obvious typographical error could not confuse the bank, particularly since the original letter of credit (with the correct letter "S") was submitted with the draft. The *New Braunfels* court recognized that the strict compliance rule provides protection to the issuer, which could not adequately assess the commercial impact of any discrepancy in the documents presented. However, it stated that the strict compliance rule did not demand "an oppressive perfectionism" *Id.* at 316. It recognized a "logical distinction between discrepancies that related to the business of the underlying transaction and those that relate to the banker's own business" such as the designation assigned by the banker to the letter of credit. *Id.* at 317. *See also, Temple-Eastex Inc. v Addison Bank*, 672 S.W.2d 793 (Tex. 1984).

C. Collusion.

In certain cases the courts have indicated that the "strict compliance" requirement seemed to be offered as a ruse to shield collusion between the bank and its customer, which wanted to avoid the draw and the obligation to reimburse its bank. *E & H Partners v. Broadway National Bank,* 39 F. Supp. 2d 275 (SD NY 1998); *BasicNet S.p.A v. CFP Servs. Ltd.*, New York Supreme Court Appellate Division, First Judicial Department (Slip opinion 02080, March 17, 2015). That element of collusion is cited as a detraction from the independence principle as the customer is attempting to draw the bank into the underlying transaction between the customer and the beneficiary.

D. Advise of Defects.

The issuer and any other party that has assumed the obligation, such as a confirmer or sometimes the adviser, must respond to the beneficiary regarding any defects. The requirement for prompt response is evident. If the letter of credit expiration date falls soon after the draw is submitted, the issuer could defeat the ability of the beneficiary to submit a subsequent conforming draw. However, the beneficiary bears responsibility for submitting conforming draws timely. *Philadelphia Gear Corp. v. Central Bank,* 717 F.2d 230 (5th Cir. 1983). The issuer is not obligated, and under its contract with its account party may not be permitted, to extend the time allowed the beneficiary to draw. The time periods within which the issuer must respond vary among UCC, ISP98, and UCP. UCP allows the issuer a reasonable time, not to exceed seven banking days, to examine and to notify the beneficiary. UCC5 § 5.108 provides a reasonable time, not beyond the end of the seventh business day, to honor or to notify the presenter of problems in the documentation. ISP98 Rule 5.01 provides that notice of dishonor must be given within a time that is not unreasonable and provides a safe harbor for examination. Notice of dishonor "within three business days is deemed to be not unreasonable and beyond seven business days is deemed to be unreasonable."

The issuer that fails to honor a presentation in accordance with the letter of credit may be liable to the beneficiary under UCC5 § 5.111 for the amount that was the subject of the dishonor, for incidental but not consequential damages, for interest, and for attorney's fees and costs.

IX. WARRANTIES OF THE PRESENTER

Just as the issuer, confirmer, and adviser have specific duties, so does the beneficiary or other party presenting the documentary drafts. The UCP, dealing primarily with the obligations or customs of banks and other issuers of letters of credit, does not specify in great detail the obligations or warranties of the beneficiary. ISP98 is completely silent as to warranties of the beneficiary. The UCC, however, drawing from the common framework of warranties found also in Chapter 3 (Negotiable Instruments), Chapter 4 (Bank Deposits and Collections), Chapter 7 (Warehouse Receipts), and Chapter 8 (Investment Securities), details the types of warranties made in connection with a submission of documents for payment.

UCC5 addresses the relationship between beneficiary and account party in separating and detailing the warranties made on presentment. Under UCC5 §5.110(a)(1), if the presentation is honored, the beneficiary warrants to the issuer and to any other person to whom presentation is made (such as a confirmer or adviser) and to the applicant that there is no fraud or forgery, such as the submission of a document that is forged or materially fraudulent, or that the honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or the applicant. UCC5 §5.110(a)(2) adds an independent warranty to the applicant "that the drawing does not violate any agreement between the beneficiary and the applicant or any other agreement intended by them to be augmented by the letter of credit." This additional warranty, which goes beyond fraud or forgery to simple breach of contract, gives the beneficiary a cause of action if the applicant's drawing breaches conditions in the underlying contract.

X. INJUNCTIONS; FRAUD AND FORGERY

If a dispute arises between the applicant and the beneficiary as to whether the beneficiary is entitled to draw under the letter of credit, the applicant may attempt to persuade the issuer (typically its bank) from honoring drafts and demands for payment. As noted in Section VIII, this element of collusion has been noted with disfavor in several cases. However, if the documents appear on their face to comply with the letter of credit, the applicant's only real hope of preventing the draw is by seeking an injunction on the basis of fraud or forgery.

The fraud and forgery exception is not expressly stated in the UCP or ISP98. UCC5 §5.109 provides that if the applicant claims that "a required document is forged or materially fraudulent or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant" the court may temporarily or permanently enjoin the issuer from honoring the draft in very limited circumstances. In fact, even if the applicant claims that a document is forged or materially fraudulent or that honoring a presentation would facilitate a material fraud, the issuer may still be required to honor the draft under UCC5 §5.109(a)(1) and, even if not required, the issuer may honor or dishonor the presentation if acting in good faith under UCC5 §5.109(a)(2).

There have been several cases in Texas addressing the "fraud" required to enjoin honoring a presentation. These cases set a very high bar for the degree of fraud needed to enjoin a draw. *Philipp Bros., Inc. v. Oil Country Specialists, Ltd.*, 787 S.W.2d 38 (Tex. 1990); *CKB & Assocs. v. Moore McCormack Petroleum, Inc.*, 734 S.W.2d 653 (Tex. 1987); *Synergy Ctr., Ltd. v. Lone Star Franchising, Inc.*, 63 S.W.3d 561 (Tex. App. 3d Dist.-Austin 2001, no pet.); *SRS Prods. Co. v. LG Eng'd Co.*, 994 S.W.2d 380 (Tex. App.-Houston [14th Dist.] 1999, no pet.). In the *Philipp Bros.* case the lower court had approved the dishonor of a draw on the grounds that the beneficiary could not have truthfully made the statements in the draw request (which were otherwise correct on their face). The Supreme Court reversed, recognizing that under the independence principle an injunction can be issued only upon a showing of fraud "in which the wrong doing of the beneficiary has so vitiated the entire transaction that the legitimate purposes of the independence of the issuer's obligation would no longer be served." 787 S.W.2d at 40.

In order to obtain an injunction on the grounds of fraud or forgery, typically the account party must satisfy requirements under general law for preliminary injunction, including some probability of success on the merits, as well as proving irreparable harm. These tests are specifically stated in UCC5 §5.109(b).

XI. BANKRUPTCY TREATMENT OF LETTERS OF CREDIT

A. Overview of bankruptcy concerns.

As noted at the beginning of these materials, there are many uses for letters of credit in real estate transactions. Beneficiaries benefit from the independence principle and the ability to obtain funds promptly from the issuer (assuming strict compliance with the draw provisions of the letter of credit). They may also avoid some, but not all, of the problems that arise if the account party becomes the debtor in a bankruptcy proceeding.

B. A letter of credit is not property of the bankruptcy estate.

The bankruptcy court has broad jurisdiction over property of the debtor in a bankruptcy proceeding. 11 U.S.C. § 541. The beneficiary of a letter of credit will cite the independence principle as the reason why the letter of credit and draw proceeds should not constitute property of the debtor's estate. Clearly, as a matter of letter of credit law only the issuer and the beneficiary are parties to the letter of credit and draws are funded by the issuer from its own properties. Bankruptcy and appellate courts have respected this aspect of letter of credit law at least insofar as the ability of the beneficiary to draw on the letter of credit. *See, e.g., In re Compton Corp.*, 831 F.2d 586 (5th Cir. 1987), *modified on other grounds*, 835 F.2d 584 (5th Cir. 1988).

C. Bankruptcy injunction; automatic stay.

As neither the letter of credit nor the proceeds of a draw constitute property of the estate, a drawing on the letter of credit should not violate the automatic stay. Practitioners were very concerned by a contrary holding in *Twist Cap, Inc. v. Southeast Bank* (*In re Twist Cap, Inc.*), 1 B.R. 284 (Bankr. M.D. Fla. 1979). As is usual, debtor's property secured its reimbursement obligation to the issuer. The court was persuaded by the argument that a payment to an otherwise unsecured creditor, triggering the secured reimbursement obligation, would indirectly transfer property of the debtor to the beneficiary. Based on this, the court issued a temporary restraining order blocking the draw under the letter of credit. However, prior to a hearing, the matter was settled.

Later cases departed from the *Twist Cap* rule. *Page v. First National Bank of Maryland (In re Page),* 18 B.R. 713 (D.D.C. 1982) and *St. Petersburg Hotel Limited v. Royal Trust Bank (In re St. Petersburg Hotel Associates Ltd.),* 37 B.R. 380 (Bankr. M.D. Fla. 1984) both held that neither the letter of credit nor its proceeds were property of the estate and that presenting a draft for payment after filing Chapter 11 did not violate the automatic stay. *In re Compton Corp.*, 831 F.2d 586 (5th Cir. 1987), *modified on other grounds*, 835 F.2d 584 (5th Cir. 1988).

D. Preferences.

Although the beneficiary may be able to draw on the letter of credit, it does not mean that the beneficiary and the issuer will have no concerns arising out of the bankruptcy. For instance, if the court finds that the issuance of the letter of credit or the furnishing of collateral to the issuer constituted a preferential transfer, the preference may be recovered for the benefit of the estate. In *American Bank v. Leasing Corp.* (*In re Air Conditioning, Inc. of Stewart*), 72 B.R. 657 (S.D. Fla. 1987), *affirmed in part and reversed in part on other grounds* 845 F.2d 293 (11th Cir. 1988), *cert. den.* 488 U.S. 993 (1988) and *In re Compton Corp., 831 F.2d 586 (5th Cir. 1987), modified on other grounds, 835 F.2d 584 (5th Cir. 1988)*, the debtor had outstanding and past-due obligations to unsecured creditors. In each case, the debtor induced the issuance of a letter of credit in favor of the unsecured creditor by providing security to the issuer. Within the preference period, the debtor filed Chapter 11 proceedings. In each case the court upheld the obligation of the issuer to pay but also upheld the right of the bankruptcy court to examine a possible preference arising from the transfer of property from the debtor to the issuer for the benefit of the beneficiary. While the issuer or the beneficiary may defend on the ground that it gave "new value" to the debtor, that is a very fact-intensive review. *Compton, supra*; *In re Fuel Oil Supply & Terminaling, Inc.*, 837 F.2d 224 (5th Cir. 1988); *Pirinate Consulting Group, LLC v. Styron LLC* (*In re New Page Corp.*) 2014 Bankr. LEXIS 4270 (Bankr. D. Del. 2014).

E. Special issues for landlords.

An additional layer of analysis is involved when a letter of credit is furnished to a landlord as a security deposit for the tenant's lease obligations. Under 11 U.S.C. §502(b)(6), if a tenant files for bankruptcy protection and rejects a lease, the landlord has a claim for damages subject to a cap in the amount of any unpaid (and unaccelerated) rental due at the time of the filing plus rent (again, unaccelerated) for the greater of (a) one year or (b) 15%, not to exceed three years, of the remaining term of the lease. The limitations were imposed by statute to avoid the possibility that a landlord could recover damages for the entire accelerated period of the lease and therefore prevent a reorganization.

Would landlords be able to avoid the cap by obtaining a letter of credit to secure lease obligations? Recent cases seem to say not. While the landlord may be able to draw on the letter of credit for the full amount (due to the application of the independence principle), its ability to retain proceeds may be limited by the cap, at least in several circuits that have examined this question. *Two Trees v. Builders Transp., Inc.* (*In re Builders Transp., Inc.*) 471 F.3d 1178 (11th Cir. 2006); *In re AB Liquidating Corp.***,** 416 F.3d 961 (9th Cir. 2005); *In re PPI Enterprises (U.S.) Inc.*, 324 F.3d 197 (3d. Cir. 2003). While *In re Stonebridge Technologies, Inc.*, 430 F.3d 260 (5th Cir. 2005) allowed a landlord to retain proceeds in excess of the cap, the difference seems to be that the landlord in *Stonebridge* had not filed a claim in the tenant's bankruptcy proceeding, as 11 U.S.C. §502(b)(6) was held to be a limitation only on claims in the estate.

XII. SECURITY INTERESTS AND LETTERS OF CREDIT

The beneficiary of a letter of credit may wish to use the rights under that credit as collateral for its own obligations. For instance, a joint venture developing a project may wish to use a letter of credit issued on behalf of an equity investor to guarantee its investment as security for the development loan to the venture. A security interest in letter of credit rights may be granted under Article 9 of the Texas Business and Commerce Code. Letter of credit rights include the right to receive proceeds of a draw, but do not constitute a transfer of the letter of credit itself or the right to draw upon the letter of credit. Such a security interest is perfected by control under §9.107. Generally, control is accomplished by the issuer consenting to an assignment of proceeds under UCC5 §5.114(c). The issuer is not bound unless it affirmatively consents to the assignment.

Notwithstanding the ability to obtain a perfected security interest in the proceeds of the letter of credit, the secured creditor will be forced to rely upon its debtor's compliance with the terms of the credit, such as submission of drafts and documents, in order to obtain proceeds. As a result, a security interest in this sort of collateral may be less desirable than a security interest in a deposit account or some other collateral that would not be so dependent upon the actions of the obligor in order to realize its value.

Appendix 1

SAMPLE FORM OF LETTER OF CREDIT PROVIDING ADVANCE NOTICE TO THE APPLICANT OF THE INTENT TO DRAW

Irrevocable Letter of Credit No. ________

Beneficiary: ____________________________

We hereby issue our Irrevocable Standby Letter of Credit No. ______ in your favor for the account of [name of account party] in the amount up to but not exceeding the aggregate sum of One Million Dollars ($1,000,000) effective immediately and expiring as set forth below.

This Letter of Credit is payable only in a single drawing, upon presentation of your sight draft drawn on us and accompanied by the following:

1. A written sworn statement signed by a purportedly authorized officer of beneficiary stating that it is entitled to the amount of the draft, not to exceed the sum of $1,000,000, and that said amount is due and payable as a result of account party's failure to perform its obligations under the terms of Lease No. _________, dated ________________, by and between beneficiary and account party (the "Lease");

2. A copy of a letter or notice advising account party that the Lease has been breached, such letter or notice being addressed to account party at [address] and being dated at least thirty (30) days before the date of beneficiary's draft required above;

3. Affixed to the notice described in Subparagraph 2 above, a copy of a receipt issued by the U.S. Postal Service showing that the notice to account party was dispatched by U.S. Registered Mail at least thirty (30) days before the date of Beneficiary's draft required above; and

4. The original Letter of Credit.

This Letter of Credit shall expire on ________________. Notwithstanding the foregoing, this Letter of Credit shall be automatically extended for additional one-year periods from the present and each future expiration date unless we notify you in writing by registered mail at the above address at least thirty (30) days prior to the then present expiration date that we may elect not to extend this Letter of Credit. In the event that you are so notified, you may draw the full amount of this Letter of Credit by presenting your draft on sight to us within the ten-day period immediately preceding the then-current expiration date.

This Letter of Credit may not be transferred or assigned in whole or in part.

This Letter of Credit sets forth in full the terms of our undertaking, and such undertaking shall not in any way be modified or amplified by reference to any document, instrument, or agreement referred to herein or to which this Letter of Credit relates, and any such reference shall not be deemed to incorporate herein by reference any document, instrument or agreement.

This Letter of Credit shall be governed by the Uniform Commercial Code as enacted in the State of Texas on the date of its issuance, and shall also, to the extent not inconsistent with such code, be governed by the International Standby Practices ISP98 of the International Chamber of Commerce.

Very truly yours,

Issuer

By:____________________________

Appendix 2

SAMPLE FORM OF A CLEAN LETTER OF CREDIT THAT DOES NOT PROVIDE ADVANCE NOTICE TO THE APPLICANT

Irrevocable Letter of Credit No. ________

Beneficiary: ____________________________

We hereby issue our Irrevocable Standby Letter of Credit No. ______ in your favor for the account of [name of account party] in the amount up to but not exceeding the aggregate sum of One Million Dollars ($1,000,000) effective immediately and expiring as set forth below.

This Letter of Credit is payable only in a single drawing, upon presentation of your sight draft drawn on us and accompanied by the following:

1. A written sworn statement signed by a purportedly authorized officer of beneficiary stating that it is entitled to the amount of the draft, not to exceed the sum of $1,000,000, and that said amount is due and payable as a result of account party's failure to perform its obligations under the terms of Lease No. _________, dated _______________, by and between beneficiary and account party (the "Lease"); and

2. The original Letter of Credit.

This Letter of Credit shall expire on _______________. Notwithstanding the foregoing, this Letter of Credit shall be automatically extended for additional one-year periods from the present and each future expiration date unless we notify you in writing by registered mail at the above address at least thirty (30) days prior to the then present expiration date that we may elect not to extend this Letter of Credit. In the event that you are so notified, you may draw the full amount of this Letter of Credit by presenting your draft on sight to us within the ten day period immediately preceding the then-current expiration date.

This Letter of Credit may not be transferred or assigned in whole or in part.

This Letter of Credit sets forth in full the terms of our undertaking, and such undertaking shall not in any way be modified or amplified by reference to any document, instrument, or agreement referred to herein or to which this Letter of Credit relates, and any such reference shall not be deemed to incorporate herein by reference any document, instrument or agreement.

This Letter of Credit shall be governed by the Uniform Commercial Code as enacted in the State of Texas on the date of its issuance, and shall also, to the extent not inconsistent with such code, be governed by the International Standby Practices ISP98 of the International Chamber of Commerce.

Very truly yours,

Issuer

By:___________________________

Appendix 3

SAMPLE FORM OF SIGHT DRAFT

$_____________
_____________, 2015

At-Sight-
Pay to the order of: Beneficiary

Ten Thousand and No/100 Dollars ($10,000.00)
Value received and charged to the account of:

Account Party.

Drawn Under Irrevocable Letter of Credit No.___

TO: Big Bank
Attention: Joe Blow
Letter of Credit Department
New York, New York

Beneficiary

By:___________________________________
Its:___________________________________

Resources for Further Study

ICC Uniform Customs and Practices for Documentary Credits UCP 600, International Chamber of Commerce (2007).

International Standby Practices ISP98, Institute of International Banking Law & Practice, Inc. (2012).

James E. Bynne, *Standby & Demand Guarantee Practice. Understanding UCP 600, ISP98, and URDG 758*, Institute of International Banking Law & Practice, Inc. (2014).

David R. Kuney, *Bankruptcy Issues Affecting Retail Leases,* The ACREL Papers 1 (March, 2009).

David R. Kuney, *Letters of Credit: Remember the Independence Theory*, The ACREL Papers 183 (March, 2008).

7A Larry Lawrence, *Lawrence's Anderson on the Uniform Commercial Code* (3d ed. 2008).

3 Robin Russell, *Texas Practice Guide; Financial Transactions* (2014).

3 James V. White, Robert S. Summers, & Robert A. Hellman, *Uniform Commercial Code* (6th ed. 2014).

The website of the International Banking Law & Practice contains representative forms for standby letters of credit at www.iiblp.org.

These materials incorporate a portion of the following: Marilyn C. Maloney, *Letters of Credit*, LSU Commercial, Banking, and Consumer Seminar (1996).