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# Documentary Credit WORLD

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**Documentary Credit World**
**20203 Goshen Road., No. 343**
**Gaithersburg, MD 20879 USA**
**phone: +1-301-330-1970**
**fax: +1-301-926-1265**
**e-mail: info@doccreditworld.com**
**website: www.doccreditworld.com**

# ISP98 FORM 4 – COMMENTARY

## MODEL STANDBY FORMS UNDER ISP98

### COMMENTS ON FORM 4 – MODEL STANDBY PROVIDING FOR TRANSFER AND INCORPORATING ANNEXED FORM OF TRANSFER DEMAND

By Michael Evan AVIDON*

The promulgation by the Institute of International Banking Law & Practice, Inc. (the "**Institute**") of eight Model Standby Forms under ISP98 is a momentous step forward in the evolution of standby letter of credit practice. These forms, including the detailed endnotes, will help business people, bankers, and lawyers to become more familiar with standby letters of credit and their practice rules and to prepare clearer and therefore more reliable standby letters of credit. This should result in increased use of standby letters of credit both in the United States (where they originated and have been widely accepted) and in the rest of the world (where they have become more accepted as practitioners become more familiar with them and their advantages). This should also result in fewer disputes.

These forms will prove useful both for undertakings denominated as a "standby letter of credit" (which is the label most often seen in the United States) and for undertakings denominated as a "first demand guarantee" or "bank guarantee" (labels sometimes used in the rest of the world for their versions of independent, documentary undertakings) which are issued subject to ISP98. For convenience, the balance of this article uses the term "**standby**" to refer to any such undertaking, regardless of the actual label on the undertaking.

Over the last decade, the standby rules of choice have increasingly become the International Standby Practices 1998 ("**ISP98**"), which were promulgated by the Institute in 1998 and then published by the International Chamber of Commerce as ICC Publication No. 590. Now that ISP98 has been widely recognized as a superior set of rules for standbys, it is only fitting that the Institute should take the next step of publishing model forms for everyone's use. But these first eight Model Forms published by the Institute are more than just forms; they are heavily annotated with detailed educational endnotes that cite to relevant ISP98 rules and other authority and explain how those rules influenced the drafting of the forms. Some of the endnotes also contain suggestions for provisions to consider including in the contract(s) or other arrangement(s) that are supported by or underlay the standby. In addition, the forms contain optional provisions set off by bracketed italics, in many cases together with guidance as to when those optional provisions may be useful. Perhaps best of all, the Institute has granted unlimited permission to copy and use the ISP98 forms, including the endnotes, for all purposes except publication for a charge to a purchaser or subscriber.

* Michael Evan Avidon is a partner in the New York City law firm of Moses & Singer LLP, where he co-chairs the firm's Banking and Finance Practice. He has extensive experience with letters of credit, including actively participating in the drafting of Uniform Commercial Code Revised Article 5 and ISP98.

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This is truly a great service to the letter of credit community.

Although there is much that could be said about each of the forms, and about the relative advantages of ISP98 as compared to other practice rules, the author has been asked to focus on Form 4, which is the form of Model Standby Providing for Transfer and Incorporating Annexed Form of Transfer Demand. Form 4 builds on the basic provisions in ISP98 Model Form 1 and adds to it various transfer-related provisions, including a form of Transfer Demand. To avoid making the forms too long, the endnotes to Form 1 are generally not repeated in subsequent Forms, such as Form 4, that use text that was also used and explained in Form 1.

Accordingly, the balance of this article focuses on Form 4.

## Form 4 – Transfer

Many types of undertakings provide for the parties thereto to transfer or assign all or a portion of their rights thereunder in certain circumstances. Standbys are no exception. In standby practice, the term "transfer" has come to refer to a transfer made by the beneficiary of the standby of its drawing and other rights under a standby, while the term "assignment" has come to refer to an assignment made by the beneficiary of the standby of its right to all or a portion of the proceeds of its drawing under the standby. An assignment of proceeds is quite limited as it does not include the right to draw on the standby or the right to transfer the standby. *See* ISP98 Rule 6.

The transfer rules under ISP98 differ quite a bit from those under the Uniform Customs and Practice for Documentary Credits ("**UCP**"), whether under the 1993 revision of UCP in ICC Pub. No. 500 (which was the version of UCP in effect when ISP98 was first promulgated) or under the 2007 revision of UCP in ICC Pub. No. 600. These differences reflect different norms and expectations in the types of transactions that are often supported by standbys, on the one hand, and by commercial letters of credit (sometimes called documentary letters of credit), on the other hand.

In the commercial letter of credit context, the beneficiary of the credit is usually the seller of goods and it may wish to, and be expected to, transfer all or a portion of its rights under the commercial letter of credit to one or more transferees such as its lender or its suppliers for the goods covered under the credit. The UCP rules reflect this expectation by permitting a transferable letter of credit to be transferred in whole or in part but not allowing successive transfers. *See* UCP500 Art. 48(g) and UCP600 Art. 38(d).

The expectations as to transfers are different in the standby context. For example, the beneficiary of a standby may be an indenture trustee acting on behalf of a group of bondholders. If the indenture trustee is replaced by a successor trustee, the expectation is that the predecessor trustee will transfer all of its rights under the standby to the successor trustee. Likewise, a second trustee may need to transfer to a third trustee and so on. ISP98 reflects this expectation by permitting a transferable standby to be transferred in whole on successive occasions, but not allowing partial transfers unless the standby so provides. *See* ISP98 Rule 6.02(b).

While standby issuers typically will exercise their discretion to acknowledge a requested transfer that is permitted under ISP98, more certainty may be desired under some standbys, particularly those that are expected to be transferred and those that are issued long term in favor of a trustee bank representing bondholders or a management company representing a commercial lessor. Model Form 4 reflects these standby expectations. It was designed for use in

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transactions where the original standby beneficiary must be permitted to transfer the standby to a subsequent holder (whether an assignee or a successor) of the underlying obligation supported by the standby. Examples of such underlying obligations are loan transactions where the standby must be transferred from the original lender to successive assignees of the loan, bond transactions where the standby must be transferred from the original indenture trustee to successive indenture trustees, and real estate transactions where a standby must be transferred from the original landlord (or its management company) to whom it was originally issued as a security deposit to successive owners of the real estate (or their respective successive management companies). Although the form may be useful in other contexts as well, it is possible that other uses would require modifications to the form.

Model Form 4 obligates the issuer of the standby to transfer the standby if the terms and conditions of the standby providing for transfer are satisfied. The issuer does not have discretion to refuse to acknowledge a transfer that satisfies these requirements. The Form requires presentation to the issuer of a specified form of demand for transfer and contains optional provisions to also require presentation of the standby itself[1] and payment of the issuer's transfer fee. In addition, the Form explicitly states that the issuer's acknowledgment is subject to compliance with applicable law, which would include compliance with United Nations and other international and national sanctions restrictions.

One issue which is deserving of greater attention in letter of credit practice is the effect of a transfer on the documentary requirements for payment under the letter of credit. ISP98 Rule 6.04(b) provides that where there has been a transfer of a standby in its entirety, "the name of the transferee may [not *must*] be used in place of the name of the transferor beneficiary in any other required document." (UCP500 Art. 48(f) and UCP600 Art. 38(g) contain different rules concerning substitution of names.) Form 4 states that the transferee beneficiary's name and address "shall [not *may*] be substituted for that of the transferor on any demands, requests, or consents then or thereafter required or permitted to be made by Beneficiary [endnote omitted]." Substitution of the name of the transferee for that of the transferor makes sense in terms of who should sign a demand for payment under the standby and who should be referred to as the current beneficiary of the standby. However, this may not make sense in the case of a reference contained in the body of a form of payment demand or other attachment to a standby. For instance, suppose the form of payment demand refers to a loan as having been "made by" the beneficiary of the standby to the applicant of the standby, and then refers to the loan as being due and unpaid in an amount not less than the amount demanded. If the loan and the standby have each been transferred to the assignee of the loan, the loan is due to the transferee but it would not be correct to refer to the loan as having been "made by" the transferee; the loan was made by the transferor. It would be more accurate to refer to the loan as having been made by the original beneficiary and then assigned to the transferee so that it is now due and unpaid to the current beneficiary. This concept can easily be drafted

1. Requirements for presentation of a letter of credit are addressed in my article entitled "ISP98 Rule 3.12(a): Is it a Trap, or a Warning to an Unwary Beneficiary of a Letter of Credit?," published at 2 George Mason Journal of International Commercial Law 1 (2010), available online at http://georgemasonjicl.org/wp-content/uploads/2012/04/AVIDON_2_Geo_Mason_J_Intl_Comm_Law_1_2010.pdf.

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for in the transfer provisions.

This issue with the substitution clause in the transfer provision of Form 4 is a relatively small quibble. Overall, the Form is well-organized, with helpful headings and a direct style of drafting. Unnecessary language is generally not included in the Form. Where unnecessary language was included, a helpful endnote explains why the language was included.

## Conclusion

These forms and their explanatory endnotes will greatly enhance the understanding of standby letters of credit and prove tremendously useful to all who work with letters of credit. ■

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