

GETTING READY FOR ISP98— THE INTERNATIONAL STANDBY PRACTICES

By Michael Evan Avidon

The International Standby Practices (ISP98) has been carefully crafted for use with standby letters of credit. ISP98 is expected to become widely used for standby letters of credit commencing January 1, 1999.

This paper, which is adapted from a presentation to the American Bar Association Subcommittee on Letters of Credit, focuses on ISP98 provisions that may lead to changes in forms of standby letters of credit and reimbursement agreements, that may lead to changes in standby practices, that may alert parties to issues they had not previously focused upon, or that parties may wish to limit or vary. This paper also focuses on differences between ISP98 and the Uniform Customs and Practice for Documentary Credits, 1993 revision, ICC Publication No. 500 (UCP 500).

1. Do you want ISP98 or UCP 500 in whole or in part? ISP98 reflects generally accepted practice, custom, and usage of standby letters of credit. UCP 500 reflects letter of

credit practice more generally. *See* UCP 500 Art. 1 (UCP 500 “shall apply to all Documentary Credits (including Standby Letter(s) of Credit) where they are incorporated into the text of the Credit”). UCP 500 is currently used for both standby letters of credit and commercial letters of credit. Portions of UCP 500 emphasize commercial letters of credit and the documents typically presented under commercial letters of credit, whereas ISP98 is devoted to standbys.

2. What law do you want?

A. UCC Revised Article 5. *See* Section 5-116 (a) and (c) (choice of law and effect of rules of custom or practice, respectively).

B. United Nations Convention on Independent Guaranties and Stand-by Letters of Credit. *See* Article 1 (opt-out).

C. New York law. Per current New York UCC Section 5-102(4), New York UCC Article 5 does not apply to a standby if by its terms or by agreement, course of dealing or usage of trade it is subject in

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whole or in part to the UCP. There is no such automatic exclusion for ISP98. New York UCC Section 1-102(3) permits variation by agreement (with certain exceptions).

D. Foreign law

3. Sample ISP98 incorporation clause:

This letter of credit is issued subject to the International Standby Practices 1998 ("ISP98") and the laws of the [State of New York].

Per ISP98 Rule 1.02(b) and New York UCC Section 1-102(3), it should not be necessary to add to the incorporation clause a sentence such as:

In the event of conflict between ISP98 and a non-mandatory (variable) provision of such law, ISP98 shall govern.

However, one may wish to include such second sentence out of an abundance of caution and to alert the beneficiary and other relevant parties (e.g. confirmer, transferee, assignee of proceeds, etc.) that ISP98 varies certain UCC rules.

4. Consider dispute resolution mechanisms.

A. Express submission to arbitration.

i. ICLOCA – International Center for Letter of Credit Arbitration, Inc.

ii. UNCITRAL – United Nations Commission on International Trade Law.

iii. ICC – International Chamber of Commerce.

iv. AAA – American Arbitration Association.

v. Other.

B. Other ADR (alternative dispute resolution), e.g., DOCDEX, (ICC Rules for Documentary Credit Dispute Resolution Expertise).

C. Express submission to court jurisdiction.

D. Confirmation.

5. Letter of credit application should provide for applicant consent to choice of ISP98, governing law and any dispute resolution mechanism in the letter of credit. *See* Rule 1.04(vi). Application may also provide mechanism to resolve disputes between applicant and issuer as well as corresponding choice of law for application.

6. No need to state that letter of credit is irrevocable, or that issuer's obligations are independent and not conditioned on payment by applicant or anyone else. *See* Rule 1.06.

7. Applicant may want to limit Rule 1.08(c), which provides that an issuer is not responsible for "action or omission of others even if the other person is chosen by the issuer or [a] nominated person." For instance, applicant may want Rule 1.08(c) not to apply to the issuer's branches, agencies or other offices, which are treated as different persons than the issuer under Rule 2.02.

8. ISP98 provides ammunition to argue for the deletion from standby letters of credit of the terms "unconditional," "absolute," "primary," "clear," "payable on demand," and "payable from the issuer's own funds." *See*

Rule 1.10(a).

9. Do not use terms such as "assignable," "evergreen," "reinstate," and "revolving" unless their context gives them meaning. *See* Rule 1.10(c)(ii). Automatic extension clauses and automatic reinstatement or reduction clauses are permitted. *See* Rule 2.06.

10. Unless a confirmer wishes to be a guarantor of the issuer's performance, the confirmer should provide that it is obligated only if the drawing documents are presented to the confirmer. *See* Rule 2.01(d)(ii) (if the confirmation permits presentation to the issuer, confirmer is obligated to honor upon the issuer's wrongful dishonor as if the presentation had been made to the confirmer).

11. Rule 2.07(b) highlights the risk to an issuer or confirmer (and, hence, indirectly to the applicant) where an amendment or cancellation is not timely notified to a nominated person. This risk is greatest where there are multiple nominated persons, as is the case with a freely negotiable credit. The rule may thus discourage the use of freely negotiable standby letters of credit.

12. Drawing documents should identify the letter of credit. *See* Rule 3.03. Where forms of the drawing documents are attached as exhibits to the letter of credit, the forms of exhibits should be drafted to comply with the

Rule.

13. The precise place for presentation should be specified in the letter of credit. *See* Rule 3.04. Avoid use of terms such as “presentation must be made at our counters” unless the meaning is clear from the context.

14. Issuer and applicant should consider whether the application should authorize the issuer to accept presentations in a non-paper medium. *See* Rule 3.06(b)(ii).

15. Installment drawings and shipments should not be a problem as Rule 3.07(a) does not follow UCP 500 Art. 41.

16. Do not say “partial drawings prohibited” unless the beneficiary is only permitted to draw once for the full amount. Consider whether one drawing for less than the full amount or multiple drawings each for less than the full amount may be made. *See* Rule 3.08.

17. Beneficiary should consider requesting issuer to agree in letter of credit to replace the original letter of credit if it is lost, stolen, mutilated or destroyed. *See* Rule 3.12. This is especially important if the letter of credit requires presentation of the original as a condition to drawing or if the beneficiary ever wants to transfer the letter of credit (*cf.* Rule 6.03(b)(ii)) or assign the proceeds of the letter of credit (*cf.* Rule 6.08 (a)). *Cf.* UCC Revised 5-112 (b) (2) (transfer) and 5-114 (d) (assignment of proceeds).

18. Rule 3.13(a) should simplify drafting evergreen clauses and other clauses that refer to the expiration date of the letter of credit. It provides that if the last date for presentation stated in the letter of credit is not a business day of the issuer, then presentation made on the first following business day shall be deemed timely. It does not, however, change the “stated expiration date” to that first following business day. Therefore, if the letter of credit provides that its January 31, 1999 expiration date will be automatically extended for another year on each anniversary of its expiration date, it should be clear that the successive expiration dates will be January 31, 2000, January 31, 2001, January 31, 2002, January 31, 2003, etc., regardless of whether any of those dates or any following January 31 falls on a day that is not a business day. *See also* Rule 9.03(b). *Cf.* UCP 500 Art. 44.

19. Rule 3.14, dealing with closure on a business day, including but not limited to closure because of *force majeure*, departs from UCP 500 Art. 17 (imposing on beneficiary risk of issuer closure for *force majeure*). Parties are free to vary the 30-day extension period provided in Rule 3.14 or to exclude its application entirely. Beneficiaries may also request a provision stating the consequences if the issuer fails to reopen for business within a specified time period.

20. In major departure from UCP 500 Art. 21, presented documents need not be examined for consistency except to the extent provided in the standby. *See* Rule 4.03. Thus, each presented document need only comply with the requirements provided in the letter of credit for such document. If it is desired that the documents must also be examined for inconsistency, then the letter of credit should so provide.

21. Rule 4.07(d) provides default rules for how a signature may be made and how the status of person signing may be indicated. If different requirements are desired, they should be stated in the letter of credit.

22. If “exact” or “identical” wording is wanted in drawing documents, it must be expressly required in the letter of credit. The use of quotation marks or block indents or forms of exhibits is insufficient. *See* Rules 4.09(b) and 4.09(c). Both beneficiaries and issuers may want to avoid the rigors of Rule 4.09(c): the beneficiary because it fears that its documents may be dishonored for failure to comply “exactly”, and the issuer because it fears that it will not be entitled to reimbursement if it honors and the documents do not comply exactly (*see* Rule 8.01(a), unless otherwise provided per Rule 8.01(c)). Query how rigidly a court would enforce a requirement for identical or exact wording, on the one

hand, and how much latitude a court would give a beneficiary to deviate from quoted requirements, blocked text or forms of exhibits, on the other hand. *Cf.* reported cases on apparent typographical errors in letters of credit and drawing documents and reported cases on letter of credit provisions that are incapable of being satisfied. Of course, all drawing requirements should be stated clearly and precisely to minimize the possibility of dispute. *Cf.* Rule 4.01 (terms and conditions of the standby); UCP 500 Articles 5 and 15; UCC Revised 5-108(a); New York UCC 5-114(1).

23. Rule 4.11(a) requires that non-documentary conditions be disregarded, as does UCP 500 Article 13(c). An applicant that wishes to require compliance with a non-documentary condition should limit this Rule or re-work the condition into a documentary condition.

24. Rule 4.13(a) provides that the person honoring a presentation has no duty to the applicant to ascertain the identity of the presenter or any assignee of proceeds. Applicants may request that issuers undertake some responsibility in this regard, but absent special fee arrangements or unusual circumstances, issuers may be reluctant to do more than confirm that they will act honestly.

25. If it is intended that presentation may be made by

fax, the letter of credit should so state. *Cf.* Rules 4.15 (original, copy and multiple documents), 3.04 (where and to whom complying presentation made) and 3.06 (complying medium of presentation).

26. If the letter of credit permits the presentation of only "copies" (*see* Rule 4.15(d)), a careful beneficiary may wish to mark each of the presented documents "COPY". *Cf.* UCP 500 Art. 20(c).

27. If the letter of credit requires presentation of negotiable documents, instruments or certificates, the letter of credit should specify whether, how or to whom endorsement must be made, otherwise endorsement will not be required. *Cf.* Rule 4.18.

28. Rule 5.01 gives the issuer a three business day safe harbor to timely honor or give notice of dishonor. It also provides that taking beyond seven business days is deemed unreasonable. Whether an issuer that takes more than three business days but less than seven business days has acted within a reasonable time will depend upon the circumstances, but will not depend upon whether the beneficiary has an imminent deadline to re-present (Rule 5.01(a)(ii) and (iii)). Issuer and beneficiary may wish to shorten or lengthen the Rule 5.01 time periods. If the timing period is shortened, the issuer may wish to use special procedures (e.g., require presentation to a special

window or prescreen presented documents) to alert itself to the need to use expedited procedures when the documents are presented.

29. Parties may wish to specify to whom and by what means any notice of dishonor must be given, otherwise notice must be given to the presenter by telecommunication, if possible. *See* Rule 5.01(b) and (c). A cover instruction accompanying the presentation may specify to whom notice of dishonor should be sent and what means of telecommunication should be used to transmit the notice. *See* Rule 5.08.

30. A presenter may wish to instruct the issuer not to seek an applicant waiver of discrepancies where the presenter believes that the waiver will not be granted or that seeking waiver will delay notice of dishonor for curable discrepancies. *Cf.* Rules 5.05 and 5.06.

31. Rule 5.06(c)(ii) provides that the presenter is precluded from objecting to the discrepancies notified to it by the issuer if, after receipt of notice of dishonor, the presenter requests that the presented documents be forwarded to the issuer or that the issuer seek the applicant's waiver. The presenter should decide if it believes the documents are discrepant before it asks for a waiver or should consider reserving its right to assert that the documents are not discrepant.

32. If the letter of credit requires presentation of negotiable or otherwise valuable documents, the letter of credit should provide for disposition (return) of the documents upon dishonor. *Cf.* Rule 5.07

33. Rule 5.09 provides that an applicant that fails to timely object to issuer honor by prompt means is precluded from asserting against the issuer any discrepancy apparent on the face of the documents received by the applicant. This rule in effect shortens the one-year UCC Revised Article 5 statute of limitations for a wrongful honor claim (UCC Revised Section 5-115) and explicitly addresses some of the issues recently litigated in *Oei v. Citibank*, 957 F. Supp. 492 (S.D.N.Y. 1997). Applicants and issuers may wish to address this issue differently or more precisely in the letter of credit application (e.g., specify a precise time period for timely notice).

34. If the parties wish to permit transfers of drawing rights in their entirety (Rule 6.02(a)) or in part (Rule 6.02(b)(ii)), the letter of credit must so provide. If the issuer is to be bound to transfer drawing rights, the letter of credit must so provide. *See* Rule 6.02(b)(iii). The issuer may want to state that it is not bound to effect a transfer where the transfer would violate any applicable law or regulation.

35. If presentation of the original letter of credit is not a condition to transfer drawing rights, the letter of credit must so state. *See* Rule 6.03(b)(ii).

36. Consider whether the name of the transferee must or may be used in place of the name of the transferor on various drawing documents. For instance, if the letter of credit requires presentation of a drawing certificate stating that attached thereto is original stock certificate no. C200 for 1,000,000 shares of General Motors Corp. issued to XYZ Corp. and endorsed in blank, it would not make sense to permit the substitution of the name of a transferee for that of beneficiary XYZ Corp. on the drawing certificate. If substitution is not desired, the letter of credit should expressly provide that the name of a transferee may not be used in place of the name of the original beneficiary on certain drawing documents or in specified places on those documents. *Cf.* Rule 6.04(b) (permitting substitution).

37. If the beneficiary wants to be able to assign proceeds of the letter of credit notwithstanding possible issuer objections, the letter of credit should so provide. *Cf.* Rule 6.07(a) (issuer not obligated to give effect to an assignment it has not acknowledged, and it is not obligated to give its acknowledgment); UCC Revised 5-114(c) and (d) (issuer consent required, but issuer not

obligated to consent except that consent may not be unreasonably withheld if the assignee possesses and exhibits the letter of credit and presentation of the letter of credit is a condition to honor). *See also* current UCC Article 9 on secured transactions and proposed UCC Revised Article 9 (specifying where assignment may be made despite contractual provision prohibiting assignment). Issuer may want an express provision that it is not obligated to effect an assignment where prohibited by any applicable law or regulation or where it is not required by any applicable law or regulation to effect an assignment.

38. If presentation of the original letter of credit is not a condition to an assignment of proceeds, the letter of credit must so state. *See* Rule 6.08(a).

39. Issuers need to realize that they may be obligated under certain circumstances to honor a presentation by a claimed successor to the beneficiary. *See* Rules 6.11 - 6.14; *cf.* UCC Revised 5-113. Issuers may wish to have procedures in place to deal with drawings by claimed successors. Issuers may also wish to deal in their letter of credit application forms with issues raised by claimed successors. ■

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