



Standing By Letters of Credit in Commercial Real Estate Transactions

Presented by:
LEGAL EDUCATION DEPARTMENT
of
Attorneys' Title Fund Services, LLC

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Standing By

Letters of Credit in Commercial Real Estate Transactions



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Overview

- Definition
- Parties
- Structure
- Types
- Sources of Authority
- Assignability
- Uses
- Risks/Benefits
- ALTA Endorsement
- What Can Go Wrong?
- Practical Examples
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What is a Letter of Credit?



Definition

A letter of credit, or “credit letter,” is a document from a financial institution guaranteeing payment once the conditions of the letter of credit are met

“A unique commercial vehicle designed to substitute the creditworthiness of a neutral party for that of a party interested in an underlying transaction and assure prompt payment of obligations”
In re Lancaster Steel Co., Inc. 284 B.R. 152 (S.D. Fla. 2002)



Parties



Who's Involved in a Letter of Credit?

Three Main Parties:

1. Issuer – Bank or other party making a commitment to pay
2. Applicant – Customer of issuer seeking the LOC
 - Reimburses the issuer if payment required
3. Beneficiary – Party to be paid when terms of LOC met
 - Presents LOC to Issuer for payment



Possible Additional Parties

- Confirming Bank
 - Agrees to honor LOC issued by another bank
 - Obligated on any letter it confirms
- Advising Bank
 - Notifies Beneficiary of issuance of LOC
 - Not itself obligated on LOC

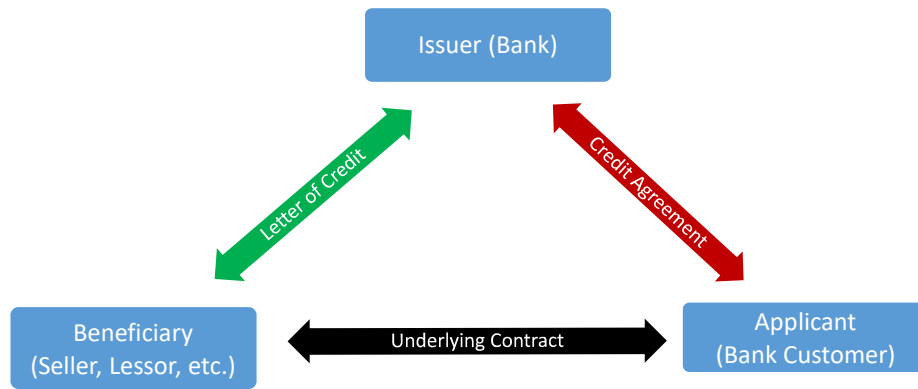


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Structure



Structure of a Letter of Credit



Types of Letters of Credit

Common Types of Letters of Credit

- Commercial
 - “Trade” letters of credit
 - Used in the completion of international trades
 - Largely defined by Uniform Customs and Practice (UCP) published by International Chamber of Commerce
- Standby
 - Payable when beneficiary did not receive promised compensation
 - Functions like insurance or a guarantee
- Revocable
 - Can be amended or canceled. Not popular with beneficiaries

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Common Types of Letters of Credit (cont'd)

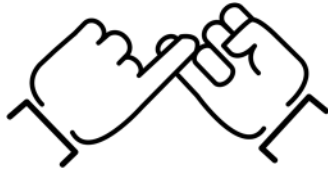
- Irrevocable
 - Cannot be amended or canceled without all parties' consent
 - May be “confirmed” by another financial institution other than applicant's
- Revolving
 - Can be used for a series of payments
 - Typically expire in one year
- Red clause
 - Includes an unsecured loan which acts as an advance on buyer's contract
 - May be used to obtain funding to buy, manufacture or transport goods

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LOC vs. SBLOC

- LOC guarantees payment when specifications met and documents received
 - Ex) Overseas seller delivers goods
- SBLOC guarantees payment when conditions have not been fulfilled
 - Ex) Rent not paid



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Sources of Authority



Florida Statutes

Sec. 675 F.S. Uniform Commercial Code: Letters of Credit (sample excerpt)

675.106 Issuance, amendment, cancellation, and duration.—(1) A letter of credit is issued and becomes enforceable according to its terms against the issuer when the issuer sends or otherwise transmits it to the person requested to advise or to the beneficiary. A letter of credit is revocable only if it so provides.

(2) After a letter of credit is issued, rights and obligations of a beneficiary, applicant, confirmer, and issuer are not affected by an amendment or cancellation to which that person has not consented except to the extent the letter of credit provides that it is revocable or that the issuer may amend or cancel the letter of credit without that consent.

(3) If there is no stated expiration date or other provision that determines its duration, a letter of credit expires 1 year after its stated date of issuance or, if none is stated, after the date on which it is issued.

(4) A letter of credit that states that it is perpetual expires 5 years after its stated date of issuance or, if none is stated, after the date on which it is issued.

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Assignability



Assignability

Ch. 675 F.S. Uniform Commercial Code: Letters of Credit

(1) For purposes of this section, the term “proceeds of a letter of credit” means the cash, check, accepted draft, or other item of value paid or delivered upon honor or giving of value by the issuer or any nominated person under the letter of credit. The term does not include a beneficiary’s drawing rights or documents presented by the beneficiary.

(2) A beneficiary may assign its right to part or all of the proceeds of a letter of credit. The beneficiary may do so before presentation as a present assignment of its right to receive proceeds contingent upon its compliance with the terms and conditions of the letter of credit.

(3) An issuer or nominated person need not recognize an assignment of proceeds of a letter of credit until it consents to the assignment.

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Assignability

Ch. 675 F.S. Uniform Commercial Code: Letters of Credit

(4) An issuer or nominated person has no obligation to give or withhold its consent to an assignment of proceeds of a letter of credit, but 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.

(5) Rights of a transferee beneficiary or nominated person are independent of the beneficiary’s assignment of the proceeds of a letter of credit and are superior to the assignee’s right to the proceeds.

(6) Neither the rights recognized by this section between an assignee and an issuer, transferee beneficiary, or nominated person nor the issuer’s or nominated person’s payment of proceeds to an assignee or a third person affect the rights between the assignee and any person other than the issuer, transferee beneficiary, or nominated person. The mode of creating and perfecting a security interest in or granting an assignment of a beneficiary’s rights to proceeds is governed by chapter 679 or other law. Against persons other than the issuer, transferee beneficiary, or nominated person, the rights and obligations arising upon the creation of a security interest or other assignment of a beneficiary’s right to proceeds and its perfection are governed by chapter 679 or other law.

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Uses



When is a Standby Letter of Credit Used?

Financial SBLOCs

- To back a financial obligation or indebtedness
 - Loan repayment
 - To irrevocably obligate Issuer if Applicant fails to honor their obligation

Performance SBLOCs

- To back performance related duties
 - Contractual, non-financial obligations, e.g.,
 - Completing a construction project
- To irrevocably obligate Issuer if Applicant fails to perform as agreed



Who Uses a Letter of Credit?

- Commercial Landlords and Tenants
 - In lieu of tenant's security deposit on a commercial lease
 - Landlords may prefer because generally available in bankruptcy
 - Tenants may prefer to avoid putting up large amounts of cash
 - In lieu of a personal guarantee in the event of tenant default
 - Limited vs. unlimited guarantee
 - Tenants may prefer to putting giving guarantee
- Tenant could require landlord to post LOC naming tenant beneficiary to ensure funds to cover completion of a build-out in event the landlord is unable to do so
- Buyer might request LOC to back seller's representations/warranties
- Seller might want LOC instead of deposit or indemnity against buyer's possible inspection damage

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Risks & Benefits



Why use a Letter of Credit?

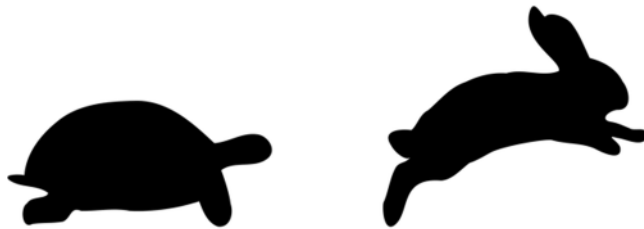
- Issuer (Bank) not part of the real estate transaction
 - If conditions met, Beneficiary may collect without discussion with Applicant
- Letters of Credit generally held not to be part of Applicant's bankruptcy estate
 - Considered an agreement between Issuer and Beneficiary
 - Ex) Landlord can make draws when tenant in bankruptcy
 - Compare to Security deposit, which requires claim in bankruptcy case
- But note: Collateral pledged by debtor as security for a LOC is property of the estate
 - Ex) \$20,000 CD transferred to bank as LOC collateral was a voidable preference
 - See, e.g., *In re Air Conditioning, Inc. of Stuart* 845 F.2d 293, 296 (11th Cir. 1988)

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Why not use a Letter of Credit?

- Cost
 - Applicant typically pays a % of the face value to bank issuing the Letter of Credit
 - Applicant may also need to give security
 - Determined by creditworthiness and other factors
- Delay
 - Ex) Commercial lease: Security deposit more readily available than LOC



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ALTA Endorsement



2021 ALTA 14.2 Future Advance Letter of Credit Endorsement (paraphrased and abbreviated)

- ALTA 14.2 endorsement is used with a loan policy
 - Where principal fluctuates as borrower draws on line of credit
 - Ex) Revolving Note Mortgage)
- Endorsement provides future advances included in coverage of policy
 - Up to amount of Insurance in Schedule A)
 - Revolving note mortgage secures future advances in which principal Indebtedness may increase or decrease during the term of the mortgage but will not exceed a stated maximum
 - Used in farm loans, some construction loans, financing inventory or operating costs, and to establish a line of credit for homeowners based on the equity in their home
- This endorsement (as shown in this section) insures the lender against the following:
 - 3a. Invalidity or unenforceability of the Insured Mortgage as security for each Advance;
 - 3b. Lack of priority of the Insured Mortgage as security for each advance; and
 - 3c. Invalidity, unenforceability, or loss of priority of the Insured Mortgage as security which results from re-advances or repayments, lack of outstanding Indebtedness before the Advance, or the failure of the insured mortgage to comply with state law regarding future advances



2021 ALTA 14.2 Future Advance Letter of Credit Endorsement (cont'd)

- ALTA 2021 form
 - Renumbered
 - Created definitions in 2.

2. The following terms when used in this endorsement mean:
 - a. "Advance": Only an advance of principal made after the Date of Policy as provided in the Agreement, but within 20 years from the date of the Insured Mortgage, including expenses of foreclosure; amounts advanced pursuant to the Insured Mortgage to pay taxes and insurance, assure compliance with laws, or to protect the lien of the Insured Mortgage before the time of acquisition of the Title; and reasonable amounts expended to prevent deterioration of improvements, together with interest on those advances.
 - b. "Agreement": The letter of credit and its reimbursement agreement, the repayment of Advances under which is secured by the Insured Mortgage.

- Changes from ALTA to FL version (same as 06)
 - Added 20-year provision
 - Removed mechanic's liens



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What Can Go Wrong?



What Can Go Wrong?

Lennar Homes v. V. Ventures LLOC, 988 So.2d 660 (Fla. 3rd DCA 2008)

- Lennar sought review of order denying motion to enjoin payment on a LOC listing V. Ventures as beneficiary
- Lennar and V. Ventures entered into option contract granting Lennar option to purchase real property owned by V. Ventures
- Lennar to purchase land in series of closings scheduled in contract
- Lennar posted a LOC with Fidelity Guaranty to secure its own performance
 - Credit could be drawn by V Ventures if Lennar defaulted and
 - V Ventures presented Fidelity with statement certifying Lennar had defaulted
- Land to be developed found subject to “panther mitigation units” requirements that were not met

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What Can Go Wrong?

Lennar Homes v. V. Ventures LLOC, 988 So.2d 660 (Fla. 3rd DCA 2008)

- Lennar did not purchase land due to lack of required panther mitigation “units”
- Lennar argued panther permit problem was V. Ventures’ obligation, relieving it of its own duty to purchase
- Lennar argued that V. Ventures certification of Lennar’s default therefore false
- DCA found no affirmative contract obligation for V. Ventures as to panther-related permitting obligations



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What Can Go Wrong?

Lennar Homes v. V. Ventures LLOC, 988 So.2d 660 (Fla. 3d DCA 2008)

- Held: Affirmed. Lennar failed to demonstrate V Ventures' presentation letter was "forged or materially fraudulent" or that honor of the presentation would facilitate a material fraud by the beneficiary on the issuer or applicant, Sec. 675.109(2), F.S.
- Material fraud by beneficiary occurs when underlying contract "deprives the beneficiary of even a 'colorable' right to" make presentment on a letter of credit. *Ground Air Transfer, Inc. v. Westates Airlines, Inc.* 899 F.2d 1269, 1273 (1st Cir. 1990) (citing *Itek Corp. v. First Nat'l Bank of Boston*, 730 F.2d 19, 25 (1st Cir. 1984))
- Beneficiary's demand for payment must have "absolutely no basis in fact." *Itek*, 730 F.2d at 25 (quoting *Dynamics Corp. of Am. V. 663 Citizens & S. Nat'l Bank*, 356 F.Supp. 991, 999 (N.D.Ga.1973))

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Practical Examples



What Does a Letter of Credit Look Like?

- Typically 1-2 page document
- Each bank issues its own form
- Beneficiary should review proposed for suitability



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What Does a Letter of Credit Look Like?

EXHIBIT I

FORM OF IRREVOCABLE STANDBY LETTER OF CREDIT NO. _____

ISSUER: [Insert Name of Issuing Bank]

ISSUE DATE: __ __ __, 200__

BENEFICIARY: TACTICAL HOLDINGS, INC. A DELAWARE CORPORATION, UNDER THE STOCK PURCHASE AGREEMENT DATED DECEMBER 29, 2007 BETWEEN PHOENIX FOOTWEAR GROUP, INC., AS SELLER AND TACTICAL HOLDINGS, INC., AS BUYER

RE: LETTER OF CREDIT ISSUED IN CONNECTION WITH SECTION 2(e) OF THE STOCK PURCHASE AGREEMENT DATED DECEMBER __ __, 2007 BETWEEN PHOENIX FOOTWEAR GROUP, INC., AS SELLER, AND TACTICAL HOLDINGS, INC., AS BUYER, TO FUND INDEMNIFICATION PAYMENTS DUE FROM SELLER TO BUYER THEREUNDER

APPLICANT: PHOENIX FOOTWEAR GROUP, INC.
5840 EL CAMINO REAL, SUITE 106
CARLSBAD, CALIFORNIA 92008

STATED EXPIRATION DATE: JUNE 29, 2009

MAXIMUM STATED AMOUNT: \$ _____ (subject to reduction as provided below)

[insert name of issuing bank] (the "Issuer") hereby issues this Irrevocable Standby Letter of Credit (the "Credit") for the account of Phoenix Footwear Group, Inc. (the "Applicant") in favor of Tactical Holdings, Inc. (the "Beneficiary") under the Stock Purchase Agreement dated December 29, 2007 between Applicant and Beneficiary (the "Stock Purchase Agreement").

Amount: The Credit is available in an aggregate amount (the "Maximum Stated Amount") not to exceed \$ _____.

Requisites for Drawing: Issuer hereby agrees with the Beneficiary that any request for a Draw (each a "Draw Request") under and in compliance with the terms of this Credit (each a "Draw" or a "Drawing") shall be duly honored by Issuer, upon presentation in the form and by the means provided below on a Business Day before the Stated Expiration Date. A "Business Day" means any day other than (i) a Saturday or Sunday, or (ii) a day on which the commercial banks in [insert relevant jurisdiction for issuing bank], are authorized by law or executive order to close. Draws shall be paid in immediately available United States funds.

Sample from
SEC website
archives



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What Does a Letter of Credit Look Like?

Sample from
SEC website
archives



Each Draw Request under the Credit shall be documented by:

1. The Beneficiary's certificate in the form of **Exhibit A** or **Exhibit B** on Beneficiary's letterhead bearing the clause "Drawn under [] Irrevocable Standby Letter of Credit Number _____", stating the amount of the Draw and executed on behalf of Beneficiary (each a "**Draw Certificate**") and delivered simultaneously to Issuer and Applicant; and
2. For any Drawing which exhausts the Maximum Stated Amount of this Letter of Credit, the original of this Credit shall accompany the Beneficiary's Draw Certificate.

Each Drawing honored shall automatically reduce the Maximum Stated Amount. In no event shall the aggregate Draws hereunder exceed the Maximum Stated Amount.

Issuer shall have no duty to verify the correctness or completeness of any certificate or instructions delivered to Issuer by Beneficiary, but rather may rely without question on any Draw Certificate as to the amount for any Drawing.

Notices; Timing of Payments: All notices, requests, demands, claims and other communications hereunder will be in writing and shall be deemed effectively given (i) upon personal delivery to the party notified, (ii) five (5) days after deposit with the United States Post Office, by registered or certified mail, postage prepaid, return receipt requested, (iii) one day after deposit with a nationally recognized air courier service such as DHL or Federal Express for next day delivery, or (iv) on the day of facsimile transmission, with confirmed transmission, to the facsimile number shown below (or to such other facsimile number as the party to be notified may indicate by ten (10) days advance written notice to the other parties in the manner herein provided), provided that notice is also given under clauses (i), (ii) or (iii) above; in any such case addressed to the party to be notified at the address indicated below for that party, or at such other address as that party may indicate by ten (10) days advance written notice to the other parties in the manner herein provided:

[insert issuing bank's name, address and contact person]

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What Does a Letter of Credit Look Like?

Sample from
SEC website
archives



Phoenix Footwear Group, Inc.
El Camino Real, Suite 106
Carlsbad, California 92008
Attention: James R. Riedman, Chairman of the Board
Telephone: 760-602-1200
Telecopy: 760-602-9684

Tactical Holdings, Inc.
c/o Golden Gate Private Equity, Inc.
One Embarcadero Center, 33rd Floor
San Francisco, CA 94111
Attention: Ken Diekroeger
Telephone: _____
Telecopy: _____

No notice, request, demand, claim or other communication shall be deemed to have been duly given unless and until it is actually received by the intended recipient.

Payment Instructions: Draws shall be paid by means of electronic funds transfer, provided that the Beneficiary shall provide complete funds transfer instructions in advance in the form requested by Issuer, or on the appropriate Draw Certificate. The Beneficiary is hereby notified that in executing such payment order, Issuer will rely on the accuracy of the instructions provided by the Beneficiary on the appropriate Draw Certificate, particularly the account and routing and transit numbers provided by the Beneficiary. Issuer has no duty to refer to names and has no liability for losses resulting from errors in the Beneficiary's instructions. The Beneficiary is requested to use extraordinary care in providing electronic funds transfer instructions.

Expiration:

This Credit shall expire on the earliest of:

- (i) 3:00 p.m. Eastern Time on June 29, 2009 (the "**Stated Expiration Date**"); and
- (ii) the date on which Issuer honors a Drawing which exhausts the Maximum Stated Amount.

This Letter of Credit sets forth in full the undertaking of Issuer, and such undertaking shall not in any way be modified, amended, amplified or limited by reference to any documents, instrument or agreement referred to herein, and any such reference shall not be deemed to incorporate herein by reference any document, instrument or agreement.

ALL BANKING CHARGES ARE FOR THE ACCOUNT OF THE APPLICANT.

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What Does a Letter of Credit Look Like?

This Credit is subject to the Uniform Customs and Practice for Documentary Credits (1993 Revision) International Chamber of Commerce Publication No. 500 (the "UCP"). As to matters not governed by the UCP, this Credit is subject to the laws of New York State as in effect from time to time.

Sample from
SEC website
archives

MANUFACTURERS AND TRADERS TRUST
COMPANY

By: _____
Name: _____
Title: _____

By: _____
Name: _____
Title: _____



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What Does a Letter of Credit Look Like?

Exhibit A

[ON BENEFICIARY'S LETTERHEAD]

**DRAW CERTIFICATE IN CONNECTION
WITH INDEMNIFICATION PAYMENTS**

**Drawn Under _____ Bank
Irrevocable Standby Letter of Credit No. _____**

The undersigned individual, a duly authorized signatory of Tactical Holdings, Inc. (the "**Beneficiary**"), hereby certifies on behalf of the Beneficiary to **[insert name of issuing bank and address]** (the "**Issuer**"), with reference to Irrevocable Standby Letter of Credit No. _____ (the "**Letter of Credit**"; capitalized terms not otherwise defined have the meanings ascribed to them in the Letter of Credit) issued by Issuer in favor of the Beneficiary as follows:

1. The Beneficiary is the buyer under the Stock Purchase Agreement dated December 29, 2007 between Phoenix Footwear Group, Inc. ("**Applicant**") and Beneficiary.
2. The Beneficiary is making a Draw in the amount of \$ _____ (the "**Draw Amount**") under the Letter of Credit to satisfy a claim for indemnification which it made pursuant to Section 7 of the Stock Purchase Agreement by a Claim Notice dated [____], a copy of which is annexed hereto. There has been acceptance of the Claim by Seller in accordance with the terms of Section 7 of the Stock Purchase Agreement. **[Attached hereto as Schedule 1 is a true and complete of the written agreement between the Beneficiary and the Applicant as to the Claim, including an authorization by Applicant to make this Draw]. [OR] Attached hereto as Schedule 1 is a true and complete copy of the judicial determination (as defined in the Stock Purchase Agreement) with respect to the Claim.** Accordingly, payment of such indemnification claim is now due from Seller.
3. The Draw Amount does not exceed the Maximum Stated Amount less the aggregate amount of all previous Draws honored by Issuer, which total \$ _____.
4. A copy of this Draw Certificate has been delivered to Applicant concurrently with delivery to Issuer.
5. Beneficiary hereby instructs Issuer to remit the Draw Amount by electronic funds transfer via Fedwire to the undersigned at account no. _____, account title _____, routing/transit no. _____, bank name and address _____.

[SIGNATURE PAGE FOLLOWS]



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Additional Resources

- Ch. 675, F.S. Uniform Commercial Code: Letters of Credit
- Uniform Customs and Practice for Documentary Credits (UCP)
 - Standardized by the International Chamber of Commerce (ICC)
 - Latest version as of 2022 is the UCP 600 (July 2007)
 - Supplemented by the eUCP intended for electronic commerce
 - <https://iccwbo.org/global-issues-trends/banking-finance/global-rules/>
- *Letters of Credit in Real Estate Transactions*
 - By Nancy Ann Connery
 - https://www.pli.edu/emktg/all_star/Lettrs_Credit27.doc
- *The 4 Types of Letters of Credit, and How They Work in CRE*
 - By Michael Myers
 - <https://leverage.com/financing/letters-of-credit/>



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Questions?



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Standing By

Letters of Credit in Commercial Real Estate Transactions

Thank You!
for coming



John B. "Jay" St. Lawrence
Legal Education Attorney
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**The
Fund**[®]



NALA – The Association of Paralegals, Inc.

7666 E. 61st, Suite 315, Tulsa, OK 74133

Phone: 918-587-6828

FAX: 918-582-6772

<http://www.nala.org>

CERTIFICATE OF ATTENDANCE

Certified Paralegals are required to submit evidence of 50 hours of continuing legal education hours to renew the CP credential every 5 years. Of the 50 hours, 5 hours must be in legal ethics, and no more than 10 hours may be recorded in non-substantive areas. If attending a non-NALA sponsored educational event, this certificate should be completed and submitted with relevant documentation for the event. Please be sure to obtain the required signatures for verification of attendance. The requirements to maintain the CP credential are available from NALA's web site at <http://www.nala.org/CPinfo.aspx>.

PLEASE COMPLETE THE SPACES BELOW AND ATTACH A PROGRAM

Session Hours	Session Topics (Description and Speakers)	Validation of Attendance
1.0 non-substantive	Standing by: Letters of Credit in Commercial Real Estate Transactions	
	John B. St. Lawrence, Fund Legal Ed. Attorney	<i>GBS</i>

Name of CP (Please Print)	149113 NALA Account Number (On Mailing Label)
Signature of CP	<i>Standing By: Letters of Credit</i> <i>Attorneys' Title Fund Services, LLC</i> Name of Seminar/Program Sponsor <i>GBS</i>
Address	Authorized Signature of Sponsor Representative
	Date of Educational Event:
	Online Webinar
Preferred e-mail address	Location:

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September 20, 2022

Reference Number:	2208287N
Title:	Standing By - Letters of Credit in Commercial Real Estate Transactions
Level:	Intermediate
Approval Period:	11/01/2022 - 05/31/2024

CLE Credits

General	1.0
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Certification Credits

Real Estate	1.0
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