When a Letter of Credit Requires Presenting Original Documents, **PRESENT ORIGINALS!**

A LETTER OF CREDIT (LC) IS A POWERFUL COLLECTION TOOL FOR CREDITORS. AN LC REQUIRES AN ISSUING OR CONFIRMING BANK TO MAKE PAYMENTS TO AN LC BENEFICIARY AFTER THE BENEFICIARY MAKES A VALID DRAW ON THE LC. IT PROVIDES THE CREDITOR/LC BENEFICIARY A SOURCE OF RECOVERY IN THE EVENT A CUSTOMER FAILS TO PAY OUTSTANDING INVOICES—SO LONG AS THE BENEFICIARY SATISFIES THE LC'S DOCUMENTARY REQUIREMENTS.

Courts generally apply the doctrine of "strict compliance" to LC draws. That is, a creditor seeking payment of an LC must strictly comply with the LC's documentary requirements. For example, LCs frequently require the presentation of original documents, such as the LC and amendments, rather than copies of those documents. Courts have held that even the slightest deviation from a requirement to present original documents will fall short of "strict compliance" and enable the bank to dishonor the LC draw.

The need to present original documents when seeking payment of an LC is highlighted in a 2024 decision by the United States District Court for the Southern District of New York, in *Milky Whey, Inc. v. HSBC Bank USA, N.A.* There, the District Court upheld a bank's dishonor of an LC draw due to the creditor's presentation of a copy of an amendment to the LC despite the LC's requirement that the original LC and amendments must be presented. Creditors seeking LC protection should try to eliminate any requirement for the presentation of the original LC and amendments or be sure that originals are available to present to the bank when drawing on the LC. Otherwise, the creditor may find itself empty-handed when seeking to obtain payment on its LC.

LETTERS OF CREDIT: AN OVERVIEW

An LC arrangement typically involves three parties and contracts, and in some instances a fourth party and contract, consisting of:

1. A contract between a creditor and debtor, such as a contract for the sale of goods, where the creditor seeks to backstop the debtor's obligations under that contract.
2. A second contract between the bank and the debtor, known as the LC applicant, who is arranging the issuance of an LC. This contract includes the terms governing the LC, the applicant's obligation to reimburse the bank for the bank's payments to the beneficiary upon the presentation of conforming documents, the collateral securing payment of the applicant's reimbursement obligation to the bank and all fees and other charges in connection with the LC that the applicant owes to the bank.
3. A third contract—the LC itself—where a bank is issuing an LC in favor of the creditor, known as the LC beneficiary. When a beneficiary submits documents to the issuing bank, the bank's only duty is to examine the documents and determine whether they comply with the LC's documentary requirements. When an issuing bank determines that the beneficiary has satisfied all of the

CREDITORS SEEKING LC PROTECTION SHOULD TRY TO ELIMINATE ANY REQUIREMENT FOR THE PRESENTATION OF THE ORIGINAL LC AND AMENDMENTS OR **BE SURE THAT ORIGINALS ARE AVAILABLE TO PRESENT TO THE BANK WHEN DRAWING ON THE LC.**

LC's requirements, the bank must then pay the amount the beneficiary requested. If the bank rejects a beneficiary's presentation of conforming documents, the bank is in breach of its obligation to pay on the LC and is subject to the beneficiary's assertion of a wrongful dishonor claim.

4. In certain instances, a fourth contract between the issuing bank and a "confirming" bank. A confirming bank takes on the issuing bank's duty to pay an LC draw upon the creditor's presentation of conforming documents to the confirming bank. Upon properly making a payment, the confirming bank is entitled to reimbursement by the issuing bank. The confirming bank effectively steps into the issuing bank's shoes and, in turn, provides an additional level of security for the creditor.

AN ISSUING BANK MUST HONOR THE BENEFICIARY'S REQUEST FOR PAYMENT, WHERE THE BENEFICIARY PRESENTS ALL OF THE DOCUMENTS THE LC REQUIRES.

The independence principle is a central tenet of LC law. Each of the relevant contracts in an LC transaction is independent of the others. An issuing bank must honor the beneficiary's request for payment where the beneficiary presents all of the documents the LC requires. It does not matter that disputes exist between the beneficiary and the applicant in their transaction or between the applicant and the issuing bank, including the applicant's inability to reimburse the issuing bank for all LC payments. Similarly, as a general rule, if the issuing bank makes payment to the beneficiary based upon the beneficiary's presentation of noncomplying documents, the bank's customer/applicant is not obligated to reimburse the bank for that payment.

GOVERNING LAW AND COMPLIANCE STANDARDS

Article 5 of the Uniform Commercial Code (UCC) is a primary source of governing law for LCs. LCs might also be governed by the Uniform Customs and Practice for Documentary Credits (UCP), or by the International Standby Practices (ISP 98), which governs standby LCs. Subject to certain exceptions, UCC § 5-103 and the UCC's official commentary state that Article 5's terms can be varied by an agreement between the relevant parties or practices adopted in a particular LC. In *Milky Whey*, the LC stated that it was subject to ISP 98 and, for matters not covered by ISP 98, the laws of the State of New York, including Article 5 of the UCC, governed.[1]

New York's UCC § 5-108(a) imposes a strict compliance standard for determining whether a creditor has presented conforming documents as part of an LC draw. While exceptions may be made in limited circumstances (e.g., for immaterial typographical errors), the strict compliance standard requires a creditor to satisfy the LC's documentary requirements without any deviation. If the creditor fails to do so, the bank is not required to honor the requested draw.

ISP 98 applies a different standard. ISP 98 Rule 4.01 states that "Demands for honour of a standby must comply with the terms and conditions of a standby." The Official Commentary to ISP 98 notes that it intentionally omits the phrase, "strict compliance," explaining that:

Rule 4.01 avoids the term "strict compliance" which is a crude and abstract formulation by which to describe the standard of examination and one which is used primarily because it is less inaccurate than the notion of "substantial compliance" against which it is typically contrasted. The test of compliance turns on the role of the particular document in standby practice. The text of some documents must correspond to the text of the standby, others must be identical or exact, whilst still others need merely be not inconsistent with the standby[.]

Nonetheless, ISP 98 Rule 4.15(a) requires that "[a] presented document must be an original." The Official Commentary notes that this rule "begins with the presumption that an original is required unless the standby states otherwise," and that, "[t]his understanding is implicit in standard practice."

BACKGROUND REGARDING THE *MILKY WHEY* DECISION

In June of 2018, The Winning Combination, Inc. applied for and obtained an irrevocable standby LC[2] in the amount of USD $800,000 from HSBC Bank Canada (HSBC CA) as the issuing bank, with The Milky Whey, Inc. (Milky Whey) as the named beneficiary of the LC. HSBC Bank USA, N.A. (HSBC USA), as the confirming bank, added its confirmation of the LC. The LC was thereafter amended three times, including a First Amendment that reduced its amount to USD $790,000.

As noted above, the LC was subject to ISP 98 and, for matters not governed by ISP 98, the laws of the State of New York (including UCC Article 5) governed. In addition, the LC required that any written demand to draw on the LC be accompanied by the original LC and all amendments.

On March 9, 2022, Milky Whey presented documents to HSBC US, seeking payment of USD $790,000 owed by The Winning Combination, Inc. to Milky Whey for goods The Winning Combination, Inc. had purchased but had not paid for. HSBC US refused to honor the LC draw because Milky Whey had presented a copy of the First Amendment rather than an original.

WHILE EXCEPTIONS MAY BE MADE IN LIMITED CIRCUMSTANCES (E.G., FOR IMMATERIAL TYPOGRAPHICAL ERRORS), THE STRICT COMPLIANCE STANDARD REQUIRES **A CREDITOR TO SATISFY THE LC'S DOCUMENTARY REQUIREMENTS WITHOUT ANY DEVIATION.**

On November 2, 2022, Milky Whey commenced an action for wrongful dishonor of the LC and breach of contract against HSBC US and HSBC CA in the New York Supreme Court, New York County. The defendants removed the action to the United States District Court for the Southern District of New York and thereafter moved to dismiss the action, arguing that Milky Whey was required to present the original First Amendment (and other original LC documents) pursuant to the LC and ISP 98.

THE DISTRICT COURT'S DECISION

The District Court granted defendants' motion to dismiss due to Milky Whey's presentment of a copy, in lieu of the original, First Amendment. To prevail on a wrongful dishonor claim, the creditor-plaintiff must prove that: (1) there is an LC issued by the defendant for the plaintiff's benefit; (2) the plaintiff timely presented conforming documents to the defendant pursuant to the LC; and (3) the defendant failed to pay the plaintiff on the LC. Here, the creditor did not timely present conforming documents—particularly the original First Amendment—as the LC required.

The Court rejected Milky Whey's argument that its presentation of a copy of the First Amendment was "a formality of no practical consequence." Milky Whey had argued that it could rely on a copy of the First Amendment based on a decision issued in 2015 by New York's Appellate Division, in *Ladenburg Thalmann & Co., Inc. v. Signature Bank*. However, the District Court distinguished *Ladenburg* for a couple of reasons. First, in *Ladenburg*, the LC was ambiguous as to whether a copy of the applicable document could be presented (whereas in *Milky Whey*, there was no such ambiguity). Also, and perhaps most importantly, the LC in *Ladenburg* had not adopted ISP 98; the *Milky Whey* LC had adopted ISP 98, including ISP 98's general rule that original documents must be presented.

The District Court concluded that Milky Whey was required to present original documents based on the LC's clear language and relevant provisions of ISP 98. *Milky Whey* had failed to do so, and therefore could not prove a wrongful dishonor claim. BC

1. The Court noted that few courts have interpreted ISP 98's provisions and, therefore, focused on UCC Article 5.

2. The beneficiary of a standby LC must first look to its customer or other obligor for payment. The standby LC serves as a backstop for payment of the claim.

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