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LETTERS OF CREDIT
IN A COMMERCIAL LEASING CONTEXT

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I. INTRODUCTION:

A letter of credit is a useful tool for commercial landlords and tenants. As a separate legal instrument, the letter of credit provides sufficient security against default and substitutes the requirement for initial cash deposits. While a letter of credit appears to be the golden goose of commercial leases, drafting an effective lease and letter of credit requires precision and understanding of the implied terms.

This paper will discuss the use, application, advantages and disadvantages of letters of credit in the commercial leasing context. This paper will also address the differences between a letter of credit, letter of guarantee and a bond. Finally, this paper will provide certain tips and traps in dealing with letters of credit.

II. TERMINOLOGY

a. Type and Structure of a Letter of Credit

Letters of credit can be drafted in many forms. For instance, a letter of credit may be “revocable” or “irrevocable”.¹ A “revocable” letter of credit can be revoked, amended or cancelled at any time by the issuer.² An “irrevocable” letter of credit creates a definite undertaking of the issuing bank and cannot be unilaterally amended or cancelled.³

An example of an irrevocable letter is a “standby letter of credit”. A standby letter of credit will only be honoured upon default of the applicant and subject to the proof of non-compliance.⁴ Standby letters of credit are a tool that both commercial landlords and tenants can use as a security device in lieu of cash deposits. The purpose of a standby letter of credit is to prove financial ability and commitment; it is not for the payment of goods or services.⁵ An example of a standby letter of credit is included in Appendix A.

¹ Lazar Sarna, *Letters of Credit: The Law and Current Practice*, 3rd ed (Toronto: Thomson Reuters Canada, 2015) (loose-leaf updated 2021, online) at § 1:22.

² *Ibid* at § 1:23.

³ *Ibid* at § 1:25.

⁴ *Ibid* at § 1:30.

⁵ Tarsem Bhogal & Arun Trivedi, *International Trade Finance: A Pragmatic Approach*, 2nd ed (London: Palgrave Macmillan, 2019) at 89.

A letter of credit serves as a separate instrument with a distinct personality from the underlying lease. The purpose and use of a letter of credit will depend upon the industry or underlying commerce to which it relates. In commercial leasing, the letter of credit is commonly used as a means of security; the landlord relies upon the credit of a banking institution as a substitute to relying upon the direct credit of the tenant.

In the commercial leasing context, the letter of credit will typically involve three parties: the beneficiary, the applicant, and the issuer. The beneficiary of the letter of credit will typically be a landlord. The landlord will rely upon the letter of credit as security against a tenant defaulting under the terms of the lease. Often the landlord will request a letter of credit in lieu of a cash security deposit.

The applicant for the letter of credit will normally be a tenant. The tenant applies to an issuer, usually their banking institution, who then provides the landlord with a letter of credit. Below is an illustration of this relationship.

Figure 1: Relationship between parties to a letter of credit for a commercial lease



In the ordinary course, the tenant will arrange for their bank to issue the letter of credit, which will allow the landlord to draw upon the money represented by the letter of credit. Typically the bank must honour the letter of credit upon the landlord’s presentation of the appropriate documents to the bank; this presentation is sufficient to trigger the bank’s obligation to pay.

The letter of credit normally consists of a short 1-2 page document and will contain a number of standard terms. Although simple in appearance, if the letter of credit, or the underlying lease, do not correctly set out the rights and obligations of the parties, serious problems may arise. The landlord must ensure that the letter of credit and lease are correctly drafted so that if the tenant does not fulfill its obligations under the lease, the landlord can claim the sum it is owed.

b. Differences Between a Letter of Credit and a Letter of Guarantee

A guarantee is an undertaking or promise to pay in the event of a debtor's default. Under a letter of guarantee, the bank is a surety that "undertakes to indemnify the creditor against loss arising from the non-payment or non-performance of the principal debtor."⁶ Conversely, under a letter of credit, the bank is liable as a principal, rather than a surety, that "undertakes to pay upon presentation of documents."⁷

The issuer's liability is an important distinction between these two letters. In *Westpac Banking Corp v Duke Group Ltd*,⁸ Farley J held that a letter of credit creates a "primary liability, to pay on the presentation of documents, rather than a secondary liability, to pay in the event that the borrower defaults."⁹ In relying on an American decision in *Re Carley Capital Group*, 119 B.R. 646 (W.D. Wis. 1990),¹⁰ Farley J cited the following passage:

"This principle relieves parties to a letter of credit transaction from the burden of ascertaining and policing contractual relationships in which they are not involved. As a result the beneficiary of a letter of credit obtains a higher level of security with the letter of credit and need only concern itself with its own contractual relationships."¹¹

The bank's obligations under a letter of credit are autonomous from the underlying document. In a letter of credit scenario, the bank has to satisfy themselves that they have received the executed documents required by the letter of credit. In the absence of clear proof of fraud, the presentation of the requisite documents is sufficient to trigger the bank's obligation to pay the landlord. The bank does not need to satisfy itself of a default as it would under a letter of guarantee. It is a letter of credit's autonomy from the underlying document which most clearly distinguishes a letter of credit from a guarantee,¹² making it a desirable option for landlords seeking a security deposit.

Letters of credit are often confused with letters of guarantee because these documents are closely analogous. While both documents provide a form of security against a tenant's default, there are subtle differences that must be understood so that the appropriate instrument is selected. An example of a letter of guarantee is included in Appendix B.

⁶ Canadian Encyclopedic Digest (online), *Guarantee, Indemnity and the Standby Letter of Credit*, "Letters of Credit" (XIV.5) at § 423 [CED Guarantee, Indemnity and Letter of Credit].

⁷ *Ibid.*

⁸ *Westpac Banking Corp v Duke Group Ltd*, [1994] OJ No 2203 (QL), 20 OR (3d) 515 [*Westpac*].

⁹ *Ibid* at para 18.

¹⁰ *Re Carley Capital Group* (1990), 119 B.R. 646 (W.D. Wisc.) in *Westpac*, *ibid* at para 18.

¹¹ *Ibid.*

¹² *Ibid.*

c. Differences Between a Letter of Credit and a Bond

Bonds fall under the umbrella of guarantee agreements. A “surety bond” is a written bond under seal and is generally made up of three parts: (i) an obligation of the issuer bank, (ii) the recitals or factual context of the underlying transaction, and (iii) conditions of the bond.¹³ Surety bonds, like guarantees, arise upon the default of the principal’s obligations. In some cases, the bond will allow the issuing bank to choose between paying the damages suffered and performing the guaranteed obligation itself.¹⁴ The scope of the bank’s obligations or liability will depend on the terms of the surety bond and the underlying contract between the parties.¹⁵ This is because a surety bond is entirely dependent on the principal debt relationship.¹⁶

There are several key distinctions between letters of credit and bonds. As previously noted, a letter of credit is independent or “autonomous” from any other transaction or contract. Conversely, a surety bond attaches to the underlying contract and liability becomes a matter of contractual interpretation.¹⁷ Where a letter of credit operates as a “primary” obligation of an issuer, a surety bond operates as a “secondary” obligation. This distinction arises from the level of security afforded to letters of credit.

Moreover, the evidentiary requirements for calling on a letter of credit or surety bond widely differ. To call on a surety or bond, the beneficiary must provide proof of default.¹⁸ In the case of a letter of credit, the issuer is bound to pay on the presentation of documents. Under a letter of credit, an issuer does not have the right to examine or consider an underlying agreement because the obligation to pay is independent.¹⁹

Commercial leases infrequently use surety bonds. Letters of credit are held to be more reliable and are a widely-used business practice.²⁰ While surety bonds may provide lower surety rates and fewer structural formalities, the evidentiary burden and secondary level of security of bonds make it less desirable for commercial landlords.²¹

¹³ *CED Guarantee, Indemnity and Letter of Credit*, *supra* note 6 (XIV.3.(b)) at § 388-389.

¹⁴ *Ibid* at § 389.

¹⁵ *Ibid* at § 388-389.

¹⁶ Sarna, *supra* note 1 at § 2:8.

¹⁷ *CED Guarantee, Indemnity and Letter of Credit*, *supra* note 6 (XIV.3.(b)) at § 388-389.

¹⁸ Sarna, *supra* note 1 at § 2:8.

¹⁹ *Ibid*.

²⁰ Elizabeth Purcell-Gibney, ed, *Best Commercial Lease Clauses*, 8th ed (New York: Vendome Real Estate Media, 2016) at 294.

²¹ Sarna, *supra* note 1 at § 1:30.

III. ADVANTAGES AND DISADVANTAGES OF LETTERS OF CREDIT FOR LANDLORDS AND TENANTS

In commercial leasing, the motivation behind letters of credit will largely depend upon whether one is a landlord or tenant, as well as the specifics of the underlying lease. With this in mind, the following discussion provides insight as to why landlords and tenants may or may not wish to use a letter of credit in lieu of cash security.

a. Advantages to Landlord

i. Protection from bankruptcy or insolvency

In the event of the tenant's bankruptcy or insolvency, the landlord is especially vulnerable. When a tenant's trustee in bankruptcy disclaims a commercial lease, this effectively ends "any future or ongoing obligations of the bankrupt tenant."²² Absent any security agreement, the landlord has no right to compensation for damages for the remainder of the lease. Instead, the landlord may only claim up to three months' accelerated rent.²³

Letters of credit do not form part of the tenant's property and may therefore offer protection to the landlord if the tenant becomes bankrupt or insolvent. Protection in these cases is one of the principle motivations behind a landlord's request for a letter of credit as security. If the landlord's security is something other than a letter of credit, or the letter of credit or lease are improperly drafted, the landlord's recourse for recovery is as a debtor in the bankruptcy process. This would put the landlord in a similar position to other unsecured creditors.

Recently in *7636156 Canada Inc (Re)*,²⁴ the Ontario Court of Appeal reaffirmed that, absent evidence of fraud, bankruptcy does not invalidate the autonomous and independent nature of a letter of credit; an issuer bank must pay the landlord upon receiving proper documentation.²⁵ The Court also noted that a landlord's entitlement to call on a letter of credit will depend on the language of the lease and letter of credit.²⁶ In this case, the lease specifically provided that the letter of credit would act as security for the landlord for losses in connection with insolvency and bankruptcy. For this reason, the well-drafted lease and letter of credit enabled the landlord to recover payments that were owed.

²² Canadian Encyclopedic Digest (online), *Bankruptcy and Insolvency*, "Election to Retain or Surrender a Lease" (VI.5.(o)) at § 272.2.

²³ *Ibid*; *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, s 136(3).

²⁴ *7636156 Canada Inc (Re)*, 2020 ONCA 681; See Virginia Gauthier, "Bankrupt Tenant: Can a Landlord Draw on a Letter of Credit After the Trustee Disclaims the Lease?" (published 9 Feb 2021), online: *Gowling WLG*, <gowlingwlg.com/en/insights-resources/articles/2021/bankrupt-tenant-can-a-landlord-draw-on-a-letter/>.

²⁵ *Ibid* at paras 66, 83.

²⁶ *Ibid* at para 83.

Correctly drafted, a letter of credit is a draw against the issuing bank and is not an attempt to realize upon the property of the tenant. As such, a letter of credit can help insulate the landlord if the tenant seeks bankruptcy protection.

ii. Timing issues for landlord

The landlord may draw upon a letter of credit whenever they deem it necessary to do so. Furthermore, a letter of credit does not necessarily require an act of default in the lease for the landlord to draw upon the letter of credit. To realize upon a letter of credit, the landlord must present to the issuing bank the documents outlined in the letter of credit.

The subjective determination as to when to present these documents may be a significant advantage from the perspective of the landlord, while it may be a significant disadvantage to the tenant. The ability to decide when to draw upon the letter of credit provides the landlord with additional leverage over the tenant.

b. Advantages to both landlord and tenant

i. Possibility of increased security amounts available with a letter of credit

The letter of credit provides an important protection for the landlord. A well-drafted letter of credit and lease may encourage a landlord to lease to a tenant whom they might not otherwise. It has been noted that:

“[L]andlords generally prefer to enter into leases with creditworthy tenants – tenants with high and demonstrable net worth, substantial tangible and liquid assets, and a long track record of successful operation and paying bills. Most landlords do not have that luxury. Moreover, even tenants that start out cash flush or rock solid can suffer credit deterioration to the point that they become high-risk tenants long before the normal commercial lease expires.”²⁷

From the perspective of the tenant, the letter of credit allows the tenant to avoid giving a cash security deposit to the landlord. As a result, this allows the tenant to provide security without unnecessarily tying up large amounts of the tenant’s capital.²⁸ The cash outlay avoided by the tenant may then be used for other aspects of their business.

²⁷ Susan Fowler McNally, Carter Klein & Michael Abrams, “Letters of Credit in Lease Transactions, Part I: Advantages to Landlord and Landlord’s Lender” (2002) 16 Prob & Prop 28 at 28.

²⁸ Calvin H Klein, “Using Letters of Credit to Secure Lease Obligations” (2005) 18:4 Commercial Leasing Law and Strategy 1 at 1.

From the perspective of the landlord, a letter of credit allows the landlord to command larger security amounts that they can rely upon should the tenant default. This is particularly advantageous to landlords who are faced with offering ever bigger inducements in order to attract tenants in a tightening market. If the letter of credit is large enough, the landlord may enter into a lease with a tenant that the landlord might otherwise have refused, due to the tenant's lack of creditworthiness.²⁹

c. Disadvantages of a letter of credit

i. Potential for fraud

Under a letter of credit, the obligation of the bank to pay the landlord is independent of default under the lease.³⁰ The autonomy between a letter of credit and the underlying lease may create an indirect inducement for fraud.³¹ This is because the breach of the lease to which payment relates is at the subjective determination of the landlord.³² From the perspective of the landlord, if there is some question about the tenant's performance under the lease, it may be easier for the landlord to draw upon the letter of credit first and ask questions later.

Prematurely drawing upon the letter of credit raises two issues for the landlord. First, by calling upon the letter of credit before confirming non-performance of the tenant's contractual obligations, the landlord may incite unwanted litigation by the tenant. If the lease obligations are eventually found to have been properly performed by the tenant, the tenant will then have to attempt to recover the cash advanced under the letter of credit by seeking a court injunction to stop payment from the bank to the landlord.³³

Second, the issuer bank may refuse to make payment under a letter of credit if there is clear evidence of fraud. Although compliance disputes between a landlord and tenant are impertinent to the landlord's right to obtain payment under the letter of credit, fraud is an exception to the letter of credit's autonomy.³⁴ That being said, this exception is not autonomic and does not constitute a pre-requisite to paying out a letter of credit.³⁵

²⁹ McNally, *supra* note 27 at 19.

³⁰ *CED Guarantee, Indemnity and Letter of Credit*, *supra* note 6 (XIV.7) at § 429.

³¹ Sarna, *supra* note 1 at § 5:2.

³² *CED Guarantee, Indemnity and Letter of Credit*, *supra* note 6 (XIV.7) at § 429.

³³ J Brian Casey, "Letters of Credit Litigation: Pitfalls and Protection" in *Effective Security and Financing Instruments in Commercial Lending* (Conference paper presented 25 March 1997) (Toronto: Insight Press, 1997) at 27-28.

³⁴ Sarna, *supra* note 1 at § 5:8.

³⁵ *Ibid.*

The bank's ability to refuse payment has been frequently litigated. The courts have maintained that unless there is clear evidence of fraud, the bank should advance the funds under a letter of credit provided the requisite documents are produced by the landlord.³⁶ To rely on the fraud exception, there must be a strong *prima facie* case; mere suspicion or a mere possibility of fraud is insufficient.³⁷ This is because the landlord does not owe an implied duty of care in drawing on the letter of credit and exercising its right for payment.³⁸ The threshold for establishing fraud is high and should only be raised in the clearest of cases.

Landlords and tenants should take the time to understanding the terms, timelines and conditions for drawing on a letter of credit. In doing so, this will avoid any surprise and allegations of wrong-doing.

ii. The tenant and the bank

While the tenant may be able to increase their cash flow by using a letter of credit in lieu of a cash deposit, it is not a fail-proof financial instrument. The tenant will normally be required to provide the bank with cash collateral that is equal to or greater than the amount pledged by the letter of credit. At the very least, the issuance of a letter of credit will reduce the amount that is available to the tenant under its line of credit.³⁹

Given that the letter of credit is an autonomous obligation upon the bank, the bank, in the ordinary course, will require the tenant to pay a fee equal to a percentage of the amount of the letter of credit. In addition to the bank's fee, the issuance of letters of credit tends to increase the dependency of the tenant upon its bank. However, if a tenant has a strong relationship with its bank, the tenant may be able to negotiate more favourable terms with the bank on the issuance of letters of credit.

³⁶ *CED Guarantee, Indemnity and Letter of Credit*, *supra* note 6 (XIV.7) at § 431-432.

³⁷ Sarna, *supra* note 1 at § 5:8.

³⁸ *Ibid* at § 2:12.

³⁹ *CED Guarantee, Indemnity and Letter of Credit*, *supra* note 6 (XIV.7) at § 431-432.

IV. INCORPORATING THE TERMS OF THE UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS

It is a standard and accepted practice to incorporate, by reference in the letter of credit, all terms set out in the codified *Uniform Customs and Practice for Documentary Credits* (the “**Uniform Customs**”).⁴⁰ The Uniform Customs are drafted by the International Chamber of Commerce (the “**ICC**”) and the current Uniform Customs are frequently referred to as “Publication 600” or “UCP 600”.⁴¹ The ICC is an international non-government body with constituent members around the world, including of industrial federations, trade associations, Chambers of Commerce, as well as industrial and commercial enterprises.⁴²

The Uniform Customs, once incorporated in the letter of credit, constitute the law between the parties.⁴³ In most cases, the letter of credit will simply state that it is subject to the terms of the Uniform Customs. The Uniform Customs are typically referenced because it provides a uniformly-accepted standard of interpretation for the letter of credit. In the absence of an incorporation by reference of the Uniform Customs, the letter of credit itself would have to define numerous terms and outline precise conditions.

The Uniform Customs provide a comprehensive framework for the obligations and liabilities of the parties to the letter of credit.⁴⁴ Once invoked, the Uniform Customs provides rules of interpretation for the letter of credit which may, to the uninitiated, lead to unanticipated results. These aspects are discussed below with reference to the necessary provisions that must be included in the underlying lease to avoid unwanted surprises.

V. TIPS AND TRAPS

The following section will discuss the various drafting tips and traps when dealing with letters of credit.

1. The lease should provide that the form and substance of the letter of credit is satisfactory to the landlord.

The landlord will want to ensure that the provisions in the letter of credit are drafted to protect the landlord. The landlord will also want to ensure that the letter of credit does not contain

⁴⁰ International Chamber of Commerce, *Uniform Customs and Practice for Documentary Credits*, 2019 Revision [UCP600].

⁴¹ Sarna, *supra* note 1 at § 2:24.

⁴² See <www.iccwbo.org/> for further information on the ICC.

⁴³ Sarna, *supra* note 1 at § 2:25.

⁴⁴ *Ibid* at § 2:26.

provisions that will make it more difficult for the landlord to draw upon the letter of credit.

2. The lease should stipulate the letter of credit is to be provided to the landlord in draft form, for its review and approval, before being issued by the bank.

Invariably, the first time the landlord sees the letter of credit is after it has been issued by the tenant's bank. Any necessary amendments required by the landlord must then be addressed by a formal amendment to the letter of credit. This is not ideal.

3. The lease should provide that the letter of credit be issued by a recognized banking institution.

The landlord is relying upon the creditworthiness of the bank as its security. A landlord can protect their interests by stipulating in the lease that the letter of credit must be issued from a Schedule 1 Bank or a Schedule 2 Bank under the *Bank Act*.

4. The lease should require that the letter of credit be transferrable.

A letter of credit is non-transferable. The Uniform Customs provide that a "bank is under no obligation to transfer a credit except to the extent and in the manner expressly consented to by that bank."⁴⁵ It is therefore important that the transferability of a letter of credit is established and negotiated when the letter of credit is drafted. It will be imperative to the landlord that, if it sells the property, it be permitted to transfer the benefit of the letter of credit to the purchaser.

It should also be noted that under the Uniform Customs, a letter of credit may only be transferred once.⁴⁶

Finally, the bank will typically charge an administration fee to transfer a letter of credit. It would be a prudent practice to stipulate in the lease, whether it is the landlord or tenant who will pay this administration transfer fee.

5. The lease should provide that the letter of credit will allow for partial draws without requiring the landlord to forfeit the balance outstanding on the letter of credit.

Ordinarily, unless specifically provided otherwise, if a landlord makes a partial draw, it will be the only draw allowed on the letter of credit. If the landlord is only able to make one draw, it will significantly limit the effectiveness of the letter of credit.

6. If the lease is for a term of more than one year, it should provide for an automatic

⁴⁵ *UCP600*, *supra* note 40, art 38a.

⁴⁶ *Ibid*, art 38d.

renewal of the letter of credit.

In the ordinary course, a letter of credit is issued for a term of one year. It is highly unlikely that a bank will issue a letter of credit for the full term of the lease. Typically, the letter of credit will stipulate that it is automatically extended in one year increments (to an outside date) unless, at least 30 days prior to the expiry of the letter of credit, the bank gives the landlord written notice that the letter of credit will not be extended. The lease should provide that the bank's election not to renew the letter of credit constitutes an event of default under the lease, thereby allowing the landlord to draw upon the letter of credit before it expires. The thirty-day overlap gives the landlord sufficient time to draw upon the expiring letter if the tenant fails to provide a replacement letter of credit.

7. The lease should provide that a letter of credit must continue until 60 days after the expiration of the lease.

This provision will protect the landlord if the tenant damages the premises while the tenant is moving out or if the landlord only discovers property damage or environmental contamination after the lease has expired.

8. The lease should expressly state that the purpose of the letter of credit is to provide security for the tenant's obligations under the lease not just its obligation to pay rent.

Commercial leases include provisions requiring the tenant to do all sorts of things in addition to paying rent, including, by way of example, the obligation to restore the premises at the end of the term, making the tenant liable for damages for breach of the lease, the obligation to repay the landlord the cost of tenant allowances, inducements, landlord's work and real estate commissions paid by the landlord.

9. The lease should provide that failure to maintain a letter of credit is an event of default that entitles the landlord to transform the letter of credit as security for the lease into a cash security deposit.⁴⁷

This provision will permit the Landlord to draw down on the letter of credit if it receives notice from the issuing bank that the bank will not renew the letter of credit.

10. Sample clauses are attached as Appendix C.

⁴⁷ Susan Fowler McNally, Carter Klein & Michael Abrams, "Letters of Credit in Lease Transactions, Part II: Drafting Tips" (2002) 16 Prob & Prop 43 at 46.

VI. INTERNATIONAL STANDBY PRACTICES AND UNIFORM CUSTOMS IN COMPARISON

Thus far, this article has been canvassing letters of credit following the Uniform Customs. However, the Institute of International Banking Law & Practice (the “IIBLP”) drafted rules specifically for standby letters of credit known as the “International Standby Practices” or “ISP98.”⁴⁸ The IIBLP is a not-for-profit education and research organization addressing issues in banking law and practice.⁴⁹

The IIBLP focussed on issues arising under standby letters of credit, which were not adequately addressed under the Uniform Customs. The ISP98 serves as a beneficial tool for landlords seeking security from tenants. ISP98 has been reviewed and upheld by the ICC as “Publication 590”, and are held to be in compliance with the United Nations Commission on International Trade Law Convention on Independent Guarantees and Standby Letters of Credit.⁵⁰

Similar to the Uniform Customs, once the ISP98 is incorporated by reference into the letter of credit, it constitutes the chosen law between the parties. However, if a term or condition within the letter of credit is inconsistent with the rules of the ISP98, that particular term or condition prevails. Conversely, if a letter of credit stipulates that it is subject to both the Uniform Customs and International Standby Practices and there is a conflict in applying the rules, the Uniform Customs will prevail.⁵¹

There are advantages to following the International Standby Practices when drafting a standby letter of credit. The following chart canvasses the current effect of the UCP600 articles on landlords and the benefits to landlords in switching to the ISP98 rules.

Comparative Analysis of UCP600 and ISP98	
UCP600 articles and their effect on landlords	ISP98 rules and their effect on landlords
Examination of Documents	
When a landlord presents documents to draw upon the letter of credit, the UCP600 requires an examiner to review the documents for consistency and compliance. ⁵² This review may increase the number	ISP98 does not require an examiner to review documents against each other for inconsistencies, unless expressly required by the letter of credit. ⁵³

⁴⁸ International Chamber of Commerce, *International Standby Practices*, 1998, [ISP98]; James E Byrne, *The Official Commentary on the International Standby Practices*, 1st ed (Maryland: The Institute of International Banking Law & Practice, 1998) at xvi – xvii.

⁴⁹ See <www.iiblp.org> for further information on the IIBLP.

⁵⁰ Sarna, *supra* note 1 at § 2:26.

⁵¹ *Ibid* at § 2:26; Also see *ISP98*, *supra* note 47, rule 1.01(c).

⁵² *UCP600*, *supra* note 40, art 14d.

⁵³ *ISP98*, *supra* note 48, rule 4.03.

<p>of days a landlord must wait before the issuer dispenses money to the landlord under the letter of credit.</p>	<p>Benefit: Decreasing the time it takes for an issuer to grant the demand for a draw on the letter of credit by the landlord.</p>
<p>Approval</p>	
<p>Some letters of credit require the tenant to issue or sign a document in order for the landlord to demand payment under the letter of credit. These requirements undermine the independence of the letter of credit as an obligation solely between the landlord and the issuer and UCP600 is silent on the issue.</p>	<p>Although standby letters of credit could require applicant approval, ISP98 discourages this practice. If such a clause is added to the letter of credit, the issuer is bound by it and is not responsible for an applicant's failure to approve the document ⁵⁴</p> <p>Benefit: Provides a warning to landlords to avoid clauses in their letters of credit that require applicant approval and may prevent collecting under their letter of credit.⁵⁵</p>
<p>Transfer</p>	
<p>When drawing rights are transferred, the transferee obtains the right to demand and receive payment under the letter of credit.⁵⁶ However, UCP600 prevents transferring letters of credit in their entirety more than once,⁵⁷ thereby preventing a landlord from selling the leased property and transferring the rights to collect under the letter of credit to the new owner.</p>	<p>The ISP98 rules allow a standby letter of credit to be transferred in its entirety more than once but must be so stated in the letter of credit.⁵⁸</p> <p>Benefit: Increased flexibility to landlords wanting to sell their property and transfer the rights under the letter of credit. Also, this reduces the burden on subsequent landlord to secure a new letter of credit from the tenant of the property they just acquired.</p>
<p>Revocable vs Irrevocable</p>	
<p>Letters of credit can take on different forms, such as "revocable" or "irrevocable" letters of credit. If a landlord wishes to rely on an irrevocable letter of credit, the credit must be drafted so as to render it irrevocable under UCP600 rules.</p>	<p>Incorporating ISP98 into the letter of credit automatically renders the standby letter of credit as an "irrevocable, independent, documentary and binding undertaking when issued" and such words need not be included when drafting the letter of credit.⁵⁹</p> <p>Benefit: Protecting landlords from possible drafting errors or omissions rendering the credit revocable by the issuer, and removing the landlord's security collected under the lease.</p>
<p>Original Documents</p>	
<p>Under UCP600, when drawing upon the letter of credit, the landlord must present an original document to the issuer if so stipulated in the letter of</p>	<p>ISP98 deemphasizes the importance of having an original letter of credit even if the requirement is contained in the letter of credit itself. If the original</p>

⁵⁴ *Ibid*, rule 4.10.

⁵⁵ Peter Ellinger & Dora Neo, *Law and Practice of Documentary Letters of Credit* (Portland: Hart Publishing Ltd, 2010) at 341.

⁵⁶ *Ibid* at 343.

⁵⁷ *UCP600*, *supra* note 40, art 38.

⁵⁸ *ISP98*, *supra* note 48, rule 6.02.

⁵⁹ *ISP98*, *supra* note 48, rule 1.06a.

credit.	document is lost, stolen, or destroyed, the issuer does not have to replace it or waive any requirement under the letter of credit that the original be presented. ⁶⁰ Benefit: Economizing the landlord's time in the event the original document is no longer available, as they will not have to seek out replacing the document or having the original requirement waived.
Expiration	
If a landlord seeks to draw upon the letter of credit on the last day before it expires and the location for presentment of documents is closed, the risk of such a closure is imposed on the landlord, who is barred from drawing upon the letter of credit at a future date, preventing reimbursement for a tenant's default under the lease. ⁶¹	ISP98 softens the result of an issuer's closed office on the last day for timely presentation by automatically extending the date for presenting documents by thirty days. ⁶² Benefit: Protecting the landlord's ability to collect on the letter of credit for circumstances beyond their control.

In addition to the benefits noted in the above chart, the ISP98 also clarifies commonly-used terms, explains compliance measures and addresses circumstances where a letter of credit may, for instance, contain empty quotation marks or contradictory alternatives.⁶³ These clarifications provide landlords with a more effective and efficient way to determine if they are in compliance with the letter of credit when they seek to draw upon it at the issuer's place of business. As a result, there is a greater appeal for implementing and using the International Standby Practices in standby letters of credit instead of the Uniform Customs.

VII. CONCLUDING REMARKS

A letter of credit is a useful instrument for landlords and tenants to use in lieu of cash security. Properly drafted, a letter of credit can and will afford a landlord the same protection as cash security. However, it is imperative to remember that a letter of credit is not the same as cash security. A letter of credit necessarily involves the cooperation of a third party (i.e. the tenant's bank) who may have a heavily vested interest in not paying out the letter of credit. This is especially true if, at the time of the demand, the soon-to-be insolvent tenant is also indebted to the bank.

⁶⁰ Ellinger & Neo, *supra* note 55 at 340.
⁶¹ *UCP600*, *supra* note 40, art 36.
⁶² *ISP98*, *supra* note 48, rule 3.14
⁶³ Ellinger & Neo, *supra* note 55 at 337. See also Byrne, *supra* note 48 at 162-164.

Appendix "A"
Sample Letter of Credit

IRREVOCABLE STANDBY LETTER OF CREDIT

DATE:

AMOUNT: **\$**

CUSTOMER:

TO: **(the "Landlord")**

We, _____, hereby issue in your favour our Irrevocable Standby Letter of Credit for the above-mentioned amount.

This Standby Letter of Credit is available for payment up to the amount of \$_____ which may be drawn on by you at any time and from time to time upon written demand for payment made upon us by you, which demand we shall honour without enquiring whether you have a right as between yourself and our Customer to make such demand and without recognizing any claim of our Customer.

Provided, however, that you are to deliver to us at such time as a written demand for payment is made upon us a certificate purported to be signed by an appropriate officer of the Beneficiary confirming that pursuant to the terms of the Lease dated _____ between _____ to _____, as amended by a Lease Amending Agreement dated _____ (collectively referred to as "Lease"), the Beneficiary is entitled to draw down on this Letter of Credit.

The original Standby Letter of Credit (together with any amendments thereto) must accompany the demand for endorsement of any payment thereon.

Partial drawings are permitted.

This Letter of Credit shall expire with the close of business on _____, provided that it is a condition of this Letter of Credit that it shall be deemed to be automatically extended annually without amendment for additional periods of one (1) year from the present or any future expiration date hereof until _____, unless sixty (60) days prior to such date we notify you in writing by registered mail that we elect not to consider this Letter of Credit renewed for any such additional period. Upon receipt by you of such notice, you may draw by means of your demand accompanied by your written certification that the amount drawn down will be retained and used by you to meet the obligations incurred or to be incurred in connection with the Lease.

This letter of credit is transferable, in whole but not in part and once only, to a second beneficiary by means of beneficiary's letter of direction addressed to _____, and stating

that all your rights, title and interest in and on this letter of credit is transferred to such transferee. The original advice of credit must be surrendered and bank transfer charges be paid.

The rights of the Landlord hereunder in respect of the letter of credit shall continue in full force and effect and shall not be waived, released, discharged, impaired or affected by reason of the release or discharge of the Tenant in any receivership, bankruptcy, insolvency, winding up or other creditor's proceedings, including, without limitation, any proceedings under the *Bankruptcy and Insolvency Act (Canada)* or the *Companies' Creditors Arrangement Act (Canada)*, or the surrender, disclaimer, repudiation or termination of this Lease and any such proceedings and shall continue with respect to the periods prior thereto and thereafter as if the Lease had not been surrendered, disclaimed, repudiated or terminated.

This Standby Letter of Credit is subject to the "Uniform Customs and Practice for Documentary Credits (2007 Revision) International Chamber of Commerce, (Publication 600)" and engages us in accordance with the terms thereof.

For Bank

Customer Signature

Authorized Signature

Appendix "B"
Sample Letter of Guarantee
IRREVOCABLE LETTER OF GUARANTEE

No. _____

To _____

At the request of _____
(Name and address of our customer)

(hereinafter called "our Customer"), we, National Bank of Canada, _____
hereby establish in your favour our Irrevocable Letter of Guarantee for an amount not exceeding

Seventy-five thousand 00/100 ----- (\$ 75,000.00)
(Amount written out and in figures)

to guarantee payment of the sums due to you by _____
(Name of our Customer)

We agree to pay you an amount up to Seventy-five thousand 00/100 -----
----- dollars (\$ 75,000.00)
(Amount written out and in figures)

on presentation of your written demand for payment certifying that _____
(Our Customer)
has defaulted on the payment of his debt to you.

We shall honour your demand for payment made in accordance herewith, without inquiring whether you are entitled to make such demand, notwithstanding all and any disputes or objections between you and our Customer.

This Irrevocable Letter of Guarantee is not transferable and shall remain in force until _____
_____, 19 ____ . No claim shall be paid if received after such expiry date.
(Validity or expiry date)

All correspondence and/or claims shall be addressed to the National Bank of Canada _____

(Complete address)

and shall refer to our Irrevocable Letter of Guarantee No. _____

Executed at _____, on the _____ day of _____ 19 ____ .

 NATIONAL BANK OF CANADA

Per _____

Per _____

Appendix "C"
Sample Lease Clauses

Letter of Credit

- (a) On or before ■, the Tenant shall deposit with the Landlord and shall maintain throughout the Term, as renewed or extended and any period of overholding, an irrevocable unconditional letter of credit payable to the Landlord issued by a Schedule I Canadian Chartered bank in the amount of ■ Canadian Dollars (CDN \$■) (the "Letter of Credit"), substantially in the form attached hereto as Schedule "A". **[NTD: ensure the LC permits partial draws.]** The Letter of Credit shall be held by the Landlord as security for the faithful performance by the Tenant of all the terms, covenants and conditions of this Lease by the Tenant to be kept, observed and performed and irrespective of:
- (i) the unenforceability of this Lease as against the Tenant;
 - (ii) the termination of any obligations of the Tenant under this Lease by operation of law or otherwise; or
 - (iii) the bankruptcy, insolvency, dissolution, winding-up or other liquidation of the Tenant including, without limitation, the repudiation of this Lease by the Tenant or any surrender or disclaimer of this Lease by a court or trustee in bankruptcy of the Tenant.

The obligations of the said Chartered Bank under the Letter of Credit shall be absolute and unconditional and shall be in no way released, discharged or reduced, and the rights of the Landlord under the Letter of Credit shall be in no way prejudiced or impaired by any neglect, delay or forbearance of the Landlord in demanding, requiring or enforcing performance by the Tenant or any other obligated person of any of its obligations under this Lease or by granting any extensions of time for performance, or by waiving any performance (except as to the particular performance which has been waived), or by permitting or consenting to any assignment or by the bankruptcy, receivership, insolvency or any other creditor's proceedings of or against the Tenant, or by the winding-up or dissolution of the Tenant, or any other event or occurrence which would have the effect at law of terminating the existence of obligations of the Tenant prior to the termination of this Lease or by any agreements or other dealings between the Landlord and Tenant having the effect of amending or altering this Lease or the obligations of the Tenant hereunder or by any want of notice by the Landlord to the said Chartered bank of any default of the Tenant or by any matter, thing, act or omission of the Landlord whatsoever.

- (b) If at any time during Term, Rent is overdue and unpaid, or if the Tenant fails to keep or perform any of the terms, covenants and conditions of this Lease to be kept, observed and performed by the Tenant, irrespective of the matters referred to in subsection (a), then the Landlord, at its option, may, in addition to any and all other rights and remedies provided for in this Lease or by law, appropriate and draw upon the Letter of Credit:

- (i) in full in the event of the bankruptcy, insolvency, dissolution, winding-up or other liquidation of the Tenant; or
- (ii) in the event of any other breach on the part of the Tenant, so much thereof as is necessary to compensate the Landlord for loss or damage sustained or suffered by the Landlord due to such breach on the part of the Tenant, and in which case the Tenant shall, within ten (10) days after demand by the Landlord, remit to the Landlord a new Letter of Credit in an amount sufficient to restore the total amount of the Letter of Credit to the original sum deposited.

If the Tenant complies with all of the terms, covenants and conditions and promptly pays all of the Rent and other sums herein provided payable by the Tenant to the Landlord, the Letter of Credit shall be returned in full to the Tenant without interest within sixty (60) days after the expiration of this Lease.

- (c) The Letter of Credit shall provide that it shall be deemed to be automatically extended for one year without amendment from the expiration date thereof, unless at least thirty (30) days prior to any such date, the said Chartered Bank notifies the Landlord in writing by registered mail or courier that it elects not to consider the Letter of Credit to be renewed for such period, in which case the Landlord, at its option, may, in addition to any and all rights and remedies provided for in this Lease or by law, appropriate and draw upon the Letter of Credit in full.
- (d) The Letter of Credit shall further provide that it may be assigned by the Landlord, by notice in writing to the Chartered Bank, to the Landlord's successor in interest whereafter the Landlord shall have no further liability with respect to the Letter of Credit.