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ORIGINALITY OF PAPER & ELECTRONIC DOCUMENTS
(Part 3)

by Pavel Andrle

LITIGATION DIGEST

Lexon Insurance Co. v. FDIC

Surety/Beneficiary appealed summary judgment, arguing that LCs are not contracts and that FDIC as Receiver of defunct Issuing Bank lacked the authority to repudiate LCs.

LC ISSUANCE STATISTICS

Outstanding LC issuance amounts from US banks for year-end 2022, with graphical analysis.

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Trade Implications from SVB & Signature Bank Failures

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Documentary Credit World, c/o IIBLP, Inc.
20405 Ryecroft Ct.
Montgomery Village, MD
20886 USA
+1.301.330.1970
info@iiblp.org
www.doccreditworld.com

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Originality of Paper and Electronic Documents

by Pavel ANDRLE

In the third part of his article series on originality of paper and electronic documents, trade finance consulting specialist Pavel Andrle delves deeper into electronic guarantees, dealing with both electronic issuance and presentation. The intention is to focus on practical interpretation and use of the rules today and what remaining issues need clarified to fully foster use of electronic records in the area of demand guarantees going forward. In his analysis, Andrle addresses both electronic issuance of international guarantees and domestic guarantees. He also take up discussion of termination of electronic guarantees and demands in electronic form under guarantees.

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UPDATES

LC Implications from the Fallout of the SVB, Signature Bank Failures

The abrupt mid-March 2023 closures of Silicon Valley Bank (SVB) and Signature Bank sent shockwaves through the US banking system and financial services community overall. The aftereffects of these bank failures are still being felt and unfolding, including announcements that Flagstar Bank, a subsidiary of New York Community Bancorp, has agreed to buy the former Signature Bank and First-Citizens Bank & Trust has agreed to purchase the former Silicon Valley Bank.

As of year-end 2022, Silicon Valley Bank was 12th and Signature Bank 31st in outstanding letter of credit values among US banks according to *DCW*'s quarterly LC statistics (see p. 33).

Following the bank collapses, the US Federal Deposit Insurance Corporation (FDIC) announced in news releases that it was appointed receiver and established bridge banks for Signature Bank and Silicon Valley Bank as temporary measures. In so doing, the FDIC also transferred all "qualified financial contracts" of each failed bank to the bridge banks. Although not explicitly stated, it is has been understood by some attorneys that this means the bridge banks assumed responsibility for all loan positions and commitments to advance undertaken by the failed banks, which include letters of credit.

One real estate attorney contacted by *DCW* indicated they had spoken directly with a regional SVB representative about the FDIC's statutory right to repudiate under the "FDIC Law, Regulations, Related Acts 1000(e)(1)" and were informed that although an LC is usually treated as a contract that can be repudiated if burdensome, instead, SVB Bridge Bank had taken full responsibility for the former SVB's LCs.

Another attorney suggested to *DCW* that "since the FDIC took a big discount in the sale of SVB loans to First Citizens, kept questionable loans, and provided a huge line of credit to First Citizens, we should expect First Citizens to honor the outstanding LCs it inherited from SVB. As for those LCs which are part of questionable loans retained by the FDIC, I would worry if I were a beneficiary."

In the past, the FDIC has repudiated the LCs of failed banks, prompting lawyers to urge beneficiaries of LCs issued by SVB or Signature Bank to pursue replacement of those LCs.

In *Lexon Insurance Co. v. FDIC*, the US Court of Appeals for the Fifth Circuit disagreed with a beneficiary's contention that letters of credit are not contracts or leases under relevant provisions and that the FDIC lacked the authority to repudiate the LCs. This case is summarized in *DCW* at p. 18.

An Office of the National Association of Insurance Commissioners (NAIC) has issued a statement summarizing how it views SVB's and Signature Bank's LCs issued by these financial institutions that have been or will be removed from its List of Qualified U.S. Financial Institutions. The memo portion of this document appears in *DCW* at p. 16.

English Court Says Sanctions Did Not Prevent Bank from Paying under LCs

Further to previous reporting ("Aviation Company Says Bank Wrongfully Dishonored LCs Backing Russian-Leased Planes", April 2022 *DCW* 6), the Commercial Court in London issued judgment on 23 March 2023 in favor of Celestial Aviation Services and Constitution Aircraft Leasing after the aircraft lessors which as beneficiaries had made admittedly conforming demands on UniCredit Bank as confirming bank for letters of credit of Russia's Sberbank aggregating over USD 69 million.

UniCredit's position for initially not paying the conforming draws on its confirmations was based on UK, US, and EU sanctions regulations prohibiting it from making payment. After Russia's February 2022 invasion of Ukraine, those sanctions prohibited transactions in connection with providing restricted goods, technology, and related financial assistance to Russian companies.

UniCredit applied for and was granted licenses by the government export regulation authorities of the UK Office of Financial Sanctions Implementation (OFSI), the UK Export Control Joint Unit (ECJU), and Germany's central bank (Bundesbank) to pay the LCs. Licenses were applied for with the US Office of Foreign Assets Control (OFAC), but no response was received from it as of the date of the opinion.

OFSI, ECJU, and Bundesbank granted licenses to UniCredit to make payment for the draws on its confirmations of Sberbank's LCs even though, the lessors claimed, UniCredit's applications were misleading because they conditioned the license to pay on UniCredit's right to recover payment from Sberbank as issuing bank.

After these licenses were granted but before the case was decided, UniCredit paid the draw amounts to the aircraft lessors. The case proceeded to determine UniCredit's liability for interest and costs. Resolution of that liability required the Court to determine whether UniCredit's position on sanctions regulations was a valid defense against making payments to draws submitted to it as confirming bank. The Court looked into and decided against UniCredit not only on the sanctions prohibiting Russian companies from obtaining or using restricted goods (which included aircraft) and technology, but also on the matter of whether payment of the LC confirmations constituted financial assistance to Russian companies "in connection with" restricted goods and technology.

The aircraft lessors' position as beneficiaries adopted by the Court was that UniCredit's confirmations of the LCs were primary and autonomous obligations of UniCredit under governing

LC rules and principles, including UCP600 Article 4(a) which provides that banks "are in no way concerned with or bound by" the sale or other contract, such as the underlying lease transaction in this case. The beneficiaries argued and the Court noted that payment does not result in or facilitate delivery of restricted goods or technology or financial assistance regarding them to Russia, particularly due to the fact that the confirmations were issued and leases entered into well before the sanctions regulations took effect and that after the invasion of Ukraine, the leases were terminated and the Russians confiscated the lessors' aircraft.

The Court also noted that the sanctions did not suspend UniCredit's obligation to make payment on its confirmations because the regulations were not in force when the payment obligation matured. With respect to OFAC sanctions, the Court stated that even if UniCredit's making payment in US dollars violated US sanctions, it would have been possible to overcome those sanctions by UniCredit's paying in another currency, e.g., Euros.

ICC Prepares Alignments of ISBP745, eRules

Following its decision to initiate a six-month review of all 140 ICC Opinions issued since formulation of ISBP745 in 2013 and evaluate the fitness of ISBP745 (Oct 2022 *DCW* 25), the ICC Banking Commission released the findings of its Working Group. Nine Opinions were identified as containing content that would be meaningful for addition within ISBP. As outlined in a 28 February 2023 email from ICC Banking Commission Policy Manager Tomasch Kubiak, these comprise:

- New Preliminary Consideration viii) stating that the absence of a credit reference number, or the mistyping of a credit reference number, on a document is not a valid reason for refusal. (**Opinion 876rev**)
- New Preliminary Consideration ix) providing that administrative conditions such as a requirement for an additional photocopy of all documents, or a statement that all documents may not be stapled, should not be incorporated by an issuing bank in a credit. (**Opinion 915rev**)
- Add 'Industries' to paragraph A1 (Abbreviations). (**Opinion 837rev**)
- Add new paragraph A17 (b) (Documents and the need for completion of a box, field or space) stating that there is no requirement for the applicant name, address and contact details (if any) to appear in a specific box, field or space on an invoice. (**Opinion 818rev**)
- Add new paragraph A31 (b) (copy documents) stating that copies of documents need not be signed and move existing A31 (b) to A31 (c). (**Opinion 842rev3**)
- Add new paragraph C7 (general issues relating to invoices) providing that an invoice presented under a credit issued in USD, bearing only the "$†sign without further qualification, fulfils the requirement of UCP 600 sub-article 18 (a) (iii) unless data in the invoice itself, or another presented document, implies that the "$†sign may refer to a currency other than USD. (**Opinion 814rev4**)
- Add new paragraphs D5 (e) (multimodal transport document), E5 (e) (bill of lading), & F4 (e) (non-negotiable sea waybill) stating that the signature of the master (captain) may be accompanied by a stamp that incorporates the name of the vessel. (**Opinion 813**)

- Add new paragraph G4 (c) (charter party bill of lading) stating that the signature of the master (captain) may be accompanied by a stamp that incorporates the name of the vessel. (**Opinion 836rev**)
- Add new paragraph K2 (b) stating that UCP 600 does not require that an agent or proxy is to be named in an insurance document and move existing paragraph K2 (b) to K2 (c). (**Opinion 835rev**)

Simultaneously, another Working Group conducted a review of eUCP and eURC for purposes of aligning these eRules with the UNCITRAL Model Law on Electronic Transferrable Records (MLETR). In his email, Kubiak elaborated on the nature and intention of the effort:

> "It is very important to note that this was not a revision nor an update of the eRules. It was solely an alignment with MLETR with respect to electronic transferable records.
>
> As stated in the ICC Commentary on the eRules, it is necessary to consider each applicable legal system with respect to usage of the eRules in order to determine whether there is any substantive conflict between the eRules definitions and those contained in the local law.
>
> At the time of drafting the eRules, very little key legislation was in place, thereby negating any need at the time to include definitions or clarification of the meaning of an electronic transferable record.
>
> However, recent developments have now made it evident that enhanced alignment with MLETR, and similar legal developments elsewhere around the world, would provide intrinsic benefit."

The specific changes involve various adjustments to eUCP sub-article e3(b) and eURC sub-article e4(b), including a new definition: "Electronic transferable record means an electronic record that contains the information that would be required in the equivalent paper document, such as a negotiable bill of lading or an assignable insurance document."

The newly aligned Versions of the eRules will be known as eUCP Version 2.1 and eURC Version 1.1. Work has also commenced on formulating electronic documentary credit templates as an appendix for the eUCP.

In responding to an email from *DCW*, Kubiak indicated that the versions will not be finalized before all members through their ICC National Committees have the opportunity to provide comments. In the case of ISBP, "given the update is aiming at implementing already final opinions we anticipate minimal feedback", Kubiak added. The intended aim for entry into force is 1 July 2023.

ICC Introduces eUCP Directory Project

The ICC Banking Commission has announced its intention to compile an eUCP Directory in order to bring attention to banks' capacities to handle eUCP letters of credit.

Inspired by the Banking Commission's Commercialisation of eRules group, the project will rely on banks voluntarily providing information on their capacities to issue and advise eUCP LCs and shine a spotlight on their abilities to use eUCP in hopes that corporates will ask about the eUCP and eventually request issuance according to eUCP. Originally released in 2002, the eUCP supplement was most recently updated in 2019. At present, SWIFT estimates that usage of the eUCP rules in MT700 is less than 1%.

Joined in a presentation on 21 March 2023 to introduce the idea by Tomasch Kubiak of ICC and Eleonore Treu of ICC Austria, Jon Boran of Lloyds Banking noted that a key factor curtailing potential eUCP use is a lack of visibility. In many cases, Boran explained that banks do not want to risk advising banks being unwilling to handle eUCP credits. Having an eUCP Directory would reduce unnecessary bank to bank negotiations ahead of issuing a desired eUCP LC.

ICC National Committees are urged to approach their member banks about joining the eUCP Directory by 1 May 2023, although member banks joining thereafter will be added when the Directory is updated on a quarterly basis. Currently, only banks who are ICC members can be included. For entry into the registry, ICC requires: Bank name & SWIFT address; Ability to issue eUCP credits (yes or no); Ability to advise/confirm eUCP credits (yes or no); and Contact name and details for additional information. Banks further have the option of declaring parameters under which they handle eUCP credits. Suggested items to add could include: Any platform participation; Acceptable document formats; Acceptable or unacceptable clauses/credit requirements; Jurisdictional requirements; Regulatory requirements; and any other details or requirements.

Implications for Trade Finance of Proposed 2022 UCC Amendments

Potentially game-changing amendments have been proposed for the Uniform Commercial Code (UCC) which is law enacted by the US states (with state-by-state variations) to govern commercial transactions, including Articles 2 (Sales), 3 (Commercial Paper), 5 (Letters of Credit), 7 (Warehouse Receipts, Bills of Lading and Other Documents of Title), and 9 (Secured Transactions). The 2022 UCC amendments focus on digital assets and technologies but cover other important matters as well.

The amendments were promulgated by the Uniform Law Commission (ULC) and the American Law Institute (ALI) to the official version of the UCC. The ULC has published several position papers supporting enactment of the amendments and over 20 U.S. jurisdictions already are considering their enactment.

Some of the amendments are especially relevant for trade finance, including digital analogs for paper negotiable instruments (such as drafts, bills of exchange, and promissory notes), digital analogs for accounts receivable and payment intangibles, and digital letters of credit and independent guarantees. Other amendments that are not digital-related include clarifying how bank branches are treated *as if* they were separate legal entities for certain purposes even though they are not separate legal entities like a parent corporation and its subsidiaries. Amendments pertaining to Article 5 (Letters of Credit) include those contained in, and Official Comments to, Section 5-104 (Formal Requirements) and Section 5-116 (Choice of Law and Forum).

The amendments are needed because commercial laws governing the rights of persons involved in electronic transactions have not kept pace with technological and market developments. While the

UCC's underlying principles and policies remain sound, many are written as if they apply only to manually-signed paper undertakings and as if physical possession of goods and documents is the most (or only) reliable or relevant evidence of control of those assets. This creates uncertainty as to the legal rights conferred by digital assets and by electronic transfers of digital and non-digital assets.

Stay tuned for further updates if and when the proposed amendments advance through the enactment process.

The author, Michael Evan Avidon, served as an Observer to the Drafting Committee and particularly involved with the proposed amendments to UCC Article 5 on Letters of Credit.

QUOTE TO NOTE

"The 2022 Amendments enable the use of emerging technologies, such as blockchain in commercial and financing transactions. UCC Article 12 recognizes controllable electronic records, which include a variety of digital assets, such as Bitcoin. UCC is well ahead of the global efforts to implement international standards to digitize trade finance, such as the Model Law on Electronic Transferable Records [MLETR]. It has already inspired a set of principles of digital assets developed by UNIDROIT. The implementation of these emerging standards to digitize commercial and financing transactions forms the backbone of new environments, such as platforms and exchanges that reduce the cost of transactions while enhancing their efficiency and certainty."

— Marek Dubovec,
Director of Law Reform Programs,
International Law Institute, and
The American Law Institute delegate
to the Study/Drafting Committee that
produced the 2022 UCC Amendments

Beneficial Ownership Reporting Guidance Released by FinCEN

On 24 March 2023, the US Financial Crimes Enforcement Network (FinCEN) issued the first installment of its guidance materials to assist the public in understanding beneficial ownership information (BOI) reporting requirements under the Corporate Transparency Act (CTA) that will enter into force on 1 January 2024.

The new regulations require many corporations and other entities created in, or registered to do business in, the United States to report to FinCEN information about the persons who ultimately own or control the company (their beneficial owners).

Educational materials now available on FinCEN's beneficial ownership information reporting webpage include: One page overviews of Key Questions and Reporting Dates; Frequently Asked Questions; a Short Introductory Video; and a more detailed Informational Video about BOI. Additional guidance will be published in the coming months.

According to its news release, FinCEN will not be accepting any beneficial ownership information before 1 January 2024.