

May the Applicant and Beneficiary of a Letter of Credit be the Same Person?

Michael Evan Avidon, Esq.
Moses & Singer LLP

May Applicant & Beneficiary be the Same Person?

UCC Sec. 5-102(a)(2)

- “Applicant” means a person at whose request or for whose account a letter of credit is issued. The term includes a person who requests an issuer to issue a letter of credit on behalf of another if the person making the request undertakes an obligation to reimburse the issuer.

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UCC Sec. 5-102(a)(3)

- “Beneficiary” means a person who under the terms of a letter of credit is entitled to have its complying presentation honored. The term includes a person to whom drawing rights have been transferred under a transferable letter of credit.

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UCC Sec. 5-102(a)(9)

- “Issuer” means a bank or other person that issues a letter of credit, but does not include an individual who makes an engagement for personal, family, or household purposes.

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UCC Sec. 5-102(a)(10)

- “Letter of credit” means a definite undertaking that satisfies the [formality] requirements of Section 5-104 by an issuer to a beneficiary at the request or for the account of an applicant or, in the case of a financial institution, to itself or for its own account, to honor a documentary presentation by payment or delivery of an item of value.

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- It is clear under the UCC that a bank can issue a letter of credit to itself or for its own account, but can it issue a letter of credit for ABC Corp. *as applicant* to ABC Corp. *as beneficiary*?
- If the bank could have issued the letter of credit for its own account to ABC Corp. as beneficiary, is there a problem to *add* ABC Corp. as the applicant?
- Does it matter whether ABC Corp.'s reimbursement obligation to the issuing bank is a full recourse obligation of ABC Corp. to the bank or recourse only to specified assets of ABC Corp.?

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- If a bank agreed to purchase assets from ABC Corp. of a type that the bank is permitted to purchase, that purchase and sale could be documented by an ordinary contract between the bank and ABC Corp.
- If ABC Corp. is comfortable with the credit risk of the bank but is afraid the bank may assert a contractual defense to payment of all or a portion of the purchase price, ABC Corp. may want a waiver of defenses or a stronger payment undertaking.
- ABC Corp. could insist that the first bank find a second bank to issue a letter of credit to ABC Corp. to support the payment of the purchase price, but is it necessary to involve a second bank in order to utilize a letter of credit?

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- The first bank could simply issue a letter of credit for its own account to ABC Corp. for the purchase price, where one of the drawing documents could be an assignment by ABC Corp. to the bank of the assets being purchased.
- If the parties wanted an even simpler drawing document, could they make ABC Corp. the letter of credit's applicant and beneficiary and agree in the reimbursement agreement that (i) ABC Corp.'s reimbursement obligation will be satisfied by ABC Corp.'s assigning to the bank the assets being purchased by the bank and (ii) ABC Corp.'s reimbursement obligation is recourse only to those assets?
- In effect the letter of credit would act as a supercharged payment obligation of the bank to ABC Corp., and performance of the "reimbursement" obligation by ABC Corp. would act as the mechanism to convey title to the assets in question to the bank.

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- Would this violate or conflict with any definitional or substantive provision of the UCC or LC practice rules? Would it violate or conflict with any banking law or regulation? Any special procedures advisable?
- Note that if this structure is problematic, it might instead be structured as a traditional three-party transaction by adding an affiliate or a branch of the issuing bank or the beneficiary as a third party.

Questions? Comments?

Contact:

Michael Evan Avidon
Moses & Singer LLP
The Chrysler Building
405 Lexington Avenue
New York, NY 10174-1299
(212) 554-7854 – direct
mavidon@mosessinger.com

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