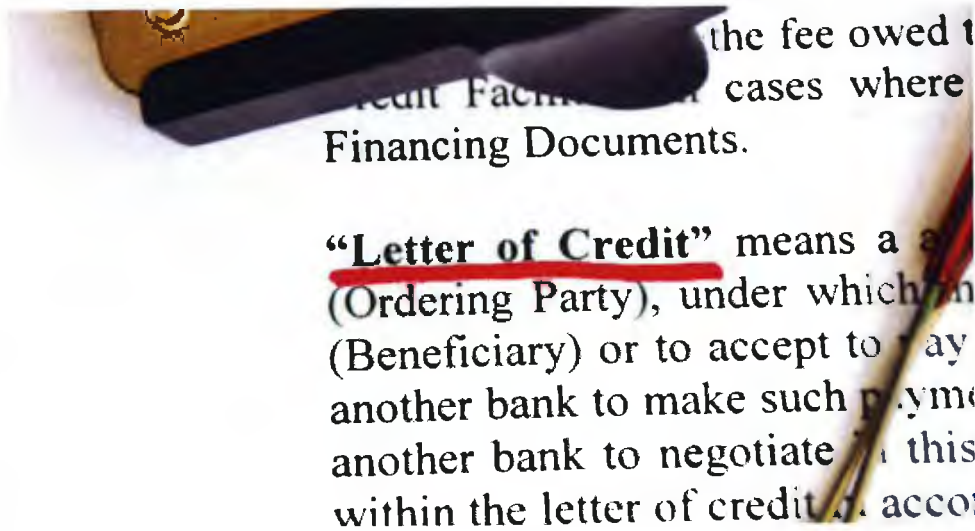


# Task Force on Governmentally-Mandated Standby Letters of Credit

By Jacob Manning, Dinsmore & Shohl LLP



The State of West Virginia, like other government agencies, allows standby letters of credit to be used to support certain obligations. Those agencies become beneficiaries of the letters of credit and require that the letter of credit be issued in a mandated form that the agency drafts.

Unfortunately, as bankers in West Virginia know, these forms are in several respects at odds with letter of credit law and practice. Thus the forms not only are problematic from the standpoint of issuers, but also, they may fail to protect the very agencies that draft them.

A project led by the Institute of International Banking Law & Practice, a non-profit educational organization, seeks to offer some guidance to these agencies. This article will summarize some of the issues that commonly arise with governmentally-mandated forms, using a West Virginia form as an example, and summarize the Task Force's work.

## Nature of the Problem

An exhaustive list of the issues that arise in governmentally-mandated standby letters of credit is beyond the scope of this article. Indeed there may be thousands of such forms in existence. Using a West

Virginia form as an example, though, the issues that can arise in such forms without careful consideration can be shown.

The West Virginia Department of Labor mandates a form standby letter of credit that may serve as a wage bond pursuant to W. Va. Code § 21-5-14. As many bankers know, any discussion of letter of credit practice in West Virginia begins and ends with this form and the Supreme Court of Appeals' decision in *Leary v. McDowell County Nat'l Bank*, 552 S.E.2d 420 (W. Va. 2001). The decision is viewed as exceptional in the letter of credit community for the extent to which it went to favor the government agency beneficiary over letter of credit policy.

Even after the *Leary* decision, the wage bond form exhibits several issues common to governmentally-mandated standby letter of credit forms. First, letters of credit are interpreted according to rules of practice, and a letter of credit may incorporate one

of two primary sets of rules of practice: the Uniform Customs and Practice for Documentary Credits (UCP) or the International Standby Practices (ISP98). It is apparent that many governmental entities are simply inexperienced with letter of credit rules and practice and choose no rules or rules of practice that are not ideal for standby letters of credit.

The wage bond form does not state that either set of rules of practice are incorporated into the letter of credit. Incorporating a set of rules of practice—particularly ISP98, which was drafted for standby letters of credit—more clearly protects the parties' rights and obligations. One of the Task Force's goals is to educate both the agencies and their counterparties on the importance of those rules.

Second, the wage bond form unnecessarily directly conflicts with letter of credit law. The wage bond form is titled, "Perpetual Irrevocable Letter of Credit". According to the letter of credit, it "may only be terminated with the approval of the Commissioner of the West Virginia Division of Labor. . . ." Other than stating that it is perpetual, the letter of credit gives no expiration date.

West Virginia Code § 46-5-106(c) states, "If there is no stated expiration date or other provision that determines its duration, a letter of credit expires one year after its stated date of issuance..." Section 46-5-106(d) goes on to state that "[a] letter of credit that states that it is perpetual expires five years after its stated date of issuance..."

According to Section 46-5-106, then, the wage bond should expire five years after its issuance (though that was not the holding in *Leary*). But what effect does the language of Section 21-5-14(g) have? If the State's purpose was to ensure that the letter of credit would not expire until at least five years had passed, there is no reason that the letter of credit could not simply state an expiration date of five years (or more). There also is no reason that automatic extension clauses could not be used to extend the expiration date. And if the letter of credit were made subject to ISP98, the letter of credit could include an extend or pay provision that protects the Department of Labor when the letter of credit is about to expire. In short, there is no reason that this form should so clearly conflict with

letter of credit law, when other drafting decisions could be made to achieve the same effect and better-protect the state.

Third, and finally, the wage bond form references Section 21-5-14 in several places, but like many governmentally-mandated standbys, it does not state for what purpose. If those references create nondocumentary conditions, Section 46-5-108(g) permits the issuer to ignore them. Again, if there is reason to require something more of the issuer, it should simply be stated in the text of the letter of credit itself.

### Organization of the Task Force

In light of these issues and others, in early 2014, the Institute of International Banking Law & Practice formed the Task Force on Model ISP98 Governmentally-Mandated Standbys to help draft a model form that all governmental agencies, such as the Department of Labor, could adopt. The Task Force is co-chaired by Fiore F. Petrassi, of JP Morgan Chase Bank, and Jacob A. Manning, of Dinsmore & Shohl's Wheeling office.

To accomplish its goal of developing a Model Form to be used by government agencies, the Task Force has brought together governmental entities, bankers, lawyers, government contracting firms, and trade associations. The Task Force's work has been organized into three main phases.

First, the Task Force has begun to discuss the issues raised by governmentally-mandated standbys, and particularly, to consider specific examples of such forms. The Task Force gathered sample forms from around the United States and identified issues

common to those forms, and it has begun discussing how the Model Form may address those issues.

In the second phase of the Task Force's work, the Task Force will call together the various stakeholders to a public meeting at which current forms and the draft of the Model Form can be discussed. The public meeting is intended to provide a forum for all stakeholders to consider the draft Model Form and comment on whether that Model Form could be adopted by governmental agencies in place of existing forms.

Finally, in the third phase of the Task Force's work, the Task Force will finalize work on the draft Model Form. The Task Force's goal is to create a Model Form that governmental agencies will find suitable to meet their needs and that private stakeholders are willing to issue. Of course, part of the Task Force's work will be to disseminate the Model Form to governmental agencies and advocate its adoption.

Ultimately, the success of the project will be determined by the governmental entities that adopt the Model Form. ■



Individuals interested in receiving more information or contributing to the success of the project may contact Jacob Manning via email at [jacob.manning@dinsmore.com](mailto:jacob.manning@dinsmore.com) for more information or to provide assistance in reviewing or disseminating the Model Form.

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