



PRACTITIONERS GUIDE

TO LETTERS OF CREDIT
FOR DFO HABITAT
MANAGEMENT STAFF

VERSION 1.0



FISHERIES AND OCEANS CANADA

The purpose of the *Practitioners Guide to Letters of Credit* is to help Habitat Management practitioners when requesting or drawing upon Letters of Credit from proponents as a condition of a subsection 35(2) *Fisheries Act* Authorization. This Guide is part of a series of Practitioners Guides that support the Habitat Management Program (HMP) in making transparent and consistent decisions during the regulatory review of works or undertakings that affect fish and fish habitat across Canada. These Guides are intended for internal use by Habitat Management practitioners. If you have any comments on this Guide or any Practitioner Guide, please refer them to your regional Habitat Management Manager. To access other HMP Guidelines please visit the Habitat Management Intranet site at:
http://oceans.ncr.dfo-mpo.gc.ca/habitat/guidelines_e.asp

Cette publication est également disponible en français.

TABLE OF CONTENTS

BRIEF OVERVIEW OF LETTERS OF CREDIT	1.0	1
REQUESTING A LETTER OF CREDIT	2.0	3
PREPARING A LETTER OF CREDIT	3.0	3
VERIFYING THE AMOUNT FOR A LETTER OF CREDIT	4.0	4
INCORPORATING THE LETTER OF CREDIT INTO A SUBSECTION 35(2) FISHERIES ACT AUTHORIZATION	5.0	4
DRAWING ON A LETTER OF CREDIT	6.0	5
NOTICE LETTER TO THE PROPONENT	6.1	5
DRAWING ON A LETTER OF CREDIT	6.2	5
CANCELLING A LETTER OF CREDIT	7.0	6
APPENDICES	8.0	7
APPENDIX A: Two Sample Letters of Credit		7
APPENDIX B: Sample Cost Estimates		9
APPENDIX C: Verify costs of the Fish Habitat Compensation works		11
LIST OF FIGURES		
FIGURE 1: Procedural steps for using letters of credit.		2

The purpose of the *Practitioners Guide to Letters of Credit* is to help Habitat Management practitioners when requesting or drawing upon "letters of credit" from proponents as a condition of a subsection 35(2) *Fisheries Act* Authorization.

Practitioners should consider the following questions when deciding if a letter of credit is needed or how much financial security is required:

- ▶ is large scale habitat compensation work involved?
- ▶ is the proposed fish habitat compensation technique new or untested? or
- ▶ is it uncertain if the objectives of the habitat compensation plan/work will be achieved?

It should be noted that the use of Letters of Credit is discretionary. Where Letters of Credit are used, Practitioners are to follow the procedures outlined in this Guide.

BRIEF OVERVIEW OF LETTERS OF CREDIT



In its simplest form, a letter of credit is a letter written by a financial institution promising to pay the beneficiary, in this case the Receiver General of Canada on behalf of Fisheries and Oceans Canada, an agreed upon sum of money if the conditions related to completing the habitat compensation works and/or the follow-up monitoring program are not fulfilled by the proponent. Figure 1 outlines the process of administering a letter of credit.

The letter of credit is referred to as an "irrevocable" letter of credit, which means that the letter cannot be changed or altered without the agreement of all three parties (DFO, the financial institution and the proponent). Letters of credit are effective because the financial institution commits to pay monies specified in the letter of credit between the beneficiary (DFO) and the proponent, which is similar to a guarantee. Letters of credit can be issued from a variety of financial institutions including banks, loan and trust companies and credit unions in favour of DFO, as long as it is a member of the Canadian Payments Association (CPA)¹. Additional guidance on letters of credit is also provided in the Treasury Board Policy on Letters of Credit².

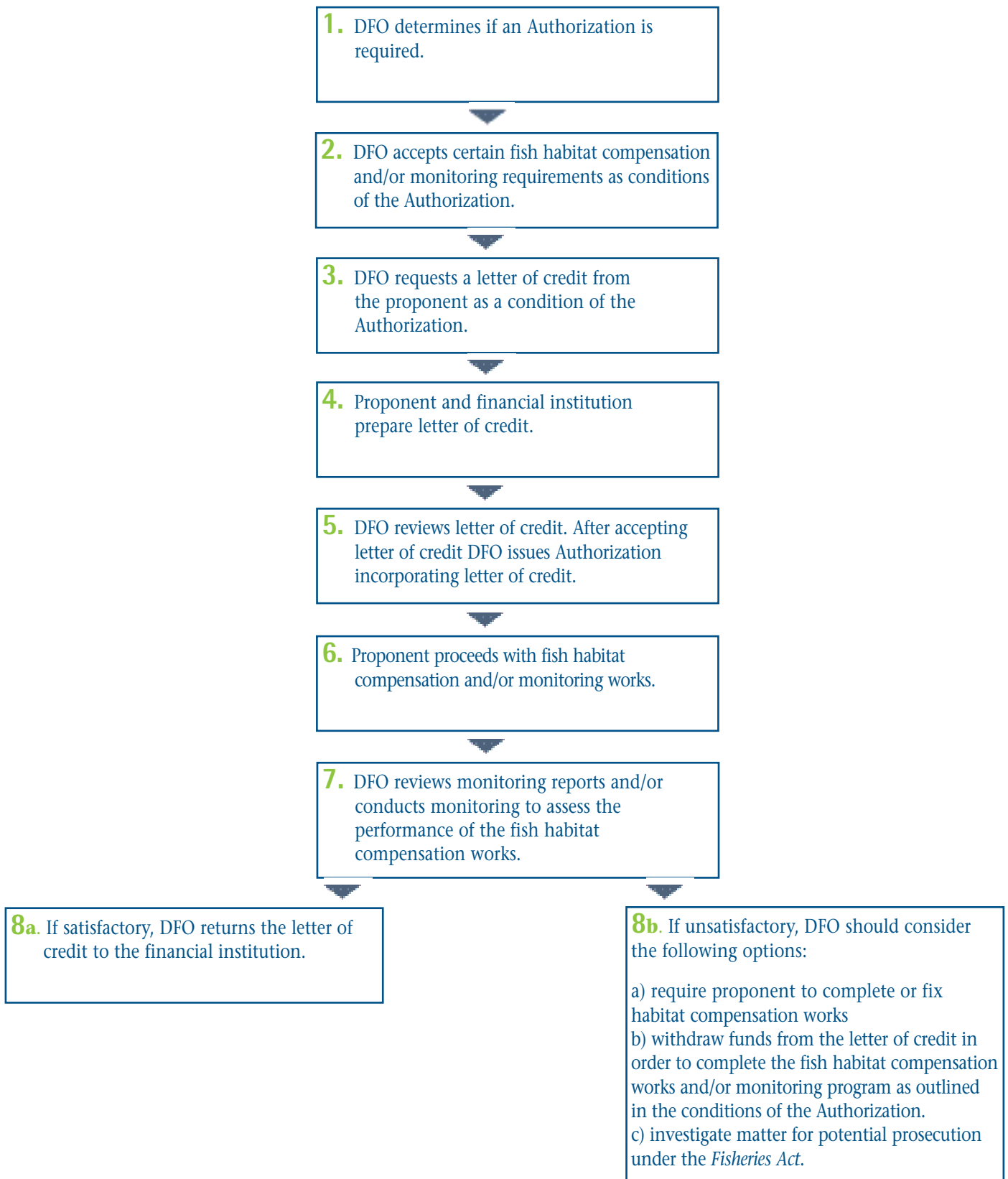
In the majority of cases, letters of credit are uniquely associated with a subsection 35(2) *Fisheries Act* authorization that includes habitat compensation works and any associated follow-up monitoring program. However, it is also possible to include multiple authorizations in a single letter of credit. For example, if a proponent is operating over a large geographical area and requires several authorizations per year, they may negotiate a single letter of credit, where the amount is confirmed annually, to cover all potential costs anticipated with multiple authorizations³.

¹ see <http://www.cdnpay.ca/membership/member.asp> for a list of member institutions

² The Treasury Board Policy on Letters of Credit (Appendix R) may be found at the following website, see: http://www.tbs-sct.gc.ca/pubs_pol/dcgpubs/Contracting/contractingpol_r_e.asp

³ Such an arrangement has recently been made with CN Rail. For further information contact National Headquarters.

FIGURE 1: Procedural steps for using letters of credit.



REQUESTING A LETTER OF CREDIT



The main vehicle for Habitat Management practitioners to request a letter of credit from the proponent is in the conditions of a subsection 35(2) *Fisheries Act* Authorization. The proponent should be advised in advance that a letter of credit will be required as financial security to ensure the fish habitat compensation works and monitoring program will be completed, as outlined in the Authorization. The proponent should be sent an example letter of credit as early in the process as is reasonable. The Authorization should not be issued if the proponent cannot secure a letter of credit or other appropriate form of financial guarantee.

Although other forms of guarantee do not suit this process as well as a letter of credit, where obtaining a letter of credit is not feasible for a proponent, DFO has accepted other forms of guarantee such as certified cheques placed in Special Purpose Accounts. Legal Services should be consulted if such guarantees are proposed.

PREPARING A LETTER OF CREDIT



A letter of credit is created between the proponent and its financial institution to provide financial security to ensure the completion and performance of the fish habitat compensation works and monitoring program. While the proponent and its financial institution are responsible for preparing the letter of credit, the Habitat Management practitioner is responsible for reviewing the letter to ensure it has the proper content and form before approving it. Legal Services can also assist in reviewing the letter. Most, if not all, financial institutions are experienced in preparing letters of credit. However, there are numerous clauses and elements that need to be included in order to be acceptable to DFO. These provisions are outlined in Appendix A and should be incorporated to ensure that the letter of credit is prepared properly to begin with.

THE LETTER OF CREDIT PREPARATION PROCESS INVOLVES TWO BASIC STEPS:

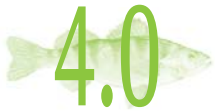
Step 1. *DFO requests the security of a letter of credit for the habitat compensation works and monitoring program:*

- ▶ DFO has determined that an Authorization is required;
- ▶ DFO has agreed to the best habitat compensation and monitoring options.
- ▶ DFO advises the proponent that a letter of credit is needed and provides example letter of credit.
- ▶ DFO requests cost estimate from proponent for the habitat compensation works and monitoring program. This is to be prepared by appropriate part(y)s - for example the construction contractor and/or the environmental consultant. Typically this material will have already been prepared for the proponent.
- ▶ DFO requests a letter of credit for the determined amount.

Step 2. *Proponent prepares the letter of credit*

- ▶ Proponent instructs its financial institution to prepare a letter of credit, including the terms provided by DFO, and provides DFO with letter of credit;
- ▶ DFO reviews letter of credit. If reviewer is unsure of enforceability or interpretation he/she should refer it to legal services.

VERIFYING THE AMOUNT OF A LETTER OF CREDIT



The value of a letter of credit acts as financial incentive for the proponent to properly complete its works. The amount of the letter of credit should be sufficient to complete the fish habitat compensation works and monitoring program in the event of unsatisfactory or non-performance of the conditions in the Authorization. It is the proponent's responsibility to supply DFO with its own cost estimates for the habitat compensation works and the monitoring program. It is DFO's responsibility to ensure the letter of credit reasonably relates to the amount required to complete these activities. For additional guidance see Appendix B.

INCORPORATING THE LETTER OF CREDIT INTO A SUBSECTION 35(2) FISHERIES ACT AUTHORIZATION



A letter of credit must be referenced in the financial security conditions of the subsection 35(2) *Fisheries Act* Authorization. The following is suggested as appropriate language for the Authorization:

The proponent shall deliver to DFO by *- insert date -* a letter of credit from a Canadian Bank in the amount of *- insert amount -* in a form acceptable to DFO which shall automatically renew each year and must be payable in *-insert city of regional DFO office.* The letter of credit may be used in any manner deemed appropriate to DFO in relation to this Authorization. The letter of credit shall be returned upon satisfactory completion of the above noted habitat compensation works and monitoring program.

The original letter of credit should be stored in a safe place and entered as a record into the Habitat Referral Tracking System (HRTS) - Program Activity Tracking for Habitat (PATH).

DRAWING ON A LETTER OF CREDIT

6.0

Habitat Management practitioners should review the monitoring program reports to ensure that the proponent is completing or has completed the work according to the conditions of the Authorization. Practitioners should also note any issues with the performance of the habitat compensation works. This documentation will be useful in the event of non-compliance.

If a proponent is not meeting its obligations then the proponent should be advised that a breach of condition of Authorization may have occurred. A time frame should be set up for the proponent to correct the problem. All or part of the letter of credit can be drawn upon if the proponent fails to correct the problem within the specified time frame.

6.1 NOTICE LETTER TO THE PROPONENT

The proponent should be advised in writing when they are not meeting their obligations under the conditions of the Authorization. A notice letter stating that a breach of a condition of Authorization has occurred, detailing the facts of the default, as well as specific damages (if known) should be sent to the proponent. The letter should also outline a time frame for the proponent to correct the problem; as well as notice that the failure to correct the problem within the specified time frame will result in DFO drawing upon all or part of the letter of credit. A copy of this notice letter should be kept on file.

6.2 DRAWING ON A LETTER OF CREDIT

DFO can draw upon a letter of credit if the proponent has not complied with its Authorization. Consider drawing upon all or part of the letter of credit, in consultation with a supervisor and legal counsel, to rectify these deficiencies if they persist and are not addressed by the proponent. If DFO has information that the proponent may not be able to fix deficiencies due to financial difficulties, DFO should consider drawing on the letter of credit forthwith.

Two documents must be presented to the issuing financial institution for payment:

- ▶ A signed sight draft that states the amount of monies requested to be drawn upon the letter of credit (this amount can be up to, but no more than the total value of the letter of credit).
- ▶ The original letter of credit needs to be presented to the financial institution for review and endorsement.

The issuing bank will generally pay the beneficiary (DFO) regardless of any alleged disputes between the proponent and DFO (e.g., whether or not the compensation work was performed or completed as specified in the Authorization) as long as it is presented with the required sight draft, the original letter of credit and any other documents referenced in the letter of credit.

Habitat Management practitioners should discuss accounting and contracting procedures with the Finance Branch after drawing upon a letter of credit. A Special Purposes Account (SPA) will need to be set up to administer these funds. Contractors may need to be hired to complete the conditions of the Authorization that have not been met. The statements of work will already be clearly identified in the conditions of the Authorization and the original letter of credit.

If the proponent does fix up the works to DFO 's satisfaction, DFO may simply return the money to the proponent.

CANCELLING A LETTER OF CREDIT



The letter of credit will be returned to the issuing financial institution when the proponent has completed the fish habitat compensation work and monitoring program to the approval of DFO.

APPENDICES

8.0

APPENDIX A - TWO SAMPLE LETTERS OF CREDIT

Please note: These are only sample letters of credit. Each financial institution will have their own specific style and content.

Fisheries & Oceans Canada
{address}

{Date}

Attention: {manager} Habitat Management

Dear Sirs:

Re: Letter of Guarantee No.: {Provided by Financial Institution}
Issued in the name of {Proponent name}

We hereby authorize you to draw on {Financial Institution}, for the account of {Proponent name}, up to the sum total of \$ {amount} Canadian dollars available on demand as follows:

Available by drafts at sight for 100% of value.

This Letter of Guarantee is being issued with respect to "XXX Habitat Compensation and Monitoring Agreement" under the following conditions:

1. Drawings are to be made in writing to {Financial Institution, address}.
2. Partial drawing may be made.
3. The Financial Institution will not inquire as to whether or not Fisheries & Oceans Canada has a right to make demand on the Letter of Guarantee.
4. This Letter of Guarantee shall be deemed to be automatically extended on an annual basis without any formal amendment unless, thirty days prior to the present expiry or any future expiry date as automatically extended, we shall notify you in writing that we elect not to extend the Letter of Guarantee for any further period, and at the same time forward to you, together with such written notice of election, a bank draft payable to Fisheries & Oceans Canada in the amount of \$ {amount} Canadian dollars less any amount previously paid under this Letter of Guarantee
5. This Letter of Guarantee is irrevocable up to the expiry date.
6. Upon successful completion of {Proponent Name} responsibilities under the Habitat Compensation and Monitoring Agreement, as determined by Fisheries and Oceans Canada, the original Letter of Guarantee shall be returned to {Financial Institution} for cancellation.

Drafts must be drawn and negotiated not later than {MM/JJ/AAAA}.

All Drafts drawn under this Letter of Guarantee are to be endorsed hereon and shall state on their face that they are drawn on {Financial Institution}.

FOR: {Financial Institution}

{name}

{name}

Corporate & Investment Banking Group

Corporate & Investment Banking Group

Letter of Guarantee No.: {Provided by Financial Institution}

Financial Institution: **{Name and Address}**
Applicant: **{Name and Address of Proponent}**
Letter of Credit Number: **{Provided by Financial Institution}**
Date of Issue: **{Date required}**

IRREVOCABLE STANDBY LETTER OF CREDIT

Beneficiary: **{Receiver General of Canada on behalf of Fisheries and Oceans Canada}**

Dear Sir or Madam:

We hereby authorize you to draw upon the **{Financial Institution, address}** for the account of our Customer **{Applicant}**, up to the sum total of **#{amount}** Canadian Dollars available on demand as follows:

Pursuant to the request of our Customer, we the **{Financial Institution}** hereby establish and give to you an irrevocable Standby Letter of Credit (the "Credit") in your favour in the total amount of **#{amount}**. The Credit may be drawn on, by you, at any time and from time to time upon written demand by you. We will honour any such demand made by you without inquiring whether you have a right as between yourself and our Customer to make such demand and without recognizing any claim, instructions, direction or notification to the contrary from the 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 you, agreeing and/or confirming that monies drawn pursuant to this Credit will be retained and used by you to meet our Customer's obligations in connection with compensation and monitoring conditions of *Fisheries Act* Subsection 35(2) Authorization (Referral File No.: **{REF/FILE NO.}**, Habitat File No.: **{HABITAT NO.}**), **{MM/DD/YYYY}** and located at **{name}**. This original Letter of Credit must also be presented at the time for endorsement of the claim paid and will be returned to you.

It is understood and agreed that the obligation of the undersigned under this Credit is an obligation to pay money only and that in no circumstances shall the undersigned be obliged to perform or cause to perform any of our Customer's actual obligations to you.

Conditions:

1. The sum total of this Credit shall be reduced from time to time as advised by written notice given to this Branch from time to time by you.
2. The Credit will continue until **{MM/DD/YYYY}** and will expire at the Branch address at the close of banking business on that date.
3. This Credit is irrevocable until that date.
4. This Credit shall be deemed to be automatically extended for one year from the present or any future expiration date hereof, unless 30 days before any such date we give you written notice that we elect not to consider this Credit renewed for any such additional period. Upon receipt by you of such notice, you may draw upon, accompanied by written certification, the amount to be retained and used by you to meet obligations incurred or to be incurred in connection with the Authorization.
5. Partial drawings on this Credit are permitted.
6. Upon successful completion of **{Applicant}** responsibilities under the compensation and monitoring conditions of the Authorization, as determined by Fisheries and Oceans Canada, the original Letter of Credit shall be returned to **{Financial Institution, address}** for cancellation.

{Signatures of responsible officials}

APPENDICES



APPENDIX B – SAMPLE COST ESTIMATES

It is the proponent's responsibility to supply DFO with its own cost estimates for the habitat compensation works and the monitoring program. It is DFO's responsibility to ensure the letter of credit reasonably relates to the amount required to complete these activities. Verification of cost estimates for the habitat compensation works and the monitoring program may be required by an independent consultant for highly complex and expensive projects.

An independent consultant should follow three basic steps to ensure that the proponent's estimate accurately reflects the costs that will be incurred to complete the compensation and monitoring works.

1. Verify the habitat compensation works and monitoring program costs: review habitat compensation works and monitoring program costs that are submitted by the proponent. This includes labour, project supervision, equipment, materials, report preparation and printing, property purchase or lease, monitoring, maintenance.
2. Determine additional costs: determine if there will be any additional costs associated with completing the habitat compensation works and monitoring program. This includes project management costs, non-competitive costs, seasonal adjustment, availability of local expertise, inflation protection, deferred compensation, contingencies, etc.
3. Establish the total estimate: the total estimate is the sum total of the habitat compensation works and monitoring program costs and any additional costs.

EXAMPLES OF ADDITIONAL COSTS

Generally these additional costs will increase as the project size increases. The following is a list of potentially relevant factors to consider when estimating additional costs:

1. **Increased project management:** Additional project management costs will be incurred when a third party is required to complete a project. It may be necessary to hire a project manager to ensure that the project is kept on schedule and within the allocated budget. Therefore increased or additional project management costs should be accounted for if it is not already included in the original project costs.

2. **Less than competitive bid:** Higher costs may be incurred when circumstances arise (e.g. work needs to be completed quickly to avoid pending inclement weather) that make it necessary to hire a contractor(s) without the benefit of a competitive bidding process. Further, other qualified contractors may be busy when the work must be done, resulting in higher prices for a given quantity of work. This is often the case in areas with short work windows where contractors plan their seasons work well in advance to maximize their opportunities. Additional work during this period may come at a premium price. If at all feasible, practitioners may also wish to consider delaying the completion of the project until a competitive bidding process can be done.

3. **Seasonality:** Costs of completing a project may vary by the time of year. It may be more expensive to complete an aspect of a project at a different time of the year than when it was originally planned. For example, at certain times of the year it is harder to access the project site or secure materials or the project may take longer due to holiday schedules.

4. **Available local expertise:** Per Diem travel and living expenses associated with non-local contractors can result in significant increases in overall project costs (e.g., as much as 20-30%) to account for these additional expenses.

5. **Inflation Protection:** Consider the impact of inflation on overall project costs for longer term projects. It is suggested that the consumer price index (CPI) be used to calculate the annual inflation rate (of total project costs) to be added to the amount of the letter of credit.

6. **Deferred Compensation:** Deferred compensation refers to compensation that is done at a time beyond which normal compensation would be completed. Deferred compensation may require larger replacement ratios to offset the extended loss of productive capacity during the time that the compensation is deferred. Usually, this cost is agreed upon and included in the original project cost at the onset of the Authorization process. Depending on the nature and complexity of the proposed compensation, the inherent risks associated with the work to be completed in the future may be greater than the work scheduled for coincidental completion. This should be considered on an individual basis and an appropriate amount should be factored in if the risk is considered significant.

7. **Contingencies:** Projects that are inherited midway by a new contractor seldom progress the way they were originally envisioned or budgeted for. It is prudent to consider the complexity of the project and add an amount for situations such as this. This may be a fixed amount or a percentage of the estimated total. In the latter case, 20% of the total estimated cost is a reasonable amount for contingencies.

APPENDICES



APPENDIX C – VERIFY COSTS OF THE FISH HABITAT COMPENSATION WORKS

The example below illustrates the process of verifying the value of a letter of credit. This is a hypothetical cost estimate submitted by a proponent to carry out the fish habitat compensation works as a condition of a subsection 35(2) *Fisheries Act* Authorization.

The itemized costs were checked with other local contractors and suppliers and were found to be verifiable estimates. The overall estimate of \$28,767.99 was accepted as a reasonable estimate of the actual cost of the project.

Cost category	No of Units	Units	Unit costs (\$)	Total Cost (\$)
<u>Materials</u>				
Physical structure	21	m	314.90	6,612.90
23-cm minus aggregate (delivered)	52	m3	41.13	2,138.76
Sand (delivered)	28	m3	29.61	829.08
Geotextile	275	m2	1.35	371.25
<u>Equipment</u>				
Excavator (20 - 25 t) with site preparation and installation	65.5	hours	132.00	8,646.00
Compactor rental	2	days	50.00	100.00
Pumps and hoses	5	days	50.00	250.00
<u>Labour</u>				
Planning site survey	1	crew	600.00	600.00
Design drawing drafting	1	set	600.00	600.00
Fish salvage	1	crew	500.00	500.00
Field crews	7	person	250.00	1,750.00
Site preparation and installation	88.5	hours	30.00	2,655.00
Surveyor during construction	40.5	hours	30.00	1,215.00
Supervision - Foreman	5	days	500.00	2,500.00
			Total	28,767.99

Determine additional costs

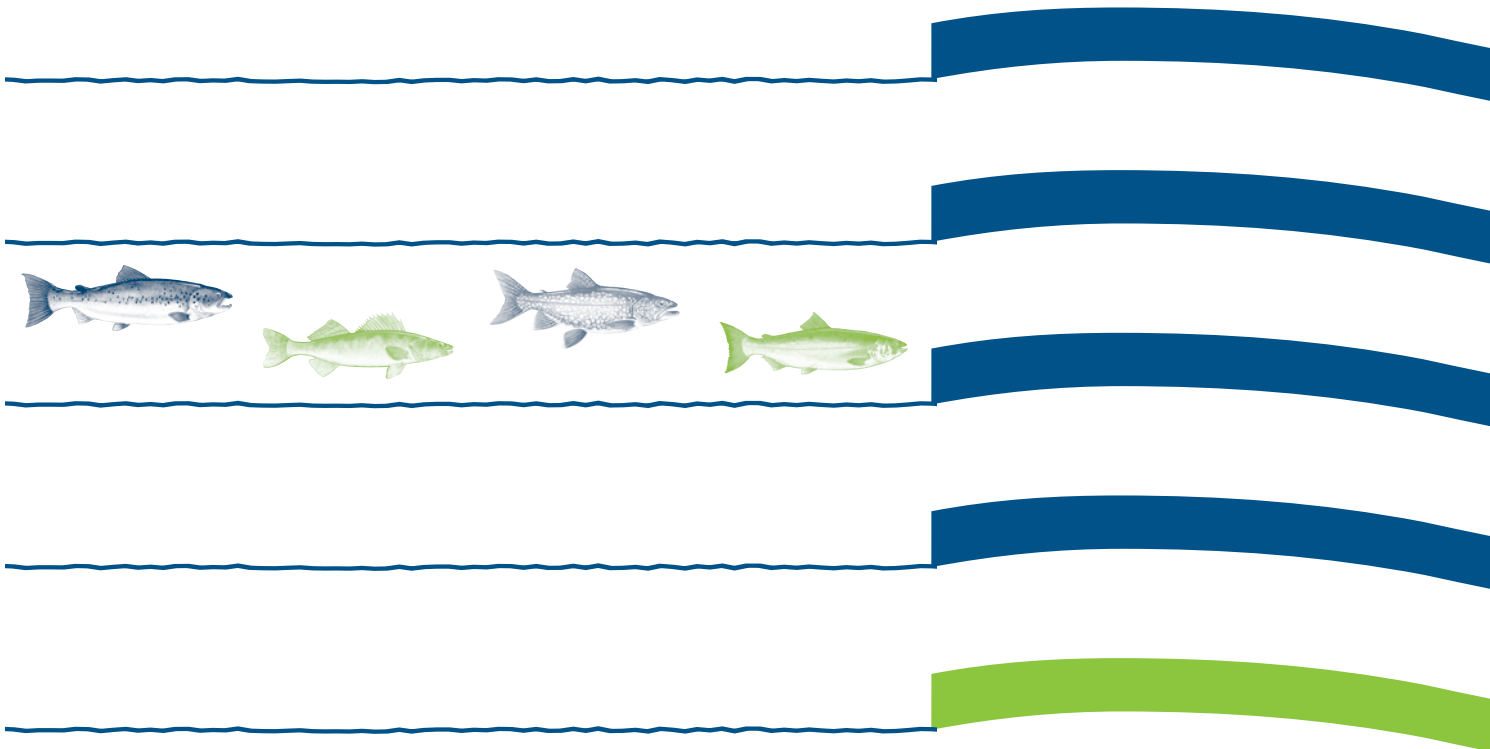
As the original project price did not include a project manager, an additional 10 days of independent project management time is added to the overall contract price. It was found that local suppliers and contractors are available should the need arise to use them. However, an additional 10 % was added as a contingency for unforeseen expenses and the likelihood of a less than competitive bid.

Additional costs

Cost category	<u>No of Units</u>	<u>Units</u>	<u>Unit costs</u> (\$)	<u>Total Cost</u> (\$)
Project manager	10	days	500	<u>5,000.00</u>
10% project contingency				2,876.80
				7,876.80

Establish Amount

A letter of credit was requested for a total of \$36,644.79, representing the original amount submitted by the proponent (\$28,767.99) and the additional amount of (\$7,876.80).



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