

Force Majeure and Closure: Recent ICC Guidance and U.S. Letter of Credit Cases From Prior Crises

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About:

Mike Avidon is a partner in Moses & Singer LLP, a New York City law firm. He Co-Chairs the Banking and Finance Practice Group and is widely recognized for his knowledge of letters of credit (LCs), lending, and secured transactions. Mike's practice emphasizes secured and unsecured lending transactions, LC transactions, trade finance, supply chain finance, accounts receivable purchases, payables programs, draft discounting, electronic contracting, outsourcing and white labeling agreements, and LC litigation. His LC work involves standby, direct pay, and commercial LCs as well as demand guarantees. His clients include money center banks (often acting as administrative agent for a syndicate of lenders) and other financial institutions.

Author:

- "Why New York Law and Jurisdiction Offer Advantages for International L/C Transactions," *Documentary Credit World* (May 2014; co-authored with David Rabinowitz)
- "Model Standby Forms Under ISP98: Comments on Form 4 – Model Standby Providing for Transfer and Incorporating Annexed Form of Transfer Demand," *Documentary Credit World* (July 2012)
- "ISP98 Rule 3.12(a): Is It a Trap, or a Warning to an Unwary Beneficiary of a Letter of Credit?" *George Mason Journal of International Law* (December 2010)
- For additional publications, see attorney profile at www.mosessinger.com/attorneys/michael-evan-avidon

Bar Association Positions:

- Co-Chair, American Bar Association, Letters of Credit Subcommittee of the UCC Committee
- Past Chair, New York State Bar Association, Letter of Credit Subcommittee of the Banking Law Committee

Other:

- Participated in revision of UCC Article 5 & preparation of the International Standby Practices 1998 (ISP98)
- Counsel to BAFT in preparation of its NY law version Master Trade Loan Agreement
- Member ICC's Bank Payment Obligation (BPO) Consultative Group
- Member, American College of Commercial Financial Lawyers
- Member, Editorial Advisory Board, *Documentary Credit World*
- Frequent speaker & panelist regarding secured transactions, LCs, UCC Articles 9, 8 & 5, UCP 600, ISP98, and URDG 758.

Independence Principle and Force Majeure

- Tension between the independent and documentary nature of letters of credit (LCs) and force majeure clauses.
- LCs are separate from both the underlying transaction between the applicant and the beneficiary (e.g., sale contract, loan agreement, or lease) and the underlying reimbursement arrangement between the applicant and the issuer.
- This is true “even if any reference whatsoever to [the underlying contract] is included in the credit.” UCP 600 Art. 4(a). *See also* ISP98 Rules 1.06-1.08, URDG 758 Art. 5.
- Thus, LCs and issuing banks are generally unaffected by force majeure clauses in underlying contracts.
- A force majeure clause in an LC might be viewed as a type of non-documentary condition. But those types of conditions are generally disregarded in LCs. UCC 5-108(g), UCP 600 Article 14(h), ISP98 Rule 4.11, URDG 758 Article 7.

Force Majeure in Various LC Legal Regimes

- LCs issued in the U.S.A. are typically governed by **Uniform Commercial Code (UCC) Article 5**. The UCC is statutory law enacted by states, with some non-uniform variations. It is not federal law. Most countries do not have statutory law for LCs.
- UCC Article 5 does not mention or allude to “force majeure.” The only defenses to non-payment of an LC codified in UCC Article 5 are: (i) lack of strict compliance (§ 5-108) and (ii) forgery or fraud (§ 5-109).
- LC issuing banks are also subject to regulation. *E.g.*, in the U.S.A., the Office of the Comptroller of the Currency (OCC) has issued Interpretive Ruling 12 C.F.R. §7.1016 concerning independent undertakings by national banks to pay against documents. This ruling does not mention force majeure.
- States in the U.S.A. have their own banking regulations.

ICC Interpretive Papers on UCP 600

- On April 7, 2020, the ICC released a 17-page Guidance paper on the impact of COVID-19 on trade finance transactions subject to ICC rules:
<https://iccwbo.org/content/uploads/sites/3/2020/04/2020-10-the-impact-of-covid-19.pdf>
- The paper was generally well received but questions were raised as to portions of the paper dealing with the delivery of paper documents.
- Consequently, on May 29, 2020, the ICC issued a 2-page paper concerning the interpretation of the first paragraph of UCP 600 Article 35 concerning the delivery of paper documents:
<https://iccwbo.org/content/uploads/sites/3/2020/06/covid-interpretative-paper-on-article-35-ucp-600.pdf>

ICC Interpretive Papers on UCP 600 (cont.)

“For the avoidance of any doubt, the ICC Banking Commission confirms that, in its true interpretation, article 35 of UCP 600 should be read also to apply to the case where the nominated bank or the confirming bank is not able to transmit or to send letters or documents in paper form (collectively “Documents”) in accordance with the requirements stated in the documentary credit because:

- the courier or postal service provider nominated in the documentary credit does not accept, collect or deliver the Documents, or
- where no courier or postal service provider has been nominated in the documentary credit, no such service provider accepts, collects or delivers the Documents at the time the nominated bank or the confirming bank is to send the Documents to the confirming bank or issuing bank,

provided that, in both cases, the nominated bank or the confirming bank has first made reasonable efforts to (a) find a courier or postal service provider that would accept or collect and thereafter deliver the Documents and (b) obtain the consent of, or instructions from, the issuing bank approving delivery in that manner.”

Determining if Force Majeure Excuses Performance

- **First**, look to the terms of the LC or other contract to be performed.



- **Second**, look to any practice rules incorporated by such LC or other contract, to the extent not inconsistent with the terms of such LC or other contract.



- **Third**, look to the applicable law or civil code, such as UCC Article 5 or judge-made common law.

Notable U.S. Case Law

***Engel Industries, Inc. v. First American Bank, N.A.*, 798 F.Supp. 9 (D.D.C. 1992).**

- Applicant wrote to Beneficiary: “In compliance with the President's Executive Order [concerning Iraq] and because of the underlying force majeure events ..., Medcon Enterprises, Inc. must and hereby does withdraw, cancel and rescind Purchase Order EI 001 You should advise your bank to return all original Letter of Credit documents to the issuing bank for cancellation.”
- American issuing bank then repudiated the LC it had issued for the benefit of an American manufacturer.
- Court: “If reputable financial institutions are able to weasel out of their obligations under their letters of credit, they will do a great disservice to business in this country and will also reduce their own profits. Letters of credit are too important a form of financing to permit them to be so easily repudiated with such finality as summarily happened here.”

Notable U.S. Case Law (cont.)

Three cases involving the Iranian Revolution:

(1) *Touche Ross & Co. v. Manufacturers Hanover Trust Co.*, 107 Misc.2d 438, 434 N.Y.S.2d 575 (Sup.Ct. 1980):

An LC was payable to an Iranian bank upon presentation of a sight draft and documentation that it had made payment on a guaranty to the Imperial Government of Iran. Against the backdrop of the Iranian Revolution, the Iranian bank drew on the LC and the applicant sought to enjoin payment. The court gave two reasons why payment should be stopped:

- The underlying contract provided that if it were terminated due to force majeure, then all guarantees would be immediately released.
- The beneficiary bank had been nationalized. Thus it could not have legitimately paid on the guaranty, as required to make an LC draw, as the Iranian bank would be effectively paying itself. Therefore, any call on the LC would be fraudulent.

This case might have been decided differently under UCC Revised Article 5, which was promulgated in the 1990s, codified the independence principle in § 5-103, and narrowed the fraud exception in § 5-109.

Notable U.S. Case Law (cont.)

Three cases involving the Iranian Revolution:

(2) *Itek Corp. v. First Nat'l Bank of Bos.*, 730 F.2d 19 (1st Cir. 1984):

- As in the *Touche Ross* case, the underlying contract was cancelled due to force majeure.
- Contract stated that “upon force majeure cancellation of the contract, all Bank Guarantees of good performance of work will be immediately released.”
- In granting injunction against payment, court focused on fact that any draw would be fraudulent: “If Melli has no plausible or colorable basis under the contract to call for payment of the letters, its effort to obtain the money is fraudulent and payment can be enjoined.”

(3) *Harris Corp. v. Nat'l Iranian Radio & Television*, 691 F.2d 1344 (11th Cir. 1982):

- Under similar facts, rejects line of argument in *Touche*, stating: “we hesitate to hold that the letters of credit were automatically terminated by the operation of the contractual provisions. Accepting Harris's first argument would create problems; a bank could honor a letter of credit only to find that it had terminated earlier.”
- However, court nevertheless enjoined payment on basis that any draw would be fraudulent because contract had been terminated due to force majeure. Further noted that “NIRT and Bank Melli had both become government enterprises, the demand was in some sense by Iran upon itself and may have been an effort by Iran to harvest undeserved bounty from Continental Bank.”

Thank you for your time.

Questions?

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