

## **Beneficiaries Preparing For Force Majeure: What Rules Govern Your LCS?**

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### **As seen in the May issue of *Documentary Credit World*.**

The protests in Egypt, earthquake in New Zealand, and disaster in Japan have again emphasized the need for contracting parties to anticipate that events beyond their control may affect their ability to perform. For most parties, a well-drafted force majeure clause will be adequate protection.

But even though not each of these events resulted in large-scale bank closures, they do serve as useful reminders that parties to a letter of credit also must allocate the risk of or otherwise plan for how unanticipated events may affect the LC transaction. That is especially true of beneficiaries, who must at least be aware how the applicable rules treat force majeure events and who should consider varying certain provisions.

In addition, though ISP98 and UCP600 both address force majeure events, there are important distinctions between them—particularly insofar as the beneficiary's right to demand payment is concerned. As a result, even the choice which rules govern a standby LC could impact whether the beneficiary is able to demand payment following a force majeure event.

This article will examine application of the two sets of rules' force majeure provisions. It concludes that the beneficiary of a commercial LC should consider varying the applicable provision of UCP600, and that the beneficiary of a standby LC first should insist upon application of ISP98 instead of UCP600, and second, if it does not succeed, consider varying the applicable provision of UCP600.

### **UCP600 Article 36**

Article 36 of UCP600 addresses force majeure events but does not favor beneficiaries. Article 36 ("Force Majeure") states:

A bank assumes no liability or responsibility for the consequences arising out of the interruption of its business by Acts of God, riots, civil commotions, insurrections, wars, acts of terrorism, or by any strikes or lockouts or any other causes beyond its control.

A bank will not, upon resumption of its business, honour or negotiate under a credit that expired during such interruption of its business.

UCP600 Art. 36 ("Force Majeure")

Article 36, in other words, limits the bank's liability when a force majeure event interrupts its business. When the letter of credit expires while the bank is closed due to a force majeure

event, the beneficiary is not able to draw upon the letter of credit upon resumption of the bank's business. Article 36 does not address the beneficiary's ability to draw when a force majeure event affects beneficiary's business.

UCP600 Article 29(a) does extend the letter of credit's expiry date when the bank is closed on the expiry date, but only if the closure is "for reasons other than those referred to in article 36." UCP600 Art. 29 ("Extension of Expiry Date or Last Day for Presentation"). Thus, the expiry date may be extended to the next banking day if, for example, the bank's closure is the result of an ordinary closure—a weekend or a holiday or the like—but not if the closure is due to a force majeure event.

It requires little imagination to foresee the scenario in which a beneficiary may be adversely affected by application of these rules. Assume beneficiary of a commercial LC has performed under a contract of sale and goods have been shipped. Beneficiary is prepared to present documents to draw under the letter of credit, and an earthquake closes the bank's offices. If the letter of credit's original expiry date passes while the offices are still closed, the expiry date is not extended by operation of Article 36. If a presentation is made on the next banking day, the bank is not obligated to pay beneficiary because the LC has expired, even if the documents are complying.

Beneficiary, of course, is not left without recourse. It has performed under the contract, and it could seek recovery of the contract price directly from buyer. But presumably beneficiary may have required a letter of credit in the first place to obtain the additional assurance of payment provided when the bank undertakes to pay under the letter of credit. If beneficiary cannot rely upon payment when a force majeure event occurs, the very reason it required a letter of credit is frustrated.

As Professor Byrne has noted, the application of Articles 29 and 36 is particularly harsh to beneficiaries of standby LCs. JAMES E. BYRNE, UCP600: AN ANALYTICAL COMMENTARY, 1184 (2010). Whereas the beneficiary of a commercial LC may retain control of the goods as security to enforce the obligation to pay beneficiary, the beneficiary of a standby LC does not usually have goods to retain and instead relies upon the bank's obligation and bears the risk that a force majeure event will close the bank on the expiry date. *Id.* at 1184, 1306.

### **ISP98 Rule 3.14**

Closure due to a force majeure event would be covered in ISP98 in Rule 3.14 ("Closure on a Business Day and Authorization of Another Reasonable Place for Presentation"), which states:

1. If on the last business day for presentation the place for presentation stated in a standby is for any reason closed and presentation is not timely made because of the closure, then the last day for presentation is automatically extended to the day occurring thirty calendar days after the place for presentation re-opens for business, unless the standby otherwise provides.
2. Upon or in anticipation of closure of the place of presentation, an issuer may authorise another reasonable place for presentation in the standby or in a communication received by the beneficiary. If it does so, then
  1. presentation must be made at that reasonable place; and

2. if the communication is received fewer than thirty calendar days before the last day for presentation and for that reason presentation is not timely made, the last day for presentation is automatically extended to the day occurring thirty calendar days after the last day for presentation.

ISP98 Rule 3.14 (“Closure on a Business Day and Authorization of Another Reasonable Place for Presentation”).

Official Comment No. 1 to Rule 3.14 relays that Rule 3.14 was intended to recognize that “many standby beneficiaries sensibly are unwilling to accept any risk of forfeiture of their rights due to the closure of the office of a solvent issuer.” JAMES E. BYRNE, THE OFFICIAL COMMENTARY ON THE INTERNATIONAL STANDBY PRACTICES, Rule 3.14, Off. Comm. 1 (1999). By stating the Rule to balance the risk between the parties, the drafters sought to “avoid the current confusion resulting from poorly drafted idiosyncratic and impractical clauses which appear in some standbys.” *Id.*

In addition, Rule 3.14 provides an alternative to the parties. Should the issuer so choose, under subpart b, it may provide the beneficiary with a reasonable alternative place of presentation.

Finally, though the Rule would apply to closures due to force majeure events, the Rule is not limited to such closures, and as a result, there is no need to determine whether such an event has actually occurred. *Id.* at Off. Comm. 3. Instead, the beneficiary need only show that its failure to timely present was caused by the closure.

### **Comparison of Article 36 and Rule 3.14**

From the perspective of the beneficiary of a standby LC, there is little doubt that Rule 3.14 is a more favorable provision. Under Rule 3.14, the extension of the expiry date is automatic if there is a closure: beneficiary need only show that its failure to timely present complying documents was caused by that closure. As a result, Rule 3.14 does not require the beneficiary to assume the risk that a business interruption will preclude its attempted presentation—an important distinction given that the beneficiary of a standby LC usually lacks the security that the beneficiary of a commercial might possess.

For those reasons, a beneficiary is better-protected by Rule 3.14 and where possible, beneficiaries of standby LCs should favor it. Even if the beneficiary is unsuccessful in seeking to have the entirety of ISP98 applied to the LC, it should consider varying the terms of UCP600, Article 36 to include the language of Rule 3.14. By achieving the balance that Rule 3.14 strikes, beneficiary may ensure that its rights under the LC are not extinguished.

Though the beneficiary of a commercial LC cannot seek application of ISP98 to the LC, it certainly may—and should—seek to vary UCP600 Article 36 to include the language of ISP98 Rule 3.14. Inclusion of that language is a reasonable extension that does not significantly change the bank’s obligations while still extending the expiry when necessary to protect the beneficiary. Even similar language allowing an extension for closures due specifically to force majeure events would similarly protect beneficiary without a significant change in the bank’s obligations.

Additionally, the language of subparagraph b of Rule 3.14, if incorporated into the varied provision, may alleviate any of the issuer’s concerns as to extending the expiry date. Issuer may avoid any potential expenses incurred through extension of the expiry date, and beneficiary is

allowed to present its documents and be paid timely. Thus, if the language of Rule 3.14 may be incorporated into a commercial LC and may offer substantially more protection than Article 36 offers.

### **Conclusion**

Even if a beneficiary does not incorporate the text of ISP98 Rule 3.14 or use similar language, it should not blindly accept the terms of UCP600 Article 36 without understanding the risks that it takes in doing so. The beneficiary who counts on a letter of credit for payment but does not address the risks presented by Article 36 does itself no favors. Instead, it should vary the terms to properly account for the risk that a force majeure event will occur and in the very least, allow itself the opportunity to draw on the LC following the conclusion of the event.