

COVID-19: its impact on letters of credit



Introduction

The spread of COVID-19 worldwide has no doubt caused serious disruptions to international trades. What are the respective parties' obligations under letters of credit in circumstances like these?

The Law

Governments worldwide have implemented various severe measures to control the spread of COVID-19, including city lockdowns, travel restrictions, closure of non-essential businesses, etc. Undoubtedly these measures have significant impact on parties' ability to perform contracts. Parties may consider releasing themselves from the contract by one of the following ways.

Force majeure

Usually, commercial contracts include a force majeure clause which excuses the parties from further performance of the contract upon occurrence of certain force majeure events. Accordingly, it is up to the parties to include in the contracts what would constitute force majeure events.

If a party wishes to rely on COVID-19 as a force majeure event to release himself from the further obligations in the contract, it must be shown that:

1. COVID-19 falls within the meaning of force majeure events in the contract; and
2. The party is prevented from performing the contract as a result of COVID-19.

It therefore depends heavily on the language of the force majeure clause in order to decide whether or not COVID-19 is covered.

Frustration

Where the parties do not include a force majeure clause in their contract, they may rely on the common law doctrine of frustration to put the contract into an end. There is no exhaustive list of events which may lead to frustration of a contract. However, it must be shown that the event:

1. occurred through no fault of either party;
2. is unforeseeable; and
3. renders performance of the contract impossible or transforms the obligations under the contract radically into something different from what was agreed by the parties.

Below are some examples of events of frustration:

1. Personal incapacity or death

As a result of COVID-19, people are incapacitated because of quarantine orders, hospitalization or even deaths. While deaths can usually amount to an event of frustration, incapacity as a result of quarantine orders and hospitalization may not always be the case.

Although it remains to be seen how Hong Kong Courts react to frustration caused by COVID-19, the cases concerning SARS in 2003 provided good guidance. In *Li Ching Wing v Xuan Yi Xong* (DCCJ 3832/2003), the defendant was a tenant in Block E of Amoy Garden, which was subject to an isolation order issued by the Department of Health. As a result of the isolation order, all the residents of Block E (including the defendant) had to be evacuated to various places for 10 days. After that, they returned to their flats. The defendant sought to rely on the isolation order to say that the tenancy agreement had been frustrated. The Court ruled that although the outbreak of SARS may arguably be an unforeseeable event, the defendant was only prevented to stay in the premises for 10

days over a term of 2 years. The isolation order did not significantly change the nature of the rights or obligations originally contemplated by the parties, and hence, cannot be an event of frustration.

2. Supervening illegality

If the law changes which prohibit performance after the contract is made, the contract may be frustrated. For example, the changes in law may render sale of certain goods illegal or use of certain materials in construction projects illegal. In the situation of COVID-19, city lockdowns and travel restrictions polices have made it illegal for people to go out other than for permissible purposes. It may render contract performances impossible.

Implications to parties under letters of credit

While the underlying transactions may be terminated or frustrated as a result of force majeure or unforeseeable events, it seems that the law is clear in that letters of credit are independent of the underlying contracts (i.e. the principle of autonomy of letters of credit) and hence, banks' obligations under the letters of credit are unaffected by the underlying transactions.

Accordingly, if notwithstanding that the underlying contract comes to an end as a result of force majeure events or frustration, the beneficiary of a letter of credit presents the documents to an issuing or nominated bank, it is not excused from its obligation under the letter of credit so long as the documents are presented on time and in compliance.

However, in light of the travel restrictions and lockdowns imposed all over the world during COVID-19, beneficiaries may have difficulty in presenting documents to the issuing banks on time. In this regard, there is no provision under UCP 600 to automatically extend the presentation deadline.

COVID-19 has shaped the way the world operates – it can be seen that technology and digitalization will play a key role in allowing businesses to operate as usual. The same applies to the operation of documentary credits.

The **eUCP** supplements UCP600 in order to allow presentation of electronic records. Below is a glimpse of the key provisions in eUCP:

1. *Article e6e.i.* provides that if the bank to which presentation is to be made is open, but its system is unable to receive the electronic records on the expiry date, the bank is deemed to be closed and the expiry date shall be extended to the next banking day on which the Bank is able to receive the electronic record.
2. *Article e12* provides that if the electronic record received by the issuing bank appears to be affected by a data corruption, the issuing bank can request the presenter to re-represent the electronic record. In such case, the time for examination is suspended until the electronic record is re-represented.
3. *Article e13* provides that a bank assumes no liability or responsibility for, *inter alia*, the identity of the sender and the source of the information, other than which is apparent in the electronic records received by the use of data processing system for the receipt, authentication and identification of the records.
4. *Article e14* provides that banks assume no liability or responsibility for, *inter alia*, inability to access a data processing system or failure of software or communications network caused by, *inter alia*, Acts of God, cyberattacks or any other causes beyond the banks' control.

Given the widespread of COVID-19, it may be time for banks and its customers to consider using electronic presentation to minimize disruptions to trade finance, which is likely to be the future trend. eUCP shall apply where the credit indicates that it is subject to eUCP.

Get in touch



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Emily is a dispute resolution lawyer with extensive experience in commercial and international trade disputes, as well as regulatory matters. Emily has handled various high profile letters of credit disputes cases, including *Swiss Singapore Overseas Enterprises Pte Ltd v China CITIC Bank Corporation Limited, Xiamen Branch*, in which she acted for the issuing bank. This case involved complicated issues of bank to bank reimbursement, and went all the way to the Court of Final Appeal, when the Court found in favour of the bank.