ARTICLES

POTENTIAL IMPACT ON LC PARTIES DUE TO DELAYS IN TRANSIT

by Peter SPROSTON*

Most of us are well aware of the recent incident in the Suez Canal in which *Ever Given*, an enormous container ship, ran aground in high winds thus blocking the canal for almost a week. The impact on global supply chains and the costs incurred ran into the billions of dollars. This may well have caused delays in both the shipping and delivering of goods. Specifically for the Letter of Credit industry, was there a material impact upon the way in which LCs were handled? What are the potential effects, hypothetically at least, on LC flows should another such event occur with longer lasting delays?

Due to the interlocking nature of the contracts involved in LC flows, between seller and buyer and between these parties and their respective banks, we must perforce consider the sales contract and take at least a cursory look at the contractual rights and obligations arising thereunder to the extent that this affects the LC itself and vice versa. The following cannot purport to be an exhaustive overview but should at least give some insight into the matter.

Are the contractual parties willing to amend the sales contract and LC to match the revised situation regarding the previously agreed loading and delivery obligations? It appears that regarding mercantile contracts time (for performance e.g. of delivery) can be expressly or impliedly to be of the essence.[1] Where both parties concur that time is of the essence regarding a

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1. *Bowes v Shand* (1877) 2 App. Cas. 455, 463, 464 et al per Chitty on Contracts, volume 1, pp 1240 para 21-013 ff

particular stipulation in the contract, thereby making it a condition, breach thereof would entitle the innocent party to terminate the contract and claim damages from the perpetrator for committing a fundamental breach of the contract.[2] Force majeure is not considered at this time but later in the article.

Or might an amendment only to the LC be construed as a variation of the underlying contract? This is a consideration often overlooked by operations staff when asking for, or agreeing to, an LC amendment. There is English case law[3] stating that mutually agreed changes to the LC were construed to vary the underlying commercial contract. The foregoing presumes that both parties were, or rather became, *ad idem* to the initial agreement. This might have consequences regarding subsequent dispute(s) as to whether a specific contractual term(s) has been breached or, by virtue of variation, not.

Can the appropriate amendments to the LC text be obtained if required viz. latest date of loading– the latest date of presentation of the documents if based on loading date e.g. 'within 21 days of the latest date of shipment' or phrases of similar effect? This would be an issue if the vessel concerned calls at various ports along its planned route to collect/discharge additional cargoes. Factors relating thereto could apply if there is a chain of linked transactions. The intransigence of one party in the chain could have a knock-on effect on all subsequent transactions e.g. creating problems in complying with presentation periods or the LC validity itself, depending on the relevant LC term.

What if the LC has not been issued as contractually required prior to the unexpected transit delay and/or the first date of the shipping period? How might the contracting parties act? The following scenarios[4] may emerge:

1. The bank(s) must advise the LC to the beneficiary within the appropriate period[5]
2. The appropriate period can be split into the following sub-sets:
   a) A specific date for issuance is stated in the contract or a mechanism for defining the date can be ascertained, or;
   b) If the contract is of a particular type, e.g. FOB or CIF (or a variation), then the LC issuance date may be determined by naming a date or by providing a mechanism for ascertaining the date[6] (this point will be discussed in more detail below), or;
   c) The appropriate date is to be based on a test of reasonableness.

2. per Chitty on Contracts, volume 1, pp 1243 para 21-015.

3. *Alan (WJ) & Co. Ltd v. El Nasr Export and Import Co* [1972] 2 QB 189 holding that LC amendment(s) may, if they depart in any respect from the terms, express or implied, of the original sale contract, constitute a binding variation.

4. Based on Raymond Jack, *Documentary Credits*, 2nd ed. [Butterworths 1993] pp 42 para 3.15 ff.

5. *Bunge Corp v. Vegetable Vitamin Foods Private Ltd* [1985] 1 Lloyd's Rep 613 at 617.

6. *Sohio Supply Co v. Gatoil (USA) Inc* [1989] 1 Lloyd's Rep 588 and/or *Transpetrol Ltd v. Transol Olieprodukten Nederland BV* [1989] 1 Lloyd's Rep 309.

In *Pavia*[7] it was held that the LC must be opened for the entire shipping period, ergo including the first date thereof. However there is precedent for holding that the LC should be issued a reasonable time before the first shipment date.[8] The issue of deciding what a reasonable period is, depending upon the specific circumstances of the case, may cause a degree of dissent between the contracting parties and/or the relevant court. The foregoing applies to CIF contracts. Regarding FOB contracts, Diplock J held that the LC must be opened no later than the earliest shipping date.[9]

What motives might a buyer have in delaying the opening of the requisite LC? His credit facility with the intended LC issuing bank might be (almost) fully utilised, hence a delay could avoid the need to seek a temporary increase in the credit line that might demand more collateral security and/or be at higher terms than his existing line. Market trends might indicate a weakening sales price for the product that would diminish his profit margin. Perhaps the purchase price is now, or anticipated to become, lower than the current market price, tempting the buyer to find some means of reneging on the contract.

What options are available to a willing seller if the buyer, for whatever reason, fails to open the LC within the appropriate or contractually agreed time? As the buyer is under an obligation to open a contractually compliant LC in due time, failure to do so would entitle the seller to construe this as a repudiation of the contract and thus terminate it. Opening a workable LC may well be deemed a condition precedent to the seller's performance of the contract obligation i.e. to ship the goods. In such case, according to Denning LJ, 'the seller can treat himself as discharged from any further performance of the contract and can sue the buyer for damages for not providing the credit', a view duly supported by Sir Nicholas Brown-Wilkinson V-C.[10]

It might be that the seller chooses not to cancel but to carry on with the contract despite the buyer's delay in opening the LC. If that is the case the seller might forfeit the right later to cancel the contract and indeed might be deemed by such action to have affirmed the contract. By extension, it might be construed that the seller still intends to avail himself of the LC. The seller's right to terminate the contract and claim damages is thus waived. The way to rectify this situation, assuming time was originally made of the essence in the contract, is for the seller once more, by serving notice on the buyer to perform within a reasonable time,[11] to make time of the essence. If the buyer then fails to open the LC within the time subsequently stipulated, the seller is entitled to cancel the contract.

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7. *Pavia & Co SpA v. Thurmann-Nielsen* [1952] 2 QB 84.

8. *Sinason-Teicher v. Oilcakes and Oilseds Trading Co* [1954] 1 WLR 935; affd [1954] 1 WLR 1394, [1954] 2 Lloyd's Rep 327.

9. *Ian Stach Ltd v. Baker Bosley Ltd* [1958] 2 QB 130.

10. *Trans Trust SPRL v Danubian Trading Co* [1952] 2 QB 297 resp. *British and Commonwealth Holdings plc v. Quadrex Holdings Inc* [1989] QB 842.

11. "A reasonable time" is open to legal construction and subject to the conditions and assumptions prevailing at the time in question.

Consider now the situation when the LC has been issued and documents have not yet been presented but there is a delay in shipping the goods. Can a unilateral recission by either party to the contract be considered acceptable and legal in the circumstances? This question arises as at least two LC terms may become impossible to perform, e.g. complying with the latest date of shipment and presenting documents within the period defined in the LC.[12] This can be rectified by the buyer, acting at the seller's request, instructing the issuing bank to make an appropriate amendment to the LC. Although unlikely, hypothetically the issuing bank might decline to amend the LC due to circumstances surrounding its client, the buyer/applicant, preferring instead to render the LC potentially unworkable for the seller. This opens up a fascinating and wide-ranging topic due to the interlocking contractual obligations involved in LC transactions! Putting that risk aside, and assuming the issuing bank declines to provide the amendment as requested, what remedies are available to the seller?

Clearly the seller is dependent on the buyer/applicant to obtain an LC amendment. However, it was held that the seller could not cancel the contract without first giving the buyer the opportunity of rectifying the situation or giving the buyer due notice of the seller's intention to cancel.[13] It is quite possible that the buyer and seller agree that the LC is nevertheless to be availed in payment of documents presented, even when documents are found to be discrepant by the banks concerned; the buyer simply instructing the issuing bank to take up and pay the documents 'as presented'. In this case the seller has to make a commercial decision. The goods will have been shipped and, depending on the transit duration, might have been discharged to the buyer by the time shipping documents reach the issuing bank, albeit discharge having been effected against a letter of indemnity (LOI) and not an original bill of lading.[14] In my experience this is in fact a fairly common occurrence in dealings between mutually trusted parties. This has developed into a practical necessity as the ICC has found that some 70% or more of documents presented under LCs are initially deemed to be discrepant.[15] The obvious risk is that the buyer might renege on his undertaking to the seller and instruct his bank to reject the documents presented and return same to the seller. What then?

The seller has no claim upon the bank assuming the documents are held not to comply with the terms and conditions of the LC. Must the seller thus waive his right to payment for the goods delivered? It has been held that the seller was indeed entitled to payment as property in the goods had passed to the buyer.[16] In another case, although documents presented were clearly discrepant the buyer took possession of the goods as shipped; the court held that the LC was not the exclusive

12. Assuming the latter condition stipulates that documents are to be presented within the validity of the LC which, by virtue of the delay in shipment, might expire before documents can be presented to the bank(s).

13. *Panoutsos v. Raymond Hadley Corpn of New York* [1917] 2 KB 473.

14. For more on this topic, see "Letters of Indemnity and Banks' Collateral Security", Peter Sproston, Feb 2021 *DCW*, p. 27.

15. https://eximconsulting.wordpress.com/category/discrepancies/

16. *Newman Industries Ltd v. Indo-British Industries* [1956] 2 Lloyd's Rep 219.

source of payment.[17] These cases held the LC to be a conditional mode of payment. Lord Denning[18] stated that 'In my opinion a letter of credit is not to be regarded as absolute payment unless the seller stipulates, expressly or impliedly, that it should be so.' An earlier case[19] held the LC to be an absolute means of payment, in which the seller's documents were rejected by the bank. The goods were sold for the seller's account upon arrival and the seller subsequently sued the buyer for damages. In his summary, McNair J stated that the buyer had performed his payment obligation by providing an LC via a reliable and solvent bank and that the seller did not have the option to present documents direct to the buyer and furthermore that, whilst the LC as issued did not comply with the contract of sale, the divergencies therefrom had been waived by the seller (see above on this point). As the documents did not conform with the terms of the LC, the seller was held to be the party liable in damages.

It is suggested that an important issue is whether a buyer takes possession of the goods or not in determining whether a buyer may be held liable for payment. In this case, if the seller cannot obtain payment via the LC provided (e.g. having presented discrepant documents to the bank) but the buyer has nonetheless taken possession of the goods, seller could sue in conversion for the value of the goods. Alternatively, if the goods' value has subsequently increased, the seller could sue in quasi-contract for the proceeds of his tort.[20] Should the seller have retained the original bills of lading (or same had been returned by the bank(s) involved together with the other shipping documents) the seller would have a claim on the carrier in conversion for misdelivery of the goods (e.g. against an LOI).[21]

There is a closing caveat to this section regarding a buyer's obligation to provide an LC via a reliable and solvent bank. It was held that the insolvency of an LC issuing bank, having accepted bills of exchange drawn upon it, that its dishonour of said bills rendered the buyer liable for payment based on *WJ Alan* whereby an LC is deemed to be a conditional, and not an absolute, means of payment. The buyer thus had to pay twice, a decision subsequently confirmed by Ackner J.[22]

Can an LC be deemed void for payment purposes if documents are presented after the latest date for shipment in the LC has passed? A priori one would assume this to be the case. But what if the buyer and seller agreed to amend the underlying contract to permit a later date of shipment due to delays in shipping the goods e.g. due to closure of the Suez Canal, but the buyer failed to amend the LC? As noted above, the seller could present documents under the LC and expect the buyer to

17. *Saffron v. Societe Miniere Cafrika* [1958] 100 CLR 231.

18. *WJ Alan & Co Ltd v. El Nasr Export and Import Co* [1972] 2 QB 189.

19. *Soproma SpA v. Marine and Animal By-Products Corp.* [1966] 1 Lloyd's Rep 367.

20. Goff & Jones *The Law of Restitution* (3rd edn) ch 32.

21. *Mannesman Handel AG v. Kaunlaran Shipping* [1993] 1 Lloyd's Rep 89 at 91.2.

22. *E D and F Man Ltd v. Nigerian Sweets and Confectionery Co Ltd* [1977] 2 Lloyd's Rep 50.

instruct the issuing bank to accept them despite the discrepancy. If, as one would expect, the bank(s) reject the seller's documents, could the seller then refer the bank(s) to the amendment agreed in the underlying contract and demand that payment be made on the grounds that, as noted earlier, an LC amendment can be deemed to vary the underlying commercial contract?

It is suggested that bank(s) will resist this interpretation as it contradicts UCP Article 4(a) and, without an express instruction from the applicant/buyer, a bank has no mandate to amend the LC issued on his behalf or, should it do so, become liable for damages for breach of the original mandate. Seller's recourse is then to the buyer alone or, if the buyer declines to amend the LC or honour the varied terms of the contract, the seller could, if still in possession of the original bills of lading, try to withhold or redirect the goods if they have not already been discharged.

At what point might force majeure[23] permit the parties to declare the original contract void and, perforce, the LC designated as the agreed means of payment? It was held in earlier so-called Suez Canal cases[24] that following a closure of the canal the contracts of sale were deemed not to have been frustrated due to that event. The alternative route around the Cape of Good Hope was triple the distance with correspondingly higher freight costs. Seller's claim that this frustrated the contract was not accepted; the court holding that although the performance was thereby varied, it was not such a fundamental change as to frustrate the seller's contractual obligation nor because it became commercially unprofitable.[25] In the former case, a date for delivery had not been fixed, it being a CIF delivery contract. If the goods concerned were perishable and/or a definite date for delivery had been fixed or there had been a dearth of shipping to carry the goods on the alternative route, it appears these could have proven sufficient grounds to hold the contract frustrated.[26]

The difference between the legal concepts of contract frustration and force majeure may, paraphrasing *Chitty*,[27] be explained thus: frustration is solely concerned with unforeseen events which occur *after* the date of formation of the contract that renders contractual performance more onerous or even impossible whereas force majeure events can be defined and expressly provided for in the appropriate contract clause *ab initio*. What this means in practice is that the wider the force majeure clause is drafted, the narrower is the practical scope of the doctrine of frustration. Thus, if an event occurs for which force majeure clausing has provided, the contract is not frustrated. The benefit of providing for force majeure events, according to *McKendrick*,[28] is that an unforeseen event, such as

23. In effect the legal concept of frustration defined by *McKendrick on Contract Law* (5th edn) Palgrave Macmillan2003 at 14.9 pp 313 as ' frustration can be invoked only where the supervening event *radically* or *fundamentally* changes the nature of performance: it cannot be invoked simply because performance has become more onerous.' Blackburn J formulated the doctrine of frustration in the early case of *Taylor v Caldwell* [1863] 3 B & S 826 at 836.

24. *Tsakiroglou & Co Ltd v. Noblee Thorl GmbH* [1962] A.C. 93.

25. *Blackburn Bobbin Co v. Allen & Sons* [1918] 2 K.B. 467.

26. *Ocean Tramp Tankers Crop v. V/O Sovfracht (The Eugenia)* [1963] 2 Q.B. 226.

27. *Chitty on Contracts* (vol 1, 29th edn) Sweet & Maxwell, London, 2004 at pp 1311 ff & 23-002 ff.

28. *McKendrick on Contract Law* (5th edn) Palgrave Macmillan 2003 at 14.9 pp 314.

the closure of the Suez Canal, would not necessarily act to frustrate the contract leading to its termination 'irrespective of the wishes of the parties'. Hence the contractual parties could continue their relationship by revising the contract terms to their mutual benefit.

Keeping the foregoing in mind, let us consider the possible outcomes in the following situation: goods have been shipped within the prescribed time-frame and thus comply with the specific condition stipulated in the LC issued to the seller. Delivery, however, is compromised by the unforeseen closure of the Suez Canal. Assuming the contract has not made a force majeure provision for this, the buyer, perhaps for entirely commercial reasons, holds the contract frustrated. Notwithstanding this, the seller decides to present LC compliant documents to the bank and gets paid. Obviously the buyer cannot unilaterally withdraw the LC and the bank will have acted in compliance with the applicant/buyer mandate, hence no reimbursement can be claimed from that quarter. The buyer could decline to take title to and possession of the goods when the vessel arrives at the discharge port. Strictly speaking, because the bank paid against compliant documents, it has obtained title to the goods but would have no use for them other than a fire sale disposal. The carrier will want a decision on discharging the goods and, whilst waiting, will be accruing demurrage costs. Thus is chaos predestined! For those with an interest in seeking to divine the outcome, various sources can be recommended.[29]

Regarding banks handling LCs and transactions subject to ICC rules, force majeure events as discussed above would not excuse banks from checking and/or paying against documents according to UCP Article 4, URDG 758 Article 5, and ISP98 Rule 1.08. The circumstances surrounding and defining force majeure events are dealt with in a recent ICC guidance paper.[30] Bankers contacted for input on this article reported no material impact upon their trade finance flows and their responses can be summarised thus: 'The Suez Canal closure has had moderate impact on our LC business, as trading companies involved quickly renegotiated contract terms and delivery dates as needed, and LCs were amended accordingly. The form was in most cases by simple email exchange, with acknowledgement of agreement on both sides, as time was short to get all the amendments processed.' Thanks are due and gratefully given to the respondent bankers for taking the time to provide their input. ■

29. Treitel, The Law of Contract, Chitty on Contracts, Ewan McKendrick on Contract Law were used in this article

30. https://iccwbo.org/publication/guidance-paper-on-the-impact-of-covid-19-on-trade-finance-transactions-issued-subject-to-icc-rules/