
Letters of Credit and the Impacts of Pandemic Emergent Rules

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ABSTRACT: *This study addresses the impact of the pandemics may impose on banks to fulfill their obligations towards Letters of Credit (LOC) that have already been issued to clients prior to the pandemic. The study focuses on the vital role of the banks in ensuring that LOC's remain active and clients may continue to take advantage of them so businesses stay operational and negative impacts of the pandemic to the economy are minimized. The Uniform Customs and Practice for Documentary Credits (UCP 600) authorized the issuance and use of LOC's. UCP 600 outlines circumstantial procedures that government bodies may adopt to control the inappropriate use of credits. When the world is hit by pandemics, governments have the option to shut down their borders to control entry of affected people and to control the spread of the virus. In such circumstances, banks may also close their doors and may discontinue to do business until such time the government reopen borders and/or banks feel they may reopen for business. When banks cease to operate, clients holding LOC's may suffer significant financial losses and may result in bankruptcies. The main issue here is that the closure came as a result of an act beyond the control of the countries and the creditors. However, the main issue that this study tries to address is compensation for impacted businesses resulting from loss of validity of LOC's. Hence, this study looks at various options and recommendations that UCP may consider the next time UCP 600 is up for review and modification.*

KEYWORD: letter of credit, UCP, bank, obligation, pandemic,

INTRODUCTION

The LOC is one of the main guarantees that business people have that helps them conduct business without fear of default on payment and facilitate on time movement of supplies and goods without having to wait for credit approvals. In addition, LOC's facilitate international trade and encourage international contracts and agreements that help countries benefit from products that are not available in the local market.

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Banks issue LOC's based on various versions of the UCP² which regulate the rights and obligations of all parties to the LOC. Since the issuing bank is the focal point of this international trade operation, the UCP concentrated on the issuing bank role to guarantee completion of the process. Additionally, the UCP determines the liability of the issuing banks in case they violate their obligations.

The UCP relinquishes the issuing bank from its liability in certain circumstances such as force majeure and in exceptional circumstance. Here where the confusion and conflict take place as force majeure and exceptional circumstances are not clearly defined and/or understood. This study will attempt to address various issues surrounding the UCP 600 and its impacts on LOC's such as the pandemic impact on banks' obligations, the nature of force majeure and exceptional circumstances, and whether the UCP distinguishes between force majeure and exceptional circumstances, the impacts of liability waiver on the economy, international trade, and local businesses.

By addressing these issues, the study will present various recommendations and suggestions that the International Trade Commission will hopefully take into consideration when the UCP600 is due for review and modification..

DISCUSSION

When doing international trade and for peace of mind, both parties to the business deal pay bank fees to produce LOC's guaranteeing financial competence of each party of the business arrangement.

The Corona Pandemic that led to the closure of banks in most parts of the world resulted in havocs to both parties of the international trades. The most significant issue resulting from bank's closure was related to the considerable delay in issuing LOC's which in turn consequently lead to the significant delay in goods delivery to the buyer and, in some circumstances, the cancellation of the business contract.

The rules and regulations of UCP 600 lay out the rights and responsibilities of LOC issuing banks. However, articles 34-37 of UCP600 exonerate banks from LOC-related liabilities in situations such as the Corona Pandemic.

² It means the rule governing the documentary credits that established by the International Chamber of Commerce to mitigate the doubts caused by individual countries promoting their own national rules on documentary credit practice. [UCP 600 📖 Guide - Uniform Customs and Practice for Documentary Credits \(Updated 2023\) ✓ \(tradefinanceglobal.com\)](https://www.tradefinanceglobal.com/).

The huge damages that resulted due to the bank's taking full advantage of the UCP 600 provisions and failure to produce LOCs in a timely manner must be compensated for in one way or another. However, under the current circumstances and the way the UCP 600 stands, it does not seem that banks have any responsibility to compensate business parties for any damages resulted due to banks delay or failure to produce LOC's. This leads to the pressing need to modify UCP 600 so benefits and, consequences due to lack, of international trades are taken into consideration especially after what we have seen from negative impacts to the world economies from the implementation of COVID-19 strict measures.

Letter of Credit, Definition and Process

In general, LOC or a credit letter is defined as a letter from the issuing bank guaranteeing that buyer will pay the seller the amount and currency by the date and time agreed upon (Jessica Olah)³. Once the issuing bank has reviewed all documents from seller and buyer and confirmed their credit worthiness, the LOC provides a safety net for the buyer to receive goods and the seller to receive payment as agreed upon in the contract. Article 14 of the UCP stipulates that after having received seller documents, banks have a five (5) work days to complete review of such documents to ensure they match the documents mentioned in the LOC⁴.

In case of any discrepancies in the documents when compared to the LOC, the bank is required to let the seller know immediately, and within the review period of 5 days, to do the necessary correction or modification⁵. However, when the bank completes their review and finds LOC and seller documents match, bank is obligated to issue payment to the seller in accordance with the LOC and turn in documents to the enforcing or issuing bank to complete review within five (5) days⁶.

In case of any discrepancies in the documents, the enforcing bank is required to reject them while the issuing bank has the right to either reject them or ask buyer to accept documents as is without the need for further correction if the errors, in the issuing bank judgement, are insignificant⁷. This is a quick summary of normal procedures that banks follow under normal circumstances to issue LOCs. However, when exceptional procedures are in place due to crises such as the COVID-19 pandemic, banks follow different procedures which have led to significant delays in issuing LOCs.

³ Jessica Olah: What is A letter of credit, [Letter of Credit: What It Is, Examples, and How One Is Used \(investopedia.com\)](https://www.investopedia.com/terms/l/letter-of-credit-definition/)

⁴ If the bank didn't inform the seller within the five work days about the result of examination the documents it considered approving the documents, see article number (16) of UCP600.

⁵ Regarding to article number (16) of UCP600.

⁶ Regarding to articles number (15) of UCP600.

⁷ This right is exclusive to issuing bank, see article number (16) of UCP600.

Pandemics impact on Banks obligation

The pandemic is defined as a widespread occurrence of an infectious disease over a whole country or the world at a particular time. Most of the diseases posing the greatest risks to humans are contagious meaning that they are caused by an infectious agent and can be spread from person to person. The World Health Organization (WHO) declares a pandemic when disease's growth is exponential causing the growth rate to skyrocket, and each day cases grow more than the day before. The virus has nothing to do with virology, population immunity, or disease severity. That virus covers a wide area, affecting several countries⁸ and populations. (WWW.publichealth.columbia.edu). Countries affected with a pandemic impose emergency declarations that may lead to the implementation of various protocols including defense laws, quarantine, curfew, and shutting down borders and businesses. To face COVID-19, most countries declared curfew in March 2020 for different periods of time. In Jordan, under defense law 1, curfew was imposed for two months.

To comply with shutting down requirements, all sectors, including banks, had to stop practicing their daily activities. To focus on banks, the shutdown led to the suspension of issuing LOCs.

The suspension or delay in issuing LOC's resulted in serious impacts to international trade. The seller and buyer still had to pay bank fees regardless of the shutdown but the banks were not responsible for the damages caused due to the lack of LOCs caused by the banks not doing the work the buyers and sellers paid them for. The non-availability of the LOC caused, in most situations, irreparable financial damages to both sellers and buyers. Sellers could not get paid because of inability to deliver documents to the bank or obtain approval from the nominated bank. The buyer suffered severe financial damages, as well. Buyers were unable to receive the goods to deliver to customers that in some situations have already entered into contracts with the buyer leading to penalties that the buyer had to pay to the customers

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Having explained briefly the serious financial damages that the sellers and buyers had to live with as a result of the bank's failure to perform and the emergent protocol imposed by the government which the banks were required to comply with. We need to keep in mind that although the emergent protocols including defense orders were imposed to protect public health in the first place, they have led to the demise of businesses and to critical impacts on the national economy. It is my personal belief that emergent protocols and procedures created to face the pandemic were not well thought out and were not properly coordinated so potential negative impacts could have been dealt with without causing bankruptcy and financial hardships to the national businesses which make up an important cornerstone of the national economy. Now that the pandemic procedures are no

⁸ The main difference between Pandemic and Epidemic, the pandemic is internationally and out of control. Publicationhealth.columbia.edu

⁹ Regarding to article 37 of UCP which confirmed on buyer responsibility to compensate the bank for any financial lose or damages.

longer in effect and banks returned to doing business as usual, I believe we need to take a serious look at compensating the two pillars of the LOC, seller and buyer, who have suffered serious financial damages because of no fault of their own. To reach a practical and reasonable outcome, this study will discuss the banks liability and obligation in accordance with the UCP. If the study concludes that the bank is not liable, it will then take the State's liability into consideration. If neither the bank nor the state are liable, this study will suggest serious review and modifications to the UCP so the rights of all parties are protected at all times.

Is the Bank liable?

UCP articles 34-37 deal with banks' exemption from liability towards the parties of the LOC, seller and buyer. Article 34 showed in various circumstances and situations that banks are exempt from liability if failure is due to force majeure, strikes, and shutting down. As stated, banks are exempt from liability in case of emergent exceptional circumstances. As such, the validity of the LOC and the allowable period for the seller to review documents are extended.

Other articles also exist that provide exemptions in case mistakes in translation, interpretation, missing bank document, and other bank mistakes. The Banks exemptions are extreme and seem to breach contractual stability especially when considering the loss of the tort party rights to any compensation in case of bank's breach of the LOC terms and conditions. The pandemic and all the circumstances that accompanied, and resulted from, the pandemic are emergent and required bank to comply or face penalties. Hence, this study believes that banks should not be blamed and are absolved from paying compensation to LOC parties. This study also believes that shutting down period should take into consideration all aspects of the economy and in case of LOC's, shutting down periods should not interfere in issuance of LOC's and related requirements such as document review and LOC validity periods.

In conclusion, the LOC parties, both seller and buyer, have no recourse and have no claim of compensation against the bank since the bank was in acting in good faith as required by government orders. However, do they have a chance to claim compensation from the legislative authorities that are responsible for issuing and enforcing the order to shut down?

Is the State liable?

Many countries, including Jordan, declared emergency and enforced defense laws to face the COVID-19 pandemic. , This study will use the country of Jordan to review and analyze defense orders and emerging procedures. In Jordan, the last declaration related to COVID19 pandemic suspended the implementation of regular laws that are in contradiction to the defense law (Article 10 from Jordan Defense Law. This study will look into ways and means that LOC buyers and sellers may utilize to file claim for compensation to cover damages resulted from implementing government defense orders.

The government of Jordan enacted the national defense law, activating the state of emergency to contain the outbreak of COVID-19 pandemic (Mohammed, 2022). Strict measures were put in place, which included closure of all private and public sectors including airports, schools and universities, closure of land and air borders in addition to the closure of all private businesses and non-essential public services. These measures based on articles (3/A, 4/A, 4/G, 4/H and 10 from Jordan Defense Law).

As a private business, banks had to comply with the defense orders and shutdown for as long as the orders required. The public outcry over the closure of banks drove the government to take a second look at the defense order and allow banks to reopen after having closed for five (5) days. The five (5) days of banks shut down and the suspension of LOC issuance resulted in severe financial impacts where buyers and sellers lost and/or delayed many international trades resulting in fines and other financial liabilities. This study takes a look at Jordan defense laws and tries to look into the rights of LOC parties to claim compensation for damages from the Government. Two articles of the defense law are related to the LOC. Article 11 suspended all contractual actions and required modification to LOCs so they can restart when the closure has ended. Unfortunately, this article did not take into consideration that LOC's are issued in accordance with the UCP where only provisions of the UCP apply (Article 1 of UCP600), so Article 11 of the Jordan Defense law was not helpful in presenting a resolution.

Article 9 of the Defense Law regulates the compensation for any damage that result from complying with defense orders. Article 9 states that "Every person who is assigned to any work, service or present of money, and whoever has his property seized, transported or destroyed, and whoever has taken action against him under this law or any order or assignment issued pursuant thereto has the right to compensation, and the Prime Minister (PM) may determine the amount of compensation or decide to pay it in cash, work or procedure within a period not exceeding sixty days from the submission of the application for compensation. In case of claim denial, claimant shall have the right to file a lawsuit with the competent court to claim fair compensation in accordance with the provisions of the laws in force".it seems that Jordan defense law took into consideration the issue of damages that compliance with the defense law may result in. It also gives the right to people suffering damages to file a compensation claim or file a law suit if compensation claim is denied or amount of compensation is not satisfactory to claimant.

The article also requires the PM to decide the fair amount of or deny the claim within sixty days of submission giving the right to claimant to file a laws suit in case of claim denial.As this article states, any person suffering damages as a result of action taken against them in implementation of this defense law or any order pursuant thereto has the right to compensation. It seems that this article provides an optimistic window for LOC parties to file claims for damages against the government.

CONCLUSION

We understand that strict and unwelcomed measures may have to be taken to combat unforeseen circumstances especially when people lives and properties are in jeopardy. COVID-19 pandemic presented a crises that forced the implementation and enforcement of laws to control the spread and impact of the pandemic. In many situations, such emergent laws were legislated without taking special situations into consideration. Such special situations include the issuance and use of LOC's. The shutdown of banks and suspension of LOC's may have resulted in severe financial losses and irreversible damages to LOC parties, sellers and buyers, and international trades. Based on our research and taken the country of Jordan as an example, this study recommends:

- Modify UCP600 to cover force majeure situations and compensation of damages in case of violations by government or legislative bodies of the terms and conditions of the UCP600.
- When issuing emergency legislation, government should keep in mind that, unless the emergent legislation, i.e. defense law, is well coordinated within all potentially effected private and public sectors, it will result in financial losses and in negative impacts to the national economy. To avoid, or minimize, such impacts, this study recommends that government practice limits closure to reasonable periods not to exceed a weekend so the government has time to take all interests into consideration. Arbitrary laws will lead to arbitrary conclusions.
- Any laws must protect the rights of individuals whether business or private so people sufferings are minimized. We have seen in the recent COVID-19 pandemic that many companies went out of business or went bankrupt resulting in many people losing their source of income leading to many families having to rely on assistance from neighbors and charities.
- Countries, especially developing ones, should take a look on what other countries are doing and try to avoid their mistakes.
- The study recommends that buyer and seller maintain their interest through respecting their agreement and recommends that the bank engage in the next review of UCP article 37 to modify the validity and suspension of the LOC; and to protect the rights of the buyers and sellers engaging in international trades.

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