SANCTIONS CLAUSES IN LETTER OF CREDIT TRANSACTIONS – VALID AND ENFORCEABLE?

19 DECEMBER 2022 • ARTICLE

"As these contracts are independent and autonomous, it is not necessary that the separate offer by the confirming bank, in this case JP Morgan, adopt the terms of the issuing bank's offer in their entirety."

INTRODUCTION

In the recent case of Kuvera Resources Pte Ltd v JP Morgan Chase Bank NA [2022] SGHC 213, the High Court of Singapore (the "Court") considered the validity of a sanctions clause for the first time. The case concerned an action by Kuvera Resources Pte Ltd ("Kuvera") to recover from JP Morgan Chase Bank NA ("JP Morgan") as confirming bank under a letter of credit a sum of US$2.42m as damages for its purported failure to honour the terms of the confirming letter of credit. It was decided by the Court that the sanctions clause was effectively incorporated in the confirming bank's confirmation and therefore valid and enforceable, entitling JP Morgan to refuse payment notwithstanding Kuvera's complying presentation.

BRIEF FACTS

Kuvera had advanced funds to a seller to enable it to purchase 35,0000 metric tons of coal and onsell it to its buyer. Under the arrangement, the buyer was required to and duly procured a bank in Dubai (the "issuing bank") to issue two letters of credit ("LCs") in favour of Kuvera. The issuing bank asked JP Morgan to act as the advising bank and as the nominated bank for both LCs. JP Morgan duly advised both LCs and subsequently added its confirmation to both LCs. JP Morgan's confirmations contained a sanctions clause, providing that it will not be liable for any failure to pay against a complying presentation of documents if the documents involve a vessel subject to the sanctions laws and regulations of the USA (the "Sanctions Clause"). When Kuvera made a presentation of documents, JP Morgan accepted that it was a complying presentation. However, pursuant to its sanctions screening, it was revealed that the vessel that shipped the coal, the "Omnia", was an exact match for a vessel known as "Lady Mona", which it had earlier determined fell within the scope of US sanctions on Syria as it was likely to be beneficially owned by a Syrian entity. Accordingly, JP Morgan informed both Kuvera and the presenting bank that it was unable to pay against Kuvera's presentation of the documents.

WHAT DID THE PARTIES ARGUE?

"Here, the Sanctions Clause did not contradict the fundamental commercial purpose of the confirmation – the confirmation continued to give Kuvera rights against JP Morgan which were in substance additional to Kuvera's rights against the issuing bank."

Kuvera argued that the Sanctions Clause: (a) was not a term of its contract with JP Morgan; alternatively (b) the Sanctions Clause was fundamentally inconsistent with the commercial purpose of a confirmed letter of credit; and therefore (c) ought not to allow JP Morgan to refuse to pay.

JP Morgan rejected each of these contentions.

WHAT DID THE COURT DECIDE?

The Court dismissed Kuvera's claim in its entirety, and JP Morgan was allowed to recover all costs.

(a) Whether the Sanctions Clause was a term of JP Morgan's confirmations

Kuvera sought to argue that the Sanctions Clause did not form a term of the LC contract as a confirming bank is obliged to confirm a letter of credit in precisely the same terms as the issuing bank. The Court rejected this submission and clarified that a confirmed letter of credit transaction comprises multiple separate contracts. When an issuing bank advises a letter of credit to a beneficiary, it makes an offer of a unilateral contract to the beneficiary and when a confirming bank adds its confirmation to the letter of credit, it makes a separate offer of a separate unilateral contract to the beneficiary (refer to Diagram A). As these contracts are independent and autonomous, it is not necessary that the separate offer by the confirming bank, in this case JP Morgan, adopt the terms of the issuing bank's offer in their entirety. The Court also held that JP Morgan had made it objectively and abundantly clear that the Sanctions Clause formed a term of its offer of a unilateral contract. Further, the Sanctions Clause did not need to be the subject of any consideration.

(b) Whether the Sanctions Clause is valid and enforceable

The Court here expressed the view that a term will be fundamentally inconsistent with the commercial purpose of a confirmation only if the effect of the term is directly contradictory to that purpose. Here, the Sanctions Clause did not contradict the fundamental commercial purpose of the confirmation – the confirmation continued to give Kuvera rights against JP Morgan which were in substance additional to Kuvera's rights against the issuing bank. The Court held that the Sanctions Clause was not invalid or unenforceable just because it conferred on JP Morgan a level of discretion in deciding whether to pay against a complying presentation based on its internal sanctions policy.

(c) Whether the Sanctions Clause entitled JP Morgan to refuse to pay Kuvera against a complying presentation

"The judgment recognises that banks operating internationally have strict obligations to ensure compliance with applicable sanctions laws and regulations, and this may be achieved by incorporating appropriate terms in their confirmations."

The Court held that the Sanctions Clause did, on the facts of this case, operate to permit JP Morgan to refuse to pay Kuvera against a complying presentation. This was based on three reasons. First, the Court concluded that, contrary to what had been argued by Kuvera, JP Morgan's Singapore branch is not a legal entity distinct from its US branches. Second, JP Morgan is subject to US sanctions laws and regulations in relation to its operations worldwide including through its Singapore branch. Third, the Court relied on the evidence given by JP Morgan's expert witness on US sanctions law, which established that paying Kuvera would have exposed JP Morgan to a penalty for breaching US sanctions laws and regulations. This is because JP Morgan would be breaching the Syrian Sanctions Regulations as it would, by paying Kuvera, be supplying financial services benefiting Syria.

WHAT IS THE SIGNIFICANCE OF THIS DECISION?

This judgment is a timely clarification on the interpretation and treatment of sanctions clauses, which are relevant in the current geo-political climate. This judgment is useful to participants and stakeholders in the field of commodities and trade finance (who often utilise letters of credit as a payment mechanism) as it provides valuable guidance on the nature of letter of credit transactions as well as the rights and obligations under each component of these transactions. The judgment recognises that banks operating internationally have strict obligations to ensure compliance with applicable sanctions laws and regulations, and this may be achieved by incorporating appropriate terms in their confirmations. However, a word of caution is to be given here, as not all terms can be incorporated by way of a confirmation – only terms which are not fundamentally inconsistent with the commercial purpose of a confirmed letter of credit would meet the requisite threshold and be considered as valid and enforceable. Legal advice should therefore be sought as appropriate on drafting and/or incorporating such terms.

We also note here that the case is currently under appeal.

Paralegal Aditi Mozika also contributed to this article.

KEY CONTACTS

KIMARIE CHEANG
PARTNER • SINGAPORE

T: +65 6551 9139

kcheang@wfw.com

CHENGXI TAN
ASSOCIATE • SINGAPORE

T: +65 6551 9157

cxtan@wfw.com

DISCLAIMER

Watson Farley & Williams is a sector specialist international law firm with a focus on the energy, infrastructure and transport sectors. With offices in Athens, Bangkok, Dubai, Dusseldorf, Frankfurt, Hamburg, Hanoi, Hong Kong, London, Madrid, Milan, Munich, New York, Paris, Rome, Seoul, Singapore, Sydney and Tokyo our 700+ lawyers work as integrated teams to provide practical, commercially focussed advice to our clients around the world.

All references to 'Watson Farley & Williams', 'WFW' and 'the firm' in this document mean Watson Farley & Williams LLP and/or its affiliated entities. Any reference to a 'partner' means a member of Watson Farley & Williams LLP, or a member, partner, employee or consultant with equivalent standing and qualification in WFW Affiliated Entities. A list of members of Watson Farley & Williams LLP and their professional qualifications is open to inspection on request.

Watson Farley & Williams LLP is a limited liability partnership registered in England and Wales with registered number OC312252. It is authorised and regulated by the Solicitors Regulation Authority and its members are solicitors or registered foreign lawyers.

The information provided in this publication (the "Information") is for general and illustrative purposes only and it is not intended to provide advice whether that advice is financial, legal, accounting, tax or any other type of advice, and should not be relied upon in that regard. While every reasonable effort is made to ensure that the Information provided is accurate at the time of publication, no representation or warranty, express or implied, is made as to the accuracy, timeliness, completeness, validity or currency of the Information and WFW assume no responsibility to you or any third party for the consequences of any errors or omissions. To the maximum extent permitted by law, WFW shall not be liable for indirect or consequential loss or damage, including without limitation any loss or damage whatsoever arising from any use of this publication or the Information.

This publication constitutes attorney advertising.