

# PAYMENT PERMITTED? SANCTIONS CLAUSES IN LETTERS OF CREDIT

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The Court of Appeal of Singapore (“CA”) held in a recent decision that a confirming bank was not entitled to rely on the sanctions provisions in two letters of credit to deny payment to the beneficiary of the letters of credit (the “LCs”). In reaching its decision in *Kuvera Resources Pte Ltd v JPMorgan Chase Bank, N.A.* [2023] SGCA 28, the CA (the highest court in the judicial system of Singapore) overturned the judgment of the Singapore High Court. It adopted a strict approach and held that an objective approach to the interpretation of the relevant sanctions clauses applied under Singapore law. However, it left open the issue relating to the compatibility and incorporation of sanctions provisions in the context of irrevocable documentary credit transactions.

"A balance must be struck between preserving the autonomy of individual contracts within a documentary credit transaction and upholding the commercial viability of the transaction."

## BACKGROUND FACTS

Kuvera Resources Pte Ltd (“Kuvera”) had advanced funds to a seller to enable it to purchase 35,000 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 LCs in favour of Kuvera. The issuing bank asked JPMorgan Chase Bank, N.A (“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 would 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. The Singapore High Court held that this was a valid refusal. A summary of the High Court’s decision is set out in a [previous article](#).

## THE DECISION OF THE COURT OF APPEAL

Applying an objective approach to the construction of the Sanctions Clause, the CA held that the clause did not give JP Morgan, the confirming bank, a valid basis to decline payment. Although this conclusion meant that no decision was needed on whether the Sanctions Clause had been validly incorporated and/or was compatible with the purpose of the documentary credit transaction, the court went on to make some helpful comments on this issue.

## 1. Interpretation of the Sanctions Clause

The CA held that the Sanctions Clause should be construed objectively. The starting point for contractual interpretation is to examine the text of the contract itself, whilst having regard to the relevant context as long as it is clear, obvious and known to both parties.

The Sanctions Clause would only apply if the Omnia was “*listed in or otherwise subject to any applicable restriction*”. It was undisputed that the Omnia was not “*listed in...any applicable restriction*”. In determining whether the Omnia was “*otherwise subject to any applicable restriction*”, the CA held that this must be determined on an objective basis without any third-party input (including Office of Foreign Assets Control (“OFAC”)).

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The CA held that JP Morgan had not adduced sufficient evidence to discharge its burden of proving that the Omnia (which had a non-Syrian registration) had been beneficially owned by a Syrian entity:

- the CA was critical of JP Morgan’s reliance on its correspondence with OFAC to justify its decision to refuse payment. It held that JP Morgan’s approach was unsatisfactory and unfair as it was “*entirely a reflection of risk management considerations*”. An objective approach is based on an assessment of admissible evidence on a balance of probabilities, while OFAC is not so constrained as it is strictly not bound by the rules of evidence. Allowing a nominated bank to decline payment based on the opinion of OFAC (an entity not identified in the Sanctions Clause) was speculative

and arbitrary, and failed to provide certainty to a beneficiary;

- it was insufficient that JP Morgan was subjectively concerned that making payment could result in a breach of sanctions. If JP Morgan chose to rely on its own internal list as opposed to the OFAC list, it must accept the risk that such reliance may not be sufficient to discharge its burden of proof when applying an objective test; and
- JP Morgan relied on several “red flags” surrounding the ownership of Omnia which it detected through its internal due diligence check. The CA held that these “red flags” were insufficient, not least because JP Morgan itself acknowledged that they were inconclusive.

## 2. Compatibility of the Sanctions Clause with the commercial purpose of the confirmations

The CA acknowledged that additional conditions (such as the Sanctions Clause in this case) stipulated in a confirmation could be binding and need not be separately offered and accepted, provided they did not contradict the commercial purpose of a letter of credit. The CA provided invaluable guidance on the extent of a confirming bank’s discretion to impose additional terms in a confirmation (often unilaterally) beyond those stipulated in a letter of credit:

- a balance must be struck between preserving the autonomy of individual contracts within a documentary credit transaction and upholding the commercial viability of the transaction;
- if JP Morgan's approach was adopted, then the Sanctions Clause would most likely be incompatible with commercial purpose of the confirmations, as such an interpretation would introduce significant uncertainty for the beneficiary, Kuvera, which was not involved in nominating the vessel; and
- the CA emphasised that the commercial purpose of a confirmed letter of credit was to provide security to the beneficiary that it will receive payment so long as it is able to present the requisite complying documents.

**"This decision highlights the importance that clear and specific wording would need to be used when drafting and/or incorporating sanctions clauses."**

## COMMENTS

In view of the current and evolving geopolitical situation, sanctions clauses are increasingly common in commercial transaction documents. Businesses are also continually having to assess the ambit of sanctions clauses and the extent to which they affect contractual obligations.

This decision provides clarity that under Singapore law, a sanctions clause will be construed strictly, adopting an objective test. The CA left open the issue of incorporation of sanctions clauses in the context of documentary credit transactions. This will largely turn on the wording and effect of the specific clause, there is no "one size fits all" approach.

This decision highlights the importance that clear and specific wording would need to be used when drafting and/or incorporating sanctions clauses. It also highlights the potential pitfalls for a party seeking to rely on inconclusive or evidence from a third-party organisation (particularly one not identified in the contract).

There is expected to be an increase in the number of disputes on the impact of sanctions on payment obligations in the documentary credit transactions context. For example, following on from a judgment in March 2023 that UniCredit was not prevented by sanctions from making payment under letters of credit that had already been confirmed, the English High Court held in a further judgment that it was not reasonable for UniCredit to believe that it was prohibited from making payment under the letters of credit. It therefore could not rely on the defense under section 44 of the Sanctions and Anti Money-Laundering Act 2018 and as a result was liable for the costs of the proceedings and interest (see the English cases of *Celestial Aviation Services Limited v Unicredit Bank AG, London Branch* [2023] EWHC 1071 (Comm) and *Celestial Aviation Services Limited and Constitution Aircraft Leasing (Ireland) 3 Limited and another v Unicredit Bank AG (London Branch)* [2023] EWHC 663 (Comm)).

Relevant stakeholders, especially those who operate in multiple jurisdictions, may be subject to multiple sanctions regimes and should therefore ensure that adequate and thorough due diligence is carried out, and appropriate legal advice is sought.

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