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BRIEFING

EFFECTIVE ENFORCEMENT – THIRD PARTY DEBT ORDERS AND LETTERS OF CREDIT

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- SUPREME COURT HOLDS THAT THIRD PARTY DEBT ORDERS COULD BE MADE IN RESPECT OF PAYMENTS DUE UNDER UNCONFIRMED LETTERS OF CREDIT FOR ENFORCEMENT OF ARBITRATION AWARD
- *SITUS* OF DEBT UNDER LETTER OF CREDIT CONFIRMED TO BE JURISDICTION OF THE DEBTOR

The power of the English courts to enforce arbitration awards and court judgments by intercepting funds payable to judgment and award debtors has been further strengthened by the UK Supreme Court's recent decision in *Taurus v SOMO* [1].

"THE DECISION WILL BE OF PARTICULAR INTEREST TO THOSE INVOLVED IN THE INTERNATIONAL OIL TRADE."

The decision will be of particular interest to those involved in the international oil trade, where business is regularly conducted by means of letters of credit issued from the London branches of international banks.

Background

The State Oil Marketing Company of the Ministry of Oil, Republic of Iraq ("SOMO") and Taurus Petroleum Ltd ("Taurus", a Swiss oil trading company) had concluded a series of contracts for the sale of crude oil and liquefied petroleum gas ("LPG"). Issues arose between the parties which resulted in an UNCITRAL arbitration heard in London but seated in Baghdad. The Tribunal found against SOMO and awarded Taurus close to US$9m in damages. When SOMO did not pay the award, Taurus sought to enforce through the English courts, first converting the award into a court judgment and then applying for third party debt orders ("TPDOs")[2] and a receivership order[3] to recover the sums awarded to it.

[1] *Taurus Petroleum Limited v State Oil Marketing Company of the Ministry of Oil, Republic of Iraq* [2017] UKSC 64.

[2] TPDOs transform debts due to the judgment debtor into debts to the judgment creditor. They are commonly used to target the debtor's bank accounts, but can also be used to intercept bank finance and trade debts, making the TPDO a particularly effective tool to satisfy an unpaid judgment.

[3] Receivership orders appoint a receiver in respect of a debtor's property, so as to collect the assets which are the subject of the order and to distribute them as the order directs.

Taurus requested that the orders be made in respect of payments due to SOMO under unconfirmed letters of credit that had been issued by the London branch of Crédit Agricole SA ("Crédit Agricole") to satisfy Shell's payment obligations for deliveries of crude oil.

A peculiarity of those letters of credit was that payment was to be made to a Central Bank of Iraq ("CBI") account at the Federal Reserve Bank in New York, with 95% of the funds to be used for development in Iraq and 5% for reparations to Kuwait. This was due to a sanctions regime originally imposed on Iraq by way of a 2003 UN Security Council Resolution and later continued by a decision of the Iraqi government. Therefore, although SOMO was the named beneficiary, the letters of credit stated that payment was to be made to the bank account of CBI. It was this quirk which gave rise to SOMO's challenges to Taurus' attempts at enforcement and which raised a number of issues.

1 Was the law which governed the payment of debts under the letters of credit determined by: (a) the place where Crédit Agricole, as issuing bank, resided, or (b) the place of payment?

The English courts can only make a TPDO over debts within their jurisdiction. All property, including monetary debts, has a place where it is said to be located for legal purposes, otherwise known as the *lex situs*. The normal rule is that the *situs* of a debt is determined by the jurisdiction in which the debtor resides. In this case, that was London (being where the relevant branch of Crédit Agricole, as issuing bank, resided). However, the Court of Appeal case of *Power Curber*[4] had held that the *situs* for debts arising under letters of credit was their place of payment, which in this case was New York (being where the CBI account was located).

"THE SUPREME COURT … RE-ESTABLISHED THE GENERAL RULE THAT THE *SITUS* OF A DEBT UNDER A LETTER OF CREDIT IS THE JURISDICTION OF THE DEBTOR."

The Supreme Court judges were unanimous in deciding that the rule in *Power Curber* was wrong and should not be followed. In doing so they re-established the general rule that the *situs* of a debt under a letter of credit is the jurisdiction of the debtor, in this case in London and therefore within the jurisdiction of the English courts.

2 To whom was the debt owed under the letters of credit?

Under English court rules, a TPDO can only be made in respect of a debt due from a third party (Crédit Agricole) to the judgment debtor (SOMO) as sole beneficiary of that debt. The courts will not exercise their enforcement powers to benefit one creditor to the disadvantage of another. This was a key issue in *Taurus* because, although SOMO was the named beneficiary, the letters of credit also contained the following unusual clauses:

> [A] Provided all terms and conditions of this letter of credit are complied with, proceeds of this letter of credit will be irrevocably paid in to your account with Federal Reserve Bank New York, with reference to 'Iraq Oil Proceeds Account'.
>
> These instructions will be followed irrespective of any conflicting instructions contained in the seller's commercial invoice or any transmitted letter.

[4] *Power Curber International Ltd v National Bank of Kuwait SAK* [1981] 1 WLR 1233.

> [B] We hereby engage with the beneficiary and Central Bank of Iraq that documents drawn under and in compliance with the terms of this credit will be duly honoured upon presentation as specified to credit CBI A/c with Federal Reserve Bank New York.

SOMO argued that, in substance, these clauses meant that CBI was the true beneficiary, or at least a joint beneficiary; CBI received the funds and SOMO was unable to vary the payment terms to divert them elsewhere.

This issue was critical to the Court's decision and revealed significant disagreement between the Supreme Court judges. Nevertheless, a majority of three to two held that SOMO was the sole beneficiary under the letters of credit. Of particular importance to the majority's decision was:

i. that SOMO was referred to as the beneficiary throughout the letters of credit;
ii. the narrow definition of "beneficiary" in Uniform Customs and Practice ("UCP 600"), which were incorporated into the letters of credit. Lord Clarke noted that UCP 600 commands worldwide support, and seeks to create a set of contractual rules that establish uniformity in practice, and he considered that it followed from UCP 600 that SOMO was the beneficiary alone; and
iii. that rights of assignment were expressly excluded, meaning that SOMO could not transfer the benefit of the debt.

In the absence of a clear statement to the contrary on the face of the letters of credit, Crédit Agricole's primary obligation was to make payment to SOMO only and therefore a TPDO could be granted. The additional clauses quoted above were said to create collateral obligations for Crédit Agricole to discharge the debts by payment into CBI's bank account. These obligations were owed to SOMO and CBI jointly, but breach would merely give rise to a damages claim, rather than a claim in debt.

3 Did CBI nevertheless have a sufficient interest in payment of sums under the letters of credit to prevent the court from issuing a TPDO?

SOMO sought to argue that there was an independent principle that TPDOs could only be made in respect of assets with which the debtor could "honestly deal". SOMO submitted that CBI's right to receive payment engaged this principle as SOMO had no interest in or right over CBI's bank account in New York, and that this was sufficient reason to prevent the TPDOs from being granted. A majority of the Supreme Court rejected this analysis, finding that the only relevant rule was that TPDOs cannot be made in respect of assets which do not belong to the judgment debtor. In this case, the Supreme Court was clear that unpaid debts under the letters of credit belonged solely to SOMO.

"THE ONLY RELEVANT RULE WAS THAT THIRD PARTY DEBT ORDERS CANNOT BE MADE IN RESPECT OF ASSETS WHICH DO NOT BELONG TO THE JUDGMENT DEBTOR."

As Lord Hodge concluded, if a TPDO were to be made it would override Crédit Agricole's obligation to pay SOMO, and if that were to occur there was no content in the obligation as to the mode of payment of that debt, which Crédit Agricole owed to CBI and SOMO jointly - "the discharge of the debt [owed by Crédit Agricole to SOMO] would discharge the ancillary obligation as to the mode of its payment, leaving CBI with no claim for damages or otherwise against [Crédit Agricole]". The principle of "honest dealing" was therefore not engaged.

4 Should a receivership order be granted?

The Court of Appeal had declined to make a receivership order, in part because the link between SOMO and the English jurisdiction under the Arbitration Act 1996 was held to be too tenuous to justify the exercise of the receivership jurisdiction.

A majority of the Supreme Court took a different view. Lord Clarke noted that international trade, particularly the international oil trade, is conducted predominantly by letters of credit and that successful international commerce depends upon the enforcement of arbitration awards and judgments. It was predictable in this case that if SOMO failed to pay the arbitration award, it would be sued in England for the purpose of enforcement. Against that background, Lord Clarke concluded that "it seems inconsistent to allow an international award to be turned into an English judgment for the purpose of enforcing the award and then to limit the means available for enforcement on the grounds of an allegedly insufficient connection with the jurisdiction".

As the Supreme Court had already decided that it had jurisdiction to make the requested TPDOs, an additional receivership order may have been of little practical use to Taurus. However, the Supreme Court's willingness to make a receivership order over the assets of a foreign company again demonstrates the reach of the English courts' powers to enforce unpaid judgment debts.

Conclusions

The Supreme Court's judgment gives a clear indication that the English courts recognise the commercial importance of their enforcement powers. In the case of the receivership order, Lord Neuberger noted that whilst "the principles are not in doubt … their application in this case is not easy". The Court's decision to issue both TPDOs and a receivership order in a borderline case which involved payment to a central bank of a foreign state demonstrates the reach of the English courts' powers to enforce their judgments. That the judgment in this case was converted from an arbitration award into an English court judgment emphasises the strength of England & Wales as a jurisdiction in which to resolve disputes effectively.

With that said, there are practical lessons to be derived from the case. The Court's decision turned largely on the interpretation of the letters of credit, an issue which divided the Supreme Court and led to a sweeping dissenting judgment from Lord Mance. As letters of credit are autonomous documents, the courts will be cautious in using extraneous evidence to assist in their interpretation. It is therefore particularly important that letters of credit use clear and precise language, so that there is no doubt from their face which party or parties have an interest in payments under them. The lack of clarity that arose as a result of the unusual clauses that had been inserted into the letters of credit in this case turned what might have been a relatively straightforward decision into one which split each branch of the English court system.

"THE COURT'S DECISION TO ISSUE BOTH THIRD PARTY DEBT ORDERS AND A RECEIVERSHIP ORDER IN A BORDERLINE CASE WHICH INVOLVED PAYMENT TO A CENTRAL BANK OF A FOREIGN STATE DEMONSTRATES THE REACH OF THE ENGLISH COURTS' POWERS TO ENFORCE THEIR JUDGMENTS."

FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with one of the authors below or your regular contact at Watson Farley & Williams.

ROB FIDOE
Partner
London

+44 20 7863 8919
rfidoe@wfw.com

BEN LAMBLE
Senior Associate
London

+44 20 3036 9848
blamble@wfw.com

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