Litigations Involving SBLC (Standby Letter Of Credit)

Late 2016 saw three English court rulings on whether issuing banks were obliged to pay against what, on their face, appeared to be complying demands under standby letters of credit (SBLCs). These cases were:

- *National Infrastructure Development Co. Ltd. v. BNP Paribas* [2016] EWHC 2508 (the BNPP Case);
- *National Infrastructure Development Co. Ltd. v. Banco Santander S.A.* [2016] EWHC 2990 (the Santander Case); and
- *Petrosaudi Oil Services (Venezuela) Ltd v. Novo Banco S.A.* [2016] EWHC 2456 (the Novo Banco Case).

This note looks at the key issues for trade finance practitioners.

Unlike ordinary documentary (commercial) letters of credit, which are payment instruments, SBLCs are used mainly as credit support instruments. The issuer of an SBLC undertakes to pay the beneficiary only if the applicant does not perform the underlying contract.

If a demand under an SBLC appears on its face to comply with the terms of the SBLC (and the requirements of any ICC rules, such as the Uniform Customs and Practice for Documentary Credits (UCP 600) or the International Standby Practices (ISP 98), to which the SBLC is expressed to be subject), English law has only very limited exceptions to the rule that the issuing bank must pay against an apparently compliant demand.

These exceptions include where there is:

- illegality under local law in the place of payment under the SBLC; or
- fraud in procuring the issue of the SBLC, or a fraudulent demand by the beneficiary.

The BNPP Case and the Santander Case

Both of these cases involved demands by National Infrastructure Development Co. Ltd. (NIDCO), of Trinidad and Tobago, for payment under SBLCs issued in NIDCO's favour by various international banks at the request of a Brazilian contractor, Construtora OAS (OAS). The SBLCs were English law governed, and the English courts had jurisdiction to settle disputes arising in relation to them.

NIDCO and OAS had entered into a contract for OAS to build a major highway in Trinidad (the Construction Contract). The Construction Contract was subject to Trinidad law, with dispute resolution by arbitration in Trinidad.

OAS filed for judicial reorganisation in Brazil. Following this, NIDCO terminated the Construction Contract, referred disputes under that contract to arbitration, and served demands under the SBLCs. It then emerged that the Brazilian courts had granted OAS an injunction restraining the various banks from paying under the SBLCs (the Brazilian Injunction).

The BNPP Case

BNP Paribas (BNPP) had issued SBLCs in favour of NIDCO to secure advance payments made to OAS and to provide credit support for OAS's performance obligations under the Construction Contract. The amounts demanded were not paid and NIDCO sought judgment for those amounts in the English courts.

Under Brazilian law, BNPP risked a penalty of 10 per cent of the amount of the SBLCs if it paid out in breach of the Brazilian Injunction. Did the Brazilian Injunction give BNPP grounds to refuse to pay under the SBLCs as a matter of English law?

The court held that "if a party who had opened a letter of credit could defeat the bank's obligation to pay by obtaining an injunction against the bank in its home jurisdiction" this would undermine the commercial purpose of letter of credit transactions. In addition, there was no suggestion that the fraud exception applied. BNPP therefore had to pay.

The Santander Case[1]

Banco Santander S.A. (Santander) had issued SBLCs in favour of NIDCO as a performance and retention "guarantee" under the Construction Contract. NIDCO served demands under the SBLCs. Santander claimed the fraud exception applied to these demands because, among other things:

- what was "due and owing" from OAS was the subject of arbitration, so NIDCO's claim that the sums were due and owing was not honestly made;
- NIDCO had over-claimed under the SBLCs;
- the Brazilian Injunction prevented Santander from paying under the SBLCs; and
- in all the circumstances, NIDCO's demands were unconscionable.

The court held that:

- the words "due and owing" in the demand did not mean "determined by a tribunal to be due and owing", or "due and owing as a matter of law". Instead, the trigger for payment of the SBLC was NIDCO's belief that the amounts demanded were due and owing;
- despite the ongoing arbitration, it was not seriously arguable that NIDCO did not honestly believe its demands were valid; [2]
- the alleged overcompensation was not significant and did not indicate that NIDCO's demands were dishonest;
- the potential adverse consequences for Santander for paying out in breach of the Brazilian Injunction were part of the risk that Santander had taken; and
- unlike under Singapore law, unconscionability was not a basis for restraining payment under a letter of credit under English law.

Santander therefore had to honour the demands.

The Novo Banco Case[3]

Petrosaudi Oil Services (Venezuela) Ltd (Petrosaudi) provided oil rig drilling services to PDVSA Servicios S.A. (PDV), under a Venezuelan law contract (the Drilling Contract). As credit support for PDV's payment of Petrosaudi's invoices, Novo Banco S.A. (Novo Banco) issued an English law governed SBLC in favour of Petrosaudi.

Under the Drilling Contract, if PDV disputed an invoice it had to tell Petrosaudi within a set time or it would be deemed to have accepted the invoice on a "pay now, argue later" basis. At arbitration, this arrangement was held invalid under Venezuelan law (which set out a prescribed process for approving invoices issued to a state entity, such as PDV, before that entity had to pay).

PDV failed to pay certain invoices and Petrosaudi demanded payment from Novo Banco under the SBLC. Petrosaudi's position was that the underlying debts arose once it had performed the relevant services under the Drilling Contract, and the invoices in respect of those services were "due" for

payment when issued. By contrast, PDV argued that the Venezuelan arbitration rulings meant that the invoices were not due, so the demand certifying that PDV was "obligated to the beneficiary to pay the amount demanded under the drilling contract" was fraudulent.

The court held that, at the time of the demand, the sums claimed under the SBLC had to be due for payment immediately, not at some defined or undefined point in the future. It further held that, in the light of the Venezuelan arbitration rulings, in certifying that PDV was "obligated" to Petrosaudi for the sums claimed under the SBLC the signatory of the demand either knew that the demand was false or was reckless as to its falsity. The fraud exception therefore applied and Novo Banco should not pay under the SBLC.

This decision is under appeal.

Conclusions

The English law exceptions for restricting payment under letters of credit are just that – limited departures from the fundamental principle that an issuing bank must honour a complying presentation/demand. To allow these exceptions to be invoked too readily, or to broaden their scope beyond the current narrow limits, risks greatly reducing the utility of letters of credit as "equivalent to cash".

The decisions in the two NIDCO cases are therefore not unexpected. In particular, it is reassuring that, in the Santander Case, the court dismissed the argument that English law should "admit an exception for unconscionable conduct alongside the existing, recognised, fraud exception". Singapore law recognises breach of faith or unscrupulous conduct by a beneficiary of a letter of credit falling short of fraud as distinct grounds for an issuing bank withholding payment. However, these concepts are, arguably, too broad and ill-defined to be applied with certainty and consistency.

The decision in the Novo Banco Case is less clear cut – the meaning of the term "obligated" in the demand is ambiguous, and it is, arguably, not plainly obvious on the facts of the case that there was fraud by the beneficiary in making the demand. What position the Court of Appeal takes in clarifying the issues in this complex case will be of interest and practical significance.

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[1] Affirmed by Court of Appeal, 26 January 2017 – *National Infrastructure Development Co Ltd v. Banco Santander S.A.* [2017] EWCA Civ 27.

[2] Note that at appeal, although affirming the summary judgment decision, the Court of Appeal agreed that Knowles J had applied the incorrect test by referring to serious arguability. According to the Court of Appeal, the correct test is that a defendant seeking to resist summary judgment in such cases has to establish a "real prospect" that it could be established at trial that "the only realistic inference is that the claimant could not honestly have believed in the validity of its demands".

[3] Reversed by Court of Appeal, 25 January 2017 – *Petrosaudi Oil Services (Venezuela) Ltd v. Novo Banco S.A.* [2017] EWCA Civ 9.