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Fraud and Letters of Credit - When can an Issuing Bank Rely on the Beneficiary's Representations to Resist Payment?

When invoking the fraud exception to resist payment on a letter of credit ("**LC**"), banks typically argue that the beneficiary had made false representations in the documents presented to the bank. In the context of commodities trading, banks often rely on representations made by the beneficiary in the letter of indemnity ("LOI"), which is a document issued from a seller of cargo to a buyer (or the buyer's bank) when the seller is unable to immediately obtain the original shipping documents.

However, to what extent can an issuing bank rely on the representations in a LOI when the LOI is addressed solely to the buyer (i.e. the LC applicant) and not to the bank? This question was recently addressed by the Singapore Court of Appeal in UniCredit Bank AG v Glencore Singapore Pte Ltd [2023] SGCA 41 ("***Unicredit v Glencore***"). The SGCA dismissed UniCredit's claim on the basis that the representations which UniCredit sought to rely on were not made to UniCredit, but to the buyer of the cargo.

This article follows from our earlier article on the Singapore High Court's decision in *Unicredit v Glencore* [2022] SGHC 263, which can be accessed here: Further Developments in the Law on Letters of Credit

Background

UniCredit v Glencore involved a dispute between (i) UniCredit, the issuing bank of a LC issued pursuant to an application by Hin Leong Trading Pte. Ltd. ("**HLT**"), and (ii) Glencore, the beneficiary under the LC. The LC was issued to finance HLT's purchase of High-Sulphur Fuel Oil ("**HSFO**") from Glencore.

When applying for the LC, HLT had informed UniCredit that the LC was for "*unsold cargo*". However, this was untrue; HLT had in fact contracted to sell the HSFO back to Glencore. Indeed, title to the HSFO was to pass from Glencore to HLT and back to Glencore at the same time.

Unaware of the sale-and-buyback arrangement between HLT and Glencore, UniCredit made payment under the LC on presentation of (i) Glencore's LOI, and (ii) the invoice for the Glencore-HLT sale. Following HLT's insolvency, UniCredit was left without repayment from HLT and without possession of the goods or original bills of lading as security for payment. UniCredit commenced an action against Glencore for, among other things, the tort of deceit.

In the proceedings before the Singapore High Court, the Honourable Justice Andre Maniam ("**Maniam J**") dismissed UniCredit's claim. Maniam J found that (i) the Glencore-HLT sale was not a sham, and (ii) the representations in Glencore's LOI were true.

UniCredit's appeal to the SGCA

UniCredit did not challenge Maniam J's finding that the transaction was not a sham; its appeal was solely against Maniam J's dismissal of its cause of action in the tort of deceit. UniCredit's action in deceit depended on the representations which Glencore had allegedly made in its LOI:

(a) **First**, Glencore had represented that it had agreed to locate and surrender the original shipping documents to HLT, as stated in the Glencore LOI.

(b) **Second**, Glencore represented that there was a genuine purchase of the goods by HLT from Glencore in accordance with the terms of Glencore's invoice.

UniCredit's main argument was that there was more to both representations than expressed in their plain wording (the "**Expanded Representations**"), and that these Expanded Representations were false:

(a) The First Representation meant that Glencore had also *intended* to, and would, locate and surrender the original bills of lading to HLT (as opposed to merely agreeing to do so).

(b) The Second Representation meant that there was a genuine purchase of the HSFO by HLT from Glencore, and no buyback of the HSFO by Glencore from HLT.

Before considering whether Glencore had made the Expanded Representations, the SGCA first considered whether Glencore had made any representations to UniCredit. The SGCA held that the representations in the LOI were **not** made to UniCredit, and that UniCredit's case failed on this preliminary hurdle. This was because Glencore's LOI was addressed solely to HLT, and the promise to indemnify for loss and damage was similarly made solely to HLT. UniCredit therefore could not derive the benefit of any representation from Glencore's statement that it would locate and surrender the bills of lading. Ultimately, UniCredit "*was seeking to rely on a contractual promise to which UniCredit was not privy*".

The SGCA expressly stated that the case "*would have been quite different had the Glencore LOI in question been addressed to UniCredit instead of Hin Leong*". The SGCA referenced its recent decision in *Crédit Agricole Corporate & Investment Bank v PPT Energy Trading Co Ltd* [2023] SGCA(I) 7 ("***CACIB v PPT***"), where the plaintiff bank had successfully sued for a breach of warranty under a LOI, in circumstances where the LOI was addressed to the bank.

The SGCA also contrasted *UniCredit v Glencore* with cases such as *Sztejn v Schroder Banking Corp* (1941) 31 NYS 2d 631 ("***Sztejn***") and *DBS Bank Ltd v Carrier Singapore (Pte) Ltd* [2008] 3 SLR(R) 261 ("***DBS v Carrier***"). In these cases, the banks had successfully established the fraud exception because the documents presented by the beneficiaries were "*forged or untrue in relation to the consignment of goods to which the documents refer[red]*".

(a) In *Sztejn*, the documents presented described the shipment as one for bristles when, in reality, cowhair, rubbish, and other worthless material had been shipped. As non-conforming goods had been shipped, the bank successfully established the fraud exception.

(b) Similarly, in *DBS v Carrier*, the beneficiary had falsely represented that the goods were delivered in one lot when they had in fact been delivered over a few months. The SGCA held that the documents presented in *DBS v Carrier*, in which the beneficiary fraudulently represented a false state of affairs, were "*quite different*" from the Glencore LOI, which was a genuine document.

In any event, the SGCA also held that the Expanded First Representation, if it had been made, would not have been untrue; based on the terms of the financing arrangements for Glencore's repurchase of the goods from HLT, Glencore would have had to be prepared to locate and surrender the bills of lading to HLT.

Finally, even though Unicredit did not appeal against Maniam J's finding that the Glencore-HLT sale was not a sham, the SGCA commented that the sale and buyback arrangement between HLT and Glencore was an entirely legitimate transaction, and not part of a larger scheme to defraud UniCredit. The Court accepted Glencore's evidence that the purpose of the deal was to allow Glencore to optimise its working capital, and held that this constituted a legitimate commercial purpose. The evidence was that Glencore had originally obtained a loan to purchase the HSFO. The interest on this loan was about 3.8%. Glencore then wanted to refinance this loan with another bank at the lower interest rate of about 2.2%. To do so, Glencore sold the HSFO to HLT in order to repurchase it using the more favourable financing provided by the other bank. HLT also enjoyed a commercial benefit in the form of the purchase money paid by Glencore's bank. Although much of that should have gone to Unicredit to repay the LC facility, HLT enjoyed the use of the money until it was due. Unfortunately for Unicredit

HLT's insolvency intervened. The mere fact that the transaction was structured as a simultaneous sale and buyback was not determinative of whether it was a sham.

Learning Points

The decision in UniCredit v Glencore underscores the importance of the wording of a LOI. The fact that the LOI was addressed solely to HLT, and not UniCredit, was dispositive of UniCredit's appeal. This is in stark contrast to the SGCA's decision in CACIB v PPT, where CACIB succeeded on the basis that the beneficiary, PPT, had given CACIB a warranty as to marketable title and it turned out that there was a problem with title.

That said, the SGCA's decision should also be seen in light of its finding that Glencore was not complicit in HLT's false statements that the HSFO was unsold, and the fact that the Glencore-HLT transaction was not a sham. In this regard, it is notable that the SGCA expressly contrasted UniCredit v Glencore with cases such as Sztejn and DBS v Carrier, where the documents presented by the beneficiary represented an entirely false state of affairs. As the SGCA put it, the arrangement between HLT and Glencore "was therefore not a sham agreement involving the trading of fictitious goods". The decision therefore appears unlikely to affect cases in which the issuing bank has established that different goods, or no goods, were shipped.

It is important for lenders to do due diligence and understand the business and trading model of its borrowers, and structure the financing accordingly (including the scope of the warranties in LOI). In this case, Unicredit did ask HLT the pertinent question i.e. whether the HSFO was sold and was told a lie. Different conditions applied to pre-sold goods (which was in fact the case here). Materially, Unicredit would have expected repayment from the proceeds of the sale back to Glencore which would have come from Glencore's bank. Instead, the money went to HLT and HLT continued to maintain the fiction that the HSFO remained unsold. Unicredit was therefore left waiting in vain.

Lastly it is often useful for lenders to conduct a fund flow analysis as this will often reflect the actual trading arrangements between the parties including the existence of buy-backs, price adjustments, wash-outs and set-offs and conditional payments.

Written with the assistance of Daryl Cheng (Associate) and Suresh Viswanath (Associate).

For more information, please contact:

Probin Dass
Partner
T: +65 6439 0612
E: probin.dass@shooklin.com

Shook Lin & Bok LLP
1 Robinson Road #18-00 AIA Tower Singapore 048542 **T** +65 6535 1944 **F** +65 6535 8577 **E** slb@shooklin.com **W** www.shooklin.com