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THE GOVERNING LAW(S) OF A LETTER OF CREDIT

Taurus v SOMO revisited

The decision of the Supreme Court in *Taurus v SOMO* (“*Taurus*”)¹ has been the subject of two Comments in the May 2018 edition of the *Quarterly*, by Dr CH Tham² (focusing in particular on whether a third-party debt order can or should extend to a sum directed to be paid by the debtor to a third party) and Stephen Tricks³ (principally directed to the relationships between banks under a letter of credit). Both Comments identify some difficulties with the decision of the Supreme Court.

This Comment addresses a further issue arising from *Taurus*. It is what (if anything) the Supreme Court decided about the governing law of the contracts contained in a letter of credit and in particular those contracts to which the issuing bank is a party. The point is of importance not only in relation to the factual situation in *Taurus* itself (concerning a letter of credit issued by the branch of a bank in London advised by an overseas bank to an overseas beneficiary) but also to what might be described as the mirror image of those facts: a letter of credit issued by the branch of a bank overseas through a nominated/confirming bank⁴ in London where an attachment or injunction is obtained from a court in the jurisdiction of the issuing bank which prevents or purports to prevent the issuing bank from making payment to the nominated bank or to the beneficiary. Traditionally, the English courts have taken a robust approach to such orders. One reason has been that the obligations of the issuing bank to both the beneficiary and the nominated bank are governed by English law and, even if the issuing bank is subject to the overseas court’s jurisdiction, that court order will not as such discharge those obligations as a matter

1. *Taurus Petroleum Ltd v State Oil Marketing Co of the Ministry of Oil, Iraq* [2017] UKSC 64; [2018] 1 Lloyd’s Rep 29; [2017] 3 WLR 1170.

2. “Different debts for different purposes” [2018] LMCLQ 210.

3. “Bank-to-bank relationships in letters of credit” [2018] LMCLQ 217.

4. For convenience, this Comment will refer in general to a nominated bank, since a confirming bank is essentially a nominated bank which has added an independent prior promise to pay the beneficiary against conforming documents. The obligations of an issuing bank to a nominated bank do not differ depending on whether the nominated bank has issued its confirmation as is apparent from Art.7 of UCP 600 (*infra*, fn.8).

of English law.⁵ Whether that approach can so easily be maintained in the light of the Supreme Court decision is now potentially open to question.

The background to the *Taurus* decision has been set out in the previous Comments and for present purposes can be summarised very briefly. *Taurus* is an oil trading company. SOMO is the Iraqi state marketing company responsible for the sale of Iraqi oil. In February 2013, *Taurus* obtained an arbitration award against SOMO for about US\$8.7 million arising out of a dispute between them.

In March 2013, *Taurus* (a) obtained leave to enforce the arbitration award under the Arbitration Act 1996, s.66 and (b) obtained an interim third-party debt order (“TPDO”) and a receivership order in respect of sums payable by the London branch of *Crédit Agricole* on behalf of a company or companies in the Shell Group to SOMO under two deferred payment letters of credit issued by *Crédit Agricole* via the Central Bank of Iraq (“CBI”) in Baghdad in respect of consignments of oil sold by SOMO to Shell.⁶ Part of the proceeds of the letters of credit representing the sums claimed were paid by *Crédit Agricole* into court in March 2013, so *Crédit Agricole* dropped out of the action.

The TPDO and receivership orders were subsequently set aside at first instance and that decision was upheld by the Court of Appeal (albeit on different grounds). However, by a majority of three to two, the Supreme Court restored the original interim TPDO and the receivership order. The essential reasons given, in summary, were as follows:

- (1) SOMO was the beneficiary of the letters of credit and the debt under the credits was owed by *Crédit Agricole* to SOMO.
- (2) The *situs* of the debt under the letters of credit was England, where the branch of *Crédit Agricole* had issued them, not New York, where, under conditions contained in the credits, the proceeds were payable into an account of CBI. Here the Supreme Court unanimously overruled the judgment of the Court of Appeal in *Power Curber International v National Bank of Kuwait SAK* (“*Power Curber*”).⁷
- (3) Any obligation owed by *Crédit Agricole* to CBI as to the making of payments to the New York account under the particular conditions of the letters of credit did not give CBI any proprietary interest in the proceeds but (at most) was a contractual entitlement as against *Crédit Agricole* which did not override the imposition of the TPDO. The making of the TPDO would in effect discharge the liability of *Crédit Agricole* under the credit as a matter of English law.

5. This is an aspect of the “rule in *Gibbs*”—*Antony Gibbs and Sons v La Société Industrielle et Commerciale des Métaux* (1890) 25 QBD 399—recently reaffirmed as representing English law (at least short of the Supreme Court) in *Bakhshiyeva v Sberbank of Russia and others* [2018] EWHC 59 (Ch); [2018] BPIR 287. *Gibbs* is usually cited in the context of the effect (or lack of it) of a purported discharge of an English law debt in a foreign insolvency but the principle is of general application.

6. The orders were obtained in the period between the presentation of documents under the credits and the deferred payment dates.

7. [1981] 2 Lloyd’s Rep 394.

Governing law of a letter of credit

It is rare for documentary letters of credit to contain express provisions for governing law (or jurisdiction). Instead, since the 1960s they have almost invariably been expressed to be subject to the governing provisions of the applicable Uniform Customs and Practice ("UCP") published by the International Chamber of Commerce ("ICC") from time to time, which since 1 July 2007 has been UCP 600.⁸ Although some writers say that letters of credit should contain a law and jurisdiction clause,⁹ it may be suggested that there are sound reasons why they generally do not. Most letter of credit transactions are of relatively low value, margins are tight and they are negotiated, documented and operated by trade finance specialists. If a dispute arises, the issues are usually matters of technical trade finance practice which may be resolved with reference to the provisions of UCP 600¹⁰ and the Opinions of the ICC Banking Commission. If it goes to court, the judge will often have the assistance of expert evidence.

There is also the fact that, as between the issuing bank, nominated bank and beneficiary, there are three sets of contractual relationships:

- between the issuing bank and the nominated bank;
- between the nominated bank and the beneficiary;¹¹
- between the issuing bank and the beneficiary.

These three parties (or their legal advisers if they were asked) may have differing views in the abstract as to what governing law and jurisdiction provisions should apply to a transaction which, in legal terms, is not straightforward but which, in commercial terms, is generally relatively short-term and self-liquidating. In sum, it is not usually a debate worth having.

Nonetheless, of course, over time the English courts have had to address the issue of governing law in relation to letters of credit, though more often in the context of jurisdiction than any particular substantive questions of English law or principles of construction.

At common law the choice of law test applied by the English courts was that of the law of the place of the "closest and most real connection" with the transaction in question and it had been held that all three contracts were governed by the law of the place of presentation of documents and payment, ie, generally that of the nominated bank.¹²

Following the coming into force of the Contracts (Applicable Law) Act 1990, in England the common law choice of law rules were replaced by those contained in the

8. The Uniform Customs and Practice for Documentary Credits (2007 Revision) ICC Publication No 600. There is a useful summary of the history of UCP in ch.2 of EP Ellinger and D Neo, *The Law and Practice of Documentary Letters of Credit* (Hart, Oxford, 2010) ("Ellinger & Neo").

9. See eg M Brindle and R Cox, *The Law of Bank Payments*, 5th edn (Sweet & Maxwell, 2017) ("Brindle & Cox"), [7.136]; P Cresswell, W Blair et al, *The Encyclopaedia of Banking Law* (LexisNexis Butterworths) ("Cresswell & Blair"), [764B]; and Ellinger & Neo, 374–375, 384, 398.

10. And also the ICC publication International Standard Banking Practice (2013 revision) ICC publication 745E.

11. This contract may be the giving of a confirmation by the nominated bank but may also be, for example, the incurring of a deferred payment obligation to the beneficiary upon acceptance of the documents.

12. *Offshore International SA v Banco Central SA* [1976] 2 Lloyd's Rep 402 and *Bank of Credit & Commerce Hong Kong Ltd (In Liquidation) v Sonali Bank* [1995] 1 Lloyd's Rep 227.

Rome Convention.¹³ For contracts where there was no express or implied choice of law, there was a presumption under Art.4(2) of the Convention in favour of the law of the place of residence of the party which was to “carry out the performance characteristic of the contract”; but this was subject to an “escape clause” under Art.4(5), which provided that, where it was apparent from the circumstances as a whole that the contract was more closely connected with another country, then the law of that other country should apply.

The provisions of the Rome Convention, as they apply to letters of credit, were the subject of close analysis by Mance J in *Bank of Baroda v Vysya Bank*.¹⁴ He held in particular that the performance characteristic of the contract between the branch of the issuing bank (based in India) and the branch of the confirming bank (which was in London) was that of the addition of the confirmation of the credit and the honouring of the obligation the confirming bank had undertaken to the beneficiary. So that relationship was governed by the law of the confirming bank (here English law).

Mance J went on to say that, as between the issuing bank and the beneficiary, the application of the presumption under Art.4(2) would point to the law of the issuing bank as applying to that relationship but to do so would lead to an “irregular and subjective position where the governing law of a letter of credit would vary according to whether one was looking at the position of the confirming or the issuing bank. It is of great importance to both beneficiaries and banks concerned in the issue and operation of international letters of credit that there should be clarity and simplicity in such matters”.¹⁵

In the circumstances Mance J applied the escape clause under Art.4(5) so that the same governing law (ie, that of the place of the branch of the confirming bank and hence English law) applied as between the issuing bank and beneficiary. He also said that the same would apply even if the credit was an unconfirmed credit.¹⁶

For contracts concluded after 17 December 2009, the position is now governed by the Rome I Regulation.¹⁷ The applicable provisions as regards the governing law of the obligations of an issuing bank to the nominated bank and beneficiary, in the (usual) absence of choice, are Arts 4(2) and (3). Article 4(2) contains a general rule applicable to contracts not of the specific types identified in Art.4(1):¹⁸ that the contract shall be governed by the law of the country where the party required to effect the characteristic performance of the contract has his habitual residence. Article 4(3), however, contains an escape clause: “where it is clear from all the circumstances of the case that the contract is manifestly more closely connected with a country other than that indicated in [Art.4(2)], the law of that other country shall apply”. Recital 20 to Rome I provides some guidance—

13. The Rome Convention on the law applicable to contractual obligations [1980] OJ L266/1. The common law principles will continue to have influence in other common law-based jurisdictions.

14. [1994] 2 Lloyd’s Rep 87.

15. *Ibid*, 93.

16. *Ibid*, 93. The analysis by Mance J was confirmed and approved by the Court of Appeal in *PT Pan Indonesia Bank Ltd TBK v Marconi Communications International Ltd* [2005] EWCA Civ 422; [2007] 2 Lloyd’s Rep 72.

17. Regulation (EC) No 593/2008 of 17 June 2008 on the law applicable to contractual obligations. [2008] OJ L177/6 (“Rome I”).

18. There might be an argument that the contract between the issuing bank and the beneficiary is one for the provision of services by the issuing bank and so the (*prima facie*) governing law would be that of the issuing bank under Art.4(1)(b), but this is unlikely to be correct. See *Dicey, Morris & Collins: The Conflict of Laws*, 15th edn (Sweet & Maxwell, 2012) (and supplement) (“*Dicey*”), [33.317]. However, it would not affect the following analysis if Art.4(1)(b) applied.

that, in applying the escape clause contained in Art.4(3), “account should be taken, inter alia, of whether the contract in question has a very close relationship with another contract or contracts”.

Although the provisions of Art.4(2) and the escape clause in Art.4(3) are more tightly circumscribed than the comparable provisions in the Rome Convention,¹⁹ it has generally been considered that in the context of letters of credit the same approach²⁰ should be adopted under Rome I as under the Rome Convention and the outcome should be same as in the *Bank of Baroda* and *Marconi Communications*²¹ cases.²²

Governing law in *Taurus*

The principal focus in *Taurus* was on the *situs* of the debt obligations owed by Crédit Agricole under the letters of credit and hence the decision in *Power Curber* on this point. The reason was that, if the *situs* of the debt was not in England (as *Power Curber* indicated was the position), then there was no jurisdiction to make the TPDO.

In contrast, there is only limited discussion of the governing law applicable to the letters of credit. At first instance,²³ *Taurus* argued that the letters of credit were governed by English law and SOMO argued that they were governed by Iraqi law. Field J very briefly considered Rome I, Art.4 and held²⁴ that the characteristic performance for the purposes of Art.4(2) was that of Crédit Agricole's taking steps in London to credit CBI's account in New York. The judge did not refer to the escape clause in Art.4(3).²⁵ It may be that the judge was influenced by the fact that it was said to be common ground that CBI would not be acting as a confirming bank but as a “collecting bank” and so would not undertake any payment obligation to SOMO for which it would be seeking reimbursement under the credits.²⁶

In the Court of Appeal,²⁷ the question of governing law was referred to only by Moore-Bick LJ. He considered that, even though the parties did not consider the proper law to be relevant, it was necessary to identify the proper law of the contracts, because “unless it [was] English law the receivership order could well place Crédit Agricole in the invidious position of being required to pay the receiver to avoid being in contempt of court without obtaining a good discharge of its debts”.²⁸ Moore-Bick LJ went on to decide that the governing law of the contracts was English law. However, the analysis is curious, because

19. Article 4(2) is a general rule rather than a presumption and Art.4(3) requires a “manifestly” closer connection with another country.

20. Absent of course an express choice of law.

21. *Supra*, fn.16.

22. See eg *Dicey*, [33.317]; *Brindle & Cox*, [7.132]; and *Cresswell & Blair*, [764B]. The non-binding guidance to Rome I published by the Ministry of Justice in February 2010 specifically referred to letters of credit as being a situation where Art.4(3) could be applied to ensure all the contracts were governed by a single law: see *Dicey*, [33.317], fn.1481.

23. [2013] EWHC 3494 (Comm); [2014] 1 Lloyd's Rep 432.

24. *Ibid*, [18].

25. A point observed in the supplement to *Dicey*, [33.317].

26. See the judgment at [12], n.4. The reference to CBI as a “collecting bank” is odd since it is not a term used in UCP or generally in relation to letters of credit.

27. [2015] EWCA (Civ) 835; [2016] 1 Lloyd's Rep 42.

28. *Ibid*, [35].

he appeared to do so by reference to the provisions of the Rome Convention and not Rome I, which was the instrument applicable to these letters of credit. Moreover, he did not refer to any of the case law under the Rome Convention.

In the Supreme Court, the only specific reference to the governing law of the contracts is in Lord Clarke's judgment:²⁹ "It would have been entirely foreseeable by SOMO that a majority of the letters of credit against which they sold oil would be issued out of London and subject to English law."³⁰

Nonetheless, the judgments of each of the Supreme Court judges seem to proceed on the basis that whatever rights CBI and SOMO had under the letters of credit against *Crédit Agricole* were matters governed by English law. However, there is no analysis or even mention of Rome I in this context. This is perhaps surprising, because it is apparent from the video of the hearing on the Supreme Court website that Counsel for SOMO argued that New York law applied³¹ and referred to Rome I and authorities such as *Offshore International*,³² *Bank of Baroda* and *Marconi Communications*, as well as *Dacey*;³³ and Counsel for Taurus responded to this.

One is therefore left with this question: has the Supreme Court decided that the law governing the obligations of an issuing bank under a letter of credit to both the beneficiary and the nominated bank is that of the place of the branch of the issuing bank rather than that of the nominated bank? If so, it in effect reverses the common law rule, the position as the Court of Appeal³⁴ had held it to be under the Rome Convention, and the weight of authoritative writing on the subject in relation to Rome I. It would be regrettable that this has been done without any analysis of the reasons why this should be the case.

Furthermore, if the new rule is as stated above, then that gives rise to the issue raised at the beginning of this Comment: how will the English Court respond to the situation where a letter of credit is payable through a nominated bank in London but where an order has been made in the jurisdiction of the issuing bank, for example on an application by the buyer, attaching or otherwise preventing payment of sums due under the letter of credit by the issuing bank. This is not an unfamiliar situation. There were such injunctions or attachments in place in *Power Curber* itself, *Bank of Baroda* and in *BCCI Hong Kong v Sonali Bank*.³⁵

If the obligations of the issuing bank are treated by English conflicts rules as governed by English law, then the order of the foreign court would not discharge those obligations as a matter of English law.³⁶ However, if it is now the case that (a) the *situs* of the debts owed by the issuing bank is that of the branch of the issuing bank (as *Taurus* tells us) and (b)

29. [2017] UKSC 64; [2018] 1 Lloyd's Rep 29, [54] (emphasis added).

30. Dr Tham [2018] LMCLQ 210, 211 states that the Supreme Court "concluded that English law governed the debts arising from *Crédit Agricole*'s letters of credit" and cites para [31] of Lord Clarke's judgment for this; but that paragraph appears to be directed to the (different) question of the *situs* of the debts.

31. As compared to the argument by SOMO before Field J, that Iraqi law applied (presumably) on the basis that CBI's place of residence for the purposes of Rome I was Baghdad. It might be suggested that the first thoughts were the better ones.

32. *Supra*, fn.12.

33. *Supra*, fn.18.

34. In *Marconi Communications*.

35. *Supra*, fn.12.

36. See *supra*, fn.5.

so is the law governing the relationship of the issuing bank with both the nominated bank and the beneficiary, and in particular the payment obligations of the issuing bank, then the situation seems to be on all fours with the decision of the House of Lords in *Société Eram Shipping Co Ltd v Cie Internationale de Navigation*.³⁷ (There the House of Lords held that the English court had no *subject matter* jurisdiction to make a TPDO against a bank—HSBC—even though it was present in England, in respect of a bank account whose *situs* was in Hong Kong and whose governing law was that of Hong Kong.) If so, it would mean that in the “mirror” case the English court would not have any subject matter jurisdiction over a claim by either the beneficiary or the nominated bank against the issuing bank under the letter of credit. That may be regarded as an unsatisfactory outcome.

Conclusion

Both Dr Tham and Stephen Tricks have suggested that, for differing reasons, the Supreme Court's decision in *Taurus* should be given a narrow interpretation confined to its particular and unusual facts. The same, perhaps, should apply to the matter of governing law. It is a notable feature that neither the issuing bank (whose potential liabilities were being considered) nor the nominated bank (whose rights were being adjudicated upon) were parties to the argument or the decision. In a future case, and on different (and perhaps more usual) facts, either or both may well consider there are arguments which need to be made. At all events, the issue of the governing law of the contracts contained in a letter of credit seems to be a subject to which the courts will have to return.³⁸

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37. [2003] UKHL 30; [2003] 2 Lloyd's Rep 405; [2004] 1 AC 260.

38. For a recent decision, subsequent to the decision in *Taurus* and which involves some discussion of it, see *Hardy Exploration & Production (India) Inc v Government of India* [2018] EWHC 1916 (Comm); [2018] 2 Lloyd's Rep 331.

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