

# UK Supreme Court provides important principles for the enforcement of funds payable under letters of credit

## Introduction

The recent case of *Taurus Petroleum Ltd v State Oil Marketing Company of the Ministry of Oil, Iraq*<sup>1</sup> concerns the attempt of a party to enforce its arbitral award by seeking to rely on letters of credit provided by a bank to the other party (who had refused to pay the arbitral award).

The Supreme Court was asked to assess various issues relating to these letters of credit and the third party interests in the proceeds of the same.

In doing so, it has provided useful guidance on various points of law – notably, including:

- (a) the law governing the situs of a debt under a letter of credit; and
- (b) the ability to use third party debt and receivership orders to intercept the proceeds due under letters of credit.

## Background

The underlying claim relates to disputes that arose between Taurus Petroleum Ltd (“**Taurus**”) and State Oil Marketing Co of the Ministry of Oil, Iraq (“**SOMO**”) which were referred to UNICITRAL arbitration. Although the seat of the arbitration was in Baghdad, both parties agreed for the hearings to take place in London. In the final arbitral award, SOMO was ordered to pay USD 8,716,477 to Taurus, however SOMO did not honour this award.

Taurus became aware that, under an unrelated contract, SOMO was due to be paid through two letters of credit issued by Crédit Agricole, London Branch into a designated account of the Central Bank of Iraq (“**CBI**”) at the Federal Reserve Bank in New

York. In March 2013 the High Court granted Taurus: (i) permission to enforce the arbitration award under s.66 of the Arbitration Act 1996; and (ii) both an interim Third Party Debt Order (“**TPDO**”) and a receivership order in respect of the proceeds of the two letters of credit. By order of the High Court, the proceeds were paid into court by Crédit Agricole shortly afterwards.

However, SOMO challenged the award of these orders and they were set aside by the High Court. Following an unsuccessful appeal at the Court of Appeal, the matter proceeded to the Supreme Court.

The Supreme Court was asked to consider various arguments including, most significantly:

- (a) Whether the situs of debts under letters of credit should follow the general rule of being the place where the debtor resides or if it should continue to follow the exception in *Power Curber*<sup>2</sup> that the situs of debt is the place of payment; and
- (b) Whether the construction of the letters of credit in question meant that SOMO was the sole beneficiary of the proceeds and, if CBI did have an interest, whether this precluded a third party debt order being granted in respect of the proceeds.

## Situs of debt under letters of credit

As the English court lacks authority to make a TPDO in respect of debts situated outside the jurisdiction, the Supreme Court had to consider the location of the debt.

The first question was whether the proposition outlined in *Power Curber* applied. As mentioned above, this case provided authority for the fact that the

<sup>1</sup> [2017] UKSC 64

<sup>2</sup> *Power Curber International Ltd v National Bank of Kuwait SAK* [1981] 1 WLR 1233

situs of debt due under letters of credit was the place of payment. This is opposed to the general rule that the situs of debt is where the debtor's residence is situated. The Supreme Court unanimously overruled the Court of Appeal decision in *Power Curber* and stated that the general rule should equally apply to letters of credit. It was held that *Power Curber* was wrong in principle and that “*such unreasoned distinctions do the common law, and in particular commercial law, no favours*”.

The residence of the debtor, the London branch of Crédit Agricole as the Issuing Bank, was complicated by the fact that it was a French bank. However, this issue was dealt with in Article 3 of the Uniform Customs and Practice for Documentary Credits (2007 Revision) which states that “*branches of a bank in different countries are considered to be different banks*”. As such, the London branch of the French bank was to be considered a separate bank and therefore, the situs of debt under the letters of credit was England.

### The construction of the letters of credit and whether CBI's interest in the letters of credit (if any) precluded the granting of the third party debt order

A TPDO discharges the debt and releases the debtor from their obligation and, as such, it will only apply to a debt which is due or accruing solely to the judgement debtor alone. As the debt obligation is discharged by the TPDO, if the debt is owed to joint beneficiaries, the joint beneficiary would be deprived of his interest in the debt.

The letters of credit issued by Crédit Agricole, London Branch were addressed to the CBI but named SOMO as the beneficiary. The key question was whether a promise to pay a debt owed to a named beneficiary via a nominated bank account in another's name, substituted the latter as the beneficiary under the letter of credit.

The Supreme Court was split on this question but the majority held that the true construction of the letters of credit meant that SOMO was the only beneficiary and the sole owner of the debt. It was therefore the only entity to which Crédit Agricole incurred the primary obligation to make payment and the TPDO could be granted. There was also a secondary collateral obligation owed by Crédit Agricole to SOMO and CBI jointly but this simply related to the method of paying the proceeds into the designated account.

### Did Crédit Agricole's obligation to CBI preclude a TPDO being made?

SOMO also submitted that, based on the existence of the undertaking by Crédit Agricole to CBI to pay the proceeds of the letter of credit into the CBI's designated account in New York, this was enough to bar the court from making a TPDO in relation to them. This was based on *re General Horticultural Co*<sup>3</sup>, which held that an order of that kind could only charge “*what the judgment debtor can himself honestly deal with*”. SOMO argued that it could not honestly deal with those proceeds as it had no interest in, or rights over, the account of CBI into which the debt arising from the letters of credit was to be paid.

The Supreme Court was again split on this point, but the majority rejected SOMO's argument. Lord Clarke, for instance, held that *re General Horticultural Co* did not establish “honest dealing” as an independent principle but merely reaffirmed that a judgement creditor could not execute a TPDO over property which was not owned by the judgement debtor (i.e. property that the debtor was unable to honestly deal in).

### Conclusions

The Supreme Court has provided useful clarity on the construction of letters of credit.

Firstly, and perhaps most significantly, it was unanimously held that the situs of debt due under the letters of credit is the debtor's place of residence, as opposed to the place where the sums due under the letters of credit are payable. Ironically, in overruling *Power Curber*, Lord Neuberger commented that because the decision on this point had stood unchallenged for over 35 years, there was an argument based on certainty for not departing from it, however this was of itself not enough “*to justify us following its mistaken conclusion on this issue*”.

In addition, the judgment has also confirmed that the court will permit the interception of the proceeds of letters of credit at the level of the issuing bank. This is due to the principal obligation being owed to the beneficiary and not to the nominated bank (which only has a contractual right regarding method of payment). This may therefore have the effect that sellers are disincentivised from using letters of credit if there is a risk that the proceeds owed to them could be intercepted.

3 *re General Horticultural Co, Ex p Whitehouse* (1886) 32 Ch D 512.

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