Sanctions Clauses in Documentary Credit Transactions: A Cautionary Tale

In *Kuvera Resources Pte Ltd v JPMorgan Chase Bank, N.A.* [2023] SGCA 28, the Singapore Court of Appeal held that a confirming bank was not entitled to deny payment to the beneficiary of two letters of credit (**LCs**) on the ground that its confirmations of the LCs included a contractual clause (**Sanctions Clause**) which extinguished the confirming bank's liability as the underlying commercial transaction was allegedly caught by the sanctions laws of the United States of America (**US**).

This update takes a look at the Court of Appeal's decision, which overturned the decision of the General Division of the High Court of Singapore (**High Court**) permitting the bank to deny payment by reason of the Sanctions Clause.

Our Comments

In the current geopolitical climate, sanctions are increasingly used as a foreign policy tool and can have significant implications for contractual obligations in international trade. In these circumstances, we would expect to see more sanctions clauses in contracts, including trade finance-related documents, and disputes relating to sanctions clauses.

The decision of the Court of Appeal provides helpful guidance to the limited and developing jurisprudence in this area; in particular on the interpretation and application of sanctions clauses in documentary credit transactions.

The decision confirms that sanctions clauses can be validly incorporated into confirmed documentary credits. It also underscores the importance of clarity and specificity in drafting sanctions clauses. The courts take a strict approach to the interpretation of such clauses and will require clear and objective evidence from a bank seeking to rely on such a clause that it is entitled to do so, without any input from third party entities. However, it remains to be seen how the Singapore courts will determine the issue of general compatibility of sanctions clauses with the commercial purpose of irrevocable documentary credits, as this was left open by the Court of Appeal.

Legal advice should be sought as appropriate on drafting and/or incorporating sanctions clauses. Banks should also take care to undertake sufficient due diligence on all material aspects of the transaction.

Background

The dispute centred on the refusal of JPMorgan Chase Bank, N.A. (**JPMorgan**), as confirming bank, to pay Kuvera Resources Pte Ltd (**Kuvera**) pursuant to JPMorgan's confirmations to two LCs under which Kuvera was the beneficiary.

Kuvera is a company in the business of coal trading. JPMorgan is a national banking association chartered under US laws and headquartered in New York. It has branches worldwide, including Singapore.

In July 2019, a company in Indonesia (**Seller**) entered into a contract to sell coal to a company in the United Arab Emirates (**Buyer**). To facilitate the transaction, Kuvera advanced funds to the Seller to

purchase the coal for on-selling to the Buyer. The Buyer was to pay for the coal by two irrevocable LCs expressly made subject to the Uniform Customs and Practice for Documentary Credits, 2007 Revision. The LCs named Kuvera as the beneficiary.

The bank which issued the LCs appointed JPMorgan as the advising bank and nominated bank for the LCs. The Singapore branch of JPMorgan duly advised both LCs to Kuvera (**Advices**) and confirmed the LCs and their amendments (**Confirmations**). All Advices and Confirmations contained a Sanctions Clause which provided, among other things, that JPMorgan must comply with all US sanctions laws and that it would not be liable for any failure to pay if the presented documents involved a vessel subject to US sanctions:

> [JPMorgan] must comply with **all sanctions, embargo and other laws and regulations of the U.S.** and of other applicable jurisdictions to the extent they do not conflict with such U.S. laws and regulations **("applicable restrictions")**. **Should documents be presented involving any** country, **entity, vessel** or individual **listed in or otherwise subject to any applicable restriction, [JPMorgan] shall not be liable for any** delay or **failure to pay**, process or return such documents or for any related disclosure of information.
>
> (Emphasis added)

The coal was shipped to the Buyer on the vessel, the "*Omnia*".

On or around 28 November 2019, Kuvera made a complying presentation of documents through a presenting bank (**Presenting Bank**) to JPMorgan under the LCs. It was not in dispute that this was a complying presentation.

JPMorgan then sent the presented documents for its internal sanctions screening procedure, which revealed that the *Omnia* was previously named the "*Lady Mona"*, which had earlier been determined within JPMorgan to be a vessel having a sanctions nexus and/or concern as it was likely to be beneficially owned by a Syrian entity. The vessel was included in a JPMorgan internal list, known as the Master List, which contained the names of various entities and vessels that had been determined by JPMorgan to have a sanctions nexus and/or concern. Accordingly, on 3 December 2019, JPMorgan informed Kuvera and the Presenting Bank that it was unable to pay on the LCs. The LCs expired in December 2019.

On 17 January 2020, Kuvera commenced an action against JPMorgan in the High Court, claiming that JPMorgan had acted unlawfully in not paying Kuvera the principal sum or any part thereof under Kuvera's complying presentation of documents under the LCs.

The High Court's Decision

The High Court rejected Kuvera's contention that the Sanctions Clause was not a term of its contract with JPMorgan, the terms of which are to be found in the LCs only. Instead, the High Court found, among other things, that the documentary credit transaction comprises a number of separate and discrete contracts. As the confirmation is a separate contract, it need not mirror the terms of the LCs in their entirety. Accordingly, JPMorgan was at liberty to include in the Confirmations any term which was not in the LCs, such as the Sanctions Clause, as long as the term was not fundamentally inconsistent with the commercial purpose of the confirmation.

The High Court further held that the Sanctions Clause was valid and enforceable as it was not fundamentally inconsistent with the commercial purpose of a confirmation (*viz*., to give the beneficiary an alternative avenue to receive payment other than from the issuing bank). The High Court also found, among other things, that the Sanctions Clause was sufficiently narrow and did not confer on JPMorgan a broad discretion so as to render the Confirmations *de facto* revocable; nor was it so broad as to be unworkable.

Finally, the High Court held that JPMorgan was entitled to refuse payment to Kuvera. As JPMorgan was the Singapore branch of a US-incorporated and regulated bank, it had to comply with US sanctions laws and regulations. Further, based on the evidence adduced by JPMorgan, including the evidence given by its expert witness on US sanctions law, it would have been exposed to a penalty by the US Office of Foreign Assets Control (**OFAC**) if it had paid on the LCs.

Kuvera appealed against the High Court's dismissal of its claim.

The Court of Appeal's Decision

The Court of Appeal allowed Kuvera's appeal, following a careful examination of the true effect and meaning of the Sanctions Clause.

At the outset, the Court of Appeal affirmed that LCs and confirmations are independent contracts, and it is therefore possible that a confirming bank's liability under a confirmation may be subject to conditions not reflected in the LC. Accordingly, the Court of Appeal accepted that the Sanctions Clause did not have to be separately offered or accepted and could simply be incorporated in the Confirmations, as was done in this case.

Sanctions Clause to be construed objectively and strictly

The Court of Appeal highlighted that the Sanctions Clause had to be construed objectively and its effect on JPMorgan's irrevocable obligation to pay under the Confirmations construed strictly.

On its terms, the Sanctions Clause would only apply if the *Omnia* was "*listed in or otherwise subject to applicable restriction*". It was not disputed that the only possible list was the OFAC Specially Designated Nationals and Blocked Persons list (**OFAC List**). It was also not disputed that the *Omnia* was not on the OFAC List, although it was on JPMorgan's internal Master List. Accordingly, the only premise for invoking the Sanctions Clause was for JPMorgan to establish that the *Omnia* was "*otherwise subject to any applicable restriction*".

JPMorgan contended in that regard that it was not required to prove that the *Omnia* was Syrian-owned; it only had to prove that proceeding with the transactions involving the *Omnia* (on the facts known to it at that time) would violate US sanctions, and this entailed a consideration of whether the OFAC would have made such a finding.

The Court of Appeal rejected JPMorgan's approach for the following reasons:

(a) As the party relying on the Sanctions Clause, the burden was on JPMorgan to prove, on a balance of probabilities, that the *Omnia* was in fact "*subject to any applicable restriction*". That question had to be determined on an *objective* basis without third-party input from entities such the OFAC. The applicable inquiry was directed at the ownership of the *Omnia*, i.e., whether it remained Syrian-

owned at all material times such that it was subject to US sanctions. This was a matter capable of objective determination.

(b) JPMorgan's approach required the parties as well as the court to assess the likelihood of a third party like the OFAC (which was not identified in the Sanctions Clause) concluding that JPMorgan might have been in breach of US sanctions for paying on the LCs. The Court of Appeal considered this approach speculative and arbitrary as the parties and the court would have to extrapolate what the OFAC might decide, based on largely circumstantial evidence. It would be practically impossible for a beneficiary of an LC to know with certainty whether it would be paid despite full compliance with the documentary requirements.

(c) JPMorgan had decided not to pay on the LCs in reliance on its own Master List and on several "red flags" surrounding ownership of the *Omnia* which it had detected but which could not be resolved. However, it was JPMorgan's evidence that a vessel would be added to its internal Master List so long as some "*sanctions nexus*" was identified from its due diligence (even where the risk of violation of US sanctions did not exceed 50 percent). Further, JPMorgan decided not to pay Kuvera based on its assessment of the risk of being sued by Kuvera against the risk of being found by the OFAC to have breached US sanctions. However, this stood in contrast to the objective approach which requires proof on a balance of probabilities. The Court of Appeal considered JPMorgan's approach "*unsatisfactory and unfair*" as it was entirely a reflection of JPMorgan's internal risk management considerations.

The Court of Appeal further considered the circumstantial evidence which the High Court had accepted as sufficient to prove a Syrian connection to the *Omnia*, and found instead that the evidence was inconclusive on the matter. In this connection:

(a) JPMorgan placed the *Lady Mona* on its Master List in 2015. At that time, the beneficial owner of the vessel was the Ali Samin Group, which had an office in Syria. In addition, the Ali Samin Group, its parent company and the ship operator / management company all had a place of business in Syria. In 2019, JPMorgan learned that the vessel was renamed the *Omnia*, under a new registered owner, which was a shell company in Barbados.

(b) The fact that the *Lady Mona* was properly regarded as a vessel under Syrian beneficial ownership in 2015 did not invariably mean that she should still be regarded as such under her new registered ownership in 2019. The *Omnia*'s beneficial ownership in 2019 was a separate inquiry. As the entity seeking to rely on the Sanctions Clause, it was JPMorgan's burden to establish that the *Omnia* remained Syrian-owned, and displace the *prima facie* inference of ownership arising from the non-Syrian registered owner of *Omnia* in 2019.

(c) The Court of Appeal considered that JPMorgan's correspondence with the OFAC and the expert opinion submitted by JPMorgan, taken at their highest, only demonstrated that there were risks that the *Omnia* may be subject to an applicable restriction but did not show, on a balance of probabilities, that the vessel was owned by a Syrian entity.

(d) JPMorgan had raised a number of "red flags" surrounding ownership of the *Omnia* which could not be resolved. In particular, third party websites were inconclusive regarding any updated ownership of the *Omnia*, but identified possible ownership by Sea Sovereignty Shipmanagement. Further checks indicated that Sea Sovereignty Shipmanagement was located

in Syria and that it was formerly known as Samin Shipping Company – a close name match to the company originally identified as the beneficial owner of the *Lady Mona*. In addition, the technical and international safety management code (**ISM**) manager reported by Lloyds was Serenity Ship Management JLT/DMCC, a United Arab Emirates entity, which was identified by research to be potentially owned by one Mr Ali Samin.

(e) However, the Court of Appeal held that it did not follow that there was masking or concealment about the *Omnia*'s beneficial ownership simply because the vessel's name and registered ownership had been changed with no accompanying information about the beneficial owners. Similarly, the absence of information of beneficial owners of the technical and ISM manager did not necessarily mean there was concealment of her beneficial ownership to avoid being caught by sanctions.

(f) It was insufficient for JPMorgan to rely on the apparent involvement of Mr Ali Samin, a Cypriot national, in the *Omnia*'s technical and ISM manager in 2017 to establish, on a balance of probabilities, that the Syrian beneficial ownership of the *Omnia* had continued into 2019. By 2019, the *Omnia* was owned by a Barbados company and operated by a United Arab Emirates entity with a Cypriot national as its managing director.

Ultimately, in the Court of Appeal's judgement, JPMorgan's approach fell short of establishing that the *Omnia* was subject to "*any application restriction*". By choosing to rely on an internal list (i.e., the Master List) as opposed to the OFAC List and inconclusive evidence regarding the *Omnia*'s beneficial ownership and then deciding to deny Kuvera payment after weighing the risk of being sued by Kuvera against the risk of being found guilty of breaching US sanctions laws, JPMorgan assumed the risk that such reliance might not be sufficient to discharge its burden of proof. The Court of Appeal considered that, while it might have been "*rational*" from a risk management perspective for JPMorgan to decide that it would rather be sued by Kuvera than pay on the LCs and risk being found by the OFAC to have breached US sanctions, such an approach was not contractually justified.

Provisional views on compatibility of Sanctions Clause with commercial purpose of Confirmations

Given its finding that JPMorgan was not entitled to rely on the Sanctions Clause to deny payment under the Confirmations, it was not strictly necessary for the Court of Appeal to consider whether the Sanctions Clause was compatible with the commercial purpose of the Confirmations.

However, as the parties had addressed the issue, the Court of Appeal took the opportunity to set out some provisional views on the extent of a confirming bank's discretion to impose additional terms in a confirmation beyond those stipulated in an LC. The Court of Appeal made clear that its provisional views are not intended to apply to sanctions clauses in general, but are restricted to the specific context of this case where the sanctioned entity is the owner of a vessel, because a beneficiary under a LC is typically not involved in the vessel nomination and may not know who the real beneficial owner of the vessel is.

The Court of Appeal began by noting that the question whether sanctions clauses are incompatible with the nature of irrevocable documentary credit transactions is an "*open and difficult*" one. As the Court of Appeal noted, commentators have observed that sanctions clauses may call into question the documentary and irrevocable nature of the credit; among other things, they introduce uncertainty to the documentary credit transaction and undermine conventional documentary credit law, which requires the return of documents *only* if they do not conform with the requirements of the credit.

The Court of Appeal further took note of a number of English cases which point to a trend of judicial recognition of sanctions clauses in commercial transactions, but highlighted that none of those cases considered the unique nature of documentary credit transactions in that one autonomous contract within the transaction has the effect of securing the payment promised under another autonomous contract, and the consequential impact of sanctions clauses on this unique effect of documentary credit transactions.

In the final analysis, the Court of Appeal observed that a balance must be struck between preserving the autonomy of individual contracts within a documentary credit transaction (such that it is open to parties to insert conditions in each autonomous contract) and upholding the commercial viability of a documentary credit transaction, where each autonomous contract is intended to correspond to and/or provide a safety net for the other contracts in the transaction. It added that, if the Sanctions Clause was to be construed as JPMorgan claimed it should (such that JPMorgan was entitled to deny payment against a complying presentation as long as it considered on a risk-based assessment that it would be better to be sued by Kuvera than to risk a penalty by the OFAC), then the Sanctions Clause would most likely be incompatible with the commercial purpose of the Confirmations due to the significant unpredictability such an interpretation would introduce into the Confirmations.

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