# Pratt's Journal of Bankruptcy Law

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**EDITOR'S NOTE: LESSONS**
Victoria Prussen Spears

**LESSONS FROM *CRÉDIT AGRICOLE V. PPT*: THE EVOLUTION OF THE FRAUD EXCEPTION AND THE CRITICAL ROLE OF LETTERS OF CREDIT – WHY FINANCING BANKS MUST REMAIN WARY**
Pierre Dzakpasu, Anne Jesudason and Dennis Xin

***JEVIC* KEEPS ON GIFTING: U.S. COURT OF APPEALS FOR THE THIRD CIRCUIT REAFFIRMS SOLVENT DEBTOR EXCEPTION BY HOLDING UNSECURED CREDITORS OF SOLVENT DEBTOR ENTITLED TO POST-PETITION INTEREST AT THE CONTRACT RATE**
Gregory Petrick, Ingrid Bagby, Michele Maman, Casey Servais and Thomas Curtin

**U.S. COURT OF APPEALS FOR THE THIRD CIRCUIT AGREES WITH LOWER COURT: ROYALTY OBLIGATION NOT TIED TO INTELLECTUAL PROPERTY LICENSE IS A DISCHARGEABLE UNSECURED CLAIM**
Martin E. Beeler, Dianne F. Coffino, Peter A. Schwartz and Julian Wright

**DELAWARE DISTRICT COURT SHEDS LIGHT ON STANDARDS FOR DISMISSAL OF CHAPTER 11 CASE BASED ON BAD FAITH**
Robert Klyman and Scott C. Shelley

**TOGGLE PLANS: A RISING VALUE-MAXIMIZING STRATEGY**
Lisa Schweitzer and Hoori Kim

**NOVEL BANKRUPTCY ISSUES IN THE CRYPTO BANKRUPTCY CLUSTER**
Jane VanLare and Jack Massey

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**VOLUME 20** **NUMBER 8** **November-December 2024**

**Editor's Note: Lessons**
Victoria Prussen Spears 325

**Lessons from *Crédit Agricole v. PPT*: The Evolution of the Fraud Exception and the Critical Role of Letters of Credit – Why Financing Banks Must Remain Wary**
Pierre Dzakpasu, Anne Jesudason and Dennis Xin 327

***Jevic* Keeps on Gifting: U.S. Court of Appeals for the Third Circuit Reaffirms Solvent Debtor Exception by Holding Unsecured Creditors of Solvent Debtor Entitled to Post-Petition Interest at the Contract Rate**
Gregory Petrick, Ingrid Bagby, Michele Maman, Casey Servais and Thomas Curtin 340

**U.S. Court of Appeals for the Third Circuit Agrees with Lower Court: Royalty Obligation Not Tied to Intellectual Property License Is a Dischargeable Unsecured Claim**
Martin E. Beeler, Dianne F. Coffino, Peter A. Schwartz and Julian Wright 347

**Delaware District Court Sheds Light on Standards for Dismissal of Chapter 11 Case Based on Bad Faith**
Robert Klyman and Scott C. Shelley 349

**Toggle Plans: A Rising Value-Maximizing Strategy**
Lisa Schweitzer and Hoori Kim 356

**Novel Bankruptcy Issues in the Crypto Bankruptcy Cluster**
Jane VanLare and Jack Massey 363

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# Lessons from *Crédit Agricole v. PPT*: The Evolution of the Fraud Exception and the Critical Role of Letters of Credit – Why Financing Banks Must Remain Wary

***By Pierre Dzakpasu, Anne Jesudason and Dennis Xin****

*In this article, the authors discuss a decision by the Singapore Court of Appeal that established principles relevant to lenders in the business of providing asset or trade financing through letters of credit.*

The Singapore Court of Appeal has handed down its decision in *Crédit Agricole Corporate and Investment Bank, Singapore Branch v. PPT Energy Trading Co Ltd* (Re CACIB).[1]

The judgment in *Re CACIB* imparts some valuable lessons for issuing banks seeking to protect their credit positions by relying on letters of indemnity in lieu of a bill of lading. The principles established will be relevant to lenders in the business of providing asset or trade financing through letters of credit.

## SUMMARY OF COURT DECISION

### Parties

- Crédit Agricole Corporate and Investment Bank, Singapore Branch (CACIB), as the appellant.
- PPT Energy Trading Co Ltd (PPT), as the respondent.

### Facts

- The now-defunct Zenrock Commodities Trading Pte Ltd (Zenrock) facilitated a series of transactions, wherein Zenrock was featured as both a seller and a buyer in a series of contracts relating to the same cargo (the Cargo).

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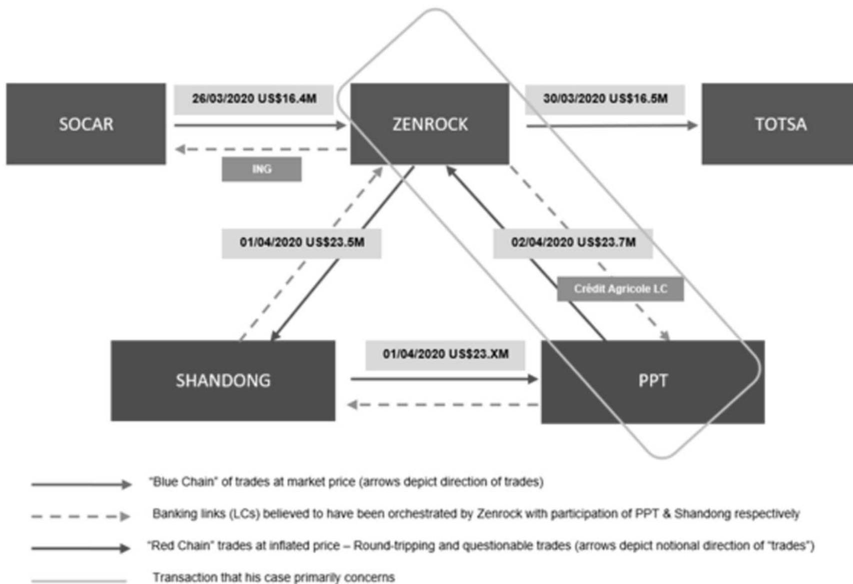
[1] Crédit Agricole Corporate and Investment Bank, Singapore Branch v. PPT Energy Trading Co Ltd [2023] SGCA(I) 7.

- Zenrock had initially contracted by a series of contracts to buy the Cargo from SOCAR and then subsequently on-sell the Cargo to Total Oil Trading SA (TOTSA). These contracts were concluded at a market price.
- Prior to shipment of the Cargo, receipt of the Cargo by Zenrock and delivery to TOTSA, Zenrock orchestrated a series of transactions that commenced with Zenrock as the seller of the Cargo and ended with Zenrock as the buyer of the Cargo. These types of circular transactions are also referred to as "round tripping." The purpose of the series of contracts was to obtain multiple overlapping financings for the same cargo acquisition. The inflated pricing was necessary to yield profits for each participant in the chain (including Zenrock).
- At Zenrock's request, PPT participated in one of the transactions in the round trip and sold the Cargo to Zenrock (the PPT Contract).




- The purchase of the Cargo from SOCAR was financed by a letter of credit issued by ING Bank NV (ING) at Zenrock's request. Zenrock created security over the Cargo to secure the financing provided by ING. The ING financing was intended to be repaid with the proceeds of selling the Cargo onward to TOTSA.
- Separately, Zenrock approached CACIB to finance its purchase of the Cargo under the PPT Contract. CACIB was provided a copy of the

PPT Contract and a fictitious sale contract for the sale of the same Cargo by Zenrock to TOTSA (the Doctored TOTSA Contract). The Doctored TOTSA Contract contained a much higher price than the true TOTSA contract and indicated that Zenrock would make a profit from its sale of the Cargo to TOTSA. In reality, Zenrock had already closed on the true TOTSA contract at a loss (relative to the purchase price payable by Zenrock to PPT). Zenrock also granted CACIB an assignment over the proceeds of the sale to TOTSA and security over the Cargo, both of which were, in fact, also secured/assigned to ING. The combination of the Doctored TOTSA Contract and the provision to two banks of the same trade receivables assignment was instrumental in bypassing market-standard due diligence processes at the banks and inducing CACIB into the financing arrangement. Logically, each bank would have advanced its financing against a number of factors, including security over the contract receivable and on the expectation that it was financing a back-to-back transaction.

- Zenrock had executed a deed of charge in favour of CACIB in order to obtain credit facilities from CACIB. The deed of charge granted CACIB a floating charge on all goods financed by CACIB. However, as indicated above, Zenrock also had a similar security arrangement with ING, leading to competing floating charges over the same Cargo. Although the inconsistent floating charges were relevant to the court's reasoning and the outcome, the floating charges were never of much practical value to CACIB or ING in terms of taking possession of the Cargo.
- CACIB issued a letter of credit to PPT to finance Zenrock's purchase under the PPT Contract on 4 April 2020. Under the letter of credit, CACIB agreed to pay PPT upon the presentation of either the original bills of lading or, failing this, a commercial invoice for the Cargo and a letter of indemnity.
- On the evidence presented at the trial, it was clear that CACIB had performed its due diligence and credit analysis consistent with market practice. It was also clear that Zenrock's fraud was precisely calibrated to escape detection by the banks' due diligence and credit analysis processes.[2] Amongst other things, Zenrock was careful to conceal its multiple roles from CACIB and ING and orchestrated the participants and financing banks in the circular trade such that CACIB and ING

[2] Crédit Agricole Corporate and Investment Bank, Singapore Branch v. PPT Energy Trading Co Ltd [2023] SGCA(I) 7, [9].

would not become aware of the circular trade in the ordinary course of their dealings with Zenrock and the respective sellers.

- On 9 April 2020, PPT presented its commercial invoice and letter of indemnity to CACIB. CACIB did not reject these documents or provide PPT with notice of any defective or invalid presentation within the stipulated time period of five days.[3] However, during this time, CACIB was alerted to the fact that Zenrock had assigned the receivables from the true TOTSA contract twice and that the Doctored TOTSA Contract was not genuine.
- CACIB did not make payment under the terms of the letter of credit and was granted an injunction by the Singapore High Court (SGHC) restraining this payment. This injunction was eventually discharged after the parties reached a commercial compromise for CACIB to initially make payment under the letter of credit but secured against a bank guarantee in its favour from the Bank of China should the court hold that there was no obligation to pay. This gave CACIB downside protection in the event that it prevailed at trial.
- There were separate interpleader proceedings between CACIB and ING, the two financiers each claiming an entitlement to the TOTSA receivables. The parties to the interpleader proceedings settled, with CACIB recovering US$6,197,532.75 as part of the settlement.

**First Instance**

- The Singapore International Commercial Court (SICC) held that, while Zenrock had committed fraud, PPT's conduct did not amount to fraud against CACIB, and so CACIB could not rely on the "Fraud Exception"[4] to deny payment under the letter of credit.
- The SICC also held that CACIB could not rely on the letter of indemnity for reimbursement from PPT, because it was, on its construction, a unilateral contract that could only be effective when its conditions are fulfilled. Therefore, its warranties and indemnity could only became effective on timely payment "at the due date" by CACIB under the letter of credit. Since payment was not made on the due date,

[3] Pursuant to The Uniform Customs and Practice for Documentary Credits 600 (UCP 600).

[4] The rule that a bank may resist payment under a letter of credit if the beneficiary, for the purpose of drawing on the credit, fraudulently presents to the confirming bank documents that contain, expressly or by implication, material representations of fact that are to its knowledge untrue. (United City Merchants (Investments) Ltd v. Royal Bank of Canada [1983] 1 AC 168).

there could be no acceptance of this unilateral contract, and therefore no warranties and indemnities became available to CACIB. This was held to be so despite the injunction restraining payment by CACIB.

**Issues on Appeal**

- Whether CACIB was entitled to rely on Zenrock's "undoubted fraud" to set aside its obligation to make payment to PPT under the letter of credit.
- Whether the letter of indemnity was effective.
- Whether the warranty contained in the letter of indemnity issued by PPT, which stated that PPT had "marketable title to such shipment, free and clear of any lien or encumbrance," had been breached and, if so, what damages were incurred.

**SGCA Decision**

- The SGCA held that CACIB was not entitled to rely on Zenrock's fraud, because a letter of credit (even if induced by Zenrock's fraud) is separate and autonomous from the underlying contractual relationship between buyers and sellers. As such, the "Fraud Exception" does not apply where the beneficiary (i.e., PPT) was not a party to the fraud.
- The SGCA reached this decision:
  - o with deference to the finding from the trial judge that:

    > "although PPT is hardly an "innocent bystander," it cannot be said to be a participant in Zenrock's fraudulent scheme, despite its awareness that Zenrock had purchased the Cargo from SOCAR before buying it from PPT, further down a chain of sales and purchases. It cannot properly be said that PPT had actual knowledge of, or was wilfully blind to, the fact that this was a fraudulent scheme because it had, in this case, been offered a pre-structured deal, similar to those that had taken place in the past, all of which had gone through successfully without any suggestion of fraud"; and

  - o in spite of the SGCA's own observation that "attempts at trial on the part of PPT's witnesses to deny any knowledge of such round-tripping were unbecoming and redolent of PPT's lack of good faith . . ." and that "PPT's ignorance of even the general

level of market prices and its disinterest in what was going on" was "[r]emarkable."

- Overturning the SICC decision at first instance, the SGCA held that the letter of indemnity was not a unilateral contract, was effective from its date of issue and that payment "at the due date" was not a condition precedent to its effectiveness. Thus, though CACIB had not made payment by the due date because of the ongoing dispute, this would not in and of itself defeat a claim under the indemnity.
- On the facts, the SGCA also held that PPT was in breach of the warranty of marketable title due to Zenrock's fraud and the fact of existing and conflicting charges over the Cargo, which had crystallised prior to the transfer of title that occurred when the Cargo was loaded onto the ship.

## PROTECTING FINANCIER'S INTEREST IN LETTER OF CREDIT SUPPLY CONTRACTS

The importance of letters of credit in international commerce cannot be overstated. Their usage in asset sale and trade finance transactions is commonplace and serves a wide-range of purposes throughout a transaction's lifetime. These include being a reliable source of both comfort and leverage in pre-dispute situations. *Re CACIB* is a warning to both issuers and beneficiaries to do their homework and come prepared when seeking to call on a payment obligation and determining the conditions to a contract's effectiveness.

This case confirmed that a letter of credit should be understood as an independent contractual agreement that is, at least legally speaking, completely separate and distinct from the underlying transaction. In practice, this means that Singapore law views the issuer's obligation to make payment under the letter of credit as autonomous and enforceable, even where there are irregularities in the underlying sale contract. This is consistent with both the SICC's and SGCA's narrow reading of the "Fraud Exemption," wherein both courts declined to apply the fraud exception on the grounds that PPT as beneficiary did not meet the threshold for fraudulent behaviour and that Zenrock, while fraudulent, was not itself party to the letter of credit. The result of this is that, even in cases where the underlying transaction has undoubtedly been tainted by fraud, and even in extreme cases such as this one where the transactions are deliberately constructed to defraud the issuer, the issuer may still be unable to rely on that fraud to avoid payments under the standalone letter of credit.[5]

[5] We note that recently in Winson Oil Trading Pte Ltd v. Oversea-Chinese Banking

In theory, an issuing bank could protect itself from such conduct by adding further conditions to the letter of credit that must be met in order to crystalise its payment obligation. Such conditions could include, for example, satisfactory evidence of or confirmation from the ultimate purchaser that the onward sales/purchase contract and price are genuine. This would allow the issuer to withhold payment under the letter of credit if these protective conditions are not met. In this circumstance, the issuing bank should rely on the conditions to refuse payment; if it makes a payment contrary to those conditions, it would not give the issuing bank a right to claim damages.

The condition suggested above will be greatly facilitated if prospective applicants would provide their consents for the issuing banks to engage directly with the ultimate purchaser. This could be further streamlined and less objectionable if both parties are customers of the issuing bank. However, we accept that it may not be possible for an issuing bank to build such protections into a documentary credit that is a low friction product from the beneficiary's perspective and that is honoured on presentation of identified documents at the bank's counters. This handicap is further exacerbated because the market for providing letters of credit to commodity traders is a highly competitive and fast-moving one with well-informed market participants.

The importance of letters of credit as the lifeblood of commerce and the accompanying principle of the autonomy of documentary credits are firmly entrenched. As evidenced by this case, courts are unlikely to roll this back for the protection of issuing banks given that even the extreme facts of this case were deemed insufficient to justify a revision of these principles.

The effect of this decision is that issuing banks remain exposed to the risk of sophisticated fraudsters who are able to recruit the participation of willing and/or unwitting beneficiaries to the letter of credit. Much will turn on the evidence in each case, especially where fraud is at issue, because it is notoriously difficult to prove in court.

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Corporation Limited [2024] SGCA 31, the Singapore Court of Appeal held that the fraud exception can also be established by "subjective recklessness" as to the existence of fraud. The Court of Appeal in Winson was careful to note that subjective reckless is a higher standard than negligence and is "only made out where there is an actual indifference to the risk of which the defendant is actually conscious." The Court of Appeal also provided some clarity in this area by also holding that "the law should "call a fraud a fraud" and the courts should apply a consistent approach in examining" fraud across "different types of financial instruments." Thus, while more lenient than the standard the SICC applied in Crédit Agricole Corporate & Investment Bank, Singapore Branch v. PPT Energy Trading Co Ltd [2022] SGHC(I) 1, it is nevertheless a difficult standard to meet in practice. It remains to be seen how this test will be applied going forward given the jurisprudential development in this area, and issuers should still be mindful of the high threshold needed to rely on the exception.

That being said, issuing banks can take some solace from the recent case of *Winson Oil Trading Pte Ltd v. Oversea-Chinese Banking Corporation Limited*,[6] which took a more favourable stance toward the issuing banks and from the self-help remedy of seeking an injunction to prevent payment under the letter of credit. Whilst it is a daunting step to take, an injunction creates the time needed to (i) investigate the circumstances surrounding the procurement of the letter of credit, the beneficiary's presentation of documents and the collection of evidence, and (ii) if supported by the evidence, to prosecute a case against the fraudsters to prevent payment altogether.

Further, although it is difficult to succeed on a case to establish fraud and vitiate obligations under a letter of credit, the facts established in running the fraud case could provide the court with helpful context when considering parallel claims on the letter of indemnity.

## DRAFTING LETTERS OF INDEMNITY IN THE ABSENCE OF A BILL OF LADING

### Marketable Title

The letter of indemnity is a key source of protection for issuers, who will often seek to rely on it in the absence of original bills of lading. The market view of such letters of indemnity is that they will make the bank whole for any losses it suffers by paying out on a letter of indemnity instead of paying on original bills of lading. The thinking goes that, in the absence of original bills of lading, the beneficiary, having delivered a letter of indemnity to the bank, is, from that moment on, obligated to indemnify the bank for all losses it suffers as a result of making payment against the letter of indemnity as opposed to original bills of lading.

However, this case proves that the position is significantly more nuanced and that, from a risk perspective, paying out against a letter of indemnity is not identical to paying out against original bills of lading.

The precise drafting of the letter of indemnity in question has a significant influence on the outcome. The decision in the *Re CACIB* case ultimately turned on the warranty of marketable title under the letter of indemnity.

The SGCA rejected the SICC's construction of the marketable title warranty as "adding nothing to the words '[title] free and clear of any lien or

[6] Winson Oil Trading Pte Ltd v. Oversea-Chinese Banking Corporation Limited [2023] SGHC 220.

encumbrance'"[7] and as simply meaning that the title may be transferred. Instead, the SGCA took the view that the words "marketable title" should "be given their own effect"[8] and "depend on the true facts,"[9] which should take into account the totality of circumstances. The SGCA included the following factors when concluding that PPT lacked a marketable title:[10]

(a) the failure of Zenrock to have acted in the ordinary course of business;

(b) PPT's failure to be a bona fide purchaser;

(c) the fact that there was a prima facie breach of warranty since the Cargo was not free of liens or encumbrances because the floating charges were crystallised before shipment (when title was argued to have passed);

(d) PPT had notice of the charges, since they were registered, although not necessarily of the terms of those charges;[11] and

(e) The uncertainty created by the absence of judicial precedent on the scope of the warranty of title "free and clear of any lien or encumbrance" makes it even more important that the warranty of "marketable title" is given a broader scope to include being free from hazard or litigation.

### Construction and Effectiveness

The SGCA also considered the construction and effectiveness of the letter of indemnity. Contrary to the SICC, the SGCA held that the letter of indemnity was "in its context effective from the moment of issue"[12] and not upon the payment under the letter of credit on its due date.[13] Further, the SGCA was not convinced that the letter of indemnity was a standalone contract. Instead, the

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[7] Crédit Agricole Corporate and Investment Bank, Singapore Branch v. PPT Energy Trading Co Ltd [2023] SGCA(I) 7, [59].

[8] Ibid., [60].

[9] Ibid., [65].

[10] Ibid., [68].

[11] The SGCA held at [68] that it is uncertain if the fact that PPT did not have notice of the exact terms of those charges mattered.

[12] Crédit Agricole Corporate and Investment Bank, Singapore Branch v. PPT Energy Trading Co Ltd [2023] SGCA(I) 7, [51].

[13] The SGCA at [55] argued that CACIB's obligation to pay was already to be found in the letter of credit as an obligation, not a condition, and it would therefore be strange to construe the equivalent obligation in the letter of indemnity as a condition.

SGCA found that the letter of indemnity and the letter of credit had been constructed to be inter-conditional and would hence need to be read together.

This position must be the correct one in our view. It is also reflective of the commercial expectations of issuing banks as recipients of letters of indemnity.

However, it is important to note that the SGCA's conclusion was based on the particular drafting of this letter of indemnity. The court noted that the prima facie position that a letter of indemnity is effective upon issue can be varied depending the drafting, so lenders should take care to ensure that the wording of any letter of indemnity is such that it cannot be construed as conditional upon payment under a letter of credit or the satisfaction of any other pre-conditions.

**Considerations for Users**

It is typical practice to rely on the presentation of the commercial invoice and letter of indemnity in lieu of an original bill of lading. Transaction parties (being both the indemnifiers and the indemnitees) must carefully consider the scope of the indemnities contained in the letter of indemnity and ensure that the specific events the indemnitee wishes to be indemnified for are drafted precisely.

Letters of indemnity should be drafted such that they are immediately effective upon issuance. Parties should avoid relying on broad terms of art like "marketable title," where there may be room for dispute and courts may differ in their interpretation, and include specific representations if possible (e.g., that the transaction in relation to which the indemnities are given is not part of a sale and repurchase transaction or a "round trip" transaction). Indemnitees should also be mindful that the granting of the indemnity is, at most, inter-conditional with the granting of the letter of credit itself and not conditional on the creditor first making payment under the letter of credit.

Issuing banks are faced with an uphill battle, because applicants typically provide the form for the letter of indemnity for adoption by the banks (often based on the template of the seller of the relevant cargo). Realistically, internal resourcing pressures and competitive pressures may well mean that issuing banks are not able to rewrite these letters of indemnity to fully suit all their requirements.

Finally, the letter of credit must be clear and unambiguous that payment is against "clean on board bills of lading" issued to the order of the financing bank or endorsed to its order or, if not available, the letter of indemnity, commercial invoice and other specified documents. This is because the court may follow the SGCA in looking to this to determine the proper context of the letter of indemnity.

## Calculating Damages

An important issue for lenders is the amount of the indemnity they can actually recover if they establish a breach of warranty. This goes to the extent of the protection afforded by any indemnity. A breach of an indemnity sounds in damages, and a letter of indemnity is thus only valuable protection to the extent the indemnifier has sufficient funds.

The letter of indemnity containing the warranty in this case was governed by English law. Under English law, the indemnity available for a breach of warranty is governed by the general principle of compensation for breach of contract, which is to put the claimant "into the same position, as far as money can do it, as [it] would have been in had the wrong not been committed."[14] In the context of a breach of warranty, the measure of compensation is therefore the difference between the claimant's position if the warranty had been true and the actual state of affairs.[15]

The Singapore Court of Appeal held that the relevant counterfactual for determining damages was what would have happened if the warranty as to the marketable title of the Cargo had been true. In that case, the court found that CACIB would have had unquestionable security over the receivable payable by the purchaser of the goods, TOTSA, in return for making payment under the letter of credit.[16] Notably, CACIB could not be compensated for the full amount of payment under the letter of credit, because, under the counterfactual, CACIB would have had to have entered into the letter of credit in order to obtain the indemnity in the first place. As the amount paid under the letter of credit was based on the fraudulently inflated price of the Doctored TOTSA Contract (which was greater than the actual value of the Cargo), the amount of damages CACIB could recover was therefore less than the amount of debt owed to it under the letter of credit. This left CACIB with a shortfall.

Whilst it is axiomatic that an issuing bank should be able to recover under the letter of indemnity to the full extent of the amount advanced under the letter of credit, this case shows that there may be unique factual situations where this may not be true. There can be types of fraud or mistake going to the value of the indemnified assets that can result in a situation where the lender's

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[14] Oversea-Chinese Banking Corporation Ltd v. ING Bank N.V. [2019] EWHC 676 at [33], citing McGregor on Damages (20th ed.) at [24-003].

[15] MDW Holdings Ltd v. Norvill and Others [2022] EWCA Civ 883 at [24]; Lion Nathan Ltd v. CC Bottlers Ltd [1997] 1 LRC 201 at 204-05.

[16] CACIB at [74].

obligation to pay under the letter of credit remains and the amount recoverable under the indemnity is less than the amount of debt incurred.

## CONCLUSION

The key takeaways from the decision for financiers that provide letters of credit and that rely on warranties and indemnities to protect their positions are:

- A financier's obligation to pay the seller under a letter of credit remains independent of matters affecting the underlying sale contract. Courts continue to construe the fraud exception to this rule narrowly, and it is a high bar to show that the seller was also involved in the purchaser's fraud in a way that would vitiate the payment obligation under the letter of credit. However, for added protection, the financier can consider drafting additional conditions of payment into the letter of credit itself.
- Although a letter of indemnity provided to protect a financier's payment under a letter of credit is generally effective upon issue, this is not an absolute rule and will depend on the drafting of both the letter of indemnity and the letter of credit. Financiers relying on warranties and indemnities should be careful to ensure these documents are drafted in a way so that the indemnity is immediately effective upon issue rather than being conditional upon the satisfaction of certain events.
- Whether a warranty for marketable title is breached depends on the totality of the circumstances. However, such totality of circumstances tests are inherently unpredictable in litigation, so it is preferable to also draft in warranties for specific events (such as inconsistent security interests and the assets being subject to potential litigation). Lenders should consider developing and using their own letters of indemnity that are specific to the needs of particular types of financing and adapting these to the risks of particular transactions. Using the letter of indemnity that is derived from the underlying sale contract between the seller/beneficiary of the letter of credit and the buyer (the customer of the issuing bank) exposes the bank to the risk on its terms when properly construed by a court. The indemnities may not work as the bank intended and may not be as protective as the bank needs it to be, because they are based on concepts that are more suited to the sale of goods rather than indemnifying the issuing bank against losses it might suffer from issuing the letter of credit.
- Another lesson is that an application for an injunction or subsequent

litigation against the beneficiary can offer the same relief. Serious thought should be given to joining the applicant (the customer of the issuing bank) to the action because of the opportunity it creates for exposing the fraud and the full extent of any collaboration between the beneficiary and the applicant of the letter of credit to defraud the issuing bank.

- Financiers should not assume that the amount of indemnity available will always cover the full extent of the debt under a letter of credit. Where there has been fraud or a mistake that goes to the value of the assets that are the subject of the indemnity, it can lead to situations where the value of the indemnity is less than the amount of debt and the financier is left with a shortfall (despite successfully claiming on the indemnity).