Banque de Commerce et de Placements SA, DIFC Branch and Another v China Aviation Oil (Singapore) Corporation Ltd and Others [2024] SGHC 145

Sham transactions and letters of credit in commodity sales

This is the most recent decision in a series of cases that have reached the Singapore courts involving banks seeking recovery of payments made under letter of credit transactions in commodity sales. This judgment - as in the string of judgments that preceded it - narrates the complex interplay between the carriage, sale and financing. It also elaborates on the additional risks that arise when string trades are executed on a back-to-back basis, and one party to the trade becomes insolvent.

The facts

Zenrock Commodities Trading Pte Ltd purchased 260,000 barrels of gasoil from China Aviation Oil (Singapore) Corporation Ltd (CAO) on FOB Melaka terms (the CAO-Zenrock sale). The CAO-Zenrock sale was itself an on-sale concluded on back-to-back terms following CAO's purchase of the cargo from Shandong Energy International (Singapore) Pte Ltd (SEIS) (the CAO-SEIS sale). Banque de Commerce et de Placements (BCP) financed the CAO-Zenrock sale by issuing a letter of credit, naming CAO as beneficiary.

CAO handled various operational aspects of the physical shipment of the goods including: (i) the appointment of independent cargo surveyors at the load port; and (ii) the supervision of the loading of the goods on to the vessel Petrolimex 18. When the loading was complete, non-negotiable bills of lading were emailed to CAO, naming Petco Trading Labuan Co as the shipper and specifying Natixis, Singapore branch as the party to whom the bills were made out. It was found out that SEIS had not provided CAO with the full set of original bills of lading. Notwithstanding this, CAO believed that SEIS had sold and transferred title in the goods to CAO.

Upon completion of the sale CAO presented a letter of indemnity (the CAO LOI) and an invoice (the CAO Invoice) to UBS Switzerland AG, the confirming bank. The presentation was consistent with the terms of the letter of credit, which permitted payment upon presentation of the CAO Invoice and the CAO LOI, provided the original bills of lading (intended for BCP) were not available at the time of presentation. UBS proceeded to pay CAO under the letter of credit, and BCP subsequently reimbursed UBS for the payment made.

BCP financed the CAO-Zenrock sale on the basis of Zenrock's representation that the goods would be on-sold to PetroChina International (East China) Co Ltd. As such, BCP anticipated that its liability under the letter of credit would be secured by an assignment of the receivables owed to Zenrock from the sale to PetroChina (the Zenrock-PetroChina sale). Therefore, BCP communicated with PetroChina requesting payment. However, PetroChina informed BCP that the Zenrock-PetroChina sale had been "cancelled", and that PetroChina was under "no obligation to make payment". BCP was also presented with a "Tripartite Agreement" between Zenrock, PetroChina and a third party, which was purported to relieve PetroChina of responsibility, if it did not, among other things, receive the goods from Zenrock.

During the insolvency proceedings following Zenrock's liquidation, BCP discovered that: (i) the CAO-Zenrock sale was allegedly a sham transaction; and (ii) CAO allegedly did not sell or deliver the goods to Zenrock. Instead, the goods loaded on Petrolimex 18 had been purchased by Zenrock from Petco, and then on-sold to Petrolimex Singapore Pte Ltd.

The arguments

BCP claimed that the CAO-Zenrock sale was a sham transaction because CAO did not physically deliver the goods to Zenrock and ought to have known that SEIS did not deliver the goods to Zenrock. Consequently, it sought to recover its loss from CAO, which was the amount paid under the letter of credit. CAO had brought third-party proceedings against SEIS should BCP be successful in its claim against CAO.

BCP argued that CAO ought to have known that SEIS did not deliver the goods for the following reasons: (i) there was no communication about the specific vessel that would be used for delivery between CAO and Zenrock; (ii) there was no correspondence between Zenrock, CAO and SEIS regarding key operational matters; and (iii) CAO failed to take steps to mitigate its risks and liabilities.

CAO contended that the CAO-Zenrock sale was genuine because: (i) the documents demonstrated that CAO genuinely believed they were entering into valid contracts; (ii) BCP's reliance on the judicial managers reports was not a reliable

approach to determine whether the CAO-Zenrock sale contract was a sham; and (iii) CAO undertook a suit of risk management measures in relation to the CAO-Zenrock and CAO-SEIS contracts.

The judgment

In general legal principles, if a contract is documented in writing, there is a presumption that the parties intended to create the legal relations that those documents purport to create.1 A sham contract refers to a situation where the parties have a common intention to not create legal rights and obligations which they give the appearance of creating.2 On this basis, the court held that the CAO-Zenrock contract was not a sham for the following reasons:

First, CAO clearly intended to enter into genuine contracts, including the CAO-Zenrock contract. This was evidenced by CAO's risk management measures which aimed to mitigate the risk of engaging in illicit transactions by, among other things, requiring transaction details to be entered into and verified against CAO's internal transaction system. CAO had conducted due diligence prior to commencing negotiations with the counterparties to the transactions.

Secondly, the fact that CAO did not inquire about the specific vessel involved in the delivery could not be interpreted as evidence of a sham transaction. Given that these were pre-structured, back-to-back deals, the trader's primary focus would be on assessing the risk and reward of the transaction and ensuring it aligns with the organisation's operational mandate. The trader would not immediately concern themselves with vessel-related details, which could be handled by the logistics operators.

Thirdly, it is standard practice that a shipping agent primarily communicates for the shipowner or charterer with the load port terminal. This role does not typically extend to intermediate parties in back-to-back transactions. Since CAO was an intermediate party, there was no requirement for direct communication with the loadport or terminal owner. Moreover, Zenrock was a trusted trading partner, responsible for setting the terms and managing logistics for all parties involved in the chain.

Lastly, the reliability of the judicial managers' reports in assessing whether the CAO-Zenrock sale was a sham was questionable for two reasons: (i) the reports included a comprehensive disclaimer, stating that the information provided did not represent an audit; and (ii) BCP acknowledged that it was unaware of the specific information or records that were utilised to compile the reports, and did not request a detailed list of such information or records.

The fraud exception to payments under letters of credit

BCP claimed that CAO misrepresented the facts in the CAO LOI by asserting that bills of lading were made out to BCP which, according to BCP, constituted a fraudulent presentation, entitling it to recover payment. BCP also contended that it was irrelevant that the documents were submitted solely to UBS (the confirming bank) rather than directly to BCP (the issuing bank).

The court defined the fraud exception in letters of credit transactions - being an exception to the principle of autonomy of letters of credits - as applicable when a beneficiary fraudulently presents documents to the bank that contain material misrepresentations known by the beneficiary to be untrue, with the intent of drawing on the letter of credit.3 It was held that three elements must be proved to invoke the fraud exception: (i) the beneficiary must have made a material false representation; (ii) the beneficiary must have known that the representation was false or did not have an honest belief that it was true; and (iii) the bank must have acted upon reliance on the representation, resulting in a loss for the bank.4

The court did not agree that BCP could invoke the fraud exception. Two reasons were highlighted. First, CAO did not knowingly make a false representation to BCP. CAO had attended to various operational aspects of the CAO-Zenrock sale, including the appointment of independent cargo surveyors at the loading port and monitoring the loading of the cargo onto the vessel. Secondly, the fraud exception requires the misrepresentation to be made by the beneficiary (in this case, CAO) to the claimant (in this case, BCP).5 However, in this case the documents were presented by CAO to UBS, the confirming bank. BCP could have relied on the fraud exception to refuse reimbursement to or recover payment from UBS, but not from CAO.

Whether CAO was liable in deceit or for false misrepresentation to BCP

BCP argued that CAO had made the following representations: (i) that the full set of bills of lading signed or endorsed to BCP existed; (ii) that CAO was entitled to possession of the documents which included the bills of lading; (iii) that CAO was

(immediately prior to the goods coming into Zenrock's possession) entitled to possession of the goods; (iv) that CAO had (immediately before title passed to Zenrock) good title to the goods; and (v) that the title in the goods had passed to Zenrock free from liens and encumbrances.

The court reaffirmed that the elements that must be satisfied for a misrepresentation to be actionable,6 which are:

(i) a representation must have been made by one party;

(ii) the representation was acted on by an innocent party; and

(iii) the innocent party suffered detriment as a result.

Further, to prove deceit, the representation must be made with the knowledge that it is false.7

The court's ruling in this matter was that CAO was not culpable for deceit or false misrepresentation. The court determined that BCP's interpretation of the CAO LOI was a literal interpretation of the phrase "we hereby represent and warrant the existence, ... of the documents" within the CAO LOI. In contrast, the court favoured CAO's purposive interpretation of the phrase which meant that the bills of lading had been issued but had not yet been endorsed to BCP at the time of the presentation. The court concluded that this interpretation aligns with the commercial objective of enabling CAO to use an LOI as an alternative means to secure payment. This interpretation is also consistent with the broader context of other related documents, such as the letter of credit and the CAO-Zenrock contract.

Upon a proper construction of the CAO LOI, BCP's argument that CAO had not possessed the documents was seen as invalid. CAO was clearly entitled to the bills of lading pursuant to (amongst others) the CAO-SEIS contract. Given the court's ruling that the CAO-Zenrock contract was not a sham, it follows that CAO was entitled to possession of the goods immediately prior to the goods coming into Zenrock's possession; CAO had (immediately before title passed to Zenrock) good title to the goods; and that title in the goods had passed to Zenrock free from liens and encumbrances.

Comment

This judgment highlights the real-world issues that arise in prompt deals struck on a back-to-back basis where the commercial reality is that any risk of any performance issues can be passed through to the next party. In the documentary sales context, this issue is particularly relevant to banks when considering the management of risk. The decision reaffirms earlier local decisions acknowledging the validity and legitimacy of circular trades even if physical delivery of goods was not contemplated (in contrast with those where no trading was contemplated at all).

Clive Navin Selvapandian, Advocate & Solicitor (High Court of Malaya), Messrs Christopher & Lee Ong.

1 Southernpec (Singapore) Pte Ltd v Goodwood Associates Pte Ltd [2020] SGHC 242 at para 114.

2 Crédit Agricole Corporate and Investment Bank, Singapore Branch v PPT Energy Trading Co Ltd [2023] Lloyd's Rep Plus 25 at para 120.

3 Crédit Agricole Corporate and Investment Bank, Singapore Branch v PPT Energy Trading Co Ltd and Another Appeal [2024] Lloyd's Rep Plus 8 at para 20; UniCredit Bank AG v Glencore Singapore Pte Ltd [2023] 2 SLR 587 at paras 16, 44 and 48.

4 The court made reference to Nelson Enonchong, The Independence Principle of Letters of Credit and Demand Guarantees (Oxford University Press, 2011) at para 5.12.

5 UniCredit Bank AG v Glencore Singapore Pte Ltd [2023] 2 SLR 587 at para 47.

6 Rahmatullah s/o Oli Mohamed v Rohayaton bte Rohani [2002] SGHC 222 at para 73.

7 Panatron Pte Ltd v Lee Cheow Lee [2001] 2 SLR(R) 435 at para 14.