Sanction Clauses: Know Your Red Flags

We draw your attention to a significant legal development stemming from the recent decision by Singapore's highest court in the case of Kuvera Resources Pte Ltd v JPMorgan Chase Bank, N.A. [2013] SGCA 28, which examined the validity of sanctions clauses under Singapore law. The court's ruling provides valuable insights into compliance considerations within the context of letters of credit and raises significant take-aways.

Brief Facts:

The case involved a contract for coal sale between an Indonesian seller and a UAE buyer, with Kuvera Resources Pte Ltd as the beneficiary of two letters of credit issued by a Dubai bank. The letters of credit included a sanctions clause obligating the bank to comply with relevant U.S. laws and regulations. The bank, acting on an internal list, refused payment due to concerns about potential violations of U.S. sanctions.

Key Compliance Lessons:

1. Strict and Objective Construction: Not all 'red flags' can discharge contractual burdens. The court emphasized a strict and objective interpretation of sanctions clauses, holding that a bank's concerns about potential adverse findings by regulatory bodies are insufficient grounds to excuse non-payment on an otherwise compliant presentation. The clause only allows payment refusal if the involved entity is explicitly listed in applicable restrictions. The court rejected a subjective approach and insisted on an objective determination of whether the vessel was subject to applicable restrictions. The mere concern of a regulatory violation, without objective evidence, does not justify non-payment.

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2. Enforceability of Sanctions Clauses: The decision questioned the enforceability of sanctions clauses within the commercial purpose of letters of credit. The court expressed doubts about the compatibility of such clauses, especially in situations involving the nomination of a vessel, where the beneficiary lacks knowledge at the time of contracting.

Challenges and Implications:

1. Lack of Clarity in Sanctions Clauses: The ruling underscores the need for clear and specific language in sanctions clauses. Internal assessments or correspondence with regulatory bodies should be explicitly addressed in the clause to provide the necessary discretion for those seeking to rely on it.

2. Balancing Discretion and Compatibility: While discretion is crucial, an excessive grant of discretion in sanctions clauses may render them incompatible with the commercial purpose of letters of credit, potentially impacting their enforceability. 3. Shift in Transaction Dynamics: Parties involved in such transactions may need to reconsider and negotiate the terms of sanctions clauses, possibly involving relevant parties (such as sellers/beneficiaries) to ensure mutual agreement and understanding.

Conclusion:

There is a clear line between actionable red flags which discharge contractual burdens and those which do not.

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