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Standby Letter of Credit

Fraud, criminal proceedings and suspension of civil proceedings

Par Marie de Gottrau le 17 May 2022

In a ruling 4A_66/2022 of March 25 concerning a standby letter of credit, the Swiss Federal Supreme Court ruled that the existence of criminal proceedings potentially directed against the standby beneficiary justified a stay of the civil proceedings aimed at determining the merits of the standby claim.

A bank was mandated to issue several standby letters of credit (“LCS”) in favor of a long-standing customer, the purpose being to guarantee the beneficiary payment by C (“C”) of the agreed price for coal deliveries. The beneficiary called in two LCS for a total amount of USD 8,750,000 on the grounds that C had not paid him the price due for two coal deliveries. The bank refused to pay the beneficiary, arguing in particular that the underlying contracts on the basis of which the LCS had been issued were devoid of any materiality and had been entered into solely to pass on to the bank the risk of C’s insolvency. The bank also filed a criminal complaint against unknown persons for fraud and forgery of documents.

The issue at stake in this ruling is to determine whether the civil case initiated by the beneficiary was rightly suspended pending the outcome of the criminal proceedings. The High Court’s reasoning here boils down to examining whether the cantonal decision (which is a provisional measure within the meaning of art. 126 al. 1 CPC) violates a constitutional right of the appellant beneficiary (art. 98 LTF), namely the principles of the prohibition of arbitrariness and expeditiousness (arts. 9 and 29 al. 1 Cst).

The Federal Court first recalls that a standby letter of credit is a security instrument which has the characteristics of a letter of credit, but which has a guarantee function : the bank, on behalf of a customer (the principal), undertakes to pay a third party (the beneficiary) a specified sum of money if the latter presents certain documents agreed in advance establishing that the principal is in default vis-à-vis the beneficiary.

While the beneficiary argued that the principle of expeditiousness required that the civil proceedings should not be suspended pending completion of the criminal proceedings, our High Court agreed with the cantonal judges that the civil proceedings should be suspended since the beneficiary’s involvement in the criminal proceedings could not be ruled out. In order to avoid contradictory judgements, the question of whether the bank was right to refuse to pay the beneficiary under the LCS should not be judged immediately. It is first necessary to know the outcome of the criminal proceedings, which should give the civil judge valuable indications

concerning the beneficiary's involvement in the fraud perpetrated against the bank, so that the suspension of the civil proceedings is justified.

Since it is limited to the question of whether the suspension of the civil proceedings pending the outcome of the criminal proceedings is arbitrary or violates the principle of expeditiousness, this judgment leaves much to be desired.

It would have been interesting to know whether the beneficiary's potential involvement in a fraud against the bank (or fraud, as the LCS is governed by English law) legitimately allowed the bank to refuse payment of the LCS or to invalidate it.

In principle, the power of the bank issuing a L/C or standby letter of credit to refuse payment to the beneficiary on the grounds of fraud is very limited. According to the established case law of the Swiss Federal Supreme Court, only particularly serious circumstances are relevant ; fraud occurs when the beneficiary knows or should know that he has no present or future claim against the principal (ATF 131 III 222), or when it is obvious that the basic claim is unlawful or immoral (ATF 130 III 462). Since one of the purposes of a letter of credit is to protect the beneficiary against the risk of insolvency of his co-contractor, the unlawful or immoral nature of the claim must be evident from immediately available evidence (ATF 131 III 222).

In the present case, it cannot be ruled out that the beneficiary and C, acting in collusion, presented the bank with fictitious documents establishing a sales contract between them, and then simulated a breach by C of his contractual obligations in order to obtain payment of the LCS. However, it is not clear whether the bank had sufficient evidence of the beneficiary's fraud at the time the beneficiary invoked the LCS. Since the bank refused payment to the beneficiary in any case, the only relevant question is whether or not the LCS claim was well-founded in view of the underlying relationship.

In our opinion, insofar as the bank claims to have been deceived by the parties to the underlying contract, since the LCS are intended to guarantee the performance of a fictitious underlying contract, it could also have declared the LCS issued invalid on the basis of a fundamental error (art. 24 para. 1 CO) or fraud (art. 28 CO) on the part of the beneficiary. It could have argued that it would never have issued the disputed LCS had it known of the beneficiary's allegedly fraudulent intentions.

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