

32 Misc. 3d 1232(A), *, 936 N.Y.S.2d 58, **;
2010 N.Y. Misc. LEXIS 6658, ***; 2010 NY Slip Op 52415(U)

Fortis Bank (Nederland) N.V., Plaintiff, against Abu Dhabi Islamic Bank, Defendant.

601948/09

SUPREME COURT OF NEW YORK, NEW YORK COUNTY

32 Misc. 3d 1232(A); 936 N.Y.S.2d 58; 2010 N.Y. Misc. LEXIS 6658; 2010 NY Slip Op 52415(U)

August 25, 2010, Decided

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PUBLISHED IN TABLE FORMAT IN THE NEW YORK SUPPLEMENT.

CORE TERMS: letter of credit, beneficiary, declaration, confirmation, issuing, structured, synthetic, underlying transaction, reimburse, presentation, genuine, liquidity, documentation, confirming, finance, fraudulent, financing, banking, sale of goods, counter, issuer, reimbursement, discounted, port, negotiating, purchaser, shipment, indicia, confirmed, discount

HEADNOTES

[**58] [*1232A] Banks and Banking--Letter of Credit--Fraud in Underlying Transaction.

JUDGES: [***1] Melvin L. Schweitzer, J. S. C.

OPINION BY: Melvin L. Schweitzer

OPINION

Melvin L. Schweitzer, J.

Plaintiff moves for summary judgment in this action pursuant to *CPLR 3212*. Defendant moves to compel the production of documents from plaintiff pursuant to *CPLR 3124*.

Background

This action for breach of contract is brought by Fortis Bank (Nederland) N.V. (Fortis), an international provider of banking and insurance services incorporated in the Netherlands, against Abu Dhabi Islamic Bank (ADIB), a bank established in the United Arab Emirates. The action is set against the backdrop of a series of financial transactions pertaining to an approximately \$40 million letter of credit. On June 16, 2008, Bank Awal (Awal), a bank established in the Kingdom of Bahrain,

issued a Letter of Credit (Letter of Credit) in favor of the beneficiary, Bunge S.A. (Bunge), a large European commodities trading company based in Switzerland, purportedly to facilitate the sale of Brazilian soybeans and maize.¹ This transaction was alleged to have been entered into by Awal upon the application of the financial arm of its parent holding company, Al Gosaibi Trading and Services Co. (ATS).

1 The transactions revolving around this particular letter [***2] of credit are singular enough to warrant an overview of the roles of the parties in a standard letter of credit transaction. To begin, an applicant requests a letter of credit from an issuing bank for the beneficiary in order to support a commercial or financial transaction. The issuing bank then issues the letter of credit, which may provide for an arrangement involving a confirming or negotiating bank. Fortis acted as the negotiating bank in this transaction. The role of the negotiating bank is to pay the beneficiary, sometimes early and at a discount, so that the beneficiary does not have to wait for payment by the issuing bank pursuant to the terms of the letter of credit. An additional or second confirming bank may be a party to the transaction. In this case, ADIB at various times, has been referred to as an advising bank and a confirming bank. ADIB's role in this transaction was that of a confirming bank, which assumes the risk of the issuing bank and agrees to honor a conforming presentation of documents.

Under the terms of the Letter of Credit arrangement, Fortis, acting as the negotiating bank (*see* n 1, *supra*), was entitled to reimbursement from Awal 360 days after it negotiated [***3] documents required under the Letter of Credit and paid Bunge, the beneficiary. Awal was obligated to reimburse Fortis on that date, contingent upon its receipt from Fortis of confirmation that documents had been presented by Bunge "in conformity with

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the L/C terms at their [Fortis'] counter and have been forwarded to the issuing bank [Awal]...."

On June 16, 2008 by SWIFT message, AWAL requested that ADIB add its confirmation to the Letter of Credit. On June 14, 2008 by SWIFT message to Fortis, ADIB, in exchange for a fee of \$499,999.96 from Awal, did add its confirmation to the Letter of Credit, thus also obligating it to reimburse Fortis. This confirmation references any ports in Taiwan or Spain as the place of final destination or delivery of the commodities to be shipped.²

2 The record before the court contains references in the Declaration of Vincent O'Brien to Maicerias Espariolas, S.B. (Dasca), a Spanish company, and in the Declaration of Ms. Delphenie Chen to certain Taiwanese companies. According to the Declarations, these companies are the purchasers of the soybeans and maize sold by Bunge.

The Letter of Credit confirmation arrangement is governed by the Uniform Customs and Practice [***4] for Documentary Credits ("UCP"), rather than the Uniform Commercial Code ("UCC"). The UCP does not have the force of law, but is binding if the terms of a letter of credit explicitly incorporate its provisions.³

3 The parties here stipulated that the UCP would control this Letter of Credit. Although the UCP does not deal with the question of fraud in a letter of credit transaction, the New York UCC prohibits honoring facially conforming documents in a fraudulent transaction, even if the letter of credit is governed by the UCP. *See Brenntag Intern. Chemicals, Inc. v Norddeutsche Landesbank GZ*, 70 F Supp 2d 399, 407-08 (SDNY 1999). *See also E & H Partners v Broadway Nat. Bank*, 39 F Supp 2d 275, 285 (SDNY 1998).

In June 2008, Fortis received the documentation required under the Letter of Credit and sent a SWIFT message to ADIB on June 23, 2008 informing ADIB that it, in fact, had negotiated "credit complying" documents and that, in accordance with the terms of the Letter of Credit, it would be sending these documents directly to Awal, the issuing bank. Fortis asked ADIB for confirmation that it would reimburse Fortis 360 days later, on June 15, 2009. In its SWIFT message, Fortis stated that [***5] "in due course we shall claim reimbursement from you for this amount with value date 15.06.2009." ADIB replied on June 24, 2008, acknowledging its obligation under its confirmation of the Letter of Credit and stating it would reimburse Fortis on that date. On July 2, 2008, Awal confirmed to ADIB that it had received and ac-

cepted the documents sent to it by Fortis and confirmed the maturity date of the Letter of Credit. Awal's SWIFT message to ADIB also said that Awal had instructed its bank in New York, HSBC, to honor ADIB's reimbursement claim on the maturity date.

The following year, on June 4, 2009, Fortis demanded reimbursement from ADIB under the confirmation arrangement, but ADIB did not reimburse Fortis. Consequently, Fortis has brought the present action to compel ADIB to make payment under its confirmation obligation.

On June 14, 2009, one day before the June 15 maturity date for the reimbursement, ADIB went to court in the Kingdom of Bahrain and obtained an *ex parte* injunction against its paying Fortis on the confirmation. ADIB alleges that it sought this injunction because it had been informed that agents of Awal's Saudi holding company, the Saad Group, were involved in fraud [***6] concerning forged signatures on financial facilities enabling the Saad Group to raise capital. Reports had appeared in the press that the Saad Group was in financial difficulty, had defaulted on its obligations and had its accounts frozen. The reports also referenced irregularities in trade finance transactions within ATS. In the Bahraini court, ADIB alleged that the sale of goods underlying the Letter of Credit never took place and was merely an arrangement to finance ATS. ADIB demanded that Fortis supply them with copies of the "credit complying" documentation it had negotiated and sent to Awal. Fortis responded that nothing in the confirmation transaction, as structured, and which ADIB had negotiated, entitled ADIB to presentation of such documents as a condition to its obligation to reimburse Fortis.

Fortis, in connection with this action, sought an order of attachment from this Court, in order to establish *quasi in rem* jurisdiction over ADIB. The Court granted Fortis' application for the order of attachment on September 25, 2009 on the basis of ADIB's contacts with New York, which consisted of New York bank accounts with Citibank, JP Morgan Chase, and Bank of America, ADIB's receipt [***7] of its \$499,999.96 fee in the JP Morgan Chase account, and ADIB's demand to be paid \$39,999,996.52 on the Letter of Credit from Awal's bank in New York, HSBC. *Fortis Bank (Nederland) N.V. v Abu Dhabi Islamic Bank*, 9/25/09.

On December 14, 2009, the High Civil Court of Bahrain rejected ADIB's case against Fortis and also AWAL and ATS. The injunction that ADIB had received enjoining its payment to Fortis was lifted the same day.

ADIB now alleges here that the Letter of Credit was a so-called "synthetic," or "structured," letter of credit which had no nexus to the trade or commercial transaction referred to therein. To support this assertion, ADIB

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submitted a Declaration of Pottengal Mukundan, a Director of the International Maritime Bureau (IMB), a division of the International Chamber of Commerce. According to his Declaration, IMB investigates fraud and malpractice in shipping and trading for banks, shipping companies and charterers. Mr. Mukundan was asked by counsel for ADIB to review the documentation issued in connection with, and circumstances surrounding, the Letter of Credit for indicia of fraud. He was also asked whether the circumstances suggested "the Letter of Credit was not [***8] used to facilitate the trade transaction for which ADIB supplied its confirmation." Mr. Mukundan's Declaration sets forth a litany of what he characterizes as aberrations in the transaction, which he says raise serious concerns regarding the legitimacy of the Letter of Credit as a means of payment for the goods shipped. Of particular significance to Mr. Mukundan is that Dasca, one of the ultimate purchasers in Spain [*see* n 2, *supra*], paid Bunge Iberia, S.A. directly for the purchase of 30,000 Metric Tons of maize, thus obviating the need to draw on the Letter of Credit to secure payment for that particular shipment. Mr. Mukundan's investigation also revealed that the payment was made two weeks before the maize had arrived in Spain and before the Letter of Credit was first confirmed.

In further support of its assertion that this Letter of Credit had no nexus to the transaction referred to therein, ADIB also submitted to the court a Declaration of Vincent O'Brien, a trade finance specialist also experienced in international banking operations. Counsel for ADIB asked Mr. O'Brien whether the Letter of Credit was used to facilitate the sale of goods by Bunge to ATS as specified in the Letter [***9] of Credit. Notably, Mr. O'Brien was not asked whether the transaction evidenced indicia of fraud.

Mr. O'Brien set out his view of the "purpose and construction of a typical letter of credit" in *Letter of Credit*, 14750(A)1a11edaMB "nhyi6(e)-16(o)-5(f)8 thns osfviatina

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the funds for their ongoing business, the funds are typically sent directly to the issuing bank, which is the liquidity raising'.

(iv) By using short term designated trade credit lines, which carry a lower risk due to the lower risk nature of genuine trade deals, it makes it much easier and simpler for issuing banks to raise liquidity using this synthetic scheme dressed up as normal trade finance. These schemes which can provide access to liquid cash resources are obviously very attractive to banks that may be experiencing difficulty in raising general lines of credit such as Awal Bank.

(v) Under this scheme, the benefit that accrues to the beneficiary, such as Bunge, is that they are able to generate a pool of liquidity at very attractive rates. This pool of liquidity is then lent to an issuing bank located in an emerging market, such as Awal Bank, at significantly higher rates than the cost of raising the pool of liquidity in the first instance. The bank that provides the confirmation and discounts the draft, such as Fortis, benefits from charging its confirmation fee and additionally profits from the margin on the cost of the funds provided [***13] when discounting the accepted draft.

Mr. O'Brien's Declaration does not state, however, that he observed indicia of fraud in the transaction.

To further support Mr. O'Brien's conclusions for the court, ADIB's counsel contacted a Taiwanese attorney to make inquiries of certain companies in Taiwan who were listed as notify parties on the bills of lading associated with other sales of commodities to Taiwan related to the Letter of Credit. These bills of lading were provided to

Discussion

Under *CPLR 3212(b)*, summary judgment shall be granted if, upon all the papers and proof submitted, the cause of action or defense shall be established sufficiently to warrant the court as a matter of law in directing judgment in favor of any party.

In order to grant summary judgment, a court must find that there are no genuine issues of material fact, that the movant has established his cause of action or defense sufficiently to warrant judgment in his favor, and that the proof provided is in an admissible form. *Menekou v Crean*, 222 AD2d 418, 419-420, 634 N.Y.S.2d 532 (2d Dept 1995). If the movant, Fortis here, sufficiently shows there are no genuine issues of material fact, the burden

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Park alleged that [***21] the Army had defrauded them by delaying presentation of documentation on the letters of credit until it appeared that the purchaser would be unable to pay for the goods. National City then paid itself out of the stock that Asbury Park had given to them as security.

In *Asbury Park*, the court decided this did not constitute fraud at all. The court reaffirmed the principle of independence in letter of credit transactions and held it dictated that there was a distinction between the letter of credit there at issue and the underlying transaction, particularly in a case where the plaintiff could have protected itself "by requiring ample security from [the purchaser], or by requiring bills of lading or other documents of title to be presented . . ." *Id.* at 989.

Here, Fortis contends ADIB is in exactly the same situation, having failed to adequately secure itself against an Awal bankruptcy and by expressly confirming a Letter of Credit in such a fashion that did not grant them the right to inspect full documentation. ADIB, in turn, counters that *Asbury Park* is distinguishable and should not provide any guidance in this case. It argues that *Asbury Park* did not overturn *Sztejn* and explicitly [***22] recognized that adequately proven allegations of fraud are a defense against payment.

ADIB's argument for distinguishing *Asbury Park* is its contention that it already has shown fraud in the very structure of the transaction. But here, ADIB was *aware* of the structure of the transaction prior to adding its confirmation to the Letter of Credit. Beyond ADIB's knowledge of the transaction's structure, it is still far from certain that ADIB has shown any indicia of fraud in the transaction. On the facts presented to the court, this case involves a financing transaction for the benefit of ATS. The fact that it was "structured" as a trade financing, while perhaps unusual, is not by itself a fraudulent or illegal scheme. Additionally, the case here is closer to *Asbury Park* than it is to *Sztejn*. Part of the court's decision in *Asbury Park* was to the effect that letters of credit could be used by individual parties in ways that the other parties in the transaction did not intend or anticipate, provided that the use is consistent with the language of the letter of credit itself. ADIB chose, as did the plaintiffs in *Asbury Park*, not to require adequate security or stricter documentation rights from [***23] the issuing bank. The fraud that ADIB alleges against Awal cannot be extended to Fortis simply because Fortis explicitly chose not to accept the same sort of risk regarding inspection of the documentation that ADIB did, and thus required presentation of the documents to Fortis.

Although *Sztejn* is an influential case which has been cited in countless letter of credit fraud cases in the United States and around the world, ADIB has directed

the court's attention to several federal and international cases that it believes should guide the court's thinking. The case most directly analogous to the facts of the case here is a British decision, *Banco Santander SA v Banque Paribas*, 2000 WL 191098 (Eng. Ct of App, Civ Div, Feb. 25, 2000). In *Banco Santander*, the court ruled that a bank which discounts a letter of credit by paying prior to the date of maturity is not entitled to protection against assertion of the fraud rule if there was fraud subsequently discovered in the underlying transaction. This is true even if the discounting bank was unaware of the fraud when it discounted the letter of credit. Again, ADIB believes it has shown fraud that puts Fortis in an even more exposed position than [***24] *Banco Santander*. It argues that *Banco Santander* was not made aware of the fraud until after the discount, while Fortis knew about the allegedly fraudulent transaction from the inception.

Fortis counters that ADIB is in error when it cites to *Banco Santander*. According to Fortis, when *Banco Santander* was decided it was at odds with generally accepted banking practices. Fortis also claims the case is no longer good law. It was decided in 2000 under the UCP 500. Revisions to the UCP, promulgated in 2007 as UCP 600, amended article 12 of the UCP. "In reaction to the Santander decision, UCP 600 Article 12(b) deems the nomination of a bank to accept a time draft or to incur a deferred payment obligation to include authorization either to prepay or to purchase the time draft that the nominated bank accepted or the deferred payment obligation that the nominated bank incurred. This implied authorization would estop the issuer, a confirmer, and the applicant from asserting a material letter-of-credit fraud defense against the obligation to reimburse the nominated bank, provided that the bank relied upon the authorization in acquiring its own obligation in good faith and without notice of material [***25] fraud." Richard F. Dole, *The Effect of UCP 600 Upon U.C.C. Article 5*, 54 *Wayne L Rev* 735, 785 (2008).

The court is of the view that ADIB's reliance on *Banco Santander* is misplaced. Even if *Banco Santander* were good law, its value to the court does not rise above mere suggestion. The logic of *Banco Santander* is a path that the court might have chosen to follow (assuming, of course, that there was a fraud of which Fortis was unaware at the time it discounted the Letter of Credit) in the absence of the UCP 600 revisions. Because of such revisions, however, the case has no binding authority. The logic in *Banco Santander* thus is essentially irrelevant here. Even if the court were to believe that *Banco Santander* were correctly decided, the UCP 600 revisions would prevail in this case.

Proof of Fraud

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Even without ADIB's prior knowledge of the structure of the Letter of Credit, it does not seem fraud was involved in the underlying transaction. Turning to ADIB's primary "evidence" of fraud, that is, Ms. Chen's declaration, the court gives it little consideration, if it is to be considered at all. Ms. Chen's declaration fits the black-letter definition of hearsay and is compounded by several additional [***26] layers of hearsay.

Had Ms. Chen's declaration been in admissible form it still would not be a particularly compelling piece of evidence. The declaration reports information of which Ms. Chen simply has no personal knowledge. Ms. Chen merely repeats information she has gleaned from her informal inquiries. Affidavits made without personal knowledge have virtually no probative value. *Roche v Hearst Corp.*, 72 AD2d 245, 249, 424 N.Y.S.2d 930 (3d Dept 1980).

Beyond admissibility and probative value, the fraud that allegedly permeated the underlying transaction here is not as obvious from Ms. Chen's declaration as ADIB seems to think it is. It appears the "synthetic" or "structured" Letter of Credit used in this case may be something of a novel and unusual device in trade finance. It differs from traditional notions of how a letter of credit

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the structure of the transaction before undertaking its own reimbursement obligation. The burden has thus shifted from Fortis to ADIB. ADIB has not met the burden of demonstrating a genuine issue of material fact. The proof ADIB offers of a material question, Ms. Chen's declaration, is not in an admissible form, and is inconsequential as well.

Accordingly, defendant's motion to compel discovery is denied, and plaintiff's motion for summary judgment is granted.

Settle Order.

Dated: August 25, 2010

ENTER:

/s/ Melvin L. Schweitzer

J. S. C

