The threshold of proving fraud for deterring payment under a Letter of Credit – Recent cases and practical tips

Insights, 24 March 2026

INTRODUCTION

- Letters of credit ("**LC**") and standby letters of credit ("**SBLC**") are essential instruments used in international trade and project financing and have been said to be the "lifeblood of international commerce"[1].

- Given their nature, there are very limited grounds on which the payment obligations in these instruments can be resisted. We will now share two developments in these areas.

WINSON OIL TRADING PTE LTD V OVERSEA-CHINESE BANKING CORPORATION LTD: FRAUD EXCEPTION APPLIES TO LCS IF BENEFICIARY IS RECKLESS IN PRESENTING DOCUMENTS FOR PAYMENT

This case concerned a dispute between a beneficiary (**Winson**) of the LCs and the issuing banks in relation to circular trades of gas oil.

The trade featured two shipments of gas oil sold by Hin Leong Trading (Pte) Ltd with the price increasing with each sale. The chain of the trade was as follows: Hin Leong to Trafigura, Trafigura to Winson, Winson to Hin Leong. The dispute centered on the last leg of this circular trade.

Hin Leong had applied to SCB and OCBC, the issuing banks, for letters of credit in favour of Winson. Subsequently, Winson made presentations to the banks under letters of indemnity (**LOI**'s). These presentations included the copy non-negotiable bills of lading (**BL**'s) - which the LOIs relied upon. However, the banks refused to pay. The banks contended that there was no physical cargo being shipped pursuant to the BLs and that the BLs were forgeries.

At first instance, the Singapore High Court (**SGHC**) dismissed Winson's claims against the issuing banks on the basis that the Fraud Exception was made out. The court's reasons were: (i) the Fraud Exception was established on the third limb of the definition of common law fraud as stated in *Derry v Peek* (1889) 14 App Cas 337 *i.e.* recklessness; (ii) Winson had made false representations on the basis that the BLs were not valid; and (iii) Winson acted fraudulently by not having belief, or at minimum was indifferent, in the truth of its representations.

1 **Lord Justice Kerr** in *RD Harbottle (Mercantile) Ltd v National Westminster Bank Ltd [1978] QB 146*

Winson appealed the decision.

Court of Appeal's decision

The Singapore Court of Appeal (**SGCA**) dismissed Winson's appeal and upheld the lower court's decision.

First, the SGCA declined to follow the SICC's analysis in *Credit Agricole Corporate & Investment Bank, Singapore Branch v PPT Energy Trading Co Ltd* [2022] 4 SLR 1. There, it was held that only the first two categories of fraud, knowingly and without honest belief in the truth, would engage the Fraud Exception. The SICC had reasoned that the last category, recklessness, did not engage the exception because there is no duty of care owed by a beneficiary to the bank when presenting documents. This presupposed that recklessness was objective.

In rejecting the SICC's analysis, the SGCA made the following observations about the definition of fraud in the reckless sense as postulated in *Derry v Peek*: (i) recklessness does not entail the existence of any duty of care; (ii) the definition of recklessness under *Derry v Peek* refers to subjective recklessness, namely an indifference to a risk which the defendant was conscious of; (iii) recklessness in *Derry v Peek* is an instance of having no belief in the truth of the false representation.

Second, the standard for fraud for the Fraud Exception in independent guarantees and letters of credit are the same. This is based on principle, precedent and policy:

- *Principle*: The beneficiary should not be allowed to benefit from its wilful disregard of the truth of the representations. Further, it defies logic to compel the bank to make payment when a beneficiary makes representations in which it has no honest belief in, and then the bank can mount a claim in the tort of deceit to reclaim that same money.

- *Precedent*: There is foreign jurisprudence where recklessness engaged the Fraud Exception in the context of letters of credit: *Royal Bank of Canada vs Darlington* [1995] OJ No 1044 and *Tukan Timber Ltd v Barclays Bank Plc* [1987] 1 Lloyd's Rep 171.

- *Policy*: There is no "widening" of the Fraud Exception. Even if there was, other jurisdictions had adopted this position without dire policy consequences.

Third, the evidence showed that Winson had made representations without honest belief in the truth of them. There were no valid BLs for the transactions and no cargo was shipped. Winson's responses to "red flags" raised by OCBC were telltale that Winson was reckless (as discussed below).

PRACTICAL TAKEAWAYS

This decision should provide some relief for banks who have reasonable concerns over highly doubtful transactions. Notably, it was Winson's reactions to "red flags" in the presentations from which the court inferred that Winson was reckless to the truth.

The way OCBC interacted with Winson which drew their reactions are useful learning points in how issuing banks could handle possible "red flags", and to use documents to later establish a fraudulent misrepresentation by the beneficiary.

- Before the first presentation to OCBC, Winson only received copy BLs from Hin Leong. Yet Winson did not follow up with Hin Leong for the loading documents.

- After rejecting Winson's first presentation, OCBC had requested for the original BL but Winson was unable to provide it. For context, a day before Winson's first presentation of the LC to OCBC, there was a WhatsApp chat between an employee from Winson and an employee of OCBC. Winson's employee had effectively doubted whether Winson had good title to the cargo. OCBC's employee thus sought the BL in an attempt to address this concern. The court inferred that Winson's concern was about the existence of cargo since a resale of the cargo to a third party would expose Winson in relation to that third party.

- By the time of second presentation, which was at least 13 days past the purported loadings, Winson still had not chased Hin Leong or its related companies (including the terminal where the cargo was loaded) for the loading documents.

From this, there are two useful takeaways:

First, even in financing transactions that seemingly only rely on the veracity of documentary representations, the court still considers the totality of factual circumstances. This is especially so for cases involving subjective recklessness under *Derry v Peek*. For example, much of the factual determinations here turned on inferences drawn from Winson's interactions surrounding the time of the presentations. It is therefore important for the bank to collate various documents proving fraud or fraudulent misrepresentation by the beneficiary. It is important to convince the court with a holistic narrative.

Second, wrong SMS messages can be detrimental. It is important to have internal document management protocols involving how to use (or not use) SMS for work. Relevant training sessions and document retention policies should also be considered.

DJY V DJZ [2025] SGHC (A) 18: UNCONSCIONABILITY IS A GROUND FOR RESTRAINING A CALL ON SBLCS WHICH ARE AKIN TO A PERFORMANCE BOND

In this recent decision, the Appellate Division of the Singapore High Court (**SGHC(A)**) restated that the *only* way for an applicant of a SBLC to restrain the payment obligation under a SBLC (which is akin to a performance bond) based on discrepancies in documents was to show that the alleged discrepancies made the call unconscionable or fraudulent.

Background Facts

This case concerned a dispute between parties in a contract to build a semi-submersible oil rig (**Rig**) in Country X.

The appellant (**DJY**) was contracted by the first respondent (**DJX**), to build the Rig (**Contract**). The Contract was for approximately US$774m and provided that no adjustment would be made to the price. However, due to a significant depreciation in the US currency and increased costs in Country X at the time, the appellant and the first respondent made an amendment to increase the contract sum by US$52.8m (**Amendment No 3**).

Subsequently, Country X's Federal Audit Court (**FAC**) started to investigate the legitimacy of the Contract and Amendment No 3. The FAC made a preliminary determination that the first respondent should hold off on making payments to the appellant *unless* the appellant obtains a guarantee to refund the first respondent if the FAC finally makes the determination.

Accordingly, the appellant applied for a standby letter of credit as security for its obligation to refund the payments made by the first respondent.

Subsequently, the appellant's motion for clarification on the appeal (**Appeal Decision**) against the FAC's First Instance Decision was dismissed. Thereafter, the first respondent called on the SBLC and presented a copy of the notification receipt from the FAC. Notably, the receipt stated that the Appeal Decision could be accessed in a portal and provided the information to access it.

The appellant sought to restrain the payment by filing an injunction in the SGHC. The Judicial Commissioner (**Judge**) at first instance dismissed the application because the appellant had no valid grounds.

The appellant appealed and raised a new argument alleging that the first respondent's call on the SBLC failed to comply with rules 3.06 and 4.04 of the International Standby Practices, International Chamber of Commerce Publication No 590 (1998) (**ISP98**) because it failed to present a copy of the Appeal Decision.

SGHC(A) Decision

The SGHC(A) dismissed the appeal and upheld the lower court's decision that there was no unconscionability in the first respondent's call for payment under the SBLC.
First, it denied the appellant permission to raise new arguments on appeal because the appellant would not have suffered any prejudice *per se*. It held that the appellant's arguments continuously evolved through the hearings. Further, the Judge would have had to make a finding on whether the appellant waived compliance with the ISP due to its delay in making the arguments. This showed that the appellant did not believe in its own arguments and only raised it after the Judge raised it in the hearing below.

Regardless, the appellant's case, which was premised on rules 3.06 and 4.04 of the ISP98, would have failed. There was no privity between the appellant and the second respondent in relation to the SBLC. Thus, the ISP98 did not govern the relationship between them. And since the second respondent had not raised any discrepancies with the documents, the only way the appellant could seek an injunction was to show that the discrepancies rendered the call unconscionable or fraudulent.

Second, the SGHC(A) agreed with the Judge's treatment of the SBLC as akin to a performance bond. The parties also did not dispute that unconscionability was a ground to restrain the call. In relation to the framework for restraining a call on a performance bond as set out in *CEX v CEY* [2021] 3 SLR 571, it should be noted that the mere fact that the conditions in the performance bond were unfulfilled or that the demand did not fall within the terms of the bond did not suffice to justify an injunction. Instead, it must be shown that the *nature* of the non-compliance was such that it was unconscionable for the beneficiary to call on the bond.

Third, the SGHC(A) disagreed with the appellant's interpretation of the requirements in the SBLC and its contentions of the finality of the FAC's decision. The court reasoned that: (i) the SBLC only required a declaration to the effect that the respondent was to be refunded sums paid under Amendment No 3; (ii) there was strict compliance with the SBLC in that the FAC's Appeal Decision had declared the payment obligation to be null and void. Further, the parties, including the appellant, did not have any doubts as to the finality of the Appeal Decision's declaration that the payment obligation was null and void; (iii) even if it was required that the Appeal Decision had to be presented independently of the notification receipt, there was still no unconscionability on the respondent's part.

Lastly, the court observed that the main difference in treating a standby letter of credit as either a performance bond or a letter of credit is whether it is possible to restrain a ground on fraud only or on unconscionability too since fraud is a higher bar to prove.

PRACTICAL TAKEAWAYS

From this, there are two useful takeaways:

First, if parties to a standby letter of credit wish to ensure protection and avoid ambiguity in the language used, it would be advisable to incorporate ICC rulebooks (such as ISP98, or URDG 78 – though this is more relevant for guarantees) into the document. For instance, Rule 4.09(a) of the ISP98 requires the use of quotation marks/blocked wording to specify precise wording. If ISP98 had not been incorporated in the SBLC here, the appellant would have been able to argue with better odds that the SBLC required the FAC to use the specific words of "null and void" in its declaration of the payment obligation being null and void.

Second, if an applicant of a SBLC is unlikely to restrain payment because it does not have strong grounds of proving unconscionability, then a safer bet for the applicant might be to pursue a claim against the issuing bank on the basis that the issuing bank has acted in breach of its mandate (given by the applicant) by paying out against non-conforming documents.

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ABOUT PETER & KIM

Peter & Kim is a specialist arbitration firm with offices in Geneva, Zurich, Sydney, Seoul, Perth and Singapore. We support clients globally through a cohesive cross-border team structure offering a depth of common and civil law expertise that is grounded in decades of combined experience at partner level in international arbitration proceedings (including ISDS cases) and in advising and representing commercial and government clients in arbitration-related proceedings before State Courts.

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