

Letters of Credit and Fraud Exception

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A bank issuing a letter of credit has a near absolute duty to honour a demand for payment under the letter. Notwithstanding, one such exception to this near absolute duty is the fraud exception. The Supreme Court of Canada recognized this exception and set a high bar for it in 1987.

In *Bank of Nova Scotia v. Angelica-Whitewear Ltd.*, 1987 CanLII 78 (SCC), [1987] 1 S.C.R. 59, the Court recognized the fraud exception to an issuing bank's near absolute duty to honour a demand for payment under a letter of credit. Writing for the Court, Le Dain J. carefully sought to balance two competing policy objectives that he described as being in "tension" in the law: the importance to international commerce that banks respect the autonomous character of letters of credit and the importance of suppressing fraud in transactions (p. 72). On the one hand, widening the fraud exception might undermine the reliability of letters of credit; on the other hand, turning a blind eye to fraud might encourage misconduct in letter transactions. Le Dain J. concluded that the fraud exception should be confined to cases of obvious fraud of the beneficiary that is so egregious that the legitimacy of the supporting letter of credit can no longer be assumed. The bar for the fraud exception was set high. In keeping with this careful balance and high bar, he wrote, the exception should not extend to the fraud of a third party of which the beneficiary is "innocent" (p. 84).

In April of 2024, the Supreme Court had occasion to revisit the fraud exception in *Eurobank Ergasias S.A. v. Bombardier inc.*, 2024 SCC 11 ("*Eurobank*"). In *Eurobank*, the Supreme Court was asked to consider if the fraud exception can extend to fraud by a third party and the circumstances in which the beneficiary's conduct will not be viewed as "innocent".

The dispute in *Eurobank* centered on a Letter of Counter-Guarantee governed by Quebec law and a dispute between Bombardier Inc. and the Hellenic Ministry of Defense ("HMOD"). In 1998, HMOD entered into a procurement contract with Bombardier for the purchase of firefighting amphibious aircraft. The parties also agreed to an offsets contract in which Bombardier would subcontract work associated with the aircraft procurement to Greek companies. The offsets contract provided that Bombardier would owe HMOD liquidated damages if it did not fulfil its subcontracting obligations. Payment of these liquidated damages was secured by a letter of credit issued by Eurobank in favour of HMOD ("Greek Letter of Guarantee"). A second letter of credit was issued by the National Bank of Canada in favour of Eurobank to secure payment of the amounts that the latter would be required to pay HMOD under the Greek Letter of Guarantee ("Canadian Letter of Counter-Guarantee"). The plan for the interlocking letters of credit was straightforward: should HMOD call on Eurobank to honour the Greek Letter of Guarantee, Eurobank would be entitled to call on the National Bank to reimburse it under the Quebec Letter of Counter-Guarantee. Disputes under the offsets contract were to be resolved by an arbitral tribunal under the rules of the International Chamber of Commerce ("ICC").

Bombardier determined it could not meet its subcontracting obligations, which led to arbitration before the ICC. HMOD formally undertook not to demand payment under the Greek Letter of Guarantee for as long as the arbitration procedure was ongoing. However, while the issuance of the final award was still pending, HMOD repeatedly demanded payment from Eurobank. Bombardier sought and obtained an order from the ICC Arbitral Tribunal preventing HMOD from demanding payment under the Greek Letter of Guarantee until issuance of the final award. It also sought and obtained provisional injunctions from the Superior Court of Quebec to prevent payment under the Greek Letter of Guarantee and the Canadian Letter of Counter-Guarantee. Despite this, HMOD made a final demand for payment, seven days before the final award was set to be released, and said that Eurobank would be subject to civil and criminal legal measures if it refused to pay. Eurobank paid HMOD under the Greek Letter of Guarantee, and Eurobank then demanded payment from the National Bank of Canada under the Canadian Letter of Counter-Guarantee.

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The ICC Arbitral Tribunal's final award decided that the offsets contract violated European Union law such that it was null and void ab initio and that no liquidated damages were due by Bombardier to HMOD. In response to the final award, Eurobank commenced proceedings before Greek courts, where it unsuccessfully sought to recover the money that it had paid to HMOD. The Greek courts decided that the conduct of HMOD under the Greek Letter of Guarantee was not fraudulent under Greek law. In parallel proceedings before Quebec courts, Bombardier sought a permanent injunction enjoining National Bank of Canada from paying Eurobank under the Canadian Letter of Counter-Guarantee. It argued that the fraud exception to an issuing bank's near absolute duty to honour a demand for payment under a letter of credit applied to Eurobank as beneficiary under the Canadian Letter of Counter-Guarantee. Given that HMOD's conduct was fraudulent, Eurobank's demand for payment under the Canadian Letter of Counter-Guarantee was, by extension, also fraudulent.

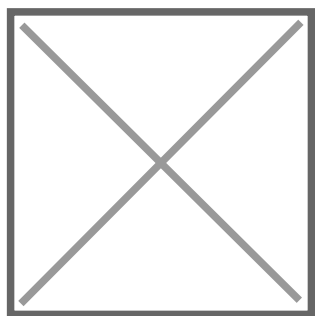
The trial judge held that HMOD engaged in fraud in obtaining payment under the Greek Letter of Guarantee. He also held that Eurobank's own conduct was fraudulent because its payment to HMOD was a result of fraud of which it was aware. He thus enjoined the National Bank of Canada from paying any amount to Eurobank under the Canadian Letter of Counter-Guarantee. The Court of Appeal for Quebec dismissed Eurobank's appeal, holding that it was open to the trial judge to conclude that the National Bank of Canada was not bound to pay Eurobank as beneficiary under the Canadian Letter of Counter-Guarantee, since the Eurobank had sufficient knowledge of the fraud prior to paying under the Greek Letter of Guarantee.

The majority of the Supreme Court held that the trial judge's finding that HMOD engaged in fraud was entitled to deference. The evidence supported a finding that HMOD engaged in a fraudulent attempt to circumvent the ICC tribunal's interim order and final award by repeatedly demanding payment. There was no basis to interfere with the trial judge's conclusion that Eurobank had clear knowledge of HMOD's fraud and that it actively participated in HMOD's fraud by paying HMOD in improper circumstances. "Fraud" in the context of this defence did not refer to fraud in the criminal sense. In the civil or commercial sense, it could include a beneficiary demanding payment while knowing that they had no right to be paid. Here, Eurobank knew that HMOD was enjoined from demanding payment under the Greek Letter of Guarantee and that the issuance of the final arbitral award was imminent. Eurobank was not merely suspicious that HMOD demanded payment contrary to the interim order; it clearly knew that this was happening. At the very least, this suggested that it knew that the demand for payment was made in contravention of at least one order, which, in the circumstances, amounted to clear knowledge of the fraudulent conduct of HMOD. The Court found that because it knew of and participated in HMOD's fraud, Eurobank became the co-author of that fraud and must, for the purposes of the fraud exception, bear responsibility for it. The Court maintained that while the bar for the fraud exception was high, and reserved for cases of "obvious fraud" which imported aspects of "impropriety, dishonesty or deceit", here, it was made out.

The minority (Karakatsanis and Côté JJ dissenting) found that the appeal should be allowed and the action instituted by Bombardier against Eurobank and the National Bank of Canada should be dismissed. They found that to conclude otherwise would dismiss the decisions of the Greek courts, which held that the conduct of HMOD was not fraudulent. The dissenting judges pointed out that international comity is an essential guiding principle when considering or enforcing foreign judgments. There was no public policy rationale for not giving weight to the judgments of the Greek courts. Eurobank was faced with a demand for payment and a judgment from the only court of competent jurisdiction (the Greek court) which held that the HMOD could validly draw on the Greek Letter of Guarantee. Additionally, HMOD's undertaking not to demand payment under the Greek Letter of Guarantee could be validly withdrawn at any time, and thus was no longer in effect when HMOD demanded payment. Taking this into account, HMOD's demand for payment under the Greek Letter of Guarantee was neither fraudulent nor tantamount to fraud; and, even if it were, Eurobank would be innocent of that fraud. A PDF version is available for download [here](#).

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