

Litigation - Cyprus

Court rules on role of letters of credit in Cyprus

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Introduction

The critical role that letters of credit have played in the growth of international trade is widely acknowledged. Their use overcomes practical and logistical problems arising from the distance between the parties to an international transaction and the different laws applicable in each jurisdiction, and allows the supplier to obtain security before shipping its goods. Simply defined, a letter of credit is a written instrument issued by a bank at the request of its customer, the buyer, by which the bank promises to pay the seller for goods, provided that all the terms and conditions set out in the letter of credit are met.

Due to the enormous volume of international trade transactions executed on a daily basis, there is extensive case law in relation to letters of credit. On several occasions the Cyprus courts have been asked to issue prohibitive injunctions forbidding a bank to make payment under a letter of credit, as in the relatively recent Nicosia District Court case of *TMP v TGSB ao*.

Facts

TMP won a competitive tender run by the Ministry of Health for the supply of surgical gloves over a period of 24 months. TMP entered into an agreement with TGSB, under which the latter would supply the gloves in four shipments. In return, for each shipment TMP would open an irrevocable letter of credit with the Central Cooperative Bank following which, as each shipment was made, the bank would release the funds to TGSB. The first shipment and release of funds by the bank occurred without incident, but on the second shipment a dispute arose in relation to the price of the gloves. TMP argued that the parties had agreed on a fixed price, whereas TGSB contended that it had been made clear to TMP that the price would fluctuate, since the costs of raw materials could change considerably over a 24-month period.

TMP brought a civil action against TGSB for breach of agreement and simultaneously applied for and obtained *ex parte* an injunction prohibiting the Central Cooperative Bank from releasing any funds under the second letter of credit until full trial of the case. TGSB and the bank separately opposed the application for an injunction and put forward a number of legal grounds and arguments detailing why the injunction should be vacated. In particular, they argued that the applicants had failed to meet the criteria for an *ex parte* injunction to be granted, as set out by Section 32 of the Courts of Justice Law (14/1960), and that there is a well-established legal principle that courts do not interfere with letters of credit unless fraud is pleaded.

Decision

The judge examined the power of the courts to grant interim injunctions by virtue of Section 32, which empowers the court to grant an injunction "in all cases in which it appears to the court just or convenient so to do".⁽¹⁾ Section 32 further provides that no such injunction should be granted unless all of the following conditions have been satisfied:

- A serious question arises to be tried at the hearing;
- There appears to be a probability that the plaintiff is entitled to relief; and
- It would be difficult or impossible to carry out complete justice at a later stage without granting the injunction.

The judge made extensive reference to the documentary evidence produced in the form of exhibits (eg, correspondence between the parties, bills of lading and letters of credit), concluding that on the face of it, there had been no agreement on a fixed price for the goods, and that neither the first nor the second criterion of Section 32 of the law had been satisfied. The judge pointed out that this alone was sufficient grounds for him to reject the application and vacate the injunction. However, in the interests of delivering a comprehensive judgment, he went on to consider two further issues that he viewed as significant.

The judge first considered the obligation of the applicant to satisfy the court that the matter was sufficiently urgent for the court to grant the injunction (as it had done) *ex parte*. The judge analysed this issue in depth, with reference to the various facts and dates, and concluded that the applicants had failed to demonstrate that the matter was urgent. This gave the court another reason to vacate the injunction.

The final issue that the judge examined was, in his view, the most significant - namely, the extent to which the court should grant injunctions affecting letters of credit. He emphasised in his judgment that letters of credit are documents of high commercial value and are regarded as the equivalent of cash. He further stated that irrespective of whether an injunction is directed against the bank or is against the beneficiary, the fundamental principle still stands that the court will not grant any injunction interfering with the performance by the bank, except "where the letter of credit or other banking contract is itself impeached as being invalid, or if prior to payment, it is obvious to the bank that the beneficiary is acting fraudulently".⁽²⁾

The judge also cited the judgment of the English Court of Appeal in *Bolivinter Oil SA v Chase Manhattan Bank NA*⁽³⁾ as follows:

"Judges who are asked, often at short notice and ex parte, to issue an injunction restraining payment by a bank under an irrevocable letter of credit or performance bond or guarantee should ask whether there is any challenge to the validity of the letter, bond or guarantee itself. If there is not or if the challenge is not substantial, prima facie no injunction should be granted and the bank should be left free to honour its contractual obligation."

A landmark case in this area of the law, also followed by the Cyprus courts, is *RD Harbottle (Mercantile) Limited v National Westminster Bank*,⁽⁴⁾ in which Judge Kerr stated:

"It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international commerce. Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration as available to them or stipulated in the contracts."⁽⁵⁾

In the light of his analysis, the judge concluded that the applicants had failed to satisfy the criteria set out in Section 32 of the law and the related case law. He therefore cancelled the injunction.

Comment

The decision in *TMP v TGSB* reaffirms the Cyprus courts' reluctance to interfere with the performance by a bank of a letter of credit unless fraud is involved. This ruling is in line with the principles set out in the English cases cited above.

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Endnotes

⁽¹⁾ See *Poltava Petroleum Co v Mexana Oil (Consolidation) Ltd*, (2001) 1 CLR 1980.

⁽²⁾ *Syvokon v Veno (Overseas) Inc*, (1998) 1 CLR 625.

⁽³⁾ (1984) 1 Lloyd's Rep 251.

⁽⁴⁾ (1977) 2 All ER 351.

⁽⁵⁾ Lord Denning quoted these words with approval in *Edward Owen Engineering Limited v Barclays Bank International*, (1978) 1 All ER 976.

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