

**\*\*Title:\*\*** Transfield Philippines, Inc. v. Luzon Hydro Corporation et al.

**\*\*Facts:\*\***

Transfield Philippines, Inc. (petitioner) and Luzon Hydro Corporation (respondent LHC) entered into a Turnkey Contract on March 26, 1997, for the construction of a 70-Megawatt hydro-electric power station on the Bakun River, with Transfield as the Turnkey Contractor responsible for design, construction, testing, and completion with a target date set for June 1, 2000. To secure performance, Transfield opened two standby letters of credit with Australia and New Zealand Banking Group Limited (ANZ Bank) and Security Bank Corporation (SBC), each in the amount of US\$8,988,907.00.

Throughout the project, Transfield sought various extensions of time (EOT) due to factors such as force majeure, which LHC denied. This led to arbitration proceedings at the Construction Industry Arbitration Commission (CIAC) and the International Chamber of Commerce (ICC), although both had not resolved the disputes by the time LHC declared Transfield in default for failure to complete the Project and demanded liquidated damages.

Transfield filed an action for injunction against LHC and the banks with the Regional Trial Court (RTC) of Makati to prevent the call on the securities, which was initially granted a temporary restraining order, but eventually denied permanent relief. Transfield's appeal to the Court of Appeals was also unsuccessful.

**\*\*Issues:\*\***

1. Can the "independence principle" of letters of credit be invoked by a beneficiary when the beneficiary's call thereon is wrongful or fraudulent?
2. Does LHC have the right to call and draw on the securities before the resolution of disputes by the appropriate tribunal?
3. Were ANZ Bank and SBC justified in releasing the amounts due under the securities despite being notified of LHC's wrongful call?
4. Will Transfield suffer grave and irreparable damage if LHC is allowed to draw on the securities before dispute resolution, and if LHC does not return amounts wrongfully drawn from the securities?

**\*\*Court's Decision:\*\***

The Supreme Court denied the petition and held that:

1. The independence principle applies and can be invoked by the beneficiary (LHC), given the nature of standby letters of credit, which are intended to assure payment based on the

banks' obligations under the letters of credit, separate from the underlying contract disputes.

2. The "fraud exception" to the independence principle was not properly raised in earlier proceedings, and petitioner failed to demonstrate a clear right to injunctive relief to justify suspension of payments under the letters of credit.

3. The banks had little choice but to honor the call for payment given their obligations under the letters of credit, independent of the underlying contractual disputes.

4. The petition had become moot as the letters of credit had been fully drawn upon at the time of the decision. If Transfield proves wrongful drawing in pending arbitration, its right to damages may still stand.

**\*\*Doctrine:\*\***

- The "independence principle" in letters of credit transactions holds that the banks' obligations are independent of the underlying contract disputes.
- The "fraud exception" to the independence principle requires clear proof of fraudulent abuse of the credit for injunction against payment to be granted.

**\*\*Class Notes:\*\***

- In letters of credit, the independence principle means the issuing bank's obligation to pay is separate from the underlying contract disputes.
- The "fraud exception" requires clear evidence of fraud directly related to the letter of credit itself, not just the underlying contract, to restrain payment.
- Temporary restraining orders and injunctions require a clear demonstration of an immediate and irreparable injury to the party seeking the relief.

**\*\*Historical Background:\*\***

This case highlights the complexities and international nature of construction contracts and the integral role of letters of credit in managing financial risks. It underscores the legal framework governing international trade financing and the balance between honoring contractual obligations and preventing fraudulent claims against financial securities.