

## SECOND DIVISION

[ G.R. No. 146717, November 22, 2004 ]

**TRANSFIELD PHILIPPINES, INC., PETITIONER, VS. LUZON  
HYDRO CORPORATION, AUSTRALIA AND NEW ZEALAND  
BANKING GROUP LIMITED AND SECURITY BANK CORPORATION,  
RESPONDENTS.**

### D E C I S I O N

**TINGA, J.:**

Subject of this case is the letter of credit which has evolved as the ubiquitous and most important device in international trade. A creation of commerce and businessmen, the letter of credit is also unique in the number of parties involved and its supranational character.

Petitioner has appealed from the *Decision*<sup>[1]</sup> of the Court of Appeals in CA-G.R. SP No. 61901 entitled "*Transfield Philippines, Inc. v. Hon. Oscar Pimentel, et al.*," promulgated on 31 January 2001.<sup>[2]</sup>

On 26 March 1997, petitioner and respondent Luzon Hydro Corporation (hereinafter, LHC) entered into a Turnkey Contract<sup>[3]</sup> whereby petitioner, as Turnkey Contractor, undertook to construct, on a turnkey basis, a seventy (70)-Megawatt hydro-electric power station at the Bakun River in the provinces of Benguet and Ilocos Sur (hereinafter, the Project). Petitioner was given the sole responsibility for the design, construction, commissioning, testing and completion of the Project.<sup>[4]</sup>

The Turnkey Contract provides that: (1) the target completion date of the Project shall be on 1 June 2000, or such later date as may be agreed upon between petitioner and respondent LHC or otherwise determined in accordance with the Turnkey Contract; and (2) petitioner is entitled to claim extensions of time (EOT) for reasons enumerated in the Turnkey Contract, among which are variations, *force majeure*, and delays caused by LHC itself.<sup>[5]</sup> Further, in case of dispute, the parties are bound to settle their differences through mediation, conciliation and such other means enumerated under Clause 20.3 of the Turnkey Contract.<sup>[6]</sup>

To secure performance of petitioner's obligation on or before the target completion date, or such time for completion as may be determined by the parties' agreement, petitioner opened in favor of LHC two (2) standby letters of credit both dated 20 March 2000 (hereinafter referred to as "the Securities"), to wit: Standby Letter of Credit No. E001126/8400 with the local branch of respondent Australia and New Zealand Banking Group Limited (ANZ Bank)<sup>[7]</sup> and Standby Letter of Credit No. IBDIDSB-00/4 with respondent Security Bank Corporation (SBC)<sup>[8]</sup> each in the amount of US\$8,988,907.00.<sup>[9]</sup>

In the course of the construction of the project, petitioner sought various EOT to complete the Project. The extensions were requested allegedly due to several factors which prevented the completion of the Project on target date, such as *force majeure* occasioned by typhoon *Zeb*, barricades and demonstrations. LHC denied the requests, however. This gave rise to a series of legal actions between the parties which culminated in the instant petition.

The first of the actions was a Request for Arbitration which LHC filed before the Construction Industry Arbitration Commission (CIAC) on 1 June 1999.<sup>[10]</sup> This was followed by another Request for Arbitration, this time filed by petitioner before the International Chamber of Commerce (ICC)<sup>[11]</sup> on 3 November 2000. In both arbitration proceedings, the common issues presented were: [1] whether typhoon *Zeb* and any of its associated events constituted *force majeure* to justify the extension of time sought by petitioner; and [2] whether LHC had the right to terminate the Turnkey Contract for failure of petitioner to complete the Project on target date.

Meanwhile, foreseeing that LHC would call on the Securities pursuant to the pertinent provisions of the Turnkey Contract,<sup>[12]</sup> petitioner—in two separate letters<sup>[13]</sup> both dated 10 August 2000—advised respondent banks of the arbitration proceedings already pending before the CIAC and ICC in connection with its alleged default in the performance of its obligations. Asserting that LHC had no right to call on the Securities until the resolution of disputes before the arbitral tribunals, petitioner warned respondent banks that any transfer, release, or disposition of the Securities in favor of LHC or any person claiming under LHC would constrain it to hold respondent banks liable for liquidated damages.

As petitioner had anticipated, on 27 June 2000, LHC sent notice to petitioner that pursuant to Clause 8.2<sup>[14]</sup> of the Turnkey Contract, it failed to comply with its obligation to complete the Project. Despite the letters of petitioner, however, both banks informed petitioner that they would pay on the Securities if and when LHC calls on them.<sup>[15]</sup>

LHC asserted that additional extension of time would not be warranted; accordingly it declared petitioner in default/delay in the performance of its obligations under the Turnkey Contract and demanded from petitioner the payment of US\$75,000.00 for each day of delay beginning 28 June 2000 until actual completion of the Project pursuant to Clause 8.7.1 of the Turnkey Contract. At the same time, LHC served notice that it would call on the securities for the payment of liquidated damages for the delay.<sup>[16]</sup>

On 5 November 2000, petitioner as plaintiff filed a *Complaint for Injunction*, with prayer for temporary restraining order and writ of preliminary injunction, against herein respondents as defendants before the Regional Trial Court (RTC) of Makati.<sup>[17]</sup> Petitioner sought to restrain respondent LHC from calling on the Securities and respondent banks from transferring, paying on, or in any manner disposing of the Securities or any renewals or substitutes thereof. The RTC issued a seventy-two (72)-hour temporary restraining order on the same day. The case was docketed as Civil Case No. 00-1312 and raffled to Branch 148 of the RTC of Makati.

After appropriate proceedings, the trial court issued an Order on 9 November 2000, extending the temporary restraining order for a period of seventeen (17) days or until 26 November 2000.<sup>[18]</sup>

The RTC, in its *Order*<sup>[19]</sup> dated 24 November 2000, denied petitioner's application for a writ of preliminary injunction. It ruled that petitioner had no legal right and suffered no irreparable injury to justify the issuance of the writ. Employing the principle of "independent contract" in letters of credit, the trial court ruled that LHC should be allowed to draw on the Securities for liquidated damages. It debunked petitioner's contention that the principle of "independent contract" could be invoked only by respondent banks since according to it respondent LHC is the ultimate beneficiary of the Securities. The trial court further ruled that the banks were mere custodians of the funds and as such they were obligated to transfer the same to the beneficiary for as long as the latter could submit the required certification of its claims.

Dissatisfied with the trial court's denial of its application for a writ of preliminary injunction, petitioner elevated the case to the Court of Appeals *via a Petition for Certiorari* under Rule 65, with prayer for the issuance of a temporary restraining order and writ of preliminary injunction.<sup>[20]</sup> Petitioner submitted to the appellate court that LHC's call on the Securities was premature considering that the issue of its default had not yet been resolved with finality by the CIAC and/or the ICC. It asserted that until the fact of delay could be established, LHC had no right to draw on the Securities for liquidated damages.

Refuting petitioner's contentions, LHC claimed that petitioner had no right to restrain its call on and use of the Securities as payment for liquidated damages. It averred that the Securities are independent of the main contract between them as shown on the face of the two Standby Letters of Credit which both provide that the banks have no responsibility to investigate the authenticity or accuracy of the certificates or the declarant's capacity or entitlement to so certify.

In its *Resolution* dated 28 November 2000, the Court of Appeals issued a temporary restraining order, enjoining LHC from calling on the Securities or any renewals or substitutes thereof and ordering respondent banks to cease and desist from transferring, paying or in any manner disposing of the Securities.

However, the appellate court failed to act on the application for preliminary injunction until the temporary restraining order expired on 27 January 2001. Immediately thereafter, representatives of LHC trooped to ANZ Bank and withdrew the total amount of US\$4,950,000.00, thereby reducing the balance in ANZ Bank to US\$1,852,814.00.

On 2 February 2001, the appellate court dismissed the petition for certiorari. The appellate court expressed conformity with the trial court's decision that LHC could call on the Securities pursuant to the first principle in credit law that the credit itself is independent of the underlying transaction and that as long as the beneficiary complied with the credit, it was of no moment that he had not complied with the underlying contract. Further, the appellate court held that even assuming that the trial court's denial of petitioner's application for a writ of preliminary injunction was erroneous, it constituted only an error of judgment which is not correctible by

certiorari, unlike error of jurisdiction.

Undaunted, petitioner filed the instant *Petition for Review* raising the following issues for resolution:

WHETHER THE “INDEPENDENCE PRINCIPLE” ON LETTERS OF CREDIT MAY BE INVOKED BY A BENEFICIARY THEREOF WHERE THE BENEFICIARY’S CALL THEREON IS WRONGFUL OR FRAUDULENT.

WHETHER LHC HAS THE RIGHT TO CALL AND DRAW ON THE SECURITIES BEFORE THE RESOLUTION OF PETITIONER’S AND LHC’S DISPUTES BY THE APPROPRIATE TRIBUNAL.

WHETHER ANZ BANK AND SECURITY BANK ARE JUSTIFIED IN RELEASING THE AMOUNTS DUE UNDER THE SECURITIES DESPITE BEING NOTIFIED THAT LHC’S CALL THEREON IS WRONGFUL.

WHETHER OR NOT PETITIONER WILL SUFFER GRAVE AND IRREPARABLE DAMAGE IN THE EVENT THAT:

A. LHC IS ALLOWED TO CALL AND DRAW ON, AND ANZ BANK AND SECURITY BANK ARE ALLOWED TO RELEASE, THE REMAINING BALANCE OF THE SECURITIES PRIOR TO THE RESOLUTION OF THE DISPUTES BETWEEN PETITIONER AND LHC.

B. LHC DOES NOT RETURN THE AMOUNTS IT HAD WRONGFULLY DRAWN FROM THE SECURITIES.<sup>[21]</sup>

Petitioner contends that the courts below improperly relied on the “independence principle” on letters of credit when this case falls squarely within the “fraud exception rule.” Respondent LHC deliberately misrepresented the supposed existence of delay despite its knowledge that the issue was still pending arbitration, petitioner continues.

Petitioner asserts that LHC should be ordered to return the proceeds of the Securities pursuant to the principle against unjust enrichment and that, under the premises, injunction was the appropriate remedy obtainable from the competent local courts.

On 25 August 2003, petitioner filed a *Supplement to the Petition*<sup>[22]</sup> and *Supplemental Memorandum*,<sup>[23]</sup> alleging that in the course of the proceedings in the ICC Arbitration, a number of documentary and testimonial evidence came out through the use of different modes of discovery available in the ICC Arbitration. It contends that after the filing of the petition facts and admissions were discovered which demonstrate that LHC knowingly misrepresented that petitioner had incurred delays— notwithstanding its knowledge and admission that delays were excused under the Turnkey Contract—to be able to draw against the Securities. Reiterating that fraud constitutes an exception to the independence principle, petitioner urges that this warrants a ruling from this Court that the call on the Securities was wrongful, as well as contrary to law and basic principles of equity. It avers that it would suffer grave irreparable damage if LHC would be allowed to use the proceeds of the Securities and not ordered to return the amounts it had wrongfully drawn

thereon.

In its *Manifestation* dated 8 September 2003,<sup>[24]</sup> LHC contends that the supplemental pleadings filed by petitioner present erroneous and misleading information which would change petitioner's theory on appeal.

In yet another *Manifestation* dated 12 April 2004,<sup>[25]</sup> petitioner alleges that on 18 February 2004, the ICC handed down its Third Partial Award, declaring that LHC wrongfully drew upon the Securities and that petitioner was entitled to the return of the sums wrongfully taken by LHC for liquidated damages.

LHC filed a *Counter-Manifestation* dated 29 June 2004,<sup>[26]</sup> stating that petitioner's *Manifestation* dated 12 April 2004 enlarges the scope of its *Petition for Review* of the 31 January 2001 *Decision* of the Court of Appeals. LHC notes that the *Petition for Review* essentially dealt only with the issue of whether injunction could issue to restrain the beneficiary of an irrevocable letter of credit from drawing thereon. It adds that petitioner has filed two other proceedings, to wit: (1) ICC Case No. 11264/TE/MW, entitled "*Transfield Philippines Inc. v. Luzon Hydro Corporation*," in which the parties made claims and counterclaims arising from petitioner's performance/misperformance of its obligations as contractor for LHC; and (2) Civil Case No. 04-332, entitled "*Transfield Philippines, Inc. v. Luzon Hydro Corporation*" before Branch 56 of the RTC of Makati, which is an action to enforce and obtain execution of the ICC's partial award mentioned in petitioner's *Manifestation* of 12 April 2004.

In its *Comment* to petitioner's *Motion for Leave to File Addendum to Petitioner's Memorandum*, LHC stresses that the question of whether the funds it drew on the subject letters of credit should be returned is outside the issue in this appeal. At any rate, LHC adds that the action to enforce the ICC's partial award is now fully within the Makati RTC's jurisdiction in Civil Case No. 04-332. LHC asserts that petitioner is engaged in forum-shopping by keeping this appeal and at the same time seeking the suit for enforcement of the arbitral award before the Makati court.

Respondent SBC in its *Memorandum*, dated 10 March 2003<sup>[27]</sup> contends that the Court of Appeals correctly dismissed the petition for certiorari. Invoking the independence principle, SBC argues that it was under no obligation to look into the validity or accuracy of the certification submitted by respondent LHC or into the latter's capacity or entitlement to so certify. It adds that the act sought to be enjoined by petitioner was already *fait accompli* and the present petition would no longer serve any remedial purpose.

In a similar fashion, respondent ANZ Bank in its *Memorandum* dated 13 March 2003<sup>[28]</sup> posits that its actions could not be regarded as unjustified in view of the prevailing independence principle under which it had no obligation to ascertain the truth of LHC's allegations that petitioner defaulted in its obligations. Moreover, it points out that since the Standby Letter of Credit No. E001126/8400 had been fully drawn, petitioner's prayer for preliminary injunction had been rendered moot and academic.

At the core of the present controversy is the applicability of the "independence principle" and "fraud exception rule" in letters of credit. Thus, a discussion of the