Bank of Montreal v. Mitchell et al. and four other motions

INDEXED-AS: Bank of Montreal v. Mitchell

143 D.L.R. (4th) 697; 1997 D.L.R. LEXIS 1176

Notice of appeal filed in the Ontario Court of Appeal by Lloyd's Names March 10, 1997; notice of cross-appeal filed by the Banks March 24, 1997 (Court File No. C26805).Ontario Court (General Division) Court File Nos. 94-CU-55536; 94-CQ-54793; 94-CU-79067; 94-CU-51543; 94-CQ-54773

JUDGES: Farley J.

February 19, 1997

KEYWORDS-1: [**1] Financial institutions -- Letters of credit -- Liability -- Banks dishonouring letters because of beneficiary's fraud -- Determining existence of fraud based on material supplied by customers -- Beneficiary recovering judgment against banks -- Banks seeking indemnity from customers -- Customers defending on basis that banks failed to plead fraud against beneficiary -- Aware of beneficiary's action but declining to take part -- Banks entitled to summary judgment dismissing that ground of defence -- Customers estopped -- Res judicata applied.

KEYWORDS-2: Negotiable instruments -- Letters of credit -- Liability -- Banks dishonouring letters because of beneficiary's fraud -- Determining existence of fraud based on material supplied by customers -- Beneficiary recovering judgment against banks -- Banks seeking indemnity from customers -- Customers defending on basis that banks failed to plead fraud against beneficiary -- Aware of beneficiary's action but declining to take part -- Banks entitled to summary judgment dismissing that ground of defence -- Customers estopped -- Res judicata applied.

KEYWORDS-3: Equity -- Estoppel -- Conduct or representation -- Banks dishonouring letters of credit because of beneficiary's [**2] fraud -- Determining existence of fraud based on material supplied by customers -- Beneficiary recovering judgment against banks -- Banks seeking indemnity from customers -- Customers defending on basis that banks failed to plead fraud against beneficiary -- Aware of beneficiary's action but declining to take part -- Banks entitled to summary judgment dismissing that ground of defence -- Customers estopped.

KEYWORDS-4: Judgments and orders -- Res judicata -- Banks dishonouring letters of credit because of beneficiary's fraud -- Determining existence of fraud based on material supplied by customers -- Beneficiary recovering judgment against banks -- Banks seeking indemnity from customers -- Customers defending on basis that banks failed to plead fraud against beneficiary -- Aware of beneficiary's action but declining to take part -- Banks entitled to [*698]

KEYWORDS-5: summary judgment dismissing that ground of defence -- Res judicata applied.

SUMMARY-5: The Corporation of Lloyd's ("Lloyd's") agreed to allow certain persons ("Names") to participate as principals in an insurance syndicate of Lloyd's. The Names agreed to unlimited liability for any obligation of the syndicate and to lodge letters of credit, issued by financial [**3] institutions, with Lloyd's to secure their liability in part. Under the agreements with the banks, the Names agreed to reimburse and indemnify the banks for any calls made by Lloyd's on the letters. Lloyd's did make a call on the banks. The banks refused to honour the call because the Names alleged fraud on the part of Lloyd's and provided material to the banks to substantiate the fraud. Lloyd's brought action against the banks in England. The banks defended, alleging the fraud, but they specifically did not plead fraud by Lloyd's against themselves. The banks sought to involve the Names in the English actions, either as party defendants or third parties, or by bringing injunctive proceedings against Lloyd's. The Names refused to do so, although they instructed English counsel who held watching briefs. The English court struck out the banks' defence of fraud and awarded judgment against the banks. The banks paid the judgment and then brought action against the Names and their guarantors for reimbursement. The Names defended, inter alia, on the ground that the banks had lost their right because they failed to plead fraud against Lloyd's. The banks moved for summary judgment, dismissing [**4] that ground of defence.
Held, the motion should be granted.

(1) The contracts involving Lloyd's, the Names and the banks were separate and autonomous transactions, since no party was privy to the contractual arrangements in all the contracts. Consequently, a party to one contract could enforce it without reference to the others, subject to an exception, namely, fraud. If the issuer of a letter of credit is satisfied, as a reasonable banker, of clear and obvious fraud on the part of the beneficiary of the letter, they are entitled to dishonour the letter, for if they pay it in those circumstances, the Names will be exonerated. However, the issuer must, if the beneficiary brings action against it, then plead and prove the fraud. The banks having apparently concluded that there was clear and obvious fraud by Lloyd's, failed to plead and prove it, but merely stated that the Names alleged the fraud and apparently left it to the Names to prove the fraud. In those circumstances the banks were properly found liable to Lloyd's, as they had no other defence. The Names were not required to share or take over defence of the English actions.

(2) If the banks had defended the English actions [**5] properly, by pleading and attempting to prove fraud, they would be entitled to indemnity from the Names. Since they did not engage in a bona fide defence, they lost their right to be indemnified. However, the banks were entitled to succeed because the Names were estopped by their conduct. The Names were aware of the English actions against the banks, the banks asked them to take part in those actions, and they had an interest in the outcome of those actions. Yet they chose to sit on the sidelines and do nothing to prove the fraud. They only cautioned the banks that if the banks insisted on making the Names active partners in the actions, the banks would lose their right to reimbursement. The banks were also entitled to succeed on the basis of res judicata. Res judicata prevents parties and their privies from raising matters that could and ought to have been raised in earlier proceedings, but were not. The Names had a privity of interest with the banks on the issue raised in the English actions, namely, whether Lloyd's was entitled to be paid on [*699] the letters of credit in the face of the alleged fraud: if the banks had won those actions, the Names would have won as well. [**6]

ATL Industries Inc. v. Han Eol Ind. Co. (1995), 36 C.P.C. (3d) 288, 53 A.C.W.S. (3d) 353, distd
Society of Lloyd's v. Canadian Imperial Bank of Commerce, Q.B. Div. (U.K.), Comm. Ct., Saville J., July 5, 1993, 1993 Folio Nos. 112-116; **Society of Lloyd's** v. Canadian Imperial Bank of Commerce, Q.B. Div. (U.K.), Comm. Ct., Saville J., July 20, 1993, 1993 Folio Nos. 112-116; Bank of Nova Scotia v. Angelica-Whitewear Ltd. (1987), 36 D.L.R. (4th) 161, [1987] 1 S.C.R. 59, 36 B.L.R. 140, 73 N.R. 158, 3 A.C.W.S. (3d) 372; Westpac Banking Corp. v. Duke Group Ltd. (1994), 17 B.L.R. (2d) 25, 27 C.B.R. (3d) 291, 20 O.R. (3d) 515, 50 A.C.W.S. (3d) 543; Royal Bank of Canada v. Darlington (1995), 54 A.C.W.S. (3d) 738; United City Merchants (Investments) Ltd. v. Royal Bank of Canada, [1982] 2 All E.R. 720; Parker v. Lewis (1873), L.R. 8 Ch. App. 1035; Nana Ofori Atta II Omanhene of Akyem Abuakwa v. Nana Abut Bonsra II as Adanshehene and as Representing the Stool of Adanse, [1958] A.C. 95; Duffield v. Scott (1789), 3 T.R. 376, 100 E.R. 628; London Guarantee and Accident Co. v. Davidson, [1926] 1 D.L.R. 66, [1926] 1 W.W.R. 148, 36 B.C.R. 301; House of Spring Gardens Ltd. v. Waite, [1990] 2 All E.R. [**7] 990; Hennig v. Northern Heights (Sault) Ltd. (1980), 116 D.L.R. (3d) 496, 17 C.P.C. 173, 30 O.R. (2d) 346, 3 A.C.W.S. (2d) 472; leave to appeal to S.C.C. refused 116 D.L.R. (3d) 496n, 30 O.R. (2d) 346n, 35 N.R. 101n; Kok Hoong v. Leong Cheong Kweng Mines, Ltd., [1964] 1 All E.R. 300; Henderson v. Henderson (1843), 3 Hare 100, 67 E.R. 313, consd

OTHER-REFERENCES-5:

Other cases referred to
Dunlop Construction Products Inc. (Receiver of) v. Flavelle Holdings Inc. (1996), 31 O.R. (3d) 58, 94 O.A.C. 348, 66 A.C.W.S. (3d) 725 [supplementary reasons 68 A.C.W.S. (3d) 168]; American Cyanamid Co. v. Ethicon Ltd., [1975] 1 All E.R. 504
Rules and regulations referred to
Rules of Civil Procedure, R.R.O. 1990, Reg. 194, Rule 20

SUMMARY-6: MOTION for summary judgment dismissing a ground of defence.

COUNSEL: R.B. Smith and P. Manderville, for plaintiffs, Bank of Montreal, Bank of Nova Scotia, Canadian Imperial Bank of Commerce and Toronto-Dominion Bank, moving parties.
A.J. Lenczner, Q.C., and G.A. Smith, for defendants, Lloyd's Names and guarantors thereof.

JUDGMENT-BY: FARLEY J.:--

JUDGMENT: Nature of This Summary Judgment Motion and Background
Counsel indicated to me after the hearing that there would be an exchange of information between them [**8] which might facilitate a consideration of partial or overall resolution after such information was received and

reviewed. On December 16, 1996, I was advised by counsel that while resolution discussions continue, it would be appropriate to have my determination on the issue argued before me. This issue was whether the moving party banks ("Banks") were entitled to a Rule 20 summary judgment in the [*700] form of a dismissal of the pleadings defence claimed by the respondent names ("Names") and respondent guarantors of such Names that the Banks had lost their reimbursement rights under their reimbursement and indemnity agreement with the Names. This defence was asserted as a result of the Banks failing to plead fraud against the Corporation of Lloyd's ("Lloyd's") in defence of the English lawsuits ("English Actions") brought against the Banks by Lloyd's for payment on the Letters of Credit ("LC") in favour of Lloyd's and issued by the Banks at the request of the Names. This partial summary judgment procedure was proposed by the parties and confirmed by Blair J. as a stream 1 defence common to all names; stream 2 defence issues were proposed to be argued hereafter.

The Banks submitted [**9] that the Names were precluded from raising this defence for four reasons:

(a) the English Actions ought to have been fought by the Names since the fraud they claimed was an act of Lloyd's against the Names and not against the Banks;
(b) the principle of indemnification required the indemnifier (Names) to defend the English actions on behalf of the indemnified person (Banks) or be estopped from denying a judgment against the indemnified person;
(c) estoppel by conduct of the Names; or
(d) res judicata.

The payment obligations of a Bank (issuer) under a letter of credit in favour of Lloyds (beneficiary) is a matter of English law; the reimbursement and indemnity obligations of a Name (issuer's customer) to a Bank is a matter of Ontario law. To the extent that the opinions of English counsel as to English law are relevant to this reimbursement case and they differ, then they would have to be tested in Ontario, which they have not been.

The Banks submitted on the undisputed facts that the Names have, due to their own actions (or inaction), no right to complain that (i) the English Actions were not properly defended by the Banks or (ii) that Lloyd's was not entitled [**10] to recover judgment for payment of the LC in the English Actions and thus there is no genuine issue for trial as to this defence by the Names. In a summary judgment motion, the respondents are required to put their best foot forward, both as to the facts and as to the law on which they rely. The Banks asserted that as a matter of law the Names lost the right to raise those objections when they repeatedly declined to take any steps in the English courts to either intervene and plead their own case of fraud against Lloyd's in the English Actions or, alternatively, to seek an English injunction [*701] restraining Lloyd's from recovering payment on the LC. The Names' position is that the Banks were required to plead fraud against Lloyd's in the English Actions once the Banks had refused to pay the call by Lloyd's on the LC based upon the Banks in essence accepting the view (and supporting documentation) of the Names that there was clear and obvious fraud by Lloyd's vis-a-vis the Names. The Names had joined Lloyd's as members knowing that they were required to provide Lloyd's with a personal covenant, unlimited in amount, to pay their respective share of any losses which might be [**11] suffered by the syndicates they invested in. As a partial supplement to and of the personal covenant, the Names were required to arrange an LC from an authorized bank to partially secure their potential liability for losses suffered by their syndicates. Some of these Lloyd's syndicates suffered enormous losses and the Names were greatly exposed to financial disaster. I have no doubt that this unfortunate situation has led to great stress for most, if not all, of the Names as many could lose an overwhelming portion of their life savings or possibly be completely wiped out. The Names have vigorously asserted that their loss exposure was caused or compounded by a fraud inflicted upon them by Lloyd's in its dealings with or relationship with various of its syndicates.

The Banks have submitted that they are entitled to be reimbursed and indemnified by the names for the monies which the Banks were required to pay out to Lloyd's as a result of the call on the LC (which liability was confirmed in the English actions as a result of a decision of Saville J. in the unreported case of **Society of Lloyd's** v. Canadian Imperial Bank of Commerce, of July 20, 1993, Queen's Bench Division, Commercial [**12] Court, 1993 Folio Nos. 112-116). Under ordinary circumstances this would be an "automatic situation"; i.e. the Banks would pay the call by Lloyd's under the agreement of the LC between the issuer (Bank) and beneficiary (Lloyd's) and the separate reimbursement and indemnification agreement between the account party being the requesting party to issue LC being the issuer's customer (Name) and the issuer who has responded to that request (Bank). The initial or underlying agreement was between Lloyd's and the Name whereby Lloyd's agreed to allow the Name to participate as a principal in an insurance syndicate of Lloyd's and the Name agreed to be liable without limitation for any obligation of the syndicate and importantly for the aspect of this motion to have an LC issued by a bank or other financial institution (here one of the Banks) to partially secure that liability. These three contracts are separate and autonomous transactions: see Bank of Nova Scotia v. Angelica- [*702]

Whitewear Ltd. (1987), 36 D.L.R. (4th) 161 (S.C.C.) at p. 166-7; Dunlop Construction Products Inc. (Receiver of) v. Flavelle Holdings Inc. (1996), 31 O.R. (3d) 58 (C.A.); and Westpac Banking Corp. v. Duke Group [**13] Ltd. (1994), 20 O.R. (3d) 515 (Gen. Div.) at pp. 522-3, as to the autonomy of letters of credit. In Angelica-Whitewear Le Dain J. for the Court stated at pp. 166-7:

The fundamental principle governing documentary letters of credit and the characteristic which gives them their international commercial utility and efficacy is that the obligation of the issuing bank to honour a draft on a credit when it is accompanied by documents which appear on their face to be in accordance with the terms and conditions of the credit is independent of the performance of the underlying contract for which the credit was issued. Disputes between the parties to the underlying contract concerning its performance cannot as a general rule justify a refusal by an issuing bank to honour a draft which is accompanied by apparently conforming documents. This principle is referred to as the autonomy of documentary credits. It is reflected in general provision c. of the Uniform Customs (1962), which states:

"Credits, by their nature, are separate transactions from the sales or other contracts on which they may be based and banks are in no way concerned with or bound by such contracts."

In Westpac I observed [**14] as follows at pp. 522-3, pp. 531-2:
The L.C. does not incorporate or depend upon the other contracts. No party is privy to the contractual arrangements in all contracts: see Urquhart Lindsay & Co. v. Eastern Bank Ltd., [1922] 1 K.B. 318 at pp. 322-23, [1921] All E.R. Rep. 340 (Comm. Ct.), where Rowlatt J. said:

"In my view the defendants committed a breach of their contract with the plaintiffs when they refused to pay the amount of the invoices as presented. Mr. Stewart Bevan contended that the letter of credit must be taken to incorporate the contract between the plaintiffs and their buyers; and that according to the true meaning of that contract the amount of any increase claimed in respect of an alleged advance in manufacturing costs was not to be included in any invoice to be presented under the letter of credit, but was to be the subject of subsequent independent adjustment. The answer to this is that the defendants undertook to pay the amount of invoices for machinery without qualification, the basis of this form of banking facility being that the buyer is taken for the purposes of all questions between himself and his banker or between his banker and the seller to be [**15] content to accept the invoices of the seller as correct. It seems to me that so far from the letter of credit being qualified by the contract of sale, the latter must accommodate itself to the letter of credit. The buyer having authorized his banker to undertake to pay the amount of the invoice as presented, it follows that any adjustment must be made by way of refund by the seller, and not by way of retention by the buyer."

See also Davis O'Brien Lumber Co. v. Bank of Montreal, [1951] 3 D.L.R. 536 at p. 558, 28 M.P.R. 22 (N.B.C.A.). It is unquestionable that a basic tenet of letter of credit law is that letters of credit are autonomous to and independent of the underlying transaction to which they relate: see Malas v. [*703] British Intex Industries Ltd., [1958] 2 Q.B. 127 at p. 129, [1958] 1 All E.R. 262 (C.A.), where Jenkins L.J. stated:

"We have been referred to a number of authorities, and it seems to be plain enough that the opening of a confirmed letter of credit constitutes a bargain between the banker and vendor of the goods, which imposes upon the banker an absolute obligation to pay, irrespective of any dispute there may be between the parties as to whether [**16] the goods are up to contract or not. An elaborate commercial system has been built up on the footing that bankers' confirmed credits are of that character, and, in my judgment, it would be wrong for this court in the present case to interfere with that established practice."

See also Edward Owen Engineering Ltd. v. Barclays Bank International Ltd., [1978] 1 All E.R. 976, [1978] Q.B. 159 (C.A.).

It is well-established that a letter of credit is an independent obligation. The issuer bank agrees to pay to the beneficiary upon the satisfaction of the conditions contained in the letter of credit itself (e.g., the presentation of the appropriate documents). This rule is quite necessary to preserve the efficiency of the letter of credit as an instrument for the financing of trade. That is, it is clear that the conventions of letters of credit must be strictly adhered to and interpreted for the overall policy reason of maintaining this quite valuable facility on an overall basis: see the Uniform Customs and Practice for Documentary Credits (1983 Revision), International Chamber of Commerce Publication No. 400 ("UCP") [pp. 522-3].
. . . . .

It would appear that letters of credit [**17] issuing institutions would be well advised to specify reimbursement: see Lord Diplock at pp. 1044-45 of United City Merchants (Investments Ltd. v. Royal Bank of Canada, [1982] 2 W.L.R. 1039, [1982] 2 All E.R. 720 (H.L.):

"So the point falls to be decided by reference to first principles as to the legal nature of the contractual obligations assumed by the various parties to a transaction consisting of an international sale of goods to be financed by means of a confirmed irrevocable documentary credit. It is trite law that there are four autonomous though interconnected contractual relationships involved. (1) The underlying contract for the sale of goods, to which the only parties are the buyer and the seller; (2) the contract between the buyer and the issuing bank under which the latter agrees to issue the credit and either itself or through a confirming bank to notify the credit to the seller and to make payments to or to the order of the seller (or to pay, accept or negotiate bills of exchange drawn by the seller) against presentation of stipulated documents; and the buyer agrees to reimburse the issuing bank for payments made under the credit. For such reimbursement the stipulated [**18] documents, if they include a document of title such as a bill of lading, constitute a security available to the issuing bank; (3) if payment is to be made through a confirming bank the contract between the issuing bank and the confirming bank authorising and requiting the latter to make such payments and to remit the stipulated documents to the issuing bank when they are received, the issuing bank in turn agreeing to reimburse the confirming bank for payments made under the credit; (4) the contract between the confirming bank and the seller under which the [*704] confirming bank undertakes to pay to the seller (or to accept or negotiate without recourse to drawer bills of exchange drawn by him) up to the amount of the credit against presentation of the stipulated documents." [Emphasis added in Westpac; pp. 531-2.]

Fraud Exception

However, the question of fraud raises an exception to the "narrow vision" or "blinkered approach" to the agreements involved in a letter of credit situation. This was touched on in Angelica-Whitewear at pp. 167-8, pp. 168-9, p. 176, pp. 177-8, pp. 180-1:

The general rule with respect to fraud is that a bank is not responsible for payment against [**19] forged or false documents which appear on their face to be regular, as indicated in art. 9 of the Uniform Customs (1962), which provides in part:

"Banks assume no liability or responsibility for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any documents, or for the general and/or particular conditions stipulated in the documents ... "

The same principles are embodied in the 1974 and 1983 revisions of the Uniform Customs and Practice for Documentary Credits.

An exception to the general role that an issuing bank is obliged to honour a draft under a documentary credit when the tendered documents appear on their face to be regular and in conformity with the terms and conditions of the credit has been recognized for the case of fraud by the beneficiary of the credit which has been sufficiently brought to the knowledge of the bank before payment of the draft or demonstrated to a court called on by the customer of the bank to issue an interlocutory injunction to restrain the bank from honouring the draft. The scope and availability in practice of the fraud exception to the autonomy of documentary credits have turned on several questions, of which [**20] the most important would appear to be the following: (a) the kinds of fraud that should be recognized as falling within the fraud exception, or more specifically, whether the exception should be confined to cases of forged or false documents or whether it should extend to fraud in the underlying transaction; (b) the related question of the proof or demonstration of fraud that should be required to relieve an issuing bank of its obligation to honour a draft or to warrant the issue of an interlocutory injunction to enjoin it from doing so: (c) whether the fraud exception should be opposable to a holder in due course of a draft, that is, one who took the draft for value and without notice of the fraud, and (d) whether the fraud exception should be confined to fraud by the beneficiary of a credit, or whether it should include fraud by a third party which affects the letter of credit transaction but of which the beneficiary of the credit is innocent. Differences of view or emphasis with respect to these issues, particularly the kind of fraud and proof required, reflect the tension between the two principal policy considerations: the importance to international commerce of maintaining the [**21] principle of the autonomy of documentary credits and the limited role of an issuing bank in the application of that principle; and the importance of discouraging or suppressing fraud in letter of credit transactions. The potential scope of the fraud exception must not be a means of [*705] creating serious uncertainty and lack of confidence in the operation of letter of credit transactions; at the same time the application of the principle of autonomy must not serve to encourage or facilitate fraud in such transactions. The relative emphasis on the one or other of these two

considerations tends to explain what have been characterized as the strict and more liberal approaches to the availability of the fraud exception, each of which has had its judicial and academic adherents [pp. 167-8].
. . . . .

Most of the cases have involved an application for a preliminary or interlocutory injunction to restrain an issuing bank from paying under a letter of credit or guarantee. Few, if any, have had to address the precise issue raised by this appeal: what the customer or applicant for the credit must show, where there has not been an application for injunction, to justify a conclusion [**22] that an issuing bank was not obliged to pay a draft under a letter of credit because of its prior knowledge of fraud by the beneficiary, and that its payment of the draft was, therefore, an improper or unauthorized one for which the customer was not obliged to reimburse the bank [pp. 168-9].
. . . . .

In my opinion, the fraud exception to the autonomy of documentary, letters of credit should not be confined to cases of fraud in the tendered documents but should include fraud in the underlying transaction of such a character as to make the demand for payment under the credit a fraudulent one. The Sztejn and Cambridge Sporting Goods cases, to which reference has been made, illustrate the difficulty of distinguishing in some cases between a case of false documents and a case of fraudulent shipment covered by documents which accurately describe the goods called for [p. 176].
. . . . . [*706]

On the issue raised by this appeal, I would draw a distinction between what must be shown on an application for an interlocutory injunction to restrain payment under a letter of credit on the ground of fraud by the beneficiary of the credit and what must be shown, in a case such as [**23] this one, to establish that a draft was improperly paid by the issuing bank after notice of alleged fraud by the beneficiary. A strong prima fade case of fraud would appear to be a sufficient test on an application for an interlocutory injunction. Where, however, no such application was made and the issuing bank has had to exercise its own judgment as to whether or not to honour a draft, the test in my opinion should be the one laid down in Edward Owen Engineering - whether fraud was so established to the knowledge of the issuing bank before payment of the draft as to make the fraud clear or obvious to the bank. The justification for this distinction, in my view, is the difficulty of the position of the issuing bank, in so far as fraud is concerned, by comparison with that of a court on an application for an interlocutory injunction. In view of the strict obligation of the issuing bank to honour a draft that is accompanied by apparently conforming documents, the fact that the decision as to whether or not to pay must as a general rule be made fairly promptly, and the difficulty in many cases of forming an opinion, on which one would hazard a lawsuit, as to whether there has been fraud [**24] by the beneficiary of the credit, it would in my view be unfair and unreasonable to require anything less of the customer in the way of demonstration of an alleged fraud [pp. 177-8].
. . . . .

It is important to bear in mind that an issuing bank does not, as a general rule, have a duty to satisfy itself by independent inquiry, that there has not been fraud by the beneficiary of a credit when it is presented with documents that appear on their face to be regular. It is only when fraud appears on the face of the documents or when fraud has been brought to its attention by its customer or some other interested party that it must decide whether fraud has been so established as to require it to refuse payment [pp. 180-1; emphasis added].

It is clear from the emphasized portions of Angelica-Whitewear that the test of it being clear and obvious to the bank is a rather high one, implicitly I would think higher than a court being satisfied of there being a strong prima facie case of fraud. Clearly a financial institution should not reach its conclusion merely as an accommodation to its customer.

Blair J. in Royal Bank of Canada v. Darlington (unreported decision released April 19, [**25] 1995, Ontario Court (General Division), Commercial List No. B312/93, B311/93, B58/94, B310/93, B73/94, B128/94) [summarized 54 A.C.W.S. (3d) 738] dealt with a case where other financial institutions ("Other Banks") were called on by Lloyd's to pay the call by Lloyd's on the letters of credit the Other Banks had issued at the request of other Canadian names ("Other Names"). Blair J. stated at p. 5:

The [Other] Banks who are Applicants in these proceedings were not persuaded that clear or obvious fraud on the part of the Society and Council of Lloyd's had been established on the documentation and materials provided to them. They honoured the Letters of Credit, and paid. They now seek re-imbursement from the Names.

The obligation to reimburse the Banks, if found, and the attendant unlimited liability which attaches to being a Lloyd's "Name", will create considerable hardship for the Respondents. There is little doubt on the evidence that these calls, and the liabilities which have been incurred as a result of the inordinate losses sustained in the Lloyd's market in recent years have wreaked havoc on the lives and fortunes of these Names, and others who find themselves in similar [**26] positions. Many are in danger of losing their homes, or worse, are on the verge of bankruptcy.

However the Other Banks in that case were not satisfied that what the Other Names had presented them was evidence of clear and obvious fraud on the part of Lloyd's, with the result that they did not honour the call by Lloyd's, although it appears that the Banks in this case got the equivalent information as the Other Banks did as to Lloyd's alleged fraud. Blair J. concluded that the Other Banks had acted appropriately in coming to their conclusion that there was no clear and obvious fraud. Apparently since that [*707] time, all calls by Lloyd's on letters of credit have been honoured by Canadian issuers.

The parties in the subject litigation on both sides have kept their cards very close to their vests. It is not altogether clear why the Banks chose to dishonour -- but then subsequently in litigation in England when Lloyd's sued them for failure to pay on the call, they did not specifically plead fraud as a defence themselves but only as an allegation of the Names. The English Actions statement of defence of the Banks in this regard asserted:

7(a) The defendant [Bank] has been [**27] provided with information which its customer [Names] alleges amount to a sufficient case of fraud as to entitle the Defendant to decline to honour the draft that has been presented. Full particulars of the said information are set out in the Schedule hereto and copies of all such information have been provided to the Plaintiff [Lloyd's].

(b) The Defendant contends that the material provided was, to a reasonable banker in the position of the Defendant, sufficient to amount to notice of clear fraud by the Plaintiff. Further or alternatively, the material provided was such as would lead a reasonable banker in the position of the Defendant to infer fraud by the Plaintiff. Accordingly, the Defendant was entitled to dishonour the draft and to decline to make any payment to the Plaintiff under the letter of credit.

(c) For the avoidance of doubt, the Defendant does not allege fraud against the Plaintiff. [Emphasis added.]

It was a curious defence by the Banks. They submitted that the Names have alerted them to and provided them with sufficient information for the Banks to conclude that there was a clear and obvious case of fraud by Lloyd's on the Names. Hence to protect their reimbursement [**28] rights against the Names they dishonoured the LC. However notwithstanding what was accepted by them as a clear and obvious case of fraud by Lloyd's, the Banks did not plead fraud on the Names against Lloyd's nor attempt in any other way to defend against payment by the Banks on the call on the LC by Lloyd's by attempting to prove this alleged fraud. It is therefore quite puzzling to also see that the Bank of Montreal (as per the affidavit of Peter Wren ("Wren"), Managing Director, Trade Finance) was possibly influenced by its customers' entreaties, was concerned about an Ontario court possibly second-guessing it, was possibly influenced by the aspect of giving its customers additional breathing room in their dispute with Lloyd's and was not apparently sufficiently concerned with the integrity of the letter of credit system:

66. In October 1993, Lloyd's delivered a "demand before action" letter to the English solicitors for the Four Banks warning that Lloyd's intended to commence court action in England to recover payment on a large number of [*708]

Other Calls dishonoured on letters of credit issued at the request of the Defendant Names. A copy of Lloyd's letter was forwarded [**29] to the Ontario solicitors for the Defendant Names, who responded that "our clients will not seek an injunction in England" [emphasis not mine].

67. As late as December 1994, correspondence exchanged with their Ontario solicitors made it clear that the Defendant Names still declined:

(a) to intervene in any English litigation brought by Lloyd's against the Four Banks to enforce payment on the letters of credit, or

(b) to take any active steps to prevent Lloyd's from obtaining judgment against the Four Banks (unless the Four Banks were to first plead fraud against Lloyd's).

68. Since the Four Banks had given clear notice that they would not plead fraud against Lloyd's, the inaction of the Defendant Names made it inevitable when Lloyd's served its "demand before action" letters that Lloyd's would obtain judgment in England for the Other Calls. If the Four Banks had further delayed payment to Lloyd's on the Other Calls, then the Four Banks would have become liable to Lloyd's for additional interest.

The Names on the other hand, despite repeated requests by the Banks to join in and take action against Lloyd's based upon the fraud they claimed had been perpetrated against [**30] them by Lloyd's, did not do so. Rather then aggressively pursuing this, once the Names had got the Banks to dishonour the call on the LC by Lloyd's, the Names became quite passive and adopted what at most might be characterized as a watching brief in the English Actions. They -- or their counsel -- did not take up Saville J.'s suggestion on May 26, 1993 and his comments from the bench that if the Names failed to seek an English injunction then it could be said that they had had their chance and should have intervened in the English Actions and that they could then not be heard to complain about the conduct of the Banks. This was noted by Wren when he reports in his affidavit at paragraph 85 (g) that Saville J. commented:

(a) Regarding the reimbursement rights of the Four Banks, the Defendant Names would have some explaining to do if they made no attempt to obtain an English injunction restraining payment on the letters of credit. If no injunction was sought, the Banks could say to the Names that they had had their chance and they should have intervened in the English LC actions. If the Banks decided to pay in such circumstances, the problem would be one for the Names, and not [**31] for the Banks;

(b) In the event of the trial of the proposed preliminary issue decided against the Four Banks, Mr. Justice Saville was minded to give the Banks the opportunity to consider amending the Points of Defence to plead fraud. In that event, the Defendant Names would have an opportunity to reconsider their position and to seek an English injunction to restrain payment on the letters of credit; and

(c) If the Banks decline to plead fraud against Lloyd's, then they would become legally obligated to make payment on the letters of credit. In [*709] such circumstances, the risk of prejudice to the Banks' reimbursement rights would be small. [Emphasis added.]

On the other hand, notwithstanding that Saville J. gave the Banks the opportunity for the Banks to plead fraud against Lloyd's, following his determination that the Banks pleading as set out above in the English Actions would not provide them a defence (see **Society of Lloyd's** v. Canadian Imperial Bank of Commerce, unreported decision of Saville J. dated July 5, 1993, Queen's Bench Division, Commercial Court, 1993, Folio Nos. 112-116), the Banks declined to do so. The end result was that the Banks were found [**32] liable to Lloyd's in the English Actions on July 20, 1993 and were required to pay up on the LC. Without the Banks themselves pleading fraud, the Banks were naked as in essence there was then no defence; it was not sufficient for the Banks to assert that the Names alleged fraud by Lloyd's. Saville J. had stated on July 5, 1993 at pp. 3-6:

Faced with these difficulties, Mr. Carr sought to support the defence by another route. He pointed out that a customer of a Bank who had requested the Bank to issue a Letter of Credit could obtain an injunction restraining the Bank from paying the beneficiary if he could persuade the Court that there was clear evidence of fraud of a kind which, if established, would amount to a defence to a claim on the Letter of Credit. Surely, he suggested, the Bank should in effect be able to do the same.

The difficulty with this argument is twofold. Firstly, unlike the present case, the plaintiff in the postulated case would be making an allegation of fraud. Secondly, the injunction obtained by the customer would only be of a interim kind, and would be made permanent only if the customer was able at the trial to prove that there had in fact been a fraud [**33] of a relevant kind. There is nothing in those cases to suggest that evidence of fraud, as opposed to fraud itself, provides any form of permanent as opposed to temporary defence to a claim under a Letter of Credit. The correct analogy with a customer seeking a temporary injunction would be a case where the beneficiary sought summary judgment against a Bank that resisted on the basis that there was a relevant fraud. If the Court considered that there were sufficient grounds for this allegation, it would be likely to give the Bank leave to defend the proceedings, but if the Bank ultimately failed to prove the existence of a relevant fraud, then it would be adjudged liable to honour the Letter of Credit.

At one stage in the argument Mr. Carr submitted that the present application was really only concerned with the management of the cases pending trial. This, however, is not the position. I am not dealing with an application for summary judgment but whether the plea, if established, would provide a defence to the claims.

Mr. Carr also submitted that if the Banks did have clear notice of fraud but nevertheless paid, then they would be most unlikely to obtain reimbursement from [**34] their customers, who could correctly assert that since the Banks were not legally obliged to pay, there was no corresponding obligation to reimburse them. This, of course, is true, provided that the Banks were [*710] indeed not legally obliged to pay, but to my mind this does not advance Mr. Carr's argument. If a Bank has notice of matters which might amount to evidence of fraud, then it must make up its mind whether or not the material is sufficient to justify a plea of fraud. If it is, then the Bank can resist payment on this basis and if it can establish relevant fraud it will be under no obligation to honour the Letter of Credit. If the Bank considers the material to be insufficient to plead fraud, then its assessment will be either right or wrong. If right, then ex hypothesi there will be no notice of relevant fraud and thus the customer can hardly resist reimbursing the Bank who pays in those circumstances. If the Bank incorrectly concludes that there is insufficient material to plead fraud, then it can hardly complain if it is not reimbursed, any more than it could if it mistakenly paid on non-conforming documents.

Quite apart from these considerations, I am unpersuaded [**35] that the rights and obligations under a Letter of Credit should somehow depend on whether or not the Bank has a right to reimbursement from its customer or otherwise, or on the rights and obligations existing between the Bank and these third parties. The authorities both here and abroad are unanimous in treating Letters of Credit contracts as quite independent transactions. So far as these are concerned it is to my mind clear beyond argument that the only substantive defence to a claim for payment relevant in the present context is that there was fraud of a relevant kind. As I have said, the Bank may be able to resist summary proceedings if it alleges relevant fraud and persuades the Court that there is sufficient material to justify a trial of this issue. In the present case, whether or not such material exists is irrelevant, since no plea of fraud is made.

In conclusion I should note that neither party suggested that there was anything in the form of the Letters of Credit that affected the question at issue, and all were of the view that the position would be the same whether or not the documents in question are to be regarded as more akin to performance guarantees or standby [**36] Letters of Credit than documentary Letters of Credit. I too agree with this. Finally, it seems to me to be clear beyond doubt that the proper law of the Letters of Credit is English law and even Mr. Carr, with all his skill, was unable to suggest any basis on which the contrary could be argued.

For these reasons I hold that even if the matters alleged in Paragraph 7(a) and (b) of the Points of Defence were to be established, they would provide no defence to the claim.

In Darlington at p. 55 Blair J. commented on this situation of the Banks pleading in paragraph 7 as they did:

This pleading is apparently similar to ones filed by other Canadian Banks in similar U.K. proceedings [i.e. the Banks in the English Actions]. The Respondents submitted to the Applicant Banks in these proceedings that the U.K. pleading constituted an admission on the part of the other Canadian Banks that clear or obvious fraud had been established. It constituted no such admission, however, in my view. It was simply a pleading and an attempt to set up a "reasonable banker" defence. "Fraud" was specifically not alleged against the **Society of Lloyd's.** In any any event, Mr. Justice Saville in the U.K. [**37] Court struck out the pleading, giving CIBC leave to amend to allege fraud directly against the Society. The Bank declined to do [*711] so, and judgment was subsequently granted against it in favour of the Society requiring CIBC to pay on the letters of credit.

Blair J. went on at pp. 74-5 to discuss the task of a banker faced with an assertion by its customer that the customer had been a victim of fraud by the beneficiary of the letter of credit.

What is the duty cast upon a banker presented with materials and information which the customer asserts establishes clear or obvious fraud on the part of the beneficiary of the letter of credit? Is the measuring stick by which the performance of that duty is to be assessed an objective one, i.e., is it the test of "the reasonable banker"; or is the performance of the duty to be measured by some other parameter? Does the banker have an obligation to make independent inquiries beyond the information and materials provided by the customer?

These questions raise difficult practical concerns for the bankers, for in the performance of this exercise, it seems to me, they operate under two major disabilities. In the first place they [**38] are neither lawyers nor judge. In the second place, they are not experts in the particular field of commerce or business which is the

subject of the underlying transaction. With respect to this latter difficulty, and in the context of these particular proceedings, they are not insurers; and the world insurance market, which provides the setting for the underlying transactions here, is extremely complex and sophisticated.

Although the bankers have professional advice available to them in both the legal and insurance fields, they are ill-equipped as bankers -- and it is their function as bankers which is at issue here -- to carry out the task ascribed to them by the Supreme Court of Canada in Angelica Whitewear and by the English Court of Appeal in Edwards Owens Engineering. It is for these reasons, I am sure, that both of those Courts have placed the standard of convincing so high.

For "fraud", although an easy word to say, is a concept that is not always easy to apply. And the world insurance market, as I have observed, is very complex. To ask bankers to make a determination that fraud has been established in a fashion that is "clear or obvious" in such a context, is to assign [**39] them a difficult task -- one for which, as I have said, they are not well equipped.

This can cut both ways, however, and raises two further questions. Does it follow that bankers can take a more laissez-faire approach and allow themselves to be persuaded more easily that fraud has not been "established" with the required clarity? Or, does it mean that the banker's obligations are even more onerous, and that, in such circumstances, in order to protect the interests of their customers, as well as to ensure that they are meeting their obligations to the beneficiary contracting party, that they must dig deeper and make extra enquiries and that, as Mr. Lenczner submitted, the test should be applied in a more elastic fashion (my words) in recognition that fraud may be more difficult for the customer to establish in such circumstances? [Emphasis added.] [*712]

Blair J. had considerable sympathy for the position of issuers of credit when faced with a customer claiming a fraud has occurred when he observed at p. 85:

It was said at the outset of these proceedings that the U.K. trial, when it takes place, is estimated to last several months. One might be forgiven, it seems to me, [**40] for asking --rhetorically, at least -- how bankers, who are neither lawyers nor judges, could be expected to determine that clear or obvious fraud had been established when it is expected to take a court such a long time to assess the evidence in that regard!

Questions to be Answered

As discussed infra, the Banks took a curious hybrid approach. While apparently reasonably reaching a conclusion on the material presented to them by the Names that there was a case of clear and obvious fraud by Lloyd's against the Names, the Banks declined to plead fraud against Lloyd's in the English Actions. Was this appropriate (in the sense of preserving their reimbursement rights against the Names)? To answer that it would seem to me that the following questions have to be answered:

(a) Who has the responsibility for fighting a lawsuit by the beneficiary of a letter of credit if the customer has provided the issuer with material on which the issuer reasonably makes the conclusion that there is a clear and obvious case of fraud by the beneficiary against the customer?

(b) Can this responsibility be shared or transferred?

(c) If so, on what basis? Need the issuer do anything more than resist [**41] payment and advise in its defence that while it does not plead fraud its customer alleges same leaving it to the customer to prove fraud?

(d) Do the circumstances present in this situation allow the sharing or transfer?

(e) If the issuer does not fulfill all requirements of it in the issuer-- beneficiary call on a letter of credit action, can the customer raise this deficiency in defence of a resultant reimbursement and indemnification action by the issuer?

(f) Are there other bases upon which the issuer can rely in advancing its reimbursement and indemnification action -- namely (i) the Parker v. Lewis [infra] indemnity principle; (ii) estoppel by conduct; and (iii) res judicata?

Questions (a) to (e) are intertwined; the discrete aspects of question (f) are also somewhat intertwined.

It appears clear from Angelica-Whitewear at pp. 177-8 that a customer in a letter of credit situation may take legal steps to [*713] prevent the issuer from paying out on a letter of credit. That would be for either the customer:

(i) to start legal proceedings in an attempt to obtain an interlocutory injunction prohibiting the issuer from paying out on the letter of credit pursuant to [**42] a call otherwise reasonably made by a beneficiary with the grounds for such injunction being a strong prima facie case of fraud of the beneficiary to the detriment of the customer; or

(ii) to notify the issuer of the beneficiary's fraud, providing the issuer with such evidence sufficient enough for the issuer to reasonably reach the conclusion that there was a clear and obvious case of fraud.

However in this second instance it appears to be the issuer who is required to participate in the lawsuit as a party -- i.e. be the defendant in a lawsuit which may be brought by the beneficiary for payment of the letter of credit; it is not the customer's lawsuit in the sense of a lawsuit being brought by or against the customer. I reach this conclusion in light of what Le Dain J. said at pp. 177-8 of Angelica-Whitewear:

> In view of the strict obligation of the issuing bank to honour a draft that is accompanied by apparently conforming documents, the fact that the decision as to whether or not to pay must as a general rule be made fairly promptly, and the difficulty in many cases of forming an opinion, on which one would hazard a lawsuit, as to whether there has been fraud by the beneficiary [**43] of the credit, it would in my view be unfair and unreasonable to require anything less of the customer in the way of demonstration of an alleged fraud. [Emphasis added.]

The Banks, aside from the Bank of Montreal, apparently relied on legal advice for which privilege was claimed in reaching their decision not to honour the call by Lloyd's. Wren of the Bank of Montreal appears to be the only bank official who reviewed the documentation provided by the Names. Wren, in advising that he tried to apply the test in Angelica-Whitewear, testified on August 9, 1996 in his cross-examination on his affidavit sworn November 24, 1995 as follows:

> 52. Q. Yes, a Statement of Defence was prepared on behalf of the bank and paragraph 7(b) of that defence states, and I quote -- and this is the Bank of Montreal "the defendant contends that the material provided was, to a reasonable banker in the position of the defendant, sufficient to amount to notice of clear fraud by the plaintiff Lloyds." Now stopping there, that was your Statement of Defence?
>
> A. That was part of it, yes.
>
> 53. Q. Right and the reasonable banker referred to at the Bank of Montreal is you? [*714]
>
> A. That's right. [**44]
>
> 54. Q. And it is therefore your statement that the material supplied by your customer was sufficient to amount to a notice of clear fraud?
>
> A. It was sufficient to, yes.
>
> 55. Q. And that pleading is consistent with the statement in the letter of December 24, 1992 which I have read to you, "the banks are concerned that the materials submitted has, on the objective standard of a reasonable bank, put them on notice of clear and obvious fraud"?
>
> A. Yes.
>
> 56. Q. And that was the reason for the dishonour?
>
> A. Are you asking for my reason for recommending we dishonour?
>
> 57. Q. No, that's what the Statement of Defence says, correct?
>
> A. That's what the Statement of Defence says, yes.

58. Q. Yes, that's the Bank of Montreal's Statement of Defence.

A. I guess so.

59. Q. Now, sir, prior to November of 1992, when you had to make a decision whether to honour or dishonour Lloyds' call, you were familiar with the decision of the Supreme Court of Canada in a case of Bank of Nova Scotia versus Angelica-Whitewear?

A. Yes.

. . . . .

64. Q. You knew the Supreme Court of Canada is the highest court in the land?

A. Yes.

65. Q. You knew that it was [**45] a significant decision?

A. I knew it was an important decision, yes.

66. Q. And you had read it?

A. Yes, several years before.

67. Q. And I think you knew what it stated because if I can assist you, would you turn to your paragraph 103(b) and in 103(b) in the second sentence you say, "I understand that in England and in Canada the fraud exception only applies where documented evidence of fraud by the beneficiary has been presented to the issuing bank before or at the time when a call is made on the Letter of Credit", correct?

A. What's the question, that I am aware of that?

68. Q. Yes. That's your statement, correct?

A. That's right.

69. Q. And you were aware of that in November of 1992?

A. Yes.

70. Q. And that is in effect what the Supreme Court of Canada has said in Angelica?

A. Yes.

71. Q. And then you go on to say, "once presented with such documentation the issuing bank must then decide whether that documented evidence of fraud meets the test of being clear and obvious". That's right? [*715]

A. That's right.

. . . . .

76. Q. Once it has been presented what you mean by the bank must then decide, once it has the documents [**46] it must then decide? Is that a subsequent action, having the material in front of it the bank has to decide?

A. As it does with any documents presented on a Letter of Credit it has to make a decision on them.

77. Q. It has to make a decision whether to honour or dishonour, correct?

A. Based on the material presented.

78. Q. Yes, and that was the judgement that was exercised in November of '92 by you?

A. In looking at the material that was presented with these claims by the names, by the beneficiaries, by the applicants I was sufficiently concerned that a court of law might decide that there was in fact fraud and therefore I felt uncomfortable and decided to give the benefit of the doubt to the names.

79. Q. You applied this test, didn't you? You have said, "I understand that in England and Canada the fraud exception only applies where documented evidence of fraud has been presented to the issuing bank before payment", correct? That's what you have said.

A. Right, that's what I have said.

80. Q. And that was your understanding of the legal tests that applied?

A. At the time that I made the decision I didn't have all this information in terms of the [**47] legal tests in mind. I was looking at the evidence that was presented, a lot of the material that you provided yourself on behalf of the names, and looked at it and felt that the issues were sufficiently complex that there might be a chance that some court might decide that there was in fact fraud and therefore I felt uncomfortable in honouring the payments.

. . . . .

85. Q. What did you hear about it? From somebody on the street said, oh, before you have to make up your mind whether to honour or dishonour this you have to have documentary evidence provided to you? Did you not understand that this is a test that was being applied by various courts?

A. I was aware that fraud was a reason not to pay under Letters of Credit, if it could be proved.

86. Q. Then you go on to say, "the issuing bank must then decide whether that documented evidence of fraud meets the test of clear and obvious". Where did you understand that from?

A. From various sources of information, including the Supreme Court case that you mentioned.

87. Q. Right, including the Angelica case?

A. Right.

88. Q. All right, and so this was your understanding of the test that comes partly out [**48] of Angelica, is that fair? [*716]

A. Yes.

89. And that is the test that you tried to apply in November of 1992?

A. Well, can you define again what you think the test is?

90. Q. The test, sir, that you have set out yourself. I am not trying to put out anybody else's. The issuing bank, being the Bank of Montreal, must then decide whether that documented evidence of fraud meets the test of being clear and obvious. That's the test that you tried to apply?

A. That's the test that I tried to apply. [Emphasis added.]

As presently constituted and set out in Angelica-Whitewear the clear and obvious fraud reason for an issuer to dishonour an otherwise regular call by a beneficiary on a letter of credit is a question for the issuer to decide. It is up to the issuer to make up its mind; the issuer does not have the luxury of having a court make up the issuer's mind. It is for that reason as well that the test is set so high -- it must be clear and obvious to the issuer that the beneficiary has perpetrated a fraud against the issuer's customer. The test for the issuer is not whether a court will or may eventually determine that there was fraud, but rather when the issuer [**49] looked at the situation, was it clear and obvious to him acting reasonably that there had been a fraud.

Blair J. then went on in Darlington to discuss a bank's duty to advise its customer. While he was looking at the front end of the situation in the sense of whether a bank had an obligation to counsel its customer relating to the customer's use of the money being advanced by the bank when they were entering into a loan or credit

relationship, it would seem to me that a bank when faced with a customer claiming to be victim of fraud by the beneficiary of a letter of credit would have no higher duty regarding the question to honour or dishonour. Blair J. stated at pp. 112-3:

In my opinion, no such dominating influence existed between the Banks and the respondent customers in these proceedings with respect to the issuance of the Letters of Credit; nor were there any circumstances of vulnerability or dependency, which could give rise to any relationship other than that of ordinary lender and borrower. The Respondents were each arms-length commercial customers who came to the Banks with the form of instrument they were seeking to have issued on their behalf (and which, indeed, they [**50] were required by contract with Lloyd's to have issued). They requested the Banks to issue that instrument. The Banks did so. No one asked for any advice. Most had independent legal and accounting advice available to them, and some even took such advice. With the exception of Mrs. Marjorie Hendrie, and the possible exception of Mrs. Perrin (who did not testify), they were all reasonably sophisticated people with business experience. To the extent that they were careless in not protecting their own interests, or were content to rely on others to do so, they cannot shift the responsibility for that conduct to the Banks in these circumstances. No duty to advise or to explain arises in a relationship of the son which existed [*717] between the Banks, as issuers of the Letters of Credit, and the Respondents, as customers requesting their issuance, in my view, and none existed here.

Blair J. determined that the Other Banks were justified in coming to the conclusion on the evidence presented to them by the Other Names that there was no clear and obvious case of fraud made out in that material. He determined that the Other Names were required to reimburse the Other Banks. That issue [**51] of reimbursement is a question of Canadian law. What is before me is one aspect of the reimbursement litigation between the Banks and the Names; the subject case will have to be determined pursuant to Canadian law. Thus while the observations of Saville J. in the English Actions well may be prudent counsel for all involved, not only are they merely observations in the English Actions but they do not of course set out Canadian law, nor do they purport to do so. I take his observations as intended to have the positions of the Names in essence primarily advanced by those Names in light of their stake in the situation and not to have something go by way of "default" when that result would affect the vital interests of the Names. His observations insofar as the aspect of the Banks being required to plead fraud and his giving them time to do so on the other hand directly affected the Banks in the English Actions since that litigation was governed by English law.

In the same way the situation is somewhat murky as to why the Banks acceded to the Names in dishonouring the call of Lloyd's on the LC when the Other Banks reached what Blair J. considered to be a justified conclusion in determining [**52] that there was no clear and obvious case of fraud made out in the documentation presented to them (as it seems that each had equivalent material presented to it). Although of course Blair J. determined at pp. 74-8 that the banker's duty was not an objective one but rather that the banker must exercise his own judgment reasonably in the sense of acting honestly and in good faith in his capacity as a banker. Thus each issuer had to make up his own mind. However at pp. 97-8 Blair J. concluded that the Other Banks had in any event met the "reasonable banker" objective test if he were in error and it were the applicable test. It is similarly puzzling why the Banks not only dishonoured the call originally but persisted in doing so all the way through the English Actions but without providing any evidence of fraud. Rather as seen in their defence in paragraph 7, they pleaded that the Names were asserting fraud but that the Banks were not pleading fraud themselves. Rather than carry the ball (of proving fraud) themselves, they wished to effectively retire from the playing field and have the Names come into the game as substitutes. In passing I would observe that I have the greatest of [*718] [**53] sympathy for the predicament of the Banks. In the real world of banking, including in particular situations involving letters of credit, decisions and actions have to be taken forthwith in the circumstances. Letters of credit as a genus unless "instantly" acted on -- i.e. an otherwise regular call upon a letter of credit -- would depreciate radically in value as a general financial obligation. Then as well, one must consider the business result for a financial institution which dithered as to whether to honour a call; I think it a fair observation that its letters of credit would be downgraded in the marketplace if not generally shunned. UCP 400 applies to documentary and standby letters of credit (the subject case being a standby letter of credit situation). The issuing bank, pursuant to article 16(c), has a reasonable time in which to examine the material and to decide whether to refuse payment.

In their factum the Banks stated that they did not plead fraud against Lloyd's because:

48. (a) banks do not undertake when issuing letters of credit either to investigate or to litigate their customers' complaints against the beneficiaries of the letters of credit; (b) the Four [**54] Banks neither participated in, nor were victims of, Lloyd's alleged fraud against the Names; and (c) the Defendant Names themselves declined to plead fraud in England or to seek an English injunction when called upon by the Four Banks to do so.

Wren in his affidavit gave the following reasons why the Banks (the Four Banks as they are referred to) did not plead fraud in the English Actions:

102. In essence, the Four Banks declined to plead fraud against Lloyd's for two reasons: (1) When a bank issues its letter of credit it does not undertake to its customer that it will investigate or litigate any subsequent complaints made by its customer against the beneficiary of the letter of credit (such as breach of contract, negligence, or fraud), and (2) Secondly, the Four Banks neither participated in, nor were they the intended victims of, Lloyd's alleged fraud on the Defendant Names. The Four Banks had no responsibility for establishing the fraud allegations made by the Defendant Names against Lloyd's. These two reasons will be more fully explained below.

103. Firstly, no undertaking is given by an issuing bank to either investigate or litigate its customer complaints against [**55] the beneficiary of a letter of credit for the following reasons:

(a) The economic viability of letter of credit turns on the so-called "autonomy principle" codified by Article 3 of UCP 400 and General Provision (c) of UCP 290 [earlier version of UCP 400] and also recognized by the Supreme Court of Canada in Angelica Whitewear. The autonomy principle states, in essence, that the payment obligation of the issuing bank on a letter of credit is independent of, or unaffected by, any commercial dispute that may arise as between the parties to the underlying transaction which gave rise to that letter of credit. The independence of letter of credit under the autonomy principle is [*719] recognized by Mr. Justice Saville at page 5 of his Reasons of July 5, 1993 (previously identified as Exhibit 27).

(b) The autonomy principle is subject to the fraud exception, which is not codified in the UCP and which, I understand, is applied somewhat differently by the courts of various countries. I understand that in England and in Canada, the fraud exception only applies where documented evidence of fraud by the beneficiary has been presented to the issuing bank before, or at the time when, [**56] a call is made on the letter of credit. The issuing Bank must then decide whether that documented evidence of fraud meets the test of being "clear and obvious".

(c) Article 15 of UCP 400 and Article 7 of UCP 290 provide that it is the responsibility of the issuing bank to take reasonable care to ensure that call documents presented by the beneficiary for payment conform in all respects with the terms of that letter of credit. This principle is often referred to as the "rule of strict documentary compliance".

(d) In essence, the combined effect of the autonomy principle, the fraud exception, and the strict rule of documentary compliance is to make the issuing bank under a letter of credit an examiner of documents". By this, I mean that the issuing bank acts like an examiner of documents for the purpose of determining whether call documents comply with the terms of the letter of credit or whether documented evidence of fraud by the beneficiary received at the time of a call meets the "clear and obvious" test. The bank has no responsibility for the underlying business transaction or for any commercial disputes which may arise from that transaction and its decisions. Underlying [**57] disputes, if any, are usually settled by the applicant and beneficiary and, if not resolved, may become subject to review by the courts.

(e) As examiners of paper, banks do not, when they issue a letter of credit, give their customer any undertaking to investigate or to litigate for that customer whatever allegations of wrongdoing that customer might in future assert against the beneficiary, whether those allegations be for breach of the underlying contract, negligence, or fraud.

(f) To the contrary, when such allegations are made by the customer, the usual practice is for a Bank to ask its customer to pursue its own remedies against the beneficiary. These may include injunctive relief in appropriate cases in the proper jurisdiction.

(g) In the rare circumstance where an issuing bank decides to plead fraud against the beneficiary, either the beneficiary has admitted its fraud or the bank has concluded that its own interests will be best served by making that pleading.

(h) Letters of credit are most commonly issued at the outset of a business transaction before either party has begun to perform its business obligations. At that time, the issuing bank has no reason to [**58] suspect that it could be drawn into expensive litigation between the applicant and beneficiary. In all my years of experience, 1 have never heard that any Bank anywhere in the world routinely requires its customers to provide security

sufficient to cover investigation or litigation costs for advancing a customer's position in disputes that might arise in future with the beneficiary of the letter of credit.

(i) Since banks usually ask their customers to litigate their own allegations of wrongdoing against the beneficiary of a letter of credit, the fees [*720]

charged for letters of credit are very small, usually in the magnitude of 1% of the face amount of the credit per annum (or less), based on the credit risk of the applicant. Banks do not factor in the heavy costs of investigating or litigating any allegations (fraud or otherwise) that our customer may make against the beneficiary.

(j) I am unaware of any institution anywhere in the world which prices its letter of credit business or defines its security requirements to include the cost of investigating and litigating fraud or other disputes that may arise between a customer and the beneficiary. To do so would fundamentally [**59] alter letter of credit business by making it too expensive and raising a risk factor not justified from experience. To do so, would in my view seriously imperil the business viability of Canadian letters of credit in the international marketplace.

104. Secondly, as set out below, the Four Banks neither participated in, nor were they the intended victims of, Lloyd's alleged fraud on the Defendant Names. For the following reasons, the Four Banks had no responsibility for establishing the fraud allegations made by the Defendant Names:

(a) As explained in paragraph 25(i), the Defendant Names admit that the Four Banks had no involvement in Lloyd's alleged fraud. Further, the Four Banks are not parties to the English Fraud Actions (where the merits of the fraud allegations will ultimately be decided at trial). The factual merits of the fraud dispute raise issues solely between Lloyd's and the defendant Names.

(b) The Defendant Names were given many opportunities to participate in the English LC Actions and to plead and make their case of fraud against Lloyd's. They declined every opportunity to do so, even though they pleaded (or adopted) fraud allegations made against Lloyd's [**60] in the Ash Action, the Alper Action, and the English Fraud Actions. They also declined to seek an English injunction restraining payment on the letters of credit.

(c) The Defendant Names (being the alleged victims of Lloyd's fraud) were in the best position to plead and prove their case of fraud against Lloyd's in the English LC Actions and the Four Banks repeatedly called upon them to do so. When the Defendant Names declined to plead fraud against Lloyd's in those proceedings or to take any other active steps to protect their position before Saville J., I was persuaded that Bank of Montreal should not in the circumstances of this case undertake the enormous costs and risks of pleading serious allegations of fraud against Lloyd's. The legal costs for trial of the Mason English Fraud Action were estimated by the English barrister for the Defendant Names, Mr. Craig Orr, to be in excess of 1 million British pounds sterling for each party (as explained in paragraph 83(g) above).

(d) Since the Four Banks were not involved in Lloyd's alleged fraudulent acts and the Ash Names declined every opportunity to plead their own case of fraud in the English LC Actions or to otherwise protect [**61] their own interests by seeking an English injunction against Lloyd's, the Four Banks declined to plead the Defendant Names' case of fraud against Lloyd's or to participate at the trial of the issue of whether Lloyd's has in fact defrauded Mr. Mason or the other Defendant Names.

105. I infer from their inaction that the Defendant Names decided that it was in their best interests to take no steps to prevent Lloyd's from obtaining [*721] summary judgment against the Four Banks in the English LC Actions. It seems a fair inference to me that the Names declined all such opportunities in the hope that they might somehow shift the financial burden of their enormous investment losses on to the banking system. [Emphasis added in paragraph 103(g).]

As to the emphasized portion (paragraph 103(g)) I would note that the fraud on the issuer's customer by the beneficiary of a letter of credit is the only permitted defence by an issuer (here the Banks) against a beneficiary (Lloyd's) on an otherwise regular call on the issuer's obligations under the letter of credit. Hence the pleading, if so warranted (and here the Banks reached the conclusion that there was clear and obvious fraud), [**62] would have been in the Bank's own interest. I would assume that issuing institutions generally take security and price their letter of credit charges so that overall on their total book of business they do not expect to be caught short on security nor to make a loss. In his July 20, 1993 reasons Saville J. at p. 3 noted in obiter that:

It is noteworthy in this connection that nearly a year ago the Names endeavoured in Canada to injunct the banks from making payment, but that attempt failed since the proceedings were stayed on the grounds that England was the appropriate forum. However no similar application for an injunction has been made in this country. It is said by way of explanation that the reason for this is there was no need for an injunction since the banks have been minded not to pay while advancing the defence referred to earlier. However, this fails to explain why no application for an injunction has been made since 5th July, although the Names were aware of the judgment given on that day and were aware that it would result in an application for payment of the sums claimed.

I understand the concern of the banks who, following a judgment against them in this jurisdiction, [**63] will face the prospect of seeking to obtain reimbursement from their customers in Canada. However, it seems to me that the chances of them being unable to recover in Canada in the circumstances of this case are slim, but that in any event, at the end of the day that is one of the risks a bank takes when issuing letters of credit, for which of course it is remunerated. [Emphasis added.]

As for the expense of litigation, I note that contractually and by the principle of indemnification (see infra), the Banks are entitled to be reimbursed for this expense and there would not seem to be any impediment to interim billing (and collecting). The Banks do not appear to have taken steps to have the English Actions heard after or in conjunction with the English fraud litigation between Lloyd's and the Names, or if so, they would appear to have been unsuccessful. The Banks have not shown any contractual obligation in the part of the Names pursuant to the autonomous reimbursement and indemnity agreement (or otherwise) whereby the Names were required to pursue Lloyd's as a means of allowing [*722] the Banks to in essence withdraw from actively defending the Lloyd's Action (the English Actions) [**64] against the Banks to honour the Banks' autonomous obligation to Lloyd's pursuant to the letter of credit agreement.

As to the question of the Names being involved in the English Actions, the Names stated in their factum.

33. Secondly the Banks at no time requested the assistance of the Names to plead fraud and had they done so the evidence and assistance would have been forthcoming.

This statement was made without reference to any of the record before me. However it appears from the chronology summary that the Bank's factum entitled: "Chronology of Request made by the Banks to the Names as to obtain an English Injunction or to otherwise intervene in the LC Actions" that the 19 requests detailed there did not specifically request the Names to assist the Banks in pleading fraud but rather were directed to the end of the Names directly participating -- either by way of obtaining an English injunction against Lloyd's or being added as party defendants or third parties (there being of course some difficulty in third partying someone where the defendant does not have a defence himself and here the Banks were not directly availing themselves of the fraud defence). I did not see any [**65] undertaking or other indication of the Names' willingness to assist the Banks in this regard of pleading fraud although this may have been in some other way discussed or offered.

The flavour of the dynamic tension discussions between counsel for the Names and for the Banks may be illustrated by the following letters (copies of which are appended to these reasons) exchanged the week before Saville J. struck out the Banks' defence relating to fraud:

(i) July 12, 1993 letter from Names' English counsel to Banks' English counsel;

(ii) July 13, 1993 letter from Banks' Canadian counsel to Names' Canadian counsel;

(iii) July 15, 1993 letter from Banks' Canadian counsel to Names' Canadian counsel.

It would appear rather obvious that the Names did not wish to become involved as parties in the English Actions nor in any way facilitate that result; similarly it would not appear that the Names wished to take on the role of primary actor in the English Actions but rather that they appear to have been content to leave the Banks in that role. The Names appear to have been content to have the July 20, 1993 motion proceed before Saville J. without [*723] asking for an adjournment to [**66] facilitate receiving information and giving instructions to counsel to interview. As Wren said in cross-examination:

263. Q. Are you suggesting here that the names are bound by the English judgment?

A. I am saying that the names deny that they are bound by the English judgment.

264. Q. Are you suggesting that they are bound by the English judgment?

A. No, I am not saying that.

On the other hand, I am of the view that it would be inappropriate for a bank, if otherwise obligated to defend against a beneficiary's call in an alleged fraud situation, to take the position that it does not wish to take on the expense of that litigation in an attempt to justify such relative inaction by suggesting that the fee it charged the customer on the issue of the letter of credit was insufficient to engage in such expensive litigation. While I have no doubt that a situation of the magnitude and complexity of the Lloyd's matter (keeping in mind that the Banks were presented by the Names with 12 boxes of material to support the fraud claim) is fairly unique, litigation involving fraud defences to letters of credit situations are not unknown. There is no requirement that the documentation [**67] of fraud be confined to merely a few pages nor that it be self-evident on the material presented by the beneficiary. One may be tempted to observe that it is puzzling how clear and obvious the fraud as presented to the Banks was if it took 12 full boxes for the Names to demonstrate it, although one may possibly presume that there was a road map and perhaps a great deal of redundant (or repetitious), equivalent material included. If the pricing structure of a financial institution is such that it cannot afford to defend cases of the nature of the English Actions, then it should consider revising either its pricing structure or its reimbursement and indemnity agreements with its customers to directly require the customer to defend such litigation while allowing the financial institutions to take a back seat. It was the Banks' money at stake in the English Actions (not the Names' money); the second question is whether the Banks can be reimbursed by the Names for their payout of their money to Lloyd's.

I went on in Westpac at pp. 533-4 to state:

At first glance it would appear that Bank has a strong case as to its position that it should be paid by Duke Can on a reimbursement or [**68] subrogation basis. This is so especially where one takes into account that while there are multiple contracts involved, they all evolve out of one overall relationship. However, this is not a situation where the autonomy principle [*724] can be ignored or overlooked to some degree or other. It should be noted that Bank and Duke Can are not liable to SG for the same debt. There is no joint liability. Neither is it a guarantee arrangement. When Bank paid SG, it paid its own debt arising out of its own contract with SG (the L.C.); Bank did not pay Duke Can's debt to SG. In fact, it must be recognized that Duke Can defaulted on payment of its debt to SG and that it was this act which permitted SG to issue the certificate which compelled Bank to pay on its contract with SG. Granted the two amounts are identical but the parties are not. Perhaps it would be helpful to emphasize this distinction if we appreciate that there could be a standby letter of credit issued by X to Y collectible on the basis of Z failing to construct for Y a building on time (or not delivering a painting to Y or even to A), especially when it is understood that the amount of payment under the letter of credit [**69] need not be the equivalent of damages or loss.

. . . . .

The parties chose to cover off the situation by way of letter of credit arrangements. As indicated previously it would be extremely dangerous to say that this is a matter of form which one should overlook and thereby reimburse Bank on the basis of substance. One must remember that the parties chose the letter of credit method as the way of satisfying the requirements; thus they chose how the substance of this transaction would be dealt with. The autonomy principle is not form, it is a foundation of the letters of credit regime. It is this regime which on a policy basis is recognized as being quite valuable to society (and the economy) as a whole.

As an example of the reimbursement and indemnity arrangements, Dr. Bodnar's application for the Canadian Imperial Bank of Commerce to issue an LC to Lloyd's contained the following agreements by him as a customer (in the capacity as an account party):

3. The Applicant agrees to reimburse the Bank forthwith on demand for all payments that the Bank has made under the Credit. Subject to paragraph 6 hereof, reimbursement shall be in the currency in which the Bank has made payment. [**70]

5. The Applicant hereby indemnifies and agrees to hold the Bank harmless from all losses, damages, costs, demands, claims, expenses and other consequences which the Bank may incur, sustain or suffer, other than pursuant to its own gross negligence or wilful misconduct, as a result of issuing the Credit or enforcing or protecting the provisions hereof, including without limitation legal and other professional expenses reasonably incurred by the Bank and whether incurred in defending any action brought against the Bank to compel payment under the Credit or to restrain the Bank from making payment thereunder in any proceedings brought by or on

behalf of the Beneficiary or the Applicant, or in any proceedings brought by the Bank against the Applicant, any guarantor of the Applicant's liabilities to the Bank hereunder or with respect to the Applicant's or any guarantor's property charged or pledged to the Bank for the purpose of protecting, taking possession thereof, holding or realizing thereon, or otherwise in connection herewith.

10. Except as otherwise expressly provided the Credit shall be subject to Uniform Customs and Practice for Documentary Credits (1983 Revision), [*725] [**71] International Chamber of Commerce, Publication No. 400 ("UPC"). Without limitation thereof, none of the Bank, its agents or correspondents shall be responsible for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any documents received under the Credit.

12. This Confirmation and all rights, obligations and liabilities arising hereunder shall be governed by and construed in accordance with the law of the place where the Branch is situate. If this Confirmation is executed by more than one Applicant, the liabilities of the Applicants to the Bank hereunder shall be joint and several.

It does not appear that any of the other reimbursement and indemnity arrangements were materially different. It should be noted that while there is a monetary requirement of indemnification, there does not appear to be any positive obligation expressed to require a customer to join in or indeed in effect carry any litigation in defending on the grounds of beneficiary fraud the refusal to pay on a call by the beneficiary. See UCP 400 in this regard as well.

Article 1

These articles apply to all documentary credits, including, to the extent to which they may be applicable, [**72] standby letters of credit, and are binding on all parties thereto unless otherwise expressly agreed. They shall be incorporated into each documentary credit by wording in the credit indicating that such credit is issued subject to Uniform Customs and Practice for Documentary Credits.
. . . . .

Article 3

Credits by nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the credit. Article 4

In credit operations all parties concerned deal in documents, and not in goods, services and/or other performances to which the documents may relate.
. . . . .

Article 10

a. An irrevocable credit constitutes a definite undertaking of the issuing bank, provided that the stipulated documents are presented and that the terms and conditions of the credit are complied with: ...
. . . . .

Article 20

c. The applicant for the credit shall be bound by and liable to indemnify the banks against all obligations and responsibilities imposed by foreign laws and usages.

Keeping in mind the autonomy of the various contracts [**73] in a letter of credit situation, let us examine what comes into play in the present situation. [*726]

1. Lloyd's as beneficiary of an LC makes a call upon it for payment by the Bank as issuer.

2. However Name as an account party customer (rather than bringing interlocutory proceedings for an injunction against such payment by bringing an action in fraud against Lloyd's) has advised the Bank not to do so based on its allegations of fraud as supported by evidence which it anticipates will convince the Bank that there is clear and obvious fraud by Lloyd's affecting the Name so as to make it inappropriate to pay out as stated by Lord

Diplock at p. 725 of United City Merchants (Investments) Ltd. v. Royal Bank of Canada, [1982] 2 All E.R. 720 (H.L.):

The exception for fraud on the part of the beneficiary seeking to avail himself of the credit is a clear application of the maxim ex turpi causa non oritur actio or, if plain English is to be preferred, "fraud unravels all". The courts will not allow their process to be used by a dishonest person to carry out a fraud [p. 725].

3. If the Bank were to be negligent in its review of the evidence presented by the Name so that it reached [**74] a "not clear and obvious fraud conclusion" when it should have found that there was a case of clear and obvious fraud on the part of Lloyd's, then the Name would not be required to make good on its reimbursement and indemnification obligation to the Bank.

4. Apparently the Banks did reach the conclusion that there was a clear and obvious fraud case in this situation so as to justify them not honouring the call by Lloyd's. They must reach this conclusion reasonably in their banker capacity -- they cannot do so capriciously nor merely to accommodate their customer for business or humanitarian grounds.

Can the Banks resile from this conclusion? I am of the view that they cannot except in the following circumstances:

(a) A dishonouring issuer may change its decision based upon further information which may be obtained from the beneficiary, from its own independent research (if it is so inclined to do so although it is not obligated to do so) or conceivably even from the customer. This was apparently not the case here.

I am less favourably disposed to a second circumstance since a decision, although made forthwith, should be made in the first instance upon proper reflection. [**75]

(b) A dishonouring issuer may change its mind as to the correctness of its decision if upon appropriate reflection it reasonably comes to the opposite conclusion that there were no case of clear and obvious fraud on the part of the beneficiary against [*727] the issuer's customers. This implies that such a change of mind would have to be sufficiently justified to an extremely high degree so as to show that its original decision was too hastily and inappropriately reached. Similarly this was apparently not the case here either.

It would seem to me that a corollary of either change would be that the dishonouring issuer would have to advise both the customer and the beneficiary that it had made such a change and that it was going to honour the call by paying the beneficiary (thereby allowing the customer to take whatever additional steps it felt necessary). It would of course not defend a lawsuit against it by the beneficiary any further.

However what we appear to have here is a curious hybrid. The Banks have apparently reached a reasonable conclusion on the material presented to them by the Names that there was a clear and obvious case of fraud by Lloyds at the expense of the [**76] Names. Based on that conclusion the Banks (apparently recognizing that they will not be reimbursed by the Names if they paid Lloyd's) dishonoured the call and persisted in doing so notwithstanding the institution of lawsuits (the English Actions) by Lloyd's against the Banks to require the Banks to make good on their LC obligations. However the Banks did not claim in their defence that only their customers, the Names, alleged fraud by Lloyd's but they also pleaded that the Banks reasonably concluded that there was such a clear and obvious fraud present. Rather than defending the dishonour of the call on their contract (the LC) with Lloyd's on the basis of this "clear and obvious fraud", the Banks may have attempted to straddle the picket fence by curiously asserting:

7(c) For the avoidance of doubt the Defendant [Bank] does not allege fraud against the plaintiff [Lloyd's].

Further the Banks did not make any arrangements to have the Names added as parties in the English Actions by making such provisions as may have been necessary to have the Names voluntarily join in. Rather more importantly and fully within the control of the Banks (it would seem), the Banks did not fight the [**77] English Actions using the Names as witnesses to the extent necessary plus the documentation provided by the Names to prove a defence of fraud by Lloyd's on the Names. In fact it would not seem that they asked the Names to assist in this regard. Rather it appears that the Banks perceived themselves in effect as innocent bystanders to a battle between the Names and Lloyd's. In their view it was for the Names to fight this battle directly against Lloyd's. This overlooks that the litigation was brought by Lloyd's [*728] against the Banks under the Banks' autonomous obligation to pay Lloyd's upon otherwise "innocent" calls reasonably made upon

the LC issued by the Bank in favour of Lloyd's. It was not a lawsuit which either Lloyd's or the Names have brought against the other based upon their respective obligations as to the Names becoming and continuing to be members of Lloyd's under another autonomous agreement. Of course there was the remaining and third autonomous agreement whereunder the Name agreed to reimburse the Bank for any payments the Bank made to Lloyd's pursuant to the LC and to indemnify the Bank for any loss the Bank may suffer. However if the Bank paid Lloyd's "voluntarily" [**78] notwithstanding the Bank had reasonably reached the conclusion that there was a clear and obvious case of fraud by Lloyds upon the Name, then the Name would be justified in refusing to reimburse or indemnify the Bank.

In conclusion as to the first aspect of the Banks' motion, I do not find that the Banks have made out an automatic case that the Names were required to take over the defence of the English Actions effectively in the place of the Banks. The Banks had the responsibility of fighting the English Actions; they could not directly sluff this off to the Names. If the issuer adopts a passive role in this aspect, it does so with risk to itself unless it can prevail by virtue of the issues in question (f). Sometimes one has to be cruel to be kind. It may well be that in being kind to their customers, if the reason for dishonouring was to give their customers breathing time to be able themselves to fight Lloyd's in litigation, the Banks may have ended up by being cruel to themselves. I would note in passing that such an inappropriate reason for a dishonour would be completely against the integrity of the letter of credit system which is so valued by the commercial world of trade [**79] and finance (including banking). The Banks may also have inappropriately raised the hopes of the Names as to the strength of their dispute with Lloyd's in the sense of then being objective observers who had concluded to their reasonable satisfaction that there was a clear and obvious case of fraud; I hasten to note that I have reached no conclusion (on even a preliminary basis) on the strength of the Names' position since that has never been before me.

If there were no clear and obvious case of fraud reasonably concluded by the Banks or if it were otherwise determined that there were no fraud perpetrated by Lloyd's on the Names in any litigation between the Names and Lloyd's, then the Banks would have paid Lloyd's on the call and proceeded to claim reimbursement from the Names. However the twist here is that the Banks [*729] continued to dishonour the calls and defended the English actions. I would note that the Banks have lost the English Actions and have been required pursuant to that litigation to pay Lloyd's under the previously dishonoured calls. As to such payments, if Lloyd's is successful in its litigation as to those affected Names so that Lloyd's is able to obtain [**80] judgment against such Names, it would appear to me that the judgment as to quantum could only be as to the extent of the Names' then existing liability to Lloyd's -- i.e. the original liability amount less what Lloyd's has recovered from the Banks as a result of the English Actions judgment against the Banks regarding their prior dishonour. If the Banks had not dishonoured -- i.e. based on a reasonable conclusion that there was no clear and obvious case of fraud -- they would have paid Lloyd's on the call and there would be no basis grounded in the fraud exception regarding letters of credit that the Banks would not have been able to obtain judgment for reimbursement and indemnity against the Names. Thus it may well be that the Names may obtain in effect a legal windfall as to what would otherwise have been their liability to Lloyd's (assuming for the purposes of this discussion a successful result for Lloyd's in its litigation involving the Names) to the extent of the amount of the LC-- unless the Banks have some other perhaps indirect way of retrieving such amounts paid out. Practical considerations would also come into play since the legal windfall aspect of course presumes that [**81] each of the Names would be able to make good for the total amount of their individual liability to Lloyd's. If there were a shortfall then to the extent that the Banks did not hold security for reimbursement and indemnification, there would be a competition between the Banks and Lloyd's as to avoiding this deficiency.

Question (f) -- Other Considerations

If that were the extent of the Banks' arsenal in its summary judgment motion for dismissal of the Names' defence that the Banks had lost their reimbursement rights by failing to plead fraud in the English Actions, then I would dismiss that motion. However the Banks have also raised the following as weapons in such motion to the issue of a non-litigant (here the Names) being bound by judgment which he was not a party (such as the judgment in the English Actions). The Banks raised three circumstances in which they asserted this would prevail:

(a) Indemnity Principles as set out in Parker v. Lewis (1873), L.R. 8 Ch. App. 1035 (C.A.), to the effect that a person who indemnifies another under a contract of indemnity will be [*730] estopped from denying a judgment against the person indemnified if the indemnifier had notice of [**82] the proceeding but refused to defend it on behalf of the indemnified person with the result that the person indemnified defended the action but lost.

(b) Estoppel by Conduct as set out in Nana Ofori Atta II Omanhene of Akyem Abuakwa v. Nana Abut Bonsra II as Adanshehene and as Representing the Stool Adanse, [1958] A.C. 95 (P.C.), and ATL Industries Inc. v. Han Eol Ind. Co. (1995), 36 C.P.C. (3d) 288 (Ont. Ct. (Gen. Div.)), to the effect that a non-litigant may be estopped by his own conduct from denying a previous judgment which intimately involved the non-litigant.

(c) Res Judicata as discussed in Nana and ATL to the effect that a person who is a privy of a party to a prior proceeding is estopped from denying the judgment by application of the rule of res judicata.

The position of the Banks was that it ought to be successful in its summary judgment motion by knocking out the Names' defence as to the Banks having lost their reimbursement rights by virtue of the Parker v. Lewis indemnity principles, but failing that then they relied on estoppel by conduct. If failing both those thrusts then they relied on res judicata. Let us examine each of those in turn.

Parker v. Lewis Indemnity [**83] Principles

Sir G. Mellish L.J. stated at pp. 1059-60 of Parker v. Lewis:

... I think that the law with reference to express contracts of indemnity is, that if a person has agreed to indemnify another against a particular claim or a particular demand, and an action is brought on that demand, he may then give notice to the person who has agreed to indemnify him to come in and defend the action, and if he does not come in, and refuses to come in, he may then compromise at once on the best terms he can, and then bring an action on the contract of indemnity. On the other hand, if he does not choose to trust the other person with the defence to the action, he may, if he pleases, go on and defend it, and then, if the verdict is obtained against him, and judgment signed upon it, I agree that at law that judgment, in the case of express contract of indemnity is conclusive. But I apprehend it is conclusive on account of what the law considers the true meaning of such a contract of indemnity to be. It is obvious that when a person has entered into a bond, or bought land, or altered his position in any way on the faith of a contract of indemnity, and an action is brought against him for [**84] the matter against which he was indemnified, and a verdict of a jury obtained against him, it would be very hard, indeed, if, when he came to claim the indemnity, the person against whom he claimed it could fight the question over again, and run the chance of whether a second jury would take a different view and give an [*731] opposite verdict to the first. Therefore, by reason of that contract of indemnity, the judgment is conclusive; but in my opinion it is conclusive because that is the meaning of the contract between the parties, for it unquestionably is not the general rule of law that a judgment obtained by A. against B. is conclusive in an action by B. against C. On the contrary, the rule of law is otherwise. It is quite plain that the ordinary rule of law is, that a judgment in rem is conclusive, but a judgment inter partes is conclusive only between the parties and the persons claiming under them.

Duffield v. Scott (1789), 3 T.R. 376, 100 E.R. 628 (K.B.) was discussed at pp. 1058-9 of Parker v. Lewis. In Duffield Buller J. at p. 630 [E.R.] stated:

As to that, I believe there are cases which say that, to entitle a person to recover on a bond of indemnity, he must [**85] shew that he was compelled by law to pay the debt. They go a great way to prove that the plaintiff in this case is entitled to recover the costs and expenses. The purpose of giving notice is not in order to give a ground of action; but if a demand be made which the person indemnifying is bound to pay, and notice be given to him, and he refuse to defend the action, in consequence of which the person to be indemnified is obliged to pay the demand, that is equivalent to a judgment, and estops the other party from saying that the defendant in the first action was not bound to pay the money.

In London Guarantee and Accident Co. v. Davidson, [1926] 1 W.W.R. 148, [1926] 1 D.L.R. 66 (B.C.S.C.), Gregory J. commented on Parker v. Lewis at p. 153 in saying:

In Parker v. Lewis (1873) L.R. 8 Ch. 1035, at p. 1044, 43 L.J. Ch. 281, at p. 291, it was held that where A. contacts to indemnify B. against a claim, and a judgment is obtained against B. in an action bona fide defended by him and he pays the demand, A. cannot be heard to contend that the judgment was erroneous. [Emphasis added.]

In my view the emphasized portion in London is quite important. In the subject case the Banks did not [**86] allege fraud against or pursue Lloyd's on the point of what had been shown to them by the Names and concluded by the Banks to be clear and obvious fraud. That would have been, if proven, a defence to payment out on the otherwise regular call by Lloyd's for the Banks to make good on their LC. The Banks chose not to do so for

whatever reason. In effect they allowed the English actions to go against them (i.e. the Banks) in essence by default since their pleadings, after Saville J. struck the fraud defence, did not contain any defence at law. As well it would appear that the Banks did not ask the Names to defend the English Actions in the sense of taking over the Banks' defence. Rather it appears that the Banks requested the Names to bring English injunctive proceedings or to become party defendants or third parties on some consent arrangement. If the indemnified person defends the action against him without giving the opportunity to the indemnifier to defend [*732] that action, then the indemnifier is entitled to challenge that judgment according to Parker v. Lewis. If the indemnified person does give notice to the indemnifier requesting that the indemnifier defend the indemnified [**87] person in the action and the indemnifier does not do so, then the indemnified person is entitled to defend (or compromise) the claim against him in a bona fide way and then bring an action in indemnity against the indemnifier for the amounts so paid out (plus costs). On the information before me the Banks did not request the Names to take over the defence, although it appears that they did ask the Names to do everything but that in and relating to the English Actions. Additionally I do not think it reasonable to conclude on the material before me as well that the Banks appropriately defended the English Actions; rather than defending on the basis of what the Banks had satisfied themselves of -- namely the material they relied on demonstrating to the Banks that there was a clear and obvious fraud by Lloyd's against the Names which would have been a defence, if proven, to the English Actions, the Banks curiously did not allege fraud against Lloyds. Neither did the Banks take up the invitation of Saville J. to amend their pleadings to that effect. As well it is difficult to see how the Banks are entitled to reimbursement and indemnification on this principle when they consciously allowed [**88] that defence to go down the drain in the English Actions. On that basis I would not see that the Banks have made out their case for summary judgment on the principles of indemnification.

Estoppel by Conduct

In the alternative the Banks assert that a non-litigant party (the Names) who had knowledge of prior proceedings (such as the English Actions, as it is not predicated upon the proceedings being domestic), a clear interest in those proceedings and the ability to intervene as a participant to protect its interest cannot stand by (and watch those proceedings without intervening) with impunity. Rather if it stands by, then it will be estopped by its conduct in doing so from proceeding to a trial in a subsequent proceeding with one of the participants in the prior proceedings on the same issue or issues which have already been determined in the prior proceedings. The Banks submitted that the failure of the Names to participate in the English Actions by either seeking an English injunction or seeking leave to plead their own case of fraud or supporting any motion by the Banks to have them added as a party estops the Names from denying that the Banks were required to pay and Lloyd's [**89] entitled to be paid on the LC. [*733] In Nana Lord Denning at pp. 101-3 stated:

> The general rule of law undoubtedly is that no person is to be adversely affected by a judgment in an action to which he was not a party, because of the injustice of deciding an issue against him in his absence. But this general rule admits of two exceptions: one is that a person who is in privity with the parties, a "privy" as he is called, is bound equally with the parties, in which case he is estopped by res judicata: the other is that a person may have so acted as to preclude himself from challenging the judgment, in which case he is estopped by his conduct. Their Lordships propose in this case to consider first estoppel by conduct.
>
> English law recognizes that the conduct of a person may be such that he is estopped from litigating the issue all over again. This conduct sometimes consists of active participation in the previous proceedings, as, for instance, when a tenant is sued for trespassing on his neighbour's land and he defends it on the strength of the landlord's title and does so by the direction and authority of the landlord. If the tenant loses the action, the landlord would [**90] not be allowed to litigate the title all over again by bringing an action in his own name. On other occasions the conduct consists of taking an actual benefit from the judgment in the previous proceedings, such as happened in In re Lart, Wilkinson v. Blades ([1896] 2 Ch. 788). Those instances do not however cover this case, which is not one of active participation in the previous proceedings or actual benefit from them, but of standing by and watching them fought out or at most giving evidence in support of one side or the other. In order to determine this question the West African Court of Appeal quoted from a principle stated by Lord Penzance in Wytcherley v. Andrews ([1871] L.R. 2 P. & M. 327, 328). The full passage is in these words: "There is a practice in this court, by which any person having an interest may make himself a party to the suit by intervening; and it was because of the existence of that practice that the judges of the Prerogative Court held, that if a person, knowing what was passing, was content to stand by and see his battle fought by somebody else in the same interest, he should be bound by the result, and not be allowed to re-open the case. That principle is [**91] founded on justice and common sense, and is acted upon in courts of equity, where, if the persons interested are too numerous to be all made parties to the suit, one or two of the class are allowed to represent them; and if it

appears to the court that everything has been done bona fide in the interests of the parties seeking to disturb the arrangement it will not allow the matter to be re-opened."

Mr. Phineas Quass argued before their Lordships that the principle stated by Lord Penzance was confined to wills and representative actions and has never been extended further. No decision, however, was cited to their Lordships which confines the principle to wills and representative actions. Their attention was indeed drawn to one case where a like principle was applied to mortgages in somewhat special circumstances: see Farquharson v. Seton ((1828) 5 Russ. 45). But assuming, without deciding, that the English decisions have hitherto been so confined, their Lordships would point out that there is nothing in the principle itself which compels it to be limited to wills and representative actions. The principle, as Lord Penzance said, is founded on justice and common sense. [Emphasis [**92] added.] [*734] However since the Banks did not fully contest the fraud which the Banks had in their view reasonably concluded was clear and obvious by Lloyd's against the Names, can it be said that the Banks did everything bona fide in the interests of the Names who are now seeking to dispute the result of the English Actions? I think not (but this as will be seen, is not the end of this issue). This is not a case similar to ATL, supra; in that case the Bank of Montreal ("B of M") actively participated in the Korean court with a defence that the Korean banks who had acquired the drafts issued pursuant to the letters of credit were not holders in due course but rather were tainted with knowledge of the beneficiary's fraud (acknowledged by the B of M and the customer) prior to the Korean banks acquiring the drafts for value. Notwithstanding the act of participation by the customer in the Korean action as a witness for the B of M there was no evidence to refute the Korean banks' evidence that they were holders of value without notice. The B of M defended the Korean proceedings essentially at its customer's insistence. In ATL it would appear to me that the B of M did all that it [**93] could in protecting its customer's interests, especially when it is realized that the customer had "advance" knowledge of the beneficiary's fraud quite some time before notifying the B of M, apparently delaying advice to the bank for business reasons of the customer. In ATL at p. 315 I concluded:

It seems to me that ATL having knowledge of the Korean proceedings, a clear interest therein, the ability to intervene as a participant and be heard to protect its interests, and in fact, participating through having witnesses testify and be "part of the litigation teams" would be estopped by its conduct from proceeding to trial in the Ontario action when the same issues have been determined in the Korean judgment. Alternatively, I am of the view that it would be an abuse of process for ATL to re-litigate the same issues.

I do not see this as an abuse of power question in the sense of it being a coordinant of estoppel by conduct as discussed by Stuart-Smith L.J. in House of Spring Garden Ltd. v. Waite, [1990] 2 All E.R. 990 (C.A.) at p. 1000:

Abuse of Process

Sir Peter Pain did not find it necessary to deal with the question of abuse of process. In my opinion the same result [**94] can equally well be reached by this route, which is untrammelled by the technicalities of estoppel. The categories of abuse of process are not closed: see Hunter v. Chief Constable of West Midlands, [1981] 3 All E.R. 727 at 729, [1982] A.C. 529 at 536, where Lord Diplock said:

"My Lords, this is a case about abuse of the process of the High Court. It concerns the inherent power which any court of justice must possess to prevent misuses of its procedure in a way which, although not inconsistent with the literal application of its procedural rules, would [*735] nevertheless be manifestly unfair to a party to litigation before it, or would otherwise bring the administration of justice into disrepute among right-thinking people. The circumstances in which abuse of process can arise are very varied; those which give rise to the instant appeal must surely be unique. It would, in my view, be most unwise if this House were to use this occasion to say anything that might be taken as limiting to fixed categories the kinds of circumstances in which the court has a duty (I disavow the word discretion) to exercise this salutary power."

This was a case where the court would not permit [**95] a collateral attack on the decision of a court of competent jurisdiction. The principle has recently been applied in this court to analogous cases, where issues of fact have been litigated exhaustively in sample cases; it is an abuse of the process for a litigant, who was not one of the sample cases, to relitigate again all the issues of fact on the same, or substantially the same evidence: see Ashmore v. British Coal Corp., [1990] 2 All E.R. 981, [1990] 2 W.L.R. 1437.

The question is whether it would be in the interests of justice and public policy to allow the issue of fraud to be litigated again in his court, it having been tried and determined by Egan J. in Ireland. In my judgment it would not; indeed, I think it would be a travesty of justice. Not only would the plaintiffs be required to relitigate matters which have twice been extensively investigated and decided in their favour in the natural forum, but it would run

the risk of inconsistent verdicts being reached, not only as between the English and Irish courts, but as between the defendants themselves. The Waites have not appealed Sir Peter Pain's judgment, and they were quite right not to do so. The plaintiffs will no [**96] doubt proceed to execute their judgment against them. What could be a greater source of injustice, if in years to come, when the issue is finally decided, a different decision is reached in Mr. Macleod's case? Public policy requires that there should be an end of litigation and that a litigant should not be vexed more than once in the same case. [Emphasis added.]

However in the subject case here, there has been no exhaustive litigation in the English Actions; it was in essence a walk-over once the Banks failed to plead fraud notwithstanding their prior determination which they reasonably reached of a clear and obvious case of fraud by Lloyd's against the Names. Further the litigant Lloyd's is not involved as a party in the reimbursement litigation between the Banks and the Names.

With that said however, is it estoppel by conduct of the Names since they did not avail themselves of the opportunity of joining in the English Actions to pursue their claim of fraud against Lloyd's? Clearly they are aware of the English Actions; the Banks had been continually begging them to come in as parties (or take English injunctive proceedings). The Names certainly had an interest in the outcome [**97] of the English Actions: if the Banks won, then the Names would not be called upon to reimburse and indemnify the Banks; if Lloyd's won, then the Banks would demand reimbursement from the Names. No reason was given for the Names' [*736] reluctance to participate; at least they offered a token reason for not bringing English injunctive proceedings in the perhaps double-pronged submission that (i) they did not think an English Court would reach a conclusion that the balance of convenience favoured the Names if by some domino effect it meant a downfall of the long standing significant institution of Lloyd's and (ii) apparently there had not been an English injunction granted on a fraud exception in a letter of credit case until a subsequently decided one in 1995. Of course in England, the strength of the moving party's case is downgraded as a test in light of their lack of cross-examination of affidavits, a factor perhaps overlooked in those Canadian cases which advocate the American Cyanamid test adopted in England [see American Cyanamid Co. v. Ethicon Ltd., [1975] 1 All E.R. 504]. Certainly the Names stood by here and watched the English Actions proceedings. They had English counsel [**98] doing watching briefs. But notwithstanding that they had been put on notice that the Banks did not intend to amend their pleadings to allege fraud, they chose to sit on the sidelines and watch -- cautioning the Banks that the Banks would lose their reimbursement rights if they continued to insist that the Names participate as active players instead of the Banks.

Reluctantly and narrowly I must conclude that the Names are estopped by their conduct. While the Banks can be justly criticized for not appropriately defending the English Actions, the Names were well aware of the position of the Banks, yet the Names did nothing to preserve the fraud defence despite the many entreaties by the Banks that the Names should take responsibility for their own fight on this point. I think that Stuart-Smith L.J.'s views at pp. 999-1000 of Spring Gardens after reviewing the estoppel by conduct discussion in Nana as instructive (and the fact that the three defendants were joint tortfeasors does not appear to be determinative in light of the concentration on the ability of the third defendant to join in the Irish litigation if he had wished to do so):

> How are these principles to be applied in this [**99] case? All three defendants were joint tortfeasors, having acted in breach of the duty of confidence in relation to the confidential information imparted to them and in breach of the plaintiffs' copyright in the cutting patterns for the vest. The judgment against them was joint and several. If the Waites's action to set aside Costello J.'s judgment had succeeded, that judgment would have been set aside in toto, not just against the Waites; it obviously could not stand. Even if (which I do not accept) the judgment against Mr. Macleod did not automatically fall in the event of the Waites succeeding, it is plain that in the English proceedings the plea of estoppel or abuse of process would have [*737] prevented the plaintiffs pursuing the claim on Costello J.'s judgment against Mr. Macleod.
>
> Mr. Macleod was well aware of those proceedings. He could have applied to be joined in them, and no one could have opposed his application. He chose not to do so and he has vouchsafed no explanation as to why he did not. Counsel for Mr. Macleod says he was not obliged to do so; he was not obliged to go to a foreign jurisdiction; he could wait until he was sued here. He speaks as if Mr. Macleod [**100] was required to go half way round the world to some primitive system of justice. That is not so. He had to go to Dublin whose courts, as the judge said, are perfectly competent to deal with this matter. Moreover, it was a process that was good enough for the Waites. Instead, he was content to sit back and leave others to fight his battle, at no expense to himself. In my judgment, that is sufficient to make him privy to the estoppel; it is just to hold that he is bound by the decision of Egan J.

But there is a further point on which counsel for the plaintiffs relies, and it is the pleading in Mr. Macleod's defence, which I have already quoted, referring to the Waites's proceedings to set aside the judgment. Counsel submits that this is a plea of estoppel by Mr. Macleod, and that since estoppels are mutual, it can be relied on against him. Counsel cited the case of Re Defries, Norton v. Levy (1883) 48 L.T. 703 at 704, where Pollock B. said:

"But the defendants cannot be said to have waived the estoppel by not pleading this judgment, for it was not in existence when the pleadings closed. I think it will be found that there is an old decision that it is sufficient to plead pendency [**101] of another action in order to enable the party pleading to put the judgment in such action in evidence by way of estoppel."

In my judgment, the plea in the defence was a plea of estoppel; and as I have already said, had the Waites succeeded it was a plea that would have availed Mr. Macleod. It is plain that he was asserting that although he was not a party to those proceedings, he was privy to them. He was right.

Stuart-Smith L.J. did not confine the principles of Nana to a representative or sample action. Neither did Lord Denning in Nana at p. 102 where he stated:

No decision, however was cited to their Lordships which confines the principles to wills and representative actions ... But assuming, without deciding, that the English decisions have hitherto been so confined, their Lordships would point out that there is nothing in the principle itself which compels it to be limited to wills and representative actions. The principle, as Lord Penzance said, is found on justice and common sense.

The Names appear to have played a waiting game with the Banks to see which would blink first. It appears that neither did. However the Names could have joined into the English proceedings [**102] and advanced their cause by demonstrating the fraud they alleged Lloyd's perpetrated on them. Rather it seems that the Names resisted being joined with the English actions. It was in essence their money which was at stake: if Lloyd's wins, the losing Banks stand on the shoulder of the Names; if Lloyd's loses, the [*738] Names do not have to worry about reimbursing the Banks. The Banks are in many respects middlemen; the Banks do not gain anything extra if they win nor in theory do they lose anything if they lose if they are able to collect it back from the Names in turn. It would also appear to me that the Banks had only second-hand information or knowledge of the alleged fraud; the Names would be in a much better position to fight the fraud issue with direct or at least closer at hand information, knowledge and material. If the English actions had gone to trial, it may be difficult to think of any Bank employee or agent who would have been a witness of any materiality. To the extent that the Bank found it necessary to provide any of its own witnesses or evidence, I would have thought the evidence would have been so non-controversial that such would have been readily admitted [**103] by Lloyd's.

Thus on the basis of estoppel by conduct, I am of the view that the Banks have narrowly made out their case for summary judgment as claimed.

Res Judicata

The Banks submitted that the Names had a privity of interest with the Banks on the issue raised in the English Actions of whether Lloyd's was entitled to payment on the LC in face of the clear and obvious fraud evidence delivered by the Names to the Banks. In this regard see the views of Lord Denning in Nana at p. 101 as cited above. See also my views in ATL at pp. 312-4. However it should be noted that in the ATL situation, the motion before me was by the B of M to discharge the interlocutory injunction that restrained it from paying under its letter of credit obligations; the action in which that was granted did not involve the B of M's reimbursement rights against its customer (which constituted a separate autonomous contract) as discussed at p. 312.

As I said at pp. 313-4 of ATL:

Someone who is privy in interest to a party in an action and has notice of that action is equally bound by the final judgment in those proceedings. See Nana, at pp. 101-102; Oak v. Frobisher Ltd. (1959), 27 W.W.R. 594 (Sask. Q.B.), [**104] at p. 603.

What makes one privy? As Lord Reid said in Carl-Zeiss-Stiftung v. Rayner & Keeler Ltd. (no. 2), [1967] 1 A.C. 853 (H.L.), at p. 890, the requisite privy is said to be privity of either blood, title or interest and the relevant one here is privity of interest (which is difficult to detect from the authorities what constitutes this, especially what is sufficient connection).

. . . . .

In Gleeson v. J. Wippell & Co. Ltd., [1977] 3 All E.R. 54 (Ch.D.), at p. 60 Megarry V.-C. stated that there must be a sufficient degree of identification [*739] between the two persons (the party to a proceeding and a non-party) to make it just to hold that the decision to which one was party should be binding against the other. See also Sopinka, Lederman and Bryant, The Law of Evidence in Canada (Toronto: Butterworths, 1992), at pp. 1007-1009; Spencer, Bowen [sic] and Turner, The Doctrine of Res Judicata, 2nd ed. (London: Butterworths, 1969), at pp. 209-211.

It seems to me that ATL is clearly and sufficiently identified with B of M in the Korean litigation. Neither ATL nor B of M had any relevant evidence to support ATL's assertion that the Korean banks were not holders in due [**105] course of the drafts pursuant to the LCs. B of M was compelled to defend the Korean proceedings, essentially at ATL's insistence. ATL was, as a consequence of its reimbursement obligations to B of M, clearly interested in the outcome of the Korean litigation. In a futile attempt to assist B of M, ATL had its two representatives attend and testify in Korea. If B of M had won in Korea, it would have been to the advantage of ATL as it would have eliminated the reimbursement obligation. For B of M to have won in Korea, the Korean court would have had to be convinced that the Korean banks were not holders in due course. Such was not proven; as discussed there was only evidence to prove that the Korean banks were holders in due course without notice of Han's fraud when negotiating the drafts with B of M. It would seem just and common sense to apply the principle of res judicata against ATL in the Ontario action because of its close connection, identification and active participation with B of M in the Korean proceedings.

For privity of interest to exist there must be a sufficient degree of connection or identification between the two parties for it to be just and common sense to hold [**106] that a court decision involving the party litigant that it should be binding in a subsequent proceeding upon the non-litigant party in the original proceeding, as discussed above, where that non-litigant party has sufficient interest in those original proceedings to intervene but instead chooses to stand by and have the battle in which he has a practical and legal concern fought by someone else, it is appropriate to have the non-litigant abide by that previous decision: see ATL at pp. 312-4; Spring Garden at pp. 998-1000. As well, of course, it is the Names' interest at the very base of this question of the fraud defence; the interest of the Banks in this regard is in essence derivative from that of the Names.

It appears that the Names were content to let the Banks stumble and fall in the English Actions and in that regard merely reminded the Banks that they risked their reimbursement action against the Names if they did not plead fraud against Lloyd's. In that, it appears that the philosophy of the Names was that a stumble by the Banks was as good as a win by the Banks in the English Actions. It mattered not to the Names whether they achieved legal (and economic success by either [**107] route) this should be contrasted to what might well be characterized as the more regular and appropriate view that the Names and the Banks were [*740] allies in the question of attempting to prove fraud by Lloyd's -- a win by the Banks would be a win for the Names as they would not have to face a reimbursement claim by the Banks now. In ATL, the B of M and its customers were allies in the Korean litigation. Of course it may not have been timely or opportune for the Names to have fought a fraud battle with Lloyd's in 1993; they may have wished to have more time to prepare a "better case", or to have husbanded their scarce resources (although it would not appear that the Banks would have been prevented from interim billing the Names and collecting as to the legal costs of the English Actions) or to have seen how other cases came out or to have engaged in or prepared for resolution discussions. That of course is speculation. However to the extent that a win was a win for both the Banks and for the Names, they shared an identical interest in substance and therefore the Names had a privity of interest with the Banks in the English Actions.

Res judicata prevents parties and their [**108] privies from raising matters which might and ought to have been brought forward in the earlier proceedings, but were not: see Hennig v. Northern Heights (Sault) Ltd. (1980), 30 O.R. (2d) 346, 116 D.L.R. (3d) 496 (C.A.); leave to appeal to S.C.C. refused December 1, 1980 [116 D.L.R. (3d) 496n]. In Hennig at pp. 354-5 the court stated:

Mr. Mills next submitted that, if it should be considered that all of the requisite elements for the application of res judicata exist with respect to the counterclaim, the doctrine should not apply because of "special circumstances". He bases this submission on the much-quoted statement of Wigram V.-C. in Henderson v. Henderson (1843), 3 Hare 100 at p. 115, 67 E.R. 313:

" ... where a given matter becomes the subject of litigation in, and of adjudication by, a Court of competent jurisdiction, the Court requires the Parties to that litigation to bring forward their whole case, and will not (except under special circumstances) permit the same parties to open the same subject of litigation in respect of

matter which might have been brought forward as part of the subject in contest, but which was not brought forward, only because they have, from negligence, [**109] inadvertence, or even accident omitted part of their case. The plea of res judicata applies except in special cases, not only to points upon which the Court was actually required by the parties to form an opinion and pronounce a judgment, but to every point which properly belonged to the subject of litigation, and which the parties, exercising reasonable diligence, might have brought forward at the time."

(Emphasis added.)

In so far as this passage is relied upon as authority for not applying res judicata in "special circumstances": or "special cases", I think that it makes it reasonably clear that the exception is potentially applicable only with regard to the extended application of res judicata, i.e., to matters or points which might and should have been brought forward in the earlier proceeding, but which were not. I can quite appreciate the reason for some flexibility [*741] with respect to the "might have" kind of issue, but apart from the implicit reasoning in Braithwaite v. Haugh (1978), 19 O.R. (2d) 288, 84 D.L.R. (3d) 590, which I shall discuss, I am unaware of any authority countenancing the exception where what is involved in the second proceeding is the [**110] identical claim as that in the first, advanced on the basis of the same evidence and legal theory. It was with respect to a situation such as this that Lord Denning M.R. in Fidelitas Shipping Co., Ltd. v. V/O Exportchleb, [1965] 2 All E.R. 4 at p. 8, said that there is a "strict rule of law that he cannot bring another action against the same party for the same cause: Transit in rem judicatam ... " (emphasis added). (In Lockyer v. Ferryman et al. (1877), 2 App. Cas. 519 at p. 528, Lord Selborne put the matter this way: "When there is res judicata, the original cause of action is gone, and can only be restored by getting rid of the res judicata.") Lord Denning then went on to say that, with respect to issue estoppel and estoppel relating to points within an issue, respectively, res judicata is a "general rule" and "not an inflexible rule", which can be departed from in "special circumstances". Cross on Evidence, 5th ed. (1979), at p. 333, questions Lord Denning's suggestion that the extended form of res judicata may apply to issue estoppel.

In regard to my concerns about the Banks allowing the English Actions to go against them in essence "by default" when they did not plead fraud, [**111] I am mindful of what Viscount Redcliffe said in Kok Hoong v. Leong Cheong Kweng Mines, Ltd., [1964] 1 All E.R. 300 (P.C.) at pp. 305-6, in discussing what Wigram V.-C said in Henderson v. Henderson (1843), 3 Hare 100, 67 E.R. 313. He said at p. 306:

In their Lordships' opinion the New Brunswick Ry. Co. case can be taken as containing an authoritative reinterpretation of the principle of Howlett v. Tarte in simpler and less specialised terms. This reinterpretation amounts to saying that default judgments, though capable of giving rise to estoppels, must always be scrutinised with extreme particularity for the purpose of ascertaining the bare essence of what they must necessarily have decided and, to use the words of LORD MAUGHAM, L.C. , they can estop only for what must "necessarily, and with complete precision" have thereby been determined.

But in the subject case, Lloyd's was successful in the English Actions as the Banks did not and would not plead fraud and so as discussed the English Action in essence went by default as the defence as pleaded was determined by Saville J. not to be a defence. The Names were well aware of this.

As a foundation of res judicata is the avoidance [**112] of multiple litigation, I do not see that the doctrine requires that those privy in interest remain on the same side.

As to the question of special cases or circumstances, the only aspect of this case which might be considered in that regard would be that the Banks did not plead fraud against Lloyd's in the English Actions. However it seems to me that the requirement of acting with reasonable diligence applies not only to the litigating [*742] parties (here the Banks in the English Actions) but also their privies (the non-litigating Names) as it was open for them to step into the English Actions and fill the "gap" created by the Banks not pleading fraud by taking over the defence of the English Actions in pleading the fraud of Lloyd's against the Names as a defence. See above in Estoppel by Conduct the discussion as to the Names being fully conversant with the English Actions and the Banks' position. The Banks are bound by the judgment in the English Actions. As the Names are privy in interest to the Banks in that litigation, the Names cannot in law assert that the result might have been different if the Banks had pleaded fraud against Lloyd's and succeeded in the end result. [**113] It would not seem to me that the Names' defence to this reimbursement action in that regard raises a genuine issue to be tried in the reimbursement actions. In effect, notwithstanding Wren's views at Questions 263-4 supra, the Names are bound by the judgments in the English Actions by virtue of the doctrine of res judicata.

End Result

In the end result, I am of the view that the Banks have been successful but only narrowly on the basis of estoppel by conduct and on the basis of res judicata in their summary judgment motion in the reimbursement actions to have eliminated the defence of the Names as to the failure by the Banks to plead fraud in the English Actions being a bar to the Banks succeeding in the reimbursement action. Given the nature of this success by the Banks (and its lack of success on the other grounds), I would think it appropriate for counsel to book an appointment before me to argue costs (including quantum) unless they are otherwise able to resolve this question between themselves before the end of this month.

Motion granted.

APPENDIX 1

Herbert Smith & Co.
Exchange House
Primrose Street
LONDON EC2A 2HS
July 12, 1993

Dear Sirs

THE **SOCIETY OF LLOYD'S** V. [**114] ROBERT LOUIS ROBINSON & OTHERS

We acknowledge receipt of your letter of July 9, 1993. We have no instructions to accept service on behalf of the Canadian Names and can not realistically expect those instructions by July 20. There are some 200 Canadian Names in five provinces several thousand miles apart. As lay people, such Canadian Names would expect to know the nature of the proceedings and its personal effect. [*743] Furthermore, we are advised that it is in the holiday period in Canada and that many people are absent until early September. You should also be aware that the Indemnity Contracts between the Canadian Names and the Canadian Banks contain exclusive jurisdiction clauses making the respective provinces of Canada the place where the matter must be heard. Also, many of these Indemnity Contracts, if not all, have choice of law clauses, making the law of the respective province the appropriate law. Additionally, there are guarantors to the Indemnity Contracts who are not Names at Lloyd's. Their rights can not be compromised by altering the situs of the litigation, without their consent. To obtain their consent would require a full notice to these guarantors explaining [**115] the situation and advising them to obtain independent legal advice before responding. Mr. Justice Saville has on page 4 of his recent written Decision stated that it is up to the Bank to make up its mind. If the Bank believes that it has sufficient evidence of fraud, then it must plead the fraud in order to avoid payment to Lloyd's. In paragraph 7 of its Defence the Bank indicated that it had sufficient evidence of fraud. It listed, as a schedule, voluminous documentary proof of such fraud. You should now plead fraud on behalf of the Bank. If the Bank determines not to plead fraud, it will have done so intentionally and, as Saville J. states, if it did so wrongly it will not be reimbursed by its customer. Since the Bank has made no independent investigation of the evidence of fraud provided to it by its customers over the past 22 months and in the light of the voluminous evidence that it has pointing to fraud on the part of Lloyd's, the Bank would be wrong in concluding that it does not have sufficient evidence to plead fraud. Yours faithfully, MICHAEL FREEMAN & CO.

APPENDIX 2

July 13, 1993
VIA FACSIMILE
Mr. Alan J. Lenczner
Lenczner, Slaght, Royce,
Smith, Griffin
Barristers and [**116] Solicitors
130 Adelaide Street West
Suite 2300
Toronto, Ontario M5H 3P5

Dear Mr. Lenczner: Re: The **Society of Lloyds** I have reviewed your letter of July 9 and I have the following comments. In your letter, you state that the Banks are obliged to plead your clients' allegations of fraud against

Lloyd's as a consequence of the decision rendered by Mr. Justice Saville on July 5 in the English letter of credit actions. You also state that, unless the Banks make that pleading in those English actions, the Banks will lose their rights of reimbursement against your clients. For the reasons set out below, the Banks are unable to agree. [*744] The Banks are not the potential victims of Lloyds' alleged fraud and they have never made any allegations of fraud against Lloyd's. All of the allegations of fraud are made exclusively by the Canadian Names who, despite repeated requests from the Banks, have failed to step forward to plead and prove their own allegations of fraud in the English letters of credit actions. The Banks are simply not in a position to plead and prove your clients' case for them, particularly where your clients are unwilling or unable to do so themselves. In all the circumstances, [**117] the Banks cannot agree that they are under any duty to become fraud investigators on your clients' behalf or to prosecute and prove the Names' allegations of fraud in a massive and complex trial in England. Your letter also states that "the Bank has not sought to third party its customer" in the English letter of credit actions and that "the Bank had an opinion that it could not" do so. These statements are misleading for the following reasons:

1. Third Party Claims and the Banks' Legal Advice -- First, the Banks have been advised by their English lawyers that leave to issue third party claims against your clients could proceed in England if the Canadian Names will agree (or consent) to attorn to English jurisdiction on the Bank's reimbursment claims. If that consent is given, the Canadian Names will be entitled (with leave of the Court), effectively to plead fraud in defence of the main actions brought by Lloyd's against the Banks for payment on the letters of credit. In that manner, the Canadian Names could deliver the pleading (alleging fraud against Lloyd's) that the Banks are unable to deliver.

2. Third Party Claims and the Names' Consent -- I have previously asked for your [**118] consent to such third party proceedings being brought in England and you have chosen not to respond to my request. Your clients' inaction confirms that they have no real desire to plead and prove their allegations of fraud in the English letter of credit actions. It is hardly reasonable for you to rely on the fact that no third party proceedings have been brought when you have failed to provide the consent required for the Banks to pursue those proceedings effectively. I enclose a copy of a letter from Michael Freeman & Co. dated July 12 which I assume was sent on your instructions. This letter makes it clear that the Canadian Names have no intention of either providing the necessary consent to the third party proceedings or of appearing before Mr. Justice Saville to obtain an adjournment so that the necessary consents may be sought.

3. The Banks' Motion to consolidate -- Your letter ignores the fact that the Banks have served a motion in England to consolidate Lloyd's letter of credit actions with Lloyd's separate actions brought against the Canadian Names or, alternatively, to stay the letter of credit actions. (I note that your clients' pleading of fraud is due in Lloyd's actions [**119] against the Names on July 20, as indicated in your letter). I asked weeks ago for you to confirm in writing that all Canadian Names who allege fraud against Lloyd's will agree to be bound by the outcome of a trial in such a consolidated action. I also asked you to obtain instructions from your clients to bring their own motion to consolidate the same actions. You have not responded to either request, demonstrating again that your clients prefer to avoid pleading and proving their fraud allegations against Lloyd's in the English letter of credit actions.

4. Other Opportunities for the Names to Participate in England -- Your letter also ignores the many suggestions made in my letter of June 10 on the options available to the Canadian Names to protect their interests in the English letter of credit actions. Similar correspondence was simultaneously sent in mass mailings to all of your clients. Your clients had had ample time to convene a meeting to provide you with instructions on those options. Again, your [*745] clients' inaction demonstrates that they have no real interest in participating in the English letter of credit actions or in pleading and proving their allegations [**120] of fraud in those proceedings. In the Ash decision, the Ontario Court of Appeal made it clear that England, not Canada, is the proper forum for your clients to plead and prove their allegations of fraud against Lloyd's in the context of the Banks' payment obligations on their letters of credit. Your clients failure to participate in the English letter of credit actions makes it clear that their true goal is to make "an end run" around the Ash decision by reopening the fraud issue in Canada when the Banks seek to enforce their reimbursement rights. Your clients should be estopped or precluded from relying on such tactics in any future Canadian litigation. Although it seems apparent that your clients will make no effort to plead or prove their case of fraud in the letter of credit actions, the Banks have decided to proceed on July 20 with their motion in England to consolidate and in the meantime will seek leave to issue the third party proceedings against the Canadian Names. For either avenue to have any real prospect of success, the support and consent of your clients are required. Please indicate your position immediately (as requested in the past). Alternatively, please instruct [**121] your clients' English counsel to appear before

Saville J. on July 20 and to request an adjournment if you require additional time to seek and obtain instructions from your clients. Yours very truly, R. Bruce Smith

APPENDIX 3
July 15, 1993
VIA FACSIMILE
Mr. Alan J. Lenczner
Lenczner, Slaght, Royce,
Smith, Griffin
Barristers and Solicitors
130 Adelaide Street West
Suite 2300
Toronto, Ontario M5H 3P5 Dear Mr. Lenczner: Re: The **Society of Lloyds**

I have received your fax of July 15. Your clients have not filed any pleading of fraud yet in England. The pleading mentioned in your letter is in draft only and, unless the Banks' motion on July 20 is successful, that pleading has nothing to do with the letter of credit actions. Your letter incorrectly states that you have previously written to the Banks' English solicitors and consented to the Banks' consolidation motion. As far as I am aware, the only letter sent by you to the Banks' solicitors in England is your letter to Herbert Smith dated May 18, 1993, a copy of which is attached. Nowhere in this letter do you consent to the consolidation application. Your letter of today's date is, as far as I am aware, completely incorrect when it [**122] states that you have previously provided as written consent of that nature. If I am wrong, please fax me your written consent immediately. Our English solicitors had been communicating with your English solicitor, Mr. Freeman, and have been asking for your clients' active participation and support on [*746] July 20 in support of the Banks' motions to consolidate and for leave to issue third party proceedings. The Banks are persuaded that your clients must appear on July 20 and ask for an adjournment to defend the letter of credit actions on the basis of the pleadings of fraud made in your draft pleading in Lloyd's actions against the Names. Your failure to do so would likely be construed by Mr. Justice Saville as a lack of commitment to proving your case of fraud in the letter of credit actions and will almost certainly result in judgment being granted against the Banks. I am not persuaded that there are any bona fide "difficulties" in having the Canadian Names appear before Mr. Justice Saville on July 20 in active support of the relief sought by the Banks. The third Party Motion relates to only 23 Canadian Names and there are no jurisdiction clauses of the nature stated in your [**123] letter. As you have your own English solicitors, there is no reason for the Banks to waive privilege on their legal advice (even if there was a written opinion to provide you). I remain of the view that your clients' inactivity constitutes a clear attempt to make an "end run" on the Ash decision. I have provided you with copies of all the relevant court material which has been filed. If your clients fail to actively assert their unqualified support for the Banks' position on July 20, they will become the authors of their own misfortune. Yours very truly, R. Bruce Smith

<end>