THE **SOCIETY OF LLOYD'S** CANADIAN IMPERIAL BANK OF COMMERCE AND OTHERS
QUEEN'S BENCH DIVISION (COMMERCIAL COURT)
[1993] 2 Lloyd's Rep 579

HEARING-DATES: 5 July 1993
5 July 1993

CATCHWORDS:
Banking -- Letter of credit -- Allegations of fraud -- Plaintiffs claimed as beneficiary -- Defendants pleaded that material relied on amounted to notice to a reasonable banker of fraud by beneficiary or would lead a reasonable banker to infer fraud -- Whether pleading a defence to plaintiffs' claim.

HEADNOTE:
The plaintiffs claimed as beneficiary under letters of credit issued by the defendants. The defendants pleaded inter alia that it was not necessary for them to plead and establish fraud provided they could satisfy the Court that the material on which they relied would either amount to notice to a reasonable banker of clear fraud by the beneficiary or would lead a reasonable banker to infer fraud by the beneficiary.
The issue for decision was whether the matters pleaded by the defendants would, if established amount to a defence to the plaintiffs' claim.
-- Held, by QB (Com Ct) (SAVILLE J), that (1) although certain types of fraud by a beneficiary did provide a defence to a claim by a beneficiary under a letter of credit, the suggested defence could not be based on that principle for the Court was not asked to decide that there was fraud but only, in effect, that a reasonable banker would think there was, whether or not fraud actually existed in fact (see p 580, col 2);
(2) there was no suggestion in any of the authorities which lent any support to the suggested defence; the authorities, without exception proceeded on the basis that what had to be established was a fraud(see p 580, col 2);
(3) the suggested defence would produce absurd or unacceptable results; if the defence was a good one the banks would be under no obligation to pay even if at the same trial the beneficiary were to establish that in truth there was no fraud; this could not be right; alternatively the burden of proving the absence of fraud would be on the beneficiary and the bank would be under no obligation to pay on genuine documents unless and until the beneficiary proved that they were genuine; this could not be right and would be entirely inconsistent with the fraud provisions of the Uniform Customs and Practise for Documentary Credits which were incorporated into the letters of credit (see p 581, col 1).
(4) there was nothing to suggest that evidence of fraud as opposed to fraud itself provided any form of permanent as opposed to temporary defence to a claim under a letter of credit (see p 581, col 1);
(5) the authorities were unanimous in treating letters of credit contracts as independent transactions; it was clear beyond argument that the only substantive defence to a claim for payment was that there was a fraud of a relevant kind; and whether or not such material existed to justify a trial of the issue was irrelevant since no plea of fraud was made (see p 581, col 2; p 582, col 1);
(6) neither party suggested there was anything in the form of the letters of credit that affected the question at issue; the position would have been the same whether or not the documents in question were to be regarded as more akin to performance guarantees or standby letters of credit than documentary letters of credit (see p 582, col 1);
(7) even if the matters alleged in the defendants' pleading were to be established they would provide no defence to the claim (see p 582, col 1).

CASES-REF-TO:

United City Merchants (Investments) Ltd v Royal Bank of Canada, (HL) [1982] 2 Lloyd's Rep 1; [1983] 1 AC 168.

INTRODUCTION:
This was an action by the plaintiff the **Society of Lloyd's** claiming as beneficiary under letter of credit issued by the defendants Canadian Imperial Bank of Commerce and Others the issue being whether the matters pleaded by the defendants amounted to a defence to the claim.

COUNSEL:
Mr Christopher Carr QC for the defendants; Mr Stephen Ruttle for the plaintiffs.

PANEL: SAVILLE J

JUDGMENTBY-1: SAVILLE J

JUDGMENT-1:
SAVILLE J: In these proceedings the **Society of Lloyd's** is claiming as beneficiary under letters of credit issued by certain Canadian banks. I am asked to decide whether the matters pleaded by the defendant banks in para 7(a) and (b) of their points of defence would, if established, amount to a defence to the claim.
Paragraph 7 of the points of defence is in the following terms:-
7(a) The Defendant has been provided with information which its customers allege amounts to a sufficient case of fraud as to entitle the Defendant to decline to honour the drafts that have been presented. Full particulars of the said information are set out in Schedule 2 hereto and copies of all such information have been provided to the Plaintiff.
(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 drafts and to decline to make any payment to the Plaintiff under the letters of credit.
(c) For the avoidance of doubt, the Defendant does not allege fraud against the Plaintiff.
As is apparent from this pleading it is the contention of the banks that it is not necessary for themselves to plead and establish fraud provided they can satisfy the Court that the material upon which they rely would either amount to notice to a reasonable banker of clear fraud by the beneficiary, or would lead a reasonable banker to infer fraud by the beneficiary.
Despite the careful and interesting arguments advanced by Mr Carr, QC for the defendant banks I am of the view that this contention is quite unsustainable.
In the first place, it is common ground that at least certain types of fraud by the beneficiary do provide a defence to a claim by the beneficiary under a letter of credit: see, for example, United City Merchants (Investments) Ltd v Royal Bank of Canada, [1982] 2 Lloyd's Rep 1; [1983] 1 AC 168. The reason for this is of course that the Courts will not allow themselves to be used in aid of a fraud -- ex turpi causa non oritur actio. The suggested defence, however, cannot be based on this principle, for the Court is not asked to decide that there was fraud, but only, in effect, that a reasonable banker would think there was, whether or not fraud actually existed in fact.
In the second place, there is no suggestion in any of the authorities cited to me (which included cases both here and abroad) which lends any support at all to the suggested defence. On the contrary, to my mind the authorities without exception proceed on the basis that what has to be established is a fraud, albeit there are differences in the various jurisdictions over the question as to what types of fraud can provide a defence.
In the third place the suggested defence would, on the face of it, produce absurd or unacceptable results. If the defence is a good one and the Court was persuaded at trial that the material provided to the bank did amount to clear notice of fraud to a reasonable banker etc, then the bank would be under no obligation to pay even if at the same trial the beneficiary were able to establish that in truth (notwithstanding the apparently damning material) there was no fraud. This cannot possibly be right. Alternatively, if proof of no fraud in fact would be an answer to the defence, the effect of the defence would be to cast the burden of proving the absence of fraud upon the beneficiary. That in turn would involve the proposition that the bank is under no obligation to pay on genuine documents unless and until the beneficiary proves that they are genuine. This again cannot possibly be right and as Mr Ruttle for the plaintiffs pointed out would be entirely inconsistent with the fraud provisions of the Uniform Customs and Practise for Documentary Credits, which were incorporated into the letters of credit in this case.
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 an 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 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 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 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 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 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 QC 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 par 7(a) and (b) of the points of defence were to be established, they would provide no defence to the claim.

DISPOSITION:

Judgment accordingly

SOLICITORS:

Herbert Smith; Solicitors Department Corporation of Lloyds