Banco Santander SA v Bayfern Ltd [1999] Int.Com.L.R. 06/09

JUDGMENT : Mr Justice Langley: Commercial Court. 9th June 1999

THE QUESTION

1. This judgment relates to the trial of certain preliminary issues arising only between the Plaintiff, Banco Santander, and the Third Defendant, Banque Paribas in these proceedings. In a nutshell the question is whether the risk of fraud on the part of the beneficiary of a confirmed deferred payment letter of credit is to be borne by the issuing bank (and so possibly the applicant for the credit) or by the confirming bank where the confirming bank has discounted its own payment obligations to the beneficiary and paid over the discounted sum to it and the fraud is discovered only after it has done so but before the maturity date of the letter of credit. "Santander" was the Confirming Bank and "Paribas" the Issuing Bank. The applicant was Napa Petroleum Trade Inc and the Beneficiary, Bayfern Limited.

THE LETTER OF CREDIT

2. By a telex dated June 5, 1998 Paribas requested Santander to release a letter of credit to Bayfern adding Santander's confirmation. Santander had previously agreed with Bayfern that it would confirm such a credit on certain terms.

3. The letter of credit (so far as material) provided that:

We, Banque Paribas, Paris, open our irrevocable confirmed documentary credit NR. 151734G

By order and for account of:

Napa Petroleum Trade Inc.

....

In favour of :

Bayfern Limited

....

Validity :

At the counters of Banco Santander London until the 15th September 1998

Amount

USD 18,469,000 +or- 10%.

This documentary credit is available with yourselves in London by deferred payment at 180 days from Bills of Lading date against presentation of the following documents:

1/ ... Commercial Invoices ...

2/ ... Bills of Lading ...

3/ Original Certificates of Quality and Quantity issued or countersigned by Saybolt ...

4/ Cargo Insurance Certificate

Covering:

200,000 Metric Tons + or - 10%

Product :

Russian Export Blend Crude Oil ...

This documentary credit is subject to the UCP for documentary credits (1993 Revision) of the International Chamber of Commerce ...

Please advise the beneficiaries adding your confirmation by fax or courier of this credit.

At maturity we undertake to cover Banco Santander ... in accordance with their instructions.

4. On June 8 Santander duly advised Bayfern of the letter of credit by attaching a copy of it to an advice of that date in which Santander also stated that:

"*We confirm this credit and hereby agree that documents presented under and in compliance with the Credit terms and conditions will be duly accepted and honoured at maturity if presented to us on or before the stipulated expiry date. Discounting of bills accepted under this letter of credit may be possible by prior arrangement;*" and that: "*...As previously agreed our Confirmation commission is 1.25% p. a., our Deferred payment or Discount Commission is 1.25% p. a. plus out of pocket expenses ....*"

DISCOUNTING

5. Whilst not intending to suggest that what follows is necessarily agreed, so far as the issues before the court are concerned the essential facts appear from the documents to be as follows.

6. By June 15, Bayfern had presented documents to Santander which Santander had examined and found to be conforming. Santander took up the documents and under the terms of the letter of credit thereby incurred a liability to pay Bayfern on November 27, 1998 the sum of US$ 20,315,796.30. November 27 was the date 180 days from the date of the Bills of Lading.

7. On June 9 Bayfern had confirmed a request to Santander *"to discount the full value of the credit at the agreed rate of 1.25% p.a."* asking for payment to be made directly to "*our bankers"* Royal Bank of Scotland PLC.

8. On June 16, Santander replied to Bayfern's letter of June 9 and wrote:

"*... in accordance with the terms of our agreement we have discounted amount of documents and credited the sum of USD 19,667,238.84 value 17th June 1998 into your account with Royal Bank of Scotland ....*

Please complete and return to us the attached letter requesting discount and assignment of proceeds under the above mentioned Letter of Credit."

9. The sum of US$ 19,667,238.84 was shown calculated as the sum of US$ 20,315,796.30 less LIBOR plus 1.25% for 163 days (ie from 17th June to 27th November) and less a confirmation fee of 1.25% from 8th June to 17th June and a small fee relating to handling discrepant documents. The amount of the discount, ignoring the fees, was US$ 641,023.33.

10. The "*attached letter*" was duly signed and returned by Bayfern to Santander. It was also dated June 16. It set out short particulars of the letter of credit and continued:

We refer to the above-mentioned letter of credit and hereby request you to discount your deferred payment/acceptance undertaking to us as follows ... (the figures were stated) ...

In consideration we hereby irrevocably and unconditionally assign to you our rights under this letter of credit.

11. The request for and agreement to an assignment was made in accordance with Santander's Operational Procedures Manual which included the following under "*Corporate Settlements : Trade Finance*":

Where documents under a usance letter of credit are found to be in strict conformity with all the letter of credit terms and conditions, the Bank may be prepared to offer the Beneficiary a discount of the proceeds due, providing the letter of credit is either:

a) Issued by the Bank; or

b) Confirmed by the Bank.

In most cases agreement to discount, ie a 'facility' would have been reached between the Beneficiary and the Bank prior to the presentation of the documents ....

Providing the Beneficiary has a facility to discount and remains within the authorised limit, proceed as follows : ....

6. If the Beneficiary agrees to discount, request that they send to the Bank a Notice of Assignment confirming that the funds due under the letter of credit have been assigned to the Bank in return for the discount. This must be signed by the company officials.

....

18. If the letter of credit is in a foreign currency and reimbursement must be claimed from a Reimbursing Bank ... payment instructions must be given three days prior to the value date by telex.

19. ....

THE ISSUES

12. By an Order dated February 12, 1999 on an application by Santander for summary judgment against Paribas and an application by Paribas for the determination of certain questions under R.S.C. Order 14A, Rix J ordered that there be a trial of the issues raised in Paribas' order 14A application and in paragraphs 20A, 20B and 20C of Santander's Re-Amended Points of Claim. Those are the issues to which this judgment relates and I should therefore set out the terms of them.

13. Paribas' Order 14A application sought a determination of the following questions:

1. i. The effect of the "discounting" agreement between the Plaintiff ("Santander") and the first defendant ("Bayfern") contained in the letters dated 8th, 9th and 16th June annexed hereto.

ii. In particular, whether the payment by Santander of US$ 19,667,238.84 to Bayfern on 17th June 1998 was a payment made purportedly under the letter of credit or a payment outside the letter of credit in consideration of an assignment to Santander of Bayfern's rights under the letter of credit.

iii. Whether Santander's rights, if any, against Paribas are limited to such rights, if any, that Bayfern had to claim payment on 27th November 1998 from Paribas under the letter of credit.

2. In the light of the answers to (1) judgment for Paribas together with the costs of the action.

14. Paragraphs 20A, 20B and 20C read as follows:

20A. In the premises, as between the Plaintiff and the Third Defendant:

(1) The Plaintiff was the Nominated Bank under UCP Article 10(b)(i) and it had the Third Defendant's authority to incur a deferred payment undertaking to the First Defendant against documents which appeared on their face to be in compliance with the terms and conditions of the Letter of Credit.

(2) By UCP Articles 10(d) and 14(a) the Third Defendant undertook and was bound to reimburse the Plaintiff in the event of the Plaintiff incurring such a deferred payment undertaking.

(3) On 15th June 1998 the Plaintiff duly incurred a deferred payment undertaking to the First Defendant to pay the sum of US$ 20,315,796.30 on 27th November 1998.

(4) The Plaintiff duly discharged its deferred payment undertaking to the First Defendant by effecting a payment to the First Defendant of US$ 19,667,238.84 on 17th June 1998.

(5) By reason of the foregoing, the Third Defendant became bound to reimburse the Plaintiff by a payment of US$ 20,315,796.30 on 27th November 1998

20B. The Plaintiff will if necessary contend that it had the Third Defendant's authority to discharge its deferred payment undertaking by a discounted payment in that :

(1) It is routine banking practice for a bank to discount its own future payment obligation at the request of the party to whom the obligation is owed. This practice operates both generally and in the specific context of deferred payment letters of credit and acceptance letters of credit.

(2) There would be no commercial purpose in a bank's refusal to discount its own future payment obligations because such obligations can be discounted in the market in any event by third parties.

(3) In the specific context of letters of credit, the discounting of deferred payment undertakings and acceptances facilitates international trading by assisting the beneficiary's cash flow while preserving the credit period which such letters of credit give to the applicant.

(4) Accordingly, a Nominated Bank authorised to incur a deferred payment undertaking has implied and/or usual and/or customary authority to discharge any such undertaking by a discounted payment to the beneficiary.

20C. Further or alternatively, authority is to be inferred from the following additional facts and matters:

(1) The Third Defendant was at all material times the issuer of a substantial number of deferred payment letters of credit. It issued such credits intending that Nominated Banks should act on their authority to incur deferred payment undertakings.

(2) At all material times the Third Defendant knew that the potential for earning a profit on discounting is a material inducement to Nominated Banks to act on their authority to incur a deferred payment undertaking under such credits.

(3) It was the likely consequence of issuing the Letter of Credit, and the Third Defendant so intended, that the Plaintiff would incur a deferred payment undertaking and discount the same if so requested by the First Defendant.

SUBSEQUENT HISTORY

15. Santander sent to Paribas the documents received from Bayfern under the letter of credit. Santander paid the sum of US$ 19,667,238.84 into Bayfern's account at the Royal Bank of Scotland on June 17. On June 24 Paribas informed Santander of a message received from Saybolt via Napa Petroleum that the Saybolt certificates of quality and quantity "should be considered to be false". Santander obtained asset freezing relief against Bayfern that evening with the consequence that approximately US$ 14m is frozen in Bayfern's account at the Royal Bank of Scotland.

16. There are several issues in the proceedings (which have been discontinued against Royal Bank of Scotland) including whether there was any fraud, if so when it was known, and as to other alleged discrepancies in the documents. For the purpose of the issues before me it is to be assumed that Santander was not aware of any fraud when it confirmed the letter of credit or on June 17 when it paid the discounted sum to Royal Bank of Scotland but that there was fraud and it was known to both banks prior to November 27, 1998 the maturity date of the letter of credit.

THE EVIDENCE

17. The evidence was short. Santander called the head of Structured Trade and Commodity Finance of the bank's London branch, Mr MacNamara. Each side called an expert banking witness with particular experience in trade finance. Mr Turnbull gave evidence for Santander. Mr Turnbull is currently Managing Director of UBK Trade and Export Finance Ltd a wholly-owned subsidiary of the United Bank of Kuwait. He has widespread experience of trade finance, and is well-known and highly respected in his field. Mr Savage gave evidence for Paribas. I mean no disrespect in saying , as Mr Savage himself readily accepted, that his experience is more limited and substantially confined to his experience with his employers, Credit Agricole Indosuez, where he is now and has been since 1994 the Manager of the Trade Finance Department at the London Branch.

THE UNIFORM CUSTOMS AND PRACTICE FOR DOCUMENTARY CREDITS (UCP)

18. The letter of credit was subject to the UCP (1993 Revision). Articles 3 and 4 of the UCP provide for the well known rules that credits are separate transactions from the sales or other contracts on which they are based and that the parties deal with documents and not the performance of those contracts.
Article 3a provides in part that:
Consequently, the undertaking of a bank to pay, accept and pay Draft(s) or negotiate and/or to fulfil any other obligation under the Credit, is not subject to claims or defences by the Applicant resulting from his relationships with the Issuing Bank or the Beneficiary.

19. Part of the difficulty in construing this Article and all the provisions of the UCP is that, at least in this jurisdiction, they have to be read subject to or qualified by the exception for *established fraud* to which I shall have to refer further.

20. Articles 9 and 10 reflect the four types of letter of credit recognised in the UCP.

21. **Article 9** is entitled *Liability of Issuing and Confirming Banks* and so far as material provides:

a. An irrevocable Credit constitutes a definite undertaking of the Issuing Bank, provided that the stipulated documents are presented to the Nominated Bank or to the Issuing Bank and that the terms and conditions of the Credit are complied with:

i. If the Credit provides for sight payment - to pay at sight;

ii. If the Credit provides for deferred payment - to pay on the maturity date(s) determinable in accordance with the stipulations of the credit;

iii. If the Credit provides for acceptance:

a. By the Issuing Bank - to accept Draft(s) drawn by the Beneficiary on the Issuing Bank and pay them at maturity,

or

b. ....

iv. If the Credit provides for negotiation - to pay without recourse to drawers and/or bona fide holders, Draft(s) drawn by the Beneficiary and/or document(s) presented under the Credit ....

b. A confirmation of an irrevocable Credit by another bank (the "Confirming Bank") upon the authorisation or reqest of the Issuing Bank, constitutes a definite undertaking of the Confirming Bank, in addition to that of the Issuing Bank, provided that the stipulated documents are presented to the Confirming Bank or to any other Nominated Bank and that the terms and conditions of the Credit are complied with:

i. If the Credit provides for sight payment - to pay at sight;

ii. If the Credit provides for deferred payment - to pay on the maturity date(s) determinable in accordance with the stipulations of the Credit;

iii. If the Credit provides for acceptance:

b. By the Confirming Bank - to accept Draft(s) drawn by the Beneficiary on the Confirming Bank and pay them at maturity,

or

b. ....

iv If the Credit provides for negotiation - to negotiate without recourse to drawers and/or bona fide holders, Draft(s) drawn by the Beneficiary and/or document(s) presented under the Credit ....

22. Thus:

(A) The obligations of the Issuing Bank and the Confirming Bank mirror each other and are cumulative (*in addition to*);

(B) In the case of a deferred payment Credit (as here) the obligation is *to pay on the maturity date* in contrast to payment *at sight*;

(C) In the case of acceptance credits or credits available by negotiation the obligation is to accept and pay Drafts or to negotiate documents presented under the credit. *Negotiation* is defined in Article 10.b.ii.

23. **Article 10** is entitled *Types of Credit*. It provides:

a All Credits must clearly indicate whether they are available by sight payment, by deferred payment, by acceptance or by negotiation.

b .i. Unless the credit stipulates that it is available only with the Issuing Bank, all Credits must nominate the bank (the "Nominated Bank") which is authorised to pay, to incur a deferred payment undertaking, to accept Draft(s) or to negotiate ....

ii. Negotiation means the giving of value for Draft(s) and/or documents by the Bank authorised to negotiate ....

c. ....

d. By nominating another bank, or by allowing for negotiation by any bank, or by authorising or requesting another bank to add its confirmation, the Issuing Bank authorises such bank to pay, accept Draft(s) or negotiate as the case may be, against documents which appear on their face to be in compliance with the terms and conditions of the Credit and undertakes to reimburse such bank in accordance with the provisions of these Articles.

24. Read in context, the Issuing Bank's authority to the Confirming Bank *to pay* must I think be meant to cover both payment at sight and payment under a deferred payment undertaking at maturity. That is the obligation of the Confirming Bank under a deferred payment credit (Article 9.b.ii.) and it is the discharge of that obligation which the Issuing Bank is to "reimburse" in accordance with this Article of the UCP.

25. Mr Howard submits that it is Article 10d which provides for the payment obligation of the Issuing Bank to the Confirming Bank. Mr Hapgood submits (despite the formulation of paragraph 20A(2) of the Re-Amended Points of Claim) that obligation is to be found in Article 14. So far as material, Article 14, under the heading "Discrepant Documents and Notice", provides:

a. When the Issuing Bank authorises another bank to pay, incur a deferred payment undertaking, accept Draft(s) or negotiate against documents which appear on their face to be in compliance with the terms and conditions of the Credit, the Issuing Bank and the Confirming Bank, if any, are bound:

i. To reimburse the Nominated Bank which has paid, incurred a deferred payment undertaking, accepted Draft(s) or negotiated,

ii. To take up the documents.

26. The remainder of the Article is concerned with the position where the documents presented are discrepant. In this case Santander had the role of both Confirming Bank and Nominated Bank. It is not an easy reading of this Article that it is intended to provide for the right of reimbursement by a Confirming Bank from an Issuing Bank when it has that dual role. That right is in my judgment expressly addressed in Article 10d. Moreover even if both

Articles are addressing the same situation, an obligation to "*reimburse*" a party which has "*incurred a deferred payment obligation*" would I think as a matter of normal language fall to be discharged only when that latter obligation had itself been discharged by "*payment at maturity*". On that basis, as one would expect, the two Articles say the same thing. The consideration for the Confirming or Nominated Banks' undertaking to pay at maturity is that if and when it does so the Issuing Bank will reimburse it.

27. Article 14 is, I think, as Mr Howard submitted, directed at establishing that the Issuing Bank cannot complain about the documents presented under the credit once they have been taken up so as to dispute the Confirming and/or Nominated Bank's right to incur the deferred payment obligation. But that obligation remains to pay at maturity with the right to be reimbursed if you do so.

ESTABLISHED FRAUD

28. In ***United City Merchants v Royal Bank of Canada*** [1983] AC 168, the House of Lords considered the question of fraud which would entitle a banker to refuse to pay under a letter of credit notwithstanding the rule requiring payment when the documents were in order on their face. In the course of his speech, with which the other members of the House agreed, Lord Diplock, at page 183, said:

The whole commercial purpose for which the system of confirmed irrevocable documentary credits has been developed in international trade is to give to the seller an assured right to be paid before he parts with control of the goods that does not permit of any dispute with the buyer as to the performance of the contract of sale being used as a ground for non-payment or reduction or deferment of payment.

To this general statement of principle as to the contractual obligations of the confirming bank to the seller, there is one established exception, that is, where the seller, for the purpose of drawing on the credit, fraudulently presents to the confirming bank documents that contain, expressly or by implication, material representations of fact that to his knowledge are untrue. Although there does not appear among the English authorities any case in which this exception has been applied, it is well established in the American cases of which the leading or "landmark" case ***is Sztejn v J. Henry Schroder Banking Corporation*** *(1941) 31 N.Y.S. 2d 631.... 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.*

29. In my judgment it must follow on the assumed facts, that had Bayfern in this case sought to enforce the obligation of Santander to pay the letter of credit at maturity Santander would have been entitled and on the present state of law bound to refuse to make that payment or lose its right to reimbursement. The fact that the documents had been taken up before any fraud was notified would not alter the fact that when it was sought to enforce the consequent payment obligation the claimant would be dishonestly seeking to use the process of the courts to carry out a fraud: see also ***The Society of Lloyds v CIB*** [1993] 2 LL Rep 579 per Saville J at page 581.

30. In ***European Asian Bank A.G. v Punjab and Sind Bank*** [1983] 1 LL Rep 611 the Court of Appeal considered a claim by the appellant bank against the issuing bank of a deferred payment letter of credit. The Court decided that on the evidence the issuing bank had unequivocally represented to the appellants that they were entitled to act as negotiating bankers under the credit and that they would be paid as negotiating bankers on the maturity date. The appellants had negotiated the credit by paying its discounted value to the Beneficiary. Between that date and the maturity date fraud, or alleged fraud, on the part of the Beneficiary was discovered and the issuing bank denied liability under the credit. The Court held that there was no arguable defence and entered a summary judgment against the issuing bank: see in particular the judgment of the court delivered by Robert Goff LJ (as he then was) at page 621.

31. A submission on behalf of the issuing bank that the appellants were merely agents for collection for the beneficiary (and so fixed with its fraud) was rejected, but at page 619, Robert Goff LJ added:

Even if it were a fact that, as at August 13 (when the appellants had forwarded the documents to the issuing bank to enquire whether they would accept them) *the appellants had been appointed agents for collection by* (the Beneficiary) *it is beyond question that by August 20 the appellants had negotiated the letter of credit, and there is no suggestion that they acted otherwise than in good faith in so doing. Thereafter, in February 1980, they claimed payment from the respondents; and this was refused. In our judgment it is not open to the respondents, on these facts, to say against the appellants that they were justified in refusing payment on the ground that the documents were fraudulent or even forged. In our judgment the relevant time for considering this question is the time when payment falls due and is claimed and refused. If, at that time, the party claiming payment had negotiated the relevant documents in good faith, the issuing bank cannot excuse his refusal to pay on the ground that at some earlier time the negotiating bank was a mere agent for collection on behalf of the seller and allege against him fraud or forgery (if that indeed be the case) on the part of the beneficiary of the letter of credit.*

32. The essential distinction between that case and this is that in the ***European Asian Bank*** case the appellants were or were to be considered to be negotiating bankers. The credit was type a.iv. under Article 9 of the UCP. In this case the credit is type a.ii.

33. As Robert Goff LJ said at page 621:

After all it was obvious that the appellants as negotiating bankers, would be discounting the letter of credit and so paying out a very large sum of money on the faith of these messages (that is the messages which constituted the representation that the appellants were entitled to act as negotiating bankers under the letter of credit).

34. Thus the case was one in which it was in effect held that the discounting of the letter of credit was expressly authorised by the issuing bank on terms that it would be liable at the maturity date for the undiscounted sum of the credit. That reflects the meaning of "negotiation" in Article 10b.ii. of the UCP and the express undertaking of the Issuing Bank to reimburse the negotiating bank for doing just that in Article 10d.

35. If such authorisation is to be found in the present case it has to be found in Article 14 or some custom or practice or implication as paragraphs 20A, 20B and 20C of the Re-Amended Points of Claim recognise. The difficulty facing Santander is however, that the UCP spells out the extent of express authorisation in a deferred payment credit in terms of payment at maturity: Article 9.b.ii. And, as ***European Asian Bank*** illustrates, the UCP expressly permits another type of credit, a credit "for negotiation", which does authorise discounting and require the issuing bank to reimburse the "discounting" bank when it does so.

36. In this context I should add a word about acceptance credits as Mr Hapgood's submission was that there was no good reason why the effect of established fraud should differ in the case of acceptance credits and deferred payment credits. An acceptance credit, however, expressly involves authority from the Issuing Bank to the Confirming Bank to accept drafts and pay them at maturity: Article 9.b.iii. a. The Issuing Bank's obligation is to reimburse the Confirming Bank for undertaking those obligations. If the Beneficiary discounts the accepted draft to a bona fide third party the third party will be a holder in due course entitled regardless of subsequently discovered fraud to payment on the draft by virtue of the provisions of the Bills of Exchange Act 1882. If the Confirming Bank discounts its own acceptance it will become a holder of the draft and if it holds it at maturity the draft will in law then be discharged: section 61 of the Act. In either case therefore the express obligation of reimbursement of the Issuing Bank is effective. The authorised acceptance of the draft itself carries with it that consequence.

ASSIGNMENT AND PRACTICE

37. Finally, in the context of fraud by the Beneficiary, it is necessary because of the way the submissions have developed and because of the references to assignment in the documentation to which I have referred, to consider the effects of the assignment from Bayfern to Santander in this case and the evidence relating to the practice of discounting deferred payment credits.

38. The Beneficiary of a confirmed deferred payment letter of credit has the promise of both the Issuing Bank and the Confirming Bank to pay on the maturity date : UCP Article 9.b.ii.

39. If the Confirming Bank agrees to discount the proceeds of the letter of credit it is in effect agreeing to "buy" its own future promise to pay at a current price. Whether it does so and if so on what terms is, as all the witnesses agree, entirely a matter for its own decision in agreement with the Beneficiary and will be done (as it was done here) without any reference or notice to the Issuing Bank. For example, it could be done with or without recourse to the Beneficiary (in this case it was with recourse). On the evidence, it could also be done with or without taking an assignment and with or without any attempt to assess the credit or character of the Beneficiary to whom the discounted price was to be paid. Mr Turnbull said it was not his practice to ask for an assignment on discounting "his own" confirmation. But he acknowledged some banks would insist on an assignment, which he said was unnecessary as there was nothing to assign once the discounted payment had been made.

40. Santander did insist on an assignment as their own Manual required. Mr MacNamara described it as "belt and braces". Mr Savage said taking an assignment was the normal practice. Although both experts agreed that market practice would not take account of the credit risk of the beneficiary they also agreed that banks would often assess the integrity of the beneficiary. In this case Santander in fact obtained a bank reference on Bayfern from the Royal Bank of Scotland. It is obvious that any bank contemplating discounting is in a position at least to seek to know who it is dealing with.

41. The experts are also agreed that it is (and was) common market practice in London to discount deferred payment letters of credit where the beneficiary requested it. Whether the beneficiary did request it would of course depend on all sorts of individual factors.

42. Counsel are not agreed on either the utility or effect of an assignment. Mr Hapgood's first submission, indeed, is that the assignment was worthless because there was nothing to assign. He submits that the payment made by Santander to Bayfern on June 17 was "plainly intended by both parties to extinguish all Bayfern's rights under the Credit, both against Santander and against Paribas." He points to the report of *Re Charge Card Services Ltd* [1987] Ch 150 at page 175C/D where it is recorded that counsel conceded that a debt cannot be assigned in whole or in part to the debtor since such an assignment operates wholly or partially as a release. That he submits remains unaffected by the decision in ***Re BCCI SA (No 8)*** [1997] 4 All ER 568 at pages 575 to 578. Mr Hapgood also submits that in any event an assignee is not affected by the subsequent emergence of fraud *on the principle that the claim of an assignee is not defeated by an unknown fraud which induced the debtor to enter into the relevant contract*. The authority cited for this principle is the decision of the Court of Appeal in ***Stoddart v Union Trust Ltd*** [1912] 1 KB 181.

43. One context in which this question could arise directly is the forfaiting market. In simple terms a forfaiter may buy, also at a discounted price, the obligations of the issuing bank and confirming bank (if any) under a deferred payment letter of credit. In other words the forfaiter is an independent party to the Credit itself, albeit frequently a bank, and trades in trade paper by the purchase of the obligations it represents. The experts agree that there is a well established forfaiting market which deals in deferred payment undertakings both in London and

elsewhere. They also agree that the documentation in such a case provides for the forfaiter to obtain an assignment from the beneficiary of its own rights under the credit and that the forfaiter will give notice that it has done so to the banks whose obligations it has bought. In such a case the basis in law on which the forfaiter is entitled to the proceeds of the credit must be the assignment as it is not a party to the credit.

44. Mr Howard, on the other hand, submits that an assignment does involve assigning valuable rights, the rights to a future payment from both the Issuing and Confirming Banks. In other words, that even in a case where the Confirming Bank is discounting or buying its own future obligation the position is the same as for a forfaiter. He also submits, on well known principles (see Chitty on Contracts, Vol. 1, paras 19-039 to 042) that an assignee takes subject to equities against the assignor, and thus that in both cases if the assignor had no right to payment, for example because the documents were forged, then the Confirming Bank and forfaiter cannot recover as they are in no better position than the assignor.

45. These counter submissions became of more importance in the course of the parties' closing submissions because despite the fact that no claim was pleaded by Santander as assignee and therefore no reference to the effect of the assignment was expressly included in the issues ordered for preliminary trial both counsel agreed that the court should address the issue and, as it had been raised in the course of argument and Mr Hapgood indicated that if Santander was not succesful on any of its claims as formulated, it would pursue a claim as assignee, I agreed to do so.

46. At this stage I would simply record the following:

(1) It is agreed that the forfaiter's legal rights are dependant on the efficacy of the assignment to it of the rights of the beneficiary.

(2) Mr Hapgood submits and it is his primary case that the discounting Confirming Bank's rights are to be found in Article 14a of the UCP and only if he is wrong about that does he now seek to find them in the assignment.

(3) There is therefore in Santander's own primary case a material difference in the legal basis for a claim by a forfaiter and a claim by a Confirming Bank which has discounted its own obligation.

(4) On any view the rights of a bona fide assignee of an obligation owed to an assignor who has been guilty of fraud in the context of that obligation are as a matter of law of some nicety. Yet, on the evidence of Mr Turnbull, it seems the forfait market has not appreciated this or, if it has, has chosen to run the risk.

(5) It is not easy to see why a Confirming Bank which discounts its own confirmation should be in any better or different position than the forfaiter, especially so where (as here) the discounting agreement with the Beneficiary is in effect on the same basis as a forfaiter would use.

(6) It is a matter of commercial indifference for the issuing bank whether the Beneficiary is able to or chooses to "discount" its rights under a confirmed deferred payment letter of credit with the confirming bank or a forfaiter. It will also be ignorant whether one or the other has in fact occurred. Thus, if the consequences in law are different, that will be so for no apparent commercial reason and without the knowledge of the Issuing Bank.

(7) There can be no doubt that in a case where no fraud is involved both the discounting Confirming Bank and the forfaiter must have an enforceable right to be "reimbursed" by the Issuing Bank.

(8) It was comforting to hear from both experts that the incidence of fraud in these situations is very rare indeed. Thus the extent of the problem, whilst when it arises no doubt capable of involving very large sums, is such that one might expect it to ameliorate Mr Turnbull's expressed concerns about the effect on the market should Santander not be entitled to recover from Paribas. Moreover, as I have already said, the use of Credits for negotiation is an option and at the least it is agreed that the forfait market has and has always had, a "problem" in such cases but it has continued to grow and develop nonetheless. If as Mr Turnbull's evidence suggests that was because forfaiters believed they were immune from fraud once they had "bought" the obligations under a deferred payment letter of credit then the belief was wrong.

(9) I accept that it is difficult for a Confirming or any bank to protect itself against fraud and that the UCP looks to the Applicant for the credit to do that. But the law is only that payment is to be refused in cases of established fraud known to the Bank before the due date for payment. That is not harsh. This case concerns the consequences when for its own reasons and without reference to the Issuing Bank or Applicant the Confirming Bank chooses to commit itself to making a payment before it is bound to do so.

THE SUBMISSIONS

47. Apart from the competing submissions on the Assignment Issue, which I have set out and consider below, the essential submissions on the core questions can I think be fairly summarised as follows.

48. Mr Hapgood submits that:

(1) Santander is entitled to be reimbursed by Paribas under Article 14a of the UCP regardless of the assumed fact that by November 27, 1998 it knew of established fraud by Bayfern. That is his primary case.

(2) In the alternative it is entitled to be reimbursed as assignee notwithstanding the assumed fraud.

(3) In the further alternative, as set out in paragraphs 20B and 20C of the Re-Amended Points of Claim Santander had "implied, usual or customary" authority to discount and there was an obligation on Paribas to reimburse Santander for having done so as a matter of market practice.

49. Mr Howard submits that:

(1) the obligation of an Issuing Bank to reimburse a Confirming Bank is to be found in Article 10d of the UCP and not Article 14a and in any event the Articles have the same effect which is that the right to reimbursement arises only at the maturity date.

(2) In the case where a Confirming Bank discounts its obligation and there is no fraud, its right to reimbursement arises at the maturity date as a matter of analysis on the basis that :

(i) its obligation to pay the Beneficiary is deemed in law to be fulfilled or to be discharged at that date as it will then owe the liability to itself; or, as a secondary case,

(ii) as assignee of the obligation of the Issuing Bank to pay the Beneficiary at that date, such an assignment being either express (as in this case) or arising by implication from an agreement to discount. But in either case knowledge of fraud prior to the maturity date entitles the Confirming Bank to refuse payment and disentitles it from reimbursement by the Issuing Bank.

(3) There is no evidence of any relevant market practice to justify Santander's claims in paragraphs 20B and 20C.

CONCLUSIONS

50. **ARTICLE 14a** I have already expressed my view of this Article when considering the provisions of the UCP. In short, in my judgment Mr Howard is right and Mr Hapgood wrong in their submissions about it. The basic authority given by the Issuing Bank to the Confirming Bank in a deferred payment letter of credit is to pay at maturity. The consequent obligation to reimburse is to reimburse on payment being made at maturity. If at that time there is established fraud, there is no obligation on the Confirming Bank to pay nor on the Issuing Bank to reimburse. I cannot construe either Article 10d or 14a as entitling Santander to "reimbursement" for having incurred a deferred payment undertaking as opposed to paying it at maturity, as Mr Hapgood submits I should. That seems to me both to fail to recognise the existence and rationale of the established fraud exception and to be inconsistent with the normal meaning of the word reimbursement. Nor can I accept that the payment of the discounted sum discharged the obligations of Santander and Paribas under the Credit for the reasons stated below. I should make clear that it is no part of Mr Howard's case or my reasoning that "discounting" of the payment obligation under a deferred payment letter of credit is a "breach of mandate" or that for some other reason (in the absence of established fraud) the Issuing Bank's reimbursement obligation cannot be invoked. In my judgment Mr Howard is right in his submissions that:

(i)where the Confirming Bank discounts its own obligation, at maturity either it is to be deemed to make payment at that date or it is entitled to claim as assignee of the claims of the Beneficiary.

(ii) where a forfaiter discounts the Credit it is entitled to claim as assignee.

51. **Assignment.**

(a) Despite the attraction of Mr Hapgood's submission that an assignment to the debtor of his own obligation to pay extinguishes the debt and discharges it, I am not persuaded. First, the "debt" in question was owed by two parties (Paribas and Santander) not just Santander and was payable only in the future (unlike the existing debts in the ***Re Charge Card Services*** case). Second, the expressed consideration for the payment of the discounted sum was the irrevocable and unconditional assignment to Santander of Bayfern's rights under the Credit. Third, the agreement to discount and assign cannot be read as Mr Hapgood submits it is to be read as an agreement to discharge or, on payment of the discounted sum, as an actual discharge of the obligations of either Bank under the Credit. Indeed the agreement is inconsistent with such an outcome. The expressed purpose was to keep the Credit intact. Fourth, I do not see anything objectionable in one (Santander) of two parties (Santander and Paribas) liable for a future payment agreeing with the creditor (Bayfern) to acquire the creditor's rights against the other (Paribas) on terms that his own obligation to make a payment in the future to the creditor is to be preserved so as to be treated as discharged at that future date and thus available then to trigger the obligation on the other debtor to reimburse him. That seems to me to have been the intention of both Santander and Bayfern expressed in the agreement and I do not see why the court should not give effect to it.

(b) The second question in relation to assignment which now arises is whether a claim by Santander as assignee of Bayfern would be sustainable on the assumed facts that Bayfern was guilty of fraud in submitting the documents under the Credit but that fraud was unknown to Santander at the time of assignment but known at the maturity date.

52. In my judgment the answer to this question is "No". It is no surprise that Santander have not pleaded a claim on this basis. ***Stoddart's*** case has been the subject of some criticism and can be distinguished : see Chitty para 19-040. On the assumed facts, Bayfern had no rights under the Credit and so nothing to assign to Santander. Unless (which is in reality the first question) Santander has an independent right to recover from Paribas, I do not think qua assignee Santander could obtain more than Bayfern had to give at the time of the assignment.

53. **Custom and Practice.** Mr Turnbull's views are of course entitled to respect and in reaching the conclusions I have I have had them in mind. Essentially, however, I think they come to no more than a reflection of expectations on the part of Banks (or at least discounting banks with London operations) that it is safe to discount Credits and that they are not concerned with the bona fides of the Beneficiary. I cannot spell out from that any relevant custom or practice or the basis for the implication of any relevant contractual term. If I am right in my construction of the

UCP it provides for the obligations undertaken in this case and there is nothing in Mr Turnbull's evidence which can alter that. It also establishes what it was that Santander was authorised to do ("*pay at maturity*") and no wider authorisation is justified on the evidence nor any of the ways in which Santander have sought to express the claim in paragraphs 20B or 20C of the Re-Amended Points of Claim. On the evidence there is no common practice even as regards the documentation where a Confirming Bank discounts its own confirmation and the incidence of fraud has been so slight that no practice in that context could exist. Nor, as I have said, in the related case of the forfait market, would it seem that whatever the expectation it reflects the reality.

54. It follows that on all the issues before the court in my judgment Paribas are right and Santander wrong.

THE ANSWERS TO THE ISSUES

55. I will hear the parties on the form of Order to be made in the light of this judgment and the fact that both have sought to refine the specific questions which were referred to the court. My essential conclusion is that on the assumption that Bayfern was guilty of fraud in the manner alleged and that was known to Santander before November 27, 1998 the risk of that fraud falls on Santander and not Paribas.

Mr Mark Hapgood QC and Mr Roger Masefield ...instructed by Messrs Stephenson Harwood for the Plaintiffs)
Mr Mark Howard QC and Miss Helen Davies ...instructed by Messrs Norton Rose for the Third Defendants)