JUDGMENT : Mr. Justice David Steel : Commercial Court. 15th May 2007

Introduction

1. The Claimant is an Uzbek state cotton trading company. It was formerly known as JSC Innovatsia ("Innovatsia"). The Defendant ("SBL") is a London Bank which, at the material time, acted as bankers to an English cotton purchasing company, A. Meredith Jones & Co Ltd ("AMJ"). SBL was also the agent and issuing bank for a Syndicate of banks including itself ("the Syndicate") which, pursuant to a written Facility agreement dated 24th October 1997 ("the Facility"), made a pre-export finance Facility available to AMJ for the purchase of cotton from the Claimant.

2. The Claimant and AMJ had earlier entered into a written sale contract dated 20 September 1997 ("the sale contract"), pursuant to which the Claimant agreed to sell, and AMJ agreed to buy, a series of consignments of cotton ("the Cotton") on FOB terms totalling 50,000 mt. The Sale Contract required AMJ to make an advance payment to the Claimant in respect of 90% of the value of the Cotton, with the balance of the payment to be by letter of credit. AMJ was also to arrange for an advance payment guarantee with the National Bank of Uzbekistan ("NBU") for the total value of the advance payment.

3. AMJ and SBL (as an agent of the Syndicate) entered into a security deed dated 24 October 1997 pursuant to which, as security for the performance of its obligations under the Facility, AMJ assigned to SBL all its rights, title and interest under the Sale Contract and in the Cotton, although AMJ was to be free to deal with and sell the Cotton in the ordinary course of its business, provided that there was no default under the Facility.

4. On 5 November 1997 NBU opened the advance payment guarantee ("APG") in favour of the Defendant in the sum of US$65,674,688.40. The APG was subject to UCP 458 and was to be construed in accordance with English law. It expressly provided that the amount of the APG was automatically reduced by 90% of the value of each consignment of Cotton delivered to AMJ on the basis of tested telexes sent by SBL to the NBU, delivery to be proved (and this was a crucial feature of the subsequent dispute) by the presentation by NBU or by AMJ of the shipping documents and commercial invoices as required by the letter of credit. (Because of a fall in the cotton market, the 90% figure was later amended to 100%, in line with the similar amendment to the Sale Contract.)

5. On 7 November 1997 SBL opened an irrevocable letter of credit on the instructions of AMJ in favour of the Claimant ("the LOC"). The LOC required certain documents to be presented at the counters of SBL. These included a full set of three Bills of Lading (or a waybill or warehouse certificate), together with a certificate of origin, a quality certificate and a certificate of acceptance.

6. On 12 November 1997 SBL duly made an advance payment to the Claimant's account at NBU in the amount of the APG, thereby activating it.

7. During 1997 and 1998, consignments of Cotton were delivered by the Claimant pursuant to the Sale Contract; some documents were presented at the counters of SBL in relation to those consignments; the amount of the APG was automatically reduced by the value of some of these consignments on the basis of the tested telexes sent by SBL to NBU.

8. However, by September 1998, disputes had arisen between the Claimant and AMJ with regard to the performance of the Sale Contract. Those disputes concerned, amongst other things, the Claimant's failure to meet the delivery dates under the Sale Contract and the continuing failure to correct the presentation of discrepant documents at the Defendant's counters, in the sense that they did not conform with the terms of the APG and the LOC. In these circumstances, on 19 October 1998 SBL made a demand on the APG ("the Demand") in the sum of US$37,773,636.04. On the same day the amount demanded was paid to SBL by NBU.

9. But, at the time at which the Demand was made, AMJ had succeeded in obtaining possession and control of certain of the consignments of cotton in respect of which the Demand had been made ("the Received Cotton"). In some instances it did so by means of the issue of letters of indemnity ("LOIs") to vessel owners which AMJ issued and which, in some but not all occasions, representatives of SBL had countersigned. In other instances it did so by means of the issue by SBL of releases addressed to the operators of the warehouses where the Received Cotton in question was stored. In further instances AMJ obtained possession and control of the Received Cotton in question following the issuance of warehouse receipts to the order of AMJ. The Defendant however informed NBU that it rejected the documents relating to all the Received Cotton.

10. On 20 October 1998 AMJ commenced proceedings and sought and obtained a freezing injunction in respect of various consignments of cotton alleged by AMJ not to have been delivered by the Claimant under the Sale Contract. The consignments in respect of which the injunction was obtained included some of the Received Cotton. There followed arbitration proceedings between AMJ and the Claimant. In April 2000 AMJ admitted that it had in fact obtained possession and control of certain deliveries of the Received Cotton (and indeed sold them) and the freezing injunction was accordingly set aside by consent.

11. Awards were issued by the arbitrators and umpire in January and July 2000. The net effect of these awards was that there was found to be a balance in favour of the Claimant of US$8,123,916.23 together with interest and costs. The Claimant has been unable to enforce the awards because AMJ was placed in insolvent liquidation in February 2001. By a Deed of Assignment executed in July 2004, all of NBU's rights and interest in any rights of action it might have against SBL were assigned to the Claimant.

12. The principal claim advanced by the Claimant, as raised by amendments to the Particulars of Claim made in February 2006 following disclosure, is that the Demand was fraudulent as to its amount. It is the Claimant's case that in making the Demand SBL impliedly represented that so far that it was aware the Demand was not excessive. The Claimant alleges that the Demand was excessive to the knowledge of SBL (or alternatively that representatives of SBL were reckless as to whether or not the Demand was excessive), in that those same representatives knew that some of the Received Cotton had been delivered to, accepted and sold by AMJ, such that AMJ was not entitled to reject those consignments (or the documents relating to them). It is the Claimant's case that the NBU was induced by SBL's false representations to make payment under the APG, such that the Claimant (as assignee of the NBU) has a claim in deceit. An alternative claim was advanced in mistake.

13. SBL denies that the Demand was excessive. It further contends that, if the Demand was excessive, its representatives did not know or believe the Demand to be excessive. It denies that the representations alleged by the Claimants are to be implied into the making of the Demand. SBL submits that it, like the Claimant, was a victim of a fraudulent scheme on the part of AMJ. In addition to its contention that it was not dishonest, the Defendant relies on legal advice received, after the making of the Demand but before the distribution of the proceeds of the Demand to the Syndicate members.

14. In the alternative, the Claimant contends that there was a term to be implied into the APG that, in the event that any demand made should be found to have exceeded the loss sustained by AMJ or the Defendant or was otherwise excessive, the Defendant should repay that excess.

15. SBL denies that any such term was to be implied into or part of a collateral contract to the APG. It contends that the proposed implied term is (i) inconsistent with the nature and express terms of the APG; (ii) not necessary to give business efficacy to the APG or to reflect the obvious intentions of the parties and (iii) too vague and uncertain to be implied. It also contends that the NBU, the Claimant's assignor, suffered no loss, and that the only proper claim is that of the Claimant against AMJ.

16. The Claimant at one stage also advanced a claim in restitution to the extent that the proceeds of the Received Cotton were received by SBL. It was said that, having received both the proceeds of sale of the Received Cotton and the proceeds of the APG, SBL had been unjustly enriched at either the Claimant's or NBU's expense. SBL denied that the Claimant has any cause of action in restitution and in any event relied upon a change of position defence.

17. As an alternative to the restitution claim, the Claimant amended at an early stage of the trial to assert a claim based on a constructive trust. The proposition was to the effect that, in selling part of the Received Cotton, but refusing to waive discrepancies in the associated documents, AMJ became constructive trustees of the proceeds of sale and SBL was in knowing receipt of those proceeds. Further, it was unconscionable for SBL to retain the same as well as the equivalent proceeds of the APG. SBL denies that the Claimant has any cause of action and also relies upon an alleged change of position defence in having paid out the proceeds of the Demand.

18. As an alternative to its primary claims, the Claimant advances a claim in conversion in respect of certain consignments forming part of the Received Cotton on the basis that if, contrary to its primary case, AMJ and/or SBL had validly rejected the documents in respect of the Received Cotton, the Received Cotton belonged to the Claimant. The Claimant contends that SBL itself sold certain consignments forming part of the Received Cotton; these claims are the subject of the partial settlement (see section D below). The Claimant further contends that SBL asserted title to or retained the documents relating to other consignments of the Received Cotton. SBL admits that it held documents of title relating to certain of those consignments, but avers that it was entitled to do so and that it has not converted those consignments.

19. By its alternative claim in conversion, the Claimant claims damages comprising the diminution in value of the cotton said to have been converted, together with warehouse charges, legal costs and other expenses said to have been incurred. SBL denies any liability in relation to these alleged losses and contends that the Claimant failed to mitigate its losses and/or that the losses were unreasonably incurred and/or were not foreseeable.

20. As regards quantum, the Claimant contends that it is entitled to recover US$37,773,636.04 in regards to its claim in deceit being the full value of the payment made pursuant to the Demand (or alternatively the amount of the Demand but giving credit for Cotton undelivered and/or recovered as above). SBL contends that if the Demand was fraudulent as alleged, the Claimant's claim is limited to the amount by which SBL knew the Demand to be excessive.

21. By its claim based on an alleged implied term, the Claimant (as assignee of NBU) seeks to recover the price of the Received Cotton, giving credit for any sums recovered in the liquidation of AMJ and which the Claimant has been able to realise by subsequently tracing and selling the Received Cotton.

22. The quantum of the Claimant's claims in constructive trust is put forward as the value of the "double receipt" of cotton: i.e. the cotton in respect of which SBL received both the proceeds of the APG and the proceeds of sale. The quantum of the conversion claim depends on the value of the Received Cotton that is found to have been converted and on the amounts of the Claimant's alleged expenses that it can show (a) that it incurred and (b) that SBL is liable to pay.

23. In November 2006 the parties agreed a settlement of a number of the Claimant's claims. They related to the following:

(1) Claims based on letters of indemnity and releases issued or signed by representatives of SBL prior to the making of the Demand, SBL having admitted that the issue of such letters of indemnity and releases was inconsistent with SBL's right to reject the documents in relation to the cotton concerned insofar as AMJ or its buyers accepted and sold the relevant cotton;

(2) A claim that SBL had failed to notify the NBU of reductions to the APG in relation to the invoices identified in Schedule 3 to the Re-Re-Amended Particulars of claim;

(3) Certain of the conversion claims.

24. As a result of the partial settlement, the Defendant has agreed to pay the Claimant the sum of US$3,277,604.88, being a principal sum of US$2,499,151.63together with interest of US$778,453.25.

Witnesses

25. A wealth of documentary evidence was put before the Court, together with a number of substantial witness statements. There were also some expert accountancy reports. A number of the factual witnesses were called to give oral evidence. As regards the Claimant ("Innovatsia") there were three oral witnesses:-

a) Mr. Leonid Chanychev, Head of the Legal Department of Innovatsia

b) Mr. Nasrulla Ismailov, an economics specialist employed by Innovatsia: he was responsible for the sale contract, reporting to the late Mrs. Kasimova, the Deputy Director of the Sales Department

c) Mrs. Lyala Khayrutdinova, Head of Inter-bank Settlements at NBU.

26. Much of their evidence was uncontroversial. At the beginning of the trial, the Claimant was also proposing to call their former Chairman Mr. Sharkat Baratov. In the event, he was unable to come and give oral evidence or, even if it had been practicable, to give evidence by video-link. There was however an unwelcome dispute as to the reason for this. The Claimant asserted that he was unwell, although there was somewhat conflicting evidence as to the nature of his medical condition. In contrast, very late in the trial, SBL asserted that Mr.Baratov was in prison in relation to some alleged economic crimes. There ensued a flurry of statements exchanged between the parties on the topic.

27. On the material available it was not possible to resolve this issue and, fortunately, nor was it necessary. Mr. Baratov's statement was put in evidence. Although he was a signatory to a number of letters, I very much doubt whether he would have been in a position to deal with any points of detail, all of which would probably have been within the purview of his subordinates. In contrast Mr. Ismailov had something akin to an encyclopaedic knowledge of the various shipments of cotton.

28. As regards SBL the following factual witnesses were called:-

a. Mr. Peter Kennedy, an Assistant General Manager, Head of Syndications. He is now Managing Director, Specialist Finance within SBL. Prior to going to SBL he had been involved for twenty tears in investment banking with Natwest. He gave a full account of his approach to the making of the Demand for which he had stepped in and had taken responsibility. The Claimant says that his account was false.

b. Mr. Andrew Parsons, a Senior Manager in the Banking Services Department which was part of the "back office" Division of SBL. He had been in banking since 1971 with Barclays and ABN Amro. He joined SBL in 1992. He is now Head of Banking Operations at SBL. He was not involved in the Demand but at one stage it was suggested that he had been dishonest.

c. Mr. David Willman, formerly an Assistant Manager in the Trade Finance Department. Having started with ECGD in 1977 and thereafter worked in trade finance, he joined SBL in 1997. He is now a Structured Finance Advisor at Shell. He was very much involved in the operation of the AMJ transaction and in the making of the call. Innovatsia contended that he was a dishonest witness.

d. Mr. Alan Linger, an Assistant General Manager in the Trade Finance Department. He was Mr. Willman's immediate superior. He had worked for Lloyds Bank for twenty five years before joining SBL in 1997. He retired in 1999. He was not involved in the Demand.

e. Mr. Kurt Staines, one of the clerical staff in the Import Section of the Back Office Documentary Credits Section.

f. Mr. Robert Scott, a Manager in the Syndications Department who reported to Mr. Kennedy. He joined SBL in 1998 having worked for Natwest for twenty one years. He is currently a Director of Global Distribution at SBL. Innovatsia assert that his evidence was almost entirely untruthful including his assertion that he was not involved in the making of the Demand.

29. As already noted the Claimant's primary case is that SBL had acted fraudulently in pursuing its Demand under the guarantee. This allegation was expressly directed at Mr. Kennedy, Mr. Scott and Mr. Willman. However it should be noted that no such allegation was made against Mr. Linger.

30. Surprisingly, the allegation against Mr. Kennedy, who expressly accepted responsibility for the Demand, was only raised at the beginning of the trial when Innovatsia applied for and obtained leave to amend their statement of case. (As regards Mr. Parsons there was an unsatisfactory suggestion in the Claimants' skeleton argument that he also had been guilty of dishonesty. No amendment was sought in this respect and on completion of his evidence I made it plain that it was an allegation which should not have been made. It was thus particularly unsatisfactory that the allegation was repeated in the Claimant's closing submissions.)

31. It follows that the evidence of some of these witnesses was highly controversial. In this respect I should state that my clear impression was that Mr Kennedy and Mr Willman were good witnesses who sought to give a clear,

coherent and accurate account of the circumstances leading up to the Demand. Mr Scott's recollection seemed to be more uncertain but I would have little hesitation in accepting his evidence that he was not merely out of the country but had no input whatsoever into the timing or level of the Demand.

32. However impressions can be very misleading and in considering their evidence I have had very much in mind that the trial was taking place nearly nine years after the events occurred. The actual recollection of witnesses must inevitably have dimmed, giving rise to some gaps in the story and a degree of inconsistency.

33. In these circumstances I respectfully endorse the observations of Lord Justice Robert Goff in ***The Ocean Frost [1985] 1 Lloyds Rep. 1 p. 57***:- *"Speaking from my own experience, I have found it essential in cases of fraud, when considering the credibility of witnesses, always to test the veracity of their evidence by reference to the objective facts proved independently of their testimony, in particular by reference to the documents in the case, and also to pay particular regard to their motives and to the overall probabilities. It is frequently very difficult to tell whether a witness is telling the truth or not; and where there is a conflict of evidence such as there was in the present case, reference of the objective facts and the documents, to the witnesses' motives and to the overall probabilities can be of very great assistance to a judge in ascertaining the truth."*

The contractual documents

34. In Uzbekistan, cotton is harvested from the end of April through to November. Sales of cotton normally commence at the beginning of the summer. The buyer will sometimes attend at the processing gin to select and accept individual lots: otherwise acceptance is undertaken at the port of loading or the railhead. Shipment usually starts in September and ends by the summer of the following year.

35. The sale contract in the present case was concluded in September 1997. Its principal terms concerned the sale of 50,000 metric tonnes of cotton of prescribed but variable quality at various ports. The preliminary value was $72,971,876. The more significant provisions were as follows:-

i. Clause 5.3 –

THE BUYER SHALL INSPECT AND APPROVE ALL COTTON UNDER THE CONTRACT AT ORIGIN, QUALITY INSPECTION CAN BE CARRIED OUT EITHER BY THE BUYER'S NOMINATED REPRESENTATIVE OR WITH THE PARTICIPATION OF AN INDEPENDENT INTERNATIONALLY RECOGNISED CONTROLLER (W.I.S OR S.G.S) AT BUYER'S COST. INSPECTION RESULTS WILL BE EVIDENCED BY AN AKT OF ACCEPTANCE (WITH THE REMARK "OK") SIGNED BY THE BUYER'S NOMINATED REPRESENTATIVE AND/OR INDEPENDENT INTERNATIONALLY RECOGNISED CONTROLLER AND UZPAKHTASANOATSOTISH. UPON SIGNING OF THE AKT, THE INSPECTED AND APPROVED VOLUME OF COTTON WILL BE SHIPPED TO DESTINATION.

ii. Clause 6.1 -

THE SHIPMENT OF COTTON IS TO BE EFFECTED IN PORTIONS OF 8,000 METRIC TONNES PER MONTH EQUALLY, OCTOBER / NOVEMBER / DECEMBER 1997 AND IN PORTIONS OF 8,666 METRIC TONS PER MONTH EQUALLY IN JANUARY / FEBRUARY / MARCH 1998. SHIPPING QUANTITY MAY PARTLY BE CHANGED BASED ON MUTUAL AGREEMENT, EVIDENCED IN WRITING. THE PERCENTAGE ALLOWANCE (+ / - 5%) IS TO BE CALCULATED FROM THE CONTRACTUAL QUANTITY 50,000 MT AS PER THE QUALITY CERTIFICATE.

iii. Clause 7.3 –

THE BUYER IS OBLIGED TO SHIP COTTON WITHIN 21 DAYS AFTER THE DATE OF ARRIVAL OF THE COTTON AT THE PORT / WAREHOUSE AFTER THE NOTIFICATION FROM THE SELLER IN WRITING ABOUT THE ARRIVAL OF A PORTION OF THE GOODS (MINIMUM 500 METRIC TONNES). IN CASE OF DELAY IN SHIPMENT OF THE COTTON FROM THE PORT IN THIS PERIOD, THE BUYER HAS TO PAY ALL EXPENSES RELATED TO THE COTTON UNDER THIS CONTRACT FOR WAREHOUSING AFTER 21 DAYS STORAGE. CHARGES WILL BE SETTLED DIRECTLY BETWEEN THE BUYER AND THEIR LOCAL FORWARDING AGENT IN ACCORDANCE WITH THE FORWARDING AGREEMENT SIGNED BETWEEN THE BUYER'S REPRESENTATIVE AND THE LOCAL FORWARDING COMPANY / PORT WAREHOUSE COMPANY.

iv. Clause 8.3 –

IN THE EVENT THAT COTTON HAS BEEN STORED IN THE PORT WAREHOUSE FOR MORE THAN 21 DAYS FROM THE DATE OF ARRIVAL, AS EXPRESSED IN CLAUSE 7.3, THEN PAYMENT WILL BE EFFECTED BY THE OPENING BANK WITHIN 5 BANKING DAYS, UPON PRESENTATION OF THE FOLLOWING SET OF SHIPPING DOCUMENTS (DOCUMENTS IN RUSSIAN LANGUAGE ACCEPTABLE) AT THE COUNTERS OF THE OPENING BANK.:

A. ORIGINAL SIGNED COMMERCIAL INVOICE EVIDENCING THAT 90% OF THE INVOICE VALUE IS OFFSET AGAINST THE ADVANCE PAYMENT AND THAT 10% OF THE INVOICE VALUE WILL BE PAID BY THE BUYER TO THE SELLER. IN THE EVENT THAT THE WAREHOUSE RECEIPT IS ISSUED AND THE FINAL PRICE HAS YET TO BE FIXED, 90% OF THE INVOICE VALUE WILL BE OFFSET AGAINST THE ADVANCE PAYMENT AND THE 10% BALANCE WILL BE PAID BY THE BUYER TO THE SELLER UPON FIXATION OF THE PRICE – 1 ORIGINAL AND 2 COPIES WRITTEN IN ENGLISH.

B. WAREHOUSE CERTIFICATE SHOWING THAT THE RELEVANT COTTON IS HELD TO THE ORDER OF THE BUYER OR THEIR NOMINATED REPRESENTATIVE – 1 COPY.

C. A DOCUMENT OF ACCEPTANCE, SIGNED BY AN AUTHORISED REPRESENTATIVE OF THE BUYER, STATING THAT THE QUALITY IS IN ACCORDANCE WITH THE QUALITY CERTIFICATE OR AN ACT SIGNED BY BOTH PARTIES STATING THE ACTUAL QUALITY – 1 COPY. IN THE EVENT THAT DOCUMENTS ARE SENT WITHOUT THE ACT OF ACCEPTANCE SIGNED BY THE AUTHORISED REPRESENTATIVE OF THE BUYER OR AN ACT SIGNED BY BOTH PARTIES STATING THE ACTUAL QUALITY, THEN 90% OF EACH INVOICE VALUE SHALL BE OFFSET AGAINST THE ADVANCE PAYMENT, AND THIS BALANCE 10% SHALL BE PAID IMMEDIATELY UPON PRESENTATION OF THE DOCUMENT.

D. A COPY OF THE QUALITY CERTIFICATE WITH THE WEIGHT LIST FOR EACH LOT OR IN THE EVENT THAT THE WEIGHT HAS BEEN AMENDED IN ACCORDANCE WITH CLAUSE 5.7, A COPY OF THE WEIGHT REPORT ISSUED AND SIGNED BY AN INDEPENDENT INTERNATIONALLY RECOGNISED CONTROLLER CONFIRMED BY UZPAKHTASANOATSOTISH.

E. COPY OF CERTIFICATE OF ORIGIN, ISSUED BY THE SELLER, CERTIFYING THAT COTTON COVERED IN THE INVOICE HAS ORIGINATED FROM UZBEKISTAN.

v. Clause 8.6

THE FINAL SETTLEMENTS BETWEEN THE SELLER AND THE BUYER SHOULD BE CARRIED OUT WITHIN TWO MONTHS AFTER THE COMPLETION OF SHIPMENT, IN CASE THE TOTAL VALUE OF THE DELIVERED COTTON WILL EXCEED THE VALUE OF ADVANCE PAYMENT AND LETTER OF CREDIT, THE BUYER WILL PAY THIS DIFFERENCE DIRECTLY TO THE ACCOUNT OF THE SELLER AFTER COMPLETION OF FINAL SETTLEMENTS. AN ACT OF RECONCILIATION WILL BE DRAWN UP AND SIGNED BY BOTH PARTIES CONFIMING THE CONTRACT IS COMPLETED IN ALL RESPECTS. IF THE VALUE OF THE DELIVERED COTTON IS NOT EQUAL TO THE ADVANCE PAYMENT, THE SELLER GUARANTEES TO DISPATCH ADDITIONAL QUANTITIES OF COTTON TO COVER 100% OF THE SHORTFALL. IF NO COTTON IS AVAILABLE, THE OVERPAID AMOUNT WILL BE PAID BACK IN FULL BY THE NATIONAL BANK FOR FOREIGN ECONOMIC ACTIVITY OF THE REPUBLIC OF UZBEKISTAN.

36. The APG, as amended, read as follows:

"Advance Payment Guarantee N97/56

Dear Sirs

You, ('STANDARD BANK LONDON LIMITED' Canon Bridge House, 25 Dowgate Hill, London EC4R 2SB, United Kingdom) are the buyer's ('A. Meredith Jones and Co. Ltd', Great Britain) nominated bank for contract No. 178/97301/CTD-6 dd 20.09.97 concluded between FBC 'Innovatsia' Tashkent (Uzbekistan) and 'A. Meredith Jones and Co. Ltd', Great Britain, for the supply of cotton –fibre at the total price of (subject to adjustments in accordance with the terms of the contract) USD 72,971,876.00 (seventy two million nine hundred seventy one thousand eight hundred seventy six US Dollars). According to the terms of the contract you will make an advance payment of USD 65.674.688,40 (sixty five million six hundred seventy four thousand six hundred eighty eight US Dollars and forty cents) to FBC 'Innovatsia', Tashkent (Uzbekistan). As security for the possible claim for the refund of the advance payment, in the event that the contractual delivery obligations are not fulfilled, a guarantee from us shall be furnished. This guarantee is given in consideration of you making the advance payment.

At the request of FBC 'Innovatsia', we, the National Bank of Foreign Economic Activity of the Republic of Uzbekistan, Tashkent (Uzbekistan), hereby irrevocably undertake and guarantee to refund to you on first demand, irrespective of the validity, enforceability and the effects or any subsequent variation or amendment to the above mentioned contract and waiving all rights of objection, defence, subrogation or suretyship arising therefrom, and free from counterclaim, setoff, deduction and taxes, the advance payment in the amount of USD 65.674.688,40 (sixty five million six hundred seventy four thousand six hundred eighty eight US Dollars and forty cents) upon receipt of your ('STANDARD BANK LONDON LIMITED', London) duly signed request for payment stating that FBC 'Innovatsia' have failed to fulfil their contractual deliver obligations.

The total amount of this indemnity will be reduced by any payment effected hereunder….

The amount of this guarantee will automatically be reduced in proportion by 90PCT of the value of each consignment which is delivered to 'A. Meredith Jones and Co. Ltd', Great Britain, on the basis of tested telexes send by ('STANDARD BANK LONDON LIMITED' to us that guarantee may be redused to the shipment(s) effecte by USD ……..(USD amount to be indicated). Each delivery shall be proved by the presentation by the National Bank for Foreign Economic Activity of the Republic of Uzbekistan or by 'A. Meredith Jones and Co. Ltd', Great Britain, at the counters of 'STANDARD BANK LONDON LIMITED' of the shipping documents and the original of the relative commercial invoices as are required under your letter of credit issued in favour of FBC 'Innovatsia'.

Our guarantee is valid until 31.07.98 (31st. of July 1998) and expires in full and automatically if your claim has not been made on or before that date, regadless of such date being a banking day or not….

This guarantee is subject to UCP 458. The guarantee is construed in accordance with English Law. Place of jurisdiction has to be London, England."

37. Amendment No. 1 to the Sale Contract was entered into in February 1998 whereby the advance payment was to be treated as 100% of the price of each consignment. (The APG was amended to the same effect.) There followed numerous further amendments to the Sale Contract whereby delivery was extended to 31 October 1998. Again the APG was amended to the same effect.

38. All this arose because there were difficulties with the Sale Contract from the outset. For instance, AMJ were obliged to provide monthly instructions for the shipping of cotton in an amount of about 8,000 mt. But AMJ failed to do so leading to extended delays in delivery reflected in the amendments. This led to a decline in available cotton by the summer of 1998 as the previous year's crop became exhausted and cotton of non-contractual quality was tendered.

39. At the same time, Innovatsia became increasingly behind hand presenting compliant documents under the letter of credit. In particular there were prolonged delays in the dispatch of full sets of bills of lading. Indeed some were only presented after the Demand had been made. These difficulties led to each party to the Sale Contract seeking to hurry things along.

40. Innovatsia sought to make use of the procedure under clause 8.3 of the Sale contract relating to warehoused goods which still remained 21 days after arrival whereby the documents for presentation would be simplified by the inclusion of warehouse receipts stating that the cotton was held to AMJ's order. This was done on the expectation that AMJ would both obtain the goods and accept these documents (albeit not strictly compliant). As regards AMJ steps were taken to obtain a release from SBL in respect of warehoused goods or alternatively a

second set of bills of lading for an on-sale with the provision of a letter of indemnity to the ship-owners pending presentation of the original bills to SBL, a process described in more detail hereafter.

Chronology

41. Mr. Kennedy had put forward the proposal for the $70 million AMJ loan Facility to SBL's Credit Committee in September 1997. The proposal contemplated that documents in respect of each consignment of cotton should be presented at the counters of SBL for negotiation under the relevant letter of credit. The proposal went on: - *"Subject to such documentation being satisfactory to SBL, they are also evidence that Innovatsia has discharged its delivery obligations. Accordingly, the NBU guarantee will reduce pro rata. At this juncture SBL security becomes the documents against which it has paid – particularly the bills of lading made to our order."*

42. The Facility was concluded on 24 October 1997. It was followed in December 1997 by the $4 million working capital line.

43. Transactions under the sale contract and the associated facilities got underway without delay. But one of the earliest shipments demonstrates the sort of difficulties that ensued. The shipment was on board a vessel called *Gulf Bridge* in January 1998. The original bills of lading, as required under the sale contract, duly nominated the Claimant as shipper and identified the consignee as "to the Order of SBL" with AMJ the notify party. The goods had been shipped FOB at Bandar Abbas, the destination being Qingdao in the People's Republic of China. There were however delays in the presentation of the relevant documents to SBL.

44. Despite these delays, it appears that, on or about 15 January, AMJ sold the consignment to Weifang Quawai Textile Company in Shandong province. To achieve this sub-sale and arrange payment from the sub-buyer prior to the successful presentation of the documents by Innovatsia to SBL, AMJ persuaded their forwarding or shipping agents Mediterranean Chartering and Trading Inc ("MCC") to issue a second set of bills of lading with AMJ as shipper and Weifang as consignee.

45. On 15th January, having paid the proceeds of sale to SBL, AMJ presented a form of letter of indemnity ("LOI") to SBL. The form was sent to Mr. Parsons, the covering fax making reference to a conversation between Mr. Sabell of AMJ and Mr. Peter Kennedy. A second fax requested execution of the form. This was sent by Mr. David Wookey of AMJ to Mr Willman on 19 January. The fax made the pertinent additional observation that, until presentation of the original bills under the terms of the letter of credit, "the NBU guarantee in favour of SBL remains in full".

46. The presentation of an LOI had been foreshadowed in a telephone conversation between Mr. Sabell of AMJ and Alan Linger, the Assistant General Manager of the Trade Finance Department of SBL. It appears that Mr. Linger, albeit unfamiliar with the use of LOIs in such circumstances, gave instructions to his department that such LOIs could be executed but only in the event that AMJ had pre-paid the cash value of the consignment.

47. Mr Willman duly complied with that instruction in regard to the shipment and, on or about 19 January, the LOI was duly countersigned by Mr. Linger, together with Mr. Andrew Hall, a senior manager within the Trade Finance Department. The LOI provided:- *"The goods were shipped on the above vessel by [Innovatsia] and consigned to [SBL]…[MCC] have issued to us a second set of bills of lading…We hereby request you to deliver the Goods to Weifang…without production of the Original bills of Lading but upon production of the Second set of Bills of Lading. In consideration of your releasing the Goods as stated above we do hereby irrevocably undertake hold you harmless …against any claims….arising from …anybody claiming delivery of the Goods as holder of the Original Bills of Lading. Furthermore we undertake to produce and deliver to you the Original Bills of Lading as and when these are received by ourselves."*

48. On 23 January Mr. Linger and Mr. Willman visited AMJ's offices in Liverpool to review the operation of the Facility and the associated working capital line. In his file note written on his return, Mr. Willman made the following prescient observation: - *"Although over 7,000 metric tonnes have now gone to Russia (and some has already been sold and paid for) Innovatsia has yet to present documents for the 10% balance. This is basically because of Innovatsia's archaic systems – they are likely to wait until they have a "large" presentation to make. The odd effect of this is that the NBU guarantee is technically still valid for the whole amount originally advanced despite [the] fact part has left Uzbekistan, been inspected and accepted by AMJ and been paid for by the off-taker."*

49. Thereafter in the period up till April 1998 LOIs in respect of other consignments were executed on a further ten occasions, eight of which involved LOIs signed by Mr. Willman and Mr. Linger, one by Mr. Parsons and Mr. Peter Cover (a supervisor in the back office for documentary credits) and one by Mr. Linger and Mr. Parsons. The total value of the cotton involved was in the region of $5.3 million (accounting for about 4,700 tonnes). In due course, however, reductions in the APG began to be made as documents relating to the accepted and shipped cotton, including the original bills of lading, began to be presented.

50. On 7 May, Mr. Parsons and Mr. Willman made a further visit to AMJ in Liverpool. By this time the sale of a substantial amount of cotton to the Russian regional authorities of Ivanovo and Volgograd was in jeopardy, reflecting a developing financial crisis in Russia which was to have a serious impact on the London banking market including SBL. The amount concerned was some 33,000 tonnes. Much of the cotton was warehoused in Ivanovo having been accepted by AMJ and thus pledged to SBL.

51. In the result, the working capital line had been drawn down by AMJ to $3.6million against a limit of $4 million. Mr. Willman in his file note on 8 May on returning to the office reported that AMJ were "running out of money" and accordingly looking for an increase in the line to $6 million. This was not in the event furnished.

52. On 10 June 1998 Mr. Willman and Mr. Linger sent a joint memorandum about AMJ's Loan Facility to Mr. Brian Lovell, a senior manager in SBL's Credit Department. This forewarned of a likely default by AMJ in respect of the repayment of the Facility by the then due date 1 August which would need to be discussed with the Syndicate at a meeting scheduled for 19 June.

53. This meeting was addressed by representatives of AMJ in the form of a PowerPoint presentation. Present were representatives of all the Syndicate banks, including as regards SBL, Messrs Kennedy, Linger, Willman and Robert Scott (a manager in the Syndication Department).

54. One of the slides was subject to considerable examination during the trial. It is set out below as Rider A. The Claimant placed emphasis on the cash collateral sum reflecting repayment of the loan prior to presentation of documents (and the associated reduction in the APG). This was said to highlight the implications of the use of LOIs or other mechanisms which allowed AMJ to obtain possession of cotton before negotiation of the relevant documents. ***Rider A***

55. The presentation contemplated that the bulk of the Facility would be repaid but only by the end of December. The Syndicate banks expressed concern that even this repayment schedule was dependent on large scale sales to Russia which was not viewed as likely to be fruitful. Indeed, it is notable that, even at this early stage, the Syndicate banks or some of them were pressing for a call on the NBU guarantee for the estimated outstanding balance.

56. Following the meeting, Mr Kennedy, in a memorandum to Mr. Linger and Mr. Tim Whalley (the General Manager of the Trade Finance Section), recommended that detailed reports (later dubbed "sales progress sheets") should be provided by AMJ at fortnightly intervals.

57. The first of these reports was provided on 8 July 1998. Of particular note in these regular reports was a summary of SBL's exposure on the loan Facility, the level covered by the NBU guarantee and the extent of any recourse to AMJ. For example, this first report had the following table:

EXPOSURE	$57,178,145.97
NBU GUARANTEE	$51,177,223.88
AMJ RECOURSE	$6,000,922.09

58. On 27 July 1998, Mr. Willman and Mr. Kennedy sent a memorandum to SBL's Credit Committee recommending an extension of both the Syndicate loan Facility and the working capital line until 31 October. This recommendation was accepted. As regards repayment, the memorandum drew attention to "stock financing lines" available to AMJ which could provide a repayment source in addition to sales to "final off-takers". This appeared to refer to lines of credit with other banks whereby cotton delivered under the contract could be"refinanced".

59. On 14 August 1998 AMJ sent a fax to Mr. Kennedy extrapolating on the sales report provided that day. This report showed an exposure of $53,142,800.47 and an NBU Guarantee figure of $49,892,059.25. The extrapolation anticipated further sales with funds due for receipt in August of $6,908,509, together with the refinancing of cotton warehoused in Trieste, Mersin and Jebel Ali in the amount of $9 million and other expected sales for August shipments amounting to over $9 million. In the event, the figures for 3rd September showed a decrease in the exposure of about $6 million but only a small reduction in the NBU guarantee. From now on the guarantee figure was consistently to exceed the exposure figure.

60. On 2nd September a meeting took place at SBL's premises between representatives of AMJ and Mr. Linger, Mr. Willman and Mr. Scott. Mr. Scott prepared a note of the meeting which was distributed widely within SBL including copies to the Director of Banking, Mr Malcolm Wilde and the Chief Executive, Mr. Peter Prinsloo.

61. AMJ appear to have summarised the situation for the meeting as follows. Of the 20,200 tonnes then inspected and accepted by AMJ, 7,500 tons was due to be refinanced, 10,000 tonnes had been sold and 2,700 tonnes remained for sale. As regards the future, the memorandum went on to suggest the way forward for SBL as follows:-

"To ensure repayment under the cotton Facility we will need to call the NBU guarantee which is available for calling from 1 October 1998 to 31 October 1998. Innovatsia have until 30 September to arrange shipment of the remaining cotton (in quality acceptable to AMJ). This claim will be for a cash settlement for the principal amount in the region of US$24,822,723.41 plus interest costs (approximately US$1.8 million) accrued during the life of the Facility for this portion of the principal. This interest portion will be used first to repay SBL's Working Capital Facility….

Prior to visiting the NBU and calling the guarantee we have advised AMJ that we require them to accept the 20,276.52 mt in the ports. This is to ensure there is no counterclaim from the NBU. (Emphasis added)."

62. The provision of LOIs resumed on 7th September and over the next 3 weeks some 13 were executed, once again the majority by Mr. Willman and Mr. Linger but one by Mr. Parsons and Mr. Whalley and three by Mr. Shipman (a colleague of Mr. Willman).

63. As appears from a memorandum dated 8 September from Mr. Hall to Mr. Linger and Mr. Scott, it is clear that the note of the meeting held on 2 September was also sent to Mr. Hall. In particular it re-emphasised that once AMJ accepted the 20,200 tonnes of cotton the guarantee would only cover the undelivered balance of 18,000 tonnes (i.e. at a level of around $25 million).

64. A typed response to that note was contained in the chronological bundle although its author was not identified. Since Mr. Willman added a manuscript note to it referring to the response as being "from Robert", it was suggested to Mr. Scott that he was the author. He disclaimed having written it and suggested that it was probably written by a Robert Jones who was said to be another member of the Credit Department.

65. The typed note records as follows: -

"(1) Currently AMJ have inspected 18,321.25 mt of cotton in ports outside Uzbekistan the purchase value of which is US$23,911,827.19. 5,131.19 mt of this cotton is assigned to SBL and AMJ risk. The remaining 13,190.06 remain guaranteed by NBU. Under the terms of the guarantee the NBU liability is cancelled once the cotton has been accepted and shipped from the port of delivery. Innovatsia has still to delivered cotton amounts to 17,098.73 mt (US$23,170,062.20 million) of cotton to the ports. The NBU liability is therefore US$41,128,978.11. We are currently encouraging AMJ to accept all the cotton in the ports so that the value of the NBU guarantee closely reflects the amount of our claim (Emphasis added)."

66. On 15 and 16 September Mr. Linger and Mr. Willman made a visit to Tashkent to meet with both Innovatsia and NBU. The initial meeting with NBU was on 15 September when a warning was given that the APG would be called upon in October. NBU raised concerns about delays caused by AMJ's failure to accept presented documents. The line adopted by SBL in response was that the banks should not "become involved in the contract or associated disputes and that our role should remain as impartial bankers".

67. The following day Mr. Willman and Mr. Linger (accompanied by Mr. Sabell of AMJ) met with Innovatsia. Innovatsia gave a projection of a shortfall of $21.6 million. The representatives of Innovatsia (including the Chairman Mr. Shavkat Baratov and Mr. Bahtiyar Rustamov, Deputy Chairman) explained their difficulties in making prompt presentation of documents. In particular it was explained there might be delays in presenting bills of lading. In response SBL agreed to postpone any call on the guarantee until 21 October.

68. Following that meeting the party from England went back to NBU and advised it that the claim under the guarantee would be "at least $21.6 million". As the note of the meeting prepared by Mr. Willman reveals, SBL urged NBU to put pressure on Innovatsia to "perform under the contract as this could only reduce the size of the eventual guarantee claim."

69. Mr. Scott summarised the position as at the middle of September in a fax to Generale Bank (one of the more active members of the Syndicate):-

"Currently 5,131.19 mt of cotton is assigned to SBL on behalf of the Syndicate. This cotton is held in warehouses in Ivanovo. All the remaining cotton remains subject to the NBU guarantee. The terms of the cotton contract are that the NBU guarantee is released once the cotton has been shipped FOB from the delivery ports. The delivery ports are the ones set out in the cotton sales progress sheet.

Once the cotton is shipped from the delivery ports either the cotton is assigned to SBL or the end buyer remits payment at the time of loading. To date all contracts delivered have been cash against documents at the time of loading."

70. By now concerns were being raised within SBL as to repayment of the working capital line given that the profits on the principal contract would be inevitably little more than half that which had been expected. This led to an intervention on this issue by Michael Cooke, a senior manager in the Credit Department of SBL.

71. On 24 September Mr.Willman wrote to Mr. Sabell of AMJ referring to the quantity of cotton that had left Uzbekistan which, "subject to satisfactory delivery documentation being produced by Innovatsia would reduce the guarantee to approximately $21.6 million." The letter went on, "it is our and the Syndicate's view that every effort should be put into taking title of the cotton and we believe that this is your view as well."

72. A fax was prepared in Mr Scott's name on 29 September. It appears not to have been sent. Furthermore, its authorship has been much in dispute. It contained reference to various enquiries apparently raised by Syndicate banks. Of particular note was the following section:-

"Sold and Re-financed Cotton

? The NBU guarantee has only been reduced by US$4,022,802.76 since July 1998 while the Facility has been repaid by $15,452,856.90.

? How has AMJ gained title to this cotton?

? Is Innovatsia aware that this cotton has been taken by AMJ?"

73. Shortly thereafter, in early October, Mr. Kennedy prepared a "confidential aide mémoire" for circulation to the Syndicate members. This recorded that the loan Facility had been reduced to $38 million by reason of sales and re-financing whilst the "current outstanding value of the NBU guarantee" was $47 million. The note went on to

record that, if some $12.9 million of documents were presented at SBL's counters and were accepted by AMJ, the guarantee would reduce to $34.2 million. The recommendation was for pressure to be applied to Innovatsia to correct document discrepancies "to enable AMJ to accept documents". This would leave a shortfall on the Facility following a call on the guarantee of $1.3 million.

74. A meeting of the Syndicate banks was arranged for 9 October. It is clear that at this stage there was concern as to whether NBU would even honour a call on the guarantee at all or at least at a level greater than about $25 million. Prior to the meeting, on 2 October Mr Sabell of AMJ wrote in response to a request by SBL (made by Mr. Kennedy and Mr. Whalley) that a member of AMJ "should travel immediately to Tashkent to expedite AMJ's acceptance of outstanding cotton:- *"Your third point implies that AMJ have not accepted all outstanding cotton. This point is incorrect as the company has already accepted all cotton made available by Innovatsia in accordance with the contract upto expiry of Amendment No. 8 on 31st August 1998. The only purpose for a member of our staff to travel to Tashkent would be to assist Innovatsia in the preparation of documents to submit via NBU in satisfaction of the NBU guarantee. You will appreciate that it is an obligation of Innovatsia to deliver such documents of title and as the recipients of the documents to be presented we would potentially compromise our position by involving ourselves in their preparation. Notwithstanding this we already have visa applications in the Uzbek system for staff who can visit Innovatsia in Tashkent in order to speed this process."*

75. Consistent with this, Mr. Linger and Mr. Willman sent a SWIFT message to NBU on 5th October recording that the outstanding liability on the guarantee was $47,145,425.24. The message went on:- *"We are currently holding documents totalling US $12,932,995.66 although all these presentations are discrepant and we are awaiting A Meredith Jones' advice on whether or not they are to accept them. In the event that any of these are accepted your liability under the guarantee will be reduced accordingly."*

76. By now AMJ was preparing to pursue arbitration proceedings against Innovatsia. In support of those proceedings AMJ appears to have decided to prepare to seek a freezing order to restrain SBL from returning unaccepted documents to Innovatsia on the basis that the underlying cotton was Innovatsia's property (albeit much of it had been sub-sold).

77. Mr. Richard Usher, in house counsel to AMJ, sent a fax to Messrs Hammond Suddards, their solicitors, seeking to explain the position on 6th October. This fax contained the following frank explanation:- *"I appreciate this position is complex which is why it has taken so long for me to get my head around our finance and stock procedures. Please feel free to call once you have had a look at this. The reason for our wanting to injunct these documents even though the physical cotton has been sold is that if we were to reject the documents and return them to Innovatsia they would almost certainly attempt to use the documents to claim cargo from the carrier. The carrier would be forced to admit he didn't have the cargo and so pay compensation for which he would look to recover under the LOIs. By doing what we intend we will hold the documents at SBL but will already have dealt with what would have been a major fear of the court namely that the cargo would be arriving at ports and be unable to discharge without incurring demurrage and warehousing costs. In effect the value of the cotton has been realised thus making the whole administration of the process much simpler."*

78. In anticipation of the Syndicate banks' meeting on 9 October, Generale had sent a fax to SBL explaining that at the meeting it would be expecting an analysis by Messrs Wilde Sapte (solicitors retained by SBL) of the Syndicate's rights on the calling of the NBU guarantee. Generale also asked for SBL's comments on "the merits of AMJ's position on the discrepant documents".

79. The agenda for the meeting on 9 October included the item of a "general review" by Wilde Sapte on the current position. In anticipation, Mr. Kennedy wrote to Mr. Neil Noble at Wilde Sapte asking for help at the meeting in responding to Generale's enquiries and also to advise on the distribution of funds received under the guarantee.

80. Unfortunately no full minute is available of the Syndicate meeting that day. The outcome was notification to NBU of a potential call of $47,154,421.12subject to review of new documentation expected the following Monday. Indeed, by this time, Innovatsia were demonstrating considerable activity in regard to the presentation of documentation particularly that relating to the $12.9 million worth of cotton yet to be deducted by SBL from the guarantee. A delegation from Innovatsia arrived from Tashkent to deliver a large quantity of additional material to SBL on 12 October.

81. Generale posed the following question to SBL on 13th October in a fax copied to Wilde Sapte: "How much of the $18.9 million of discrepant documents ($12.1million representing cotton apparently sold by AMJ and the proceeds used to service the Facility) have not been accepted". Similarly on 14 October BCEN another Syndicate bank sent a fax asking for comment on their understanding of the figures and in particular whether it would be appropriate to deduct receipts from any and all sub-sales from the figures representing the "Uzbek Risk".

82. Consistent with his earlier pronouncements on the topic, Mr. Willman responded by return:-

"We have the unusual position whereby AMJ (through ourselves as we always retain control of the cotton as security) have taken cotton and sold it and been paid for it before Innovatsia have been able to present acceptable documents.

We currently have a situation whereby cotton has been sold and been paid for which has reduced the Syndicate's loan to US$38.6 million although proper documentation has not been presented by Innovatsia enabling the NBU guarantee to be reduced. The reason is almost always incomplete sets of bills of lading. As soon as the full documents are produced the guarantee is reduced accordingly."

83. This response went on to say that if all the documents had been properly produced the call on the guarantee would be only $35,090,405.56. In a fax to the Syndicate dated the same day (on which the Claimant placed great emphasis) Mr. Kennedy and Mr. Willman gave their estimate that the new documentation would result in a reduction in the call "by some US$9 million -$12 million".

84. Some banks nonetheless pressed for an immediate call. Generale's view as expressed in a fax the same day was that a claim should be made immediately even if that resulted in monies having to be returned to NBU reflecting the value of documents subsequently found to be acceptable. This approach was supported by ABC International Bank.

85. In the event by 13 October NBU had already been informed by SBL that acceptance of additional documentation had allowed the guarantee to be reduced by $4,793,082.13. Indeed, by this stage there was an acceleration of releases by SBL of cotton held in warehouses to AMJ's order, the bulk of which was signed by Mr. Willman. There followed a further reduction on the guarantee of $4,407,702.95 on 16 October.

86. Accordingly on 19 October Mr. Kennedy and Mr. Willman sent a SWIFT message to NBU demanding $37,773,636.04 under the guarantee and that sum was duly paid within a few hours.

87. In anticipation of advice from Wilde Sapte, Mr. Kennedy proposed in a note dated 20 October that those funds be applied against the outstanding Loan Facility leaving a balance of $880,000 to be repaid by AMJ from further sales within October. Mr. Kennedy pointed out that this left the $3 to 3.5 million of Ivanovo cotton pledged to the Syndicate which would cover the working capital line.

88. On the same day, Wilde Sapte prepared their advice as to the application of the funds. Their advice was written on the basis that the guarantee worked so that it reduced according to the value of cotton delivered to AMJ for which valid documents were delivered. In his advice, Mr. Noble duly recorded the fact that although some cotton had been physically delivered, correct documents had not. Thus the benefit derived by AMJ was not matched by a corresponding reduction in the guarantee. The question he sought to answer was whether money should be retained pending acceptance or rejection of documents.

89. His advice was that if there were any documents which had not been checked it was advisable to delay distribution of the equivalent cotton value. He completed his opinion as follows:- *"Lastly you need to consider (perhaps with the advice of your Documentary Credit Department) whether of the $2.7 m of cotton accepted by Meredith Jones the discrepant documents might have been waived/accepted by virtue of Meredith Jones accepting the cotton. This is a difficult question to answer without a detailed review of each shipment's status and its documentation. "*

90. AMJ's response to the question whether they were prepared to accept any discrepant documents was an unequivocal 'no'. Against that background Mr. Noble advised on 21 October "as such those documents will presumably be formally rejected by you as not conforming to the letter of credit which in turn means the value of cotton represented by such documents cannot be deducted from the amount payable under the guarantee. The net result of this is to "crystallise" the amount that you are and were entitled to call under the guarantee and in accordance with the comments I made in my fax of yesterday the amount that is freely available for distribution to the banks. "

91. In the meantime, on 20 October 1998, AMJ duly sought a Freezing Order in support of arbitral proceedings being commenced by AMJ against Innovatsia under the terms of the sale contract. In the supporting affidavit later sworn by Mr. Usher it was contended that any documents held by SBL but rejected as discrepant by AMJ were Innovatsia's documents and, accordingly, if it was appropriate to grant the Freezing Order in support of the claim for breach of the sale contract since it followed that these documents were assets of Innovatsia within the jurisdiction.

92. As regards the claim, the affidavit stated *inter alia* that a total of 8,170 metric tonnes of cotton had been dispatched or shipped but that the documents presented to SBL were not compliant. A schedule to the affidavit purported to set out details of the relevant documents "in respect of which the cotton has not been sold by AMJ and is in warehouses."

93. The benefit of the arbitration claim was assigned by AMJ to SBL as collateral for the working capital line. In March 1999 Innovatsia sought to recover the documents which had been rejected. SBL's response in a letter dated 19 March was that "*we are holding the documents simply because we have been ordered by the Court to do so*".

94. On 6 April 1999 SBL wrote to the solicitors acting for AMJ pointing out that, but for the injunction, "*we would have been obliged to release the documents.*" They were accordingly minded to deliver them up to Innovatsia's solicitors against an undertaking that they would not be released until the injunction was lifted.

95. The interim arbitral award was published in January 2000. As regards the injuncted cotton the arbitrators said this:- *"Unless an amicable solution could have been reached between the parties [this injunction] effectively precluded the sellers from realising the value of the assets covered by this action on our determined breach date of 19th October 1998. We cannot therefore promulgate an award on this quantity of 8,170 tons net until such time as the injunction is lifted and the cotton becomes available for sale on the open market."*

Accordingly the parties were directed to resubmit the claim following the lifting of the injunction so that the cotton could be valued. In the meantime there was to be an audit of the cotton held in the warehouses.

96. On 10 March Innovatsia wrote to SBL drawing attention to the audit requirement and asking for assistance. However on 14 April 2000 AMJ filed an affidavit in regard to the Freezing order in which it was conceded that about 5,455 metric tonnes of the 8,170 metric tonnes had been sold by AMJ before the application had been made albeit, it was claimed, "*without remitting the sale proceeds to SBL*". The affidavit went on:

> *"18 – In order to ensure the syndicate was repaid Nigel Sabell was able to keep the amount outstanding under the NBU guarantee high by the rejection of discrepant documents in relation to 8,170 mts of cotton. This meant that when the NBU Guarantee was called the hole he had created was plugged. In fact, nearly all of the cotton for which discrepant documents were rejected had been on sold and AMJ had been paid. In short, AMJ should have accepted the documents which were injuncted."*

97. Not surprisingly this led to a Consent Order setting aside the Freezing Order. This order also required AMJ "to take all steps within its power to release all unsold cotton to the Respondent free for sale, including giving instructions today to SBL to issue release notices to the warehouses…"

98. In accordance with that Order AMJ subsequently gave such notification to SBL to release the documents by a letter dated 17 April. Their immediate response to SBL's solicitors however was that the Order *"does not affect our client's rights in relation to the balance of the unsold cotton…"*

99. This response inevitably led to a stream of correspondence as to whether this change of tack was legitimate or not. Furthermore Innovatsia pressed for a repayment of $7,119,067 representing the 5,455 metric tonnes of cotton. (In addition there was a particular dispute as to the manner of disposal of cotton held at Liepaja which led to an allegation by SBL of a failure to mitigate on Innovatsia's part.)

100. In fact all (or the greater part) of the proceeds of sale had in fact been paid directly or indirectly by way of reduction of the Facility. Mr. Cooke summarised the position in an internal memorandum dated 8th June 2000:- *"Innovatsia, who now hold the rights of the National Bank of Uzbekistan under the guarantee are demanding that SBL repay to them the proceeds received by SBL for the sale of cotton detailed in (1) above. Their claim is that part of the payment under the guarantee was in respect of the cotton in (1) above and that SBL have already had the benefit of the sale proceeds from this cotton. This argument is correct, however where they will have a problem is in respect of the wording of the guarantee, which clearly states that the guarantee is only reduced by documents accepted by SBL."*

101. The arbitrators produced their final award in July. Their findings were as follows:-

> *"21. It appears that whilst they were refusing to accept the documents on the grounds that they were discrepant and did not give them title to the goods, they were actively trading this cotton and apparently obtaining release from banks, shipping lines and or warehouses. The correct procedure when they rejected documents was to allow the Sellers to retake possession of the documents from the Buyer's nominated bank without delay. This did not happen as the documents were retained at SBL under cover of the Mareva injunction. Even after the Mareva injunction (as it used to be called) was discharged, SBL have continued to refuse to release the documents to the Sellers.*
>
> *22. The buyers advise, that contrary to the figures in N Meredith Jones affidavit of 17th April 2000 documents covering a total of only 2,175,366.28 kgs of cotton remains under the control of SBL who, in correspondence with the sellers legal representative appear to claim that this cotton belongs to the buyers and are refusing to release these back to the Sellers. Our conclusion is that the bank is wrong in law. It is trite law that where a buyer rejects documents as being discrepant, property in the goods remains with the Sellers. Furthermore we do not understand how, if SBL are correct in their assertion that title had passed to the buyers, the buyers could ever have obtained an injunction over their own documents."*

102. SBL remained unpersuaded. In a letter dated 24 October 2000, SBL's solicitors took the point that the arbitrators' award was not binding on SBL and that there was evidence which supported the conclusion that SBL still had a security interest in the cotton.

103. In February 2003 Innovatsia commenced proceedings against NBU in the Tashkent Economical Court with a view to recovering *inter alia* the perceived excess payment under the guarantee. The response was to the effect that, whilst there might be a claim by NBU against SBL in respect of this excess, there was no fault on NBU's part in responding to the call. (At one stage this dispute led to the conviction of two employees of NBU in the Tashkent Criminal Court on the charges of wrongful execution of the Demand made by SBL.)

104. On 16 April a meeting took place at SBL between representatives of Innovatsia, NBU and SBL. The SBL representative was Mr. Cooke. The note of the meeting records his position as being that "SBL was not involved in the sale of cotton under unaccepted documents". This stance was repeated in a letter to the Deputy Prime Minister of Uzbekistan written by Mr. Cooke the following day.

105. The story can be brought to an end with the minutes of a meeting between representatives of Innovatsia and SBL in March 2004. Mr. Jonathan Pearson Executive Director at SBL attended with Mr. Cooke. The note records:-

> *"7. Mr. Pearson asked how cotton could have been taken by AMJ whereas documents were at SBL counters and expressed his opinion regarding the possibility of existence of two sets of documents for the same volume. Also he explained the reason for not return of documents - i.e. in accordance with High Court order. Then he explained that SBL is ready to check all documentation regarding deal and agreements with syndication. Mr. Baratov explained that it is impossible to issue two sets of shipping documents for the same volume."*

Fraud - the Law

106. It was common ground that Innovatsia's primary claim was in deceit. The elements of the tort are well established. I would summarise them as follows:

a. The Defendant must have made a representation which can be clearly identified.

b. It must be a representation of fact.

c. The representation must be false.

d. It must have been made dishonestly in the sense that the representor has no real belief in the truth of what he states: this involves conscious knowledge of the falsity of the statement.

e. The statement must have been intended to be relied upon.

f. It must have in fact been relied upon: see ***Derry v. Peek*** *(1889) 14 App. Cas. 337,* ***Angus v. Clifford*** *[1891] 2 Ch 449,* ***Armstrong v. Strain*** *[1951] 1 TLR 856,* ***The Kriti Palm*** *[2007] 1 All ER (Comm) 667.*

In addition, all the elements must be established by reference to the heightened burden of proof as discussed in ***Hornal v Newberger Products Ltd*** *[1954] 1 Q.B. 247,* ***Re H (minor)*** *[1996] A.C. 563.*

107. In the context of a performance bond or advance payment guarantee, a demand which the maker does not honestly believe to be correct as to its amount is a fraudulent demand:- *"…The question is whether when the demand was made the persons acting on behalf of the plaintiffs knew that the sum claimed was not due from Leadrail, and dishonestly made a demand despite that knowledge…":* ***Balfour Beatty v Technical General Guarantee Company Ltd*** *[1999] 68 Constr LR 180.*

108. In the present case, questions of reliance do not really arise. If a beneficiary under an advance payment guarantee makes a demand which is to his knowledge excessive the Court will readily find that he intends the paying bank to rely on it. Moreover, once a false statement has been made that is material in the sense that it is likely to induce the representee to act in the manner desired by the representor and the representee does so act, it is presumed that the representee was influenced by the statement: see ***Chitty on Contracts 29th Ed. 2004 Vol 1*** para 6-035

109. Thus it is unnecessary to call the decision maker in order to prove the inducement: see ***Smith v Chadwick*** *[1884] 9 AC 187* p.196. Indeed in the present case the presumptions clearly accord with the reality. The Demand was a call on NBU to pay the demanded sum. NBU paid the demand because they had no grounds to refuse to do so. They certainly had no reason to believe that the demand represented anything other that SBL's honest assessment of what was due.

Fraud – The facts

110. The pleaded case against SBL in the amended particulars of claim was not entirely straightforward. The underlying premise was that in making its demand, SBL impliedly represented that "so far as it was aware" the demand was "valid and was not excessive". This was defined as a representation in three senses:-

a. So far as it was aware consignments of cotton to the value of the demand had not been delivered and accepted by AMJ

b. So far as it was aware AMJ was entitled to reject the documents in respect of the consignments on the basis that they were discrepant

c. So far as it was aware there had been no acceptance by AMJ of any of the consignments of cotton represented by the documents but nonetheless rejected by the defendant and/or AMJ.

These representations were alleged to have been false and that they were known to SBL to be false or alternatively that SBL was reckless as to whether they were true or false.

111. The knowledge or recklessness as regards these representations was said to be that of Mr. Kennedy, Mr. Scott and Mr. Willman. This arose because they knew some of the consignments of cotton represented by the value of the call had in fact been delivered to AMJ, sold on to third parties and the proceeds of sale received by SBL. In the circumstances they had "reason to believe" that AMJ was not entitled to reject the documents relating to those consignments.

112. A rather different case was advanced at trial. The final skeleton on behalf of the Claimant put it this way:- *"The reason why the named managers of SBL knew that they were calling for more money than they were entitled to call for was that they knew that they were calling in respect of cotton which had been onsold by AMJ and where SBL had received the proceeds of sale. They knew that AMJ was rejecting documents dishonestly, because AMJ had onsold goods (often with the essential assistance of SBL's LOIs) and paid the proceeds to SBL and they were prepared to go along with this to suit their own purposes."*

113. In oral submissions, a further variation on this theme was advanced. First, it was submitted that SBL was "institutionally corrupt" as was demonstrated *inter alia* by its willingness to execute LOIs where a second set of bills of lading had been issued. Second, given this propensity for dishonesty, on 14 October 1998 AMJ dishonestly chose only to accept $9.4 million worth of cotton (rather than $12.9 million worth as covered by the documents presented) so as to switch over the cotton delivered under the contract but stored at Ivanovo and pledged to SBL to secure repayment of the Working Capital Facility. Third, SBL "acquiesced in this and were happy to fall in with it" since it coincided with their interests (an alternative formulation was to the effect of "going along with this"). This moving target greatly undermined the force of the Claimant's case.

The APG

114. It was common ground between the parties that the APG was independent of the sale contract. This class of guarantee has much more of the characteristics of a promissory note than a guarantee. "They are virtually promissory notes payable on demand. So long as the beneficiary makes an honest demand the bank is bound to pay: ***Encyclopaedia of Banking Law para. F507***."

115. In any event the APG was expressly subject to ICC publication 458 on uniform rules for demand guarantees. These provide at Article 2(b):- *"Guarantees by their nature are separate transactions from the contract(s) or tender conditions on which they may be based, and Guarantors are in no way concerned with or bound by such contract(s), or tender conditions despite the inclusion of a reference to them in the guarantee. The duty of a Guarantor under a Guarantee is to pay the sum or sums therein stated on the presentation of a written demand for payment and other documents specified in the Guarantee which appear on their face to be in accordance with the terms of the Guarantee."*

116. At all times the APG was to be operated in conjunction with the letter of credit which had been issued by SBL. Initially, when conforming documents were tendered under the letter of credit, 10% of the purchase price was paid by way of the LOC while 90% was "paid" by the reduction of the APG. Due to the fall in the price of cotton the parties had later agreed that the letter of credit no longer paid 10% of the purchase price. However it remained an essential vehicle for the presentation of documents which was ancillary to the APG.

117. It was an express term of the APG in describing its purpose that it was "security for the possible claim for the refund of the advance payment in the event that delivery obligations are not fulfilled…" whilst the amount of the APG was to be automatically reduced by the value of each consignment "delivered" to AMJ. Nonetheless "each delivery shall be proved" by the presentation of shipping documents at the counters of SBL together with original commercial invoices required under the letter of credit.

118. It is accordingly clear how the APG was intended to work. Documents were to be presented under the letter of credit. If the documents conformed then SBL was bound to accept them and reduce the APG. In those circumstances SBL would release the documents to AMJ in order to permit AMJ to sell the cotton but SBL would have a pledge over the documents in respect of the advance made to AMJ. AMJ would then pay the sales proceeds to SBL to reduce the Facility. The position would be identical if AMJ was asked to and did waive the discrepancies in the documents.

119. If the documents did not conform to the requirements of the letter of credit and the discrepancies were not waived by AMJ, then the documents would be rejected. A consequence of this would be that the APG would not be reduced but AMJ would not get hold of the cotton represented by the documents presented to SBL and SBL would not be able to obtain the sale proceeds for the cotton. To the contrary, on the rejection of the documents, Innovatsia would be able once again to obtain possession of the cotton.

LOIs/Releases

120. Despite the manner in which the APG should have operated it was common ground that a significant amount of cotton was delivered to and in some cases sold by AMJ without any commensurate reduction the APG. As already recorded, this was achieved in various ways, two of which involved SBL:

    a. SBL executed letters of indemnity (LOIs) to ship-owners for goods in respect of which a second set of bills of lading had been issued

    b. SBL executed releases in AMJ's favour in respect of goods that had been warehoused

121. In neither case were such documents as were presented in due course at SBL's counters accepted. Many were regarded as discrepant. But it was common ground between the parties as recorded in the list of issues:- *"The issue by the Defendant of letters of indemnity and releases in respect of certain consignments of the Received Cotton was inconsistent with the Defendant's right to reject the documents in relation to that Received Cotton."*

122. As background to the Demand, Innovatsia submit that both in issuing (or countersigning) LOIs and releases SBL's representatives were acting dishonestly. Focus in this respect is placed on the terms of the LOIs the first of which, as already noted, was issued as early as January 1998.

123. The usual circumstances in which letters of indemnity come to be executed is where carriage and discharge times are so short that documents have not or may not made have made their way through the banking channels: see e.g. ***The Delfini*** *[1990] 1 Lloyds Rep. 252*. However it is well established that, despite the convenience of such an arrangement, a ship-owner who delivers cargo other than against production of the original bills of lading does so at his peril in the sense that he will be liable in conversion in the event that delivery is made to a person not entitled to delivery under the bills: see ***Sze Hai Tong Bank Ltd v Rambler Cycle*** *[1959] AC. 576*. That said there would be nothing dishonest in furnishing an LOI at the ship-owner's request.

124. However almost all the LOIs in the present case revealed a much more elaborate arrangement. The goods had been shipped by Innovatsia and consigned to SBL (with AMJ as the notify party). The bills of lading had been issued by the ship-owners. Before these bills came to be presented at SBL's counters, a second set of bills of lading had been issued by MCC as "carrier" dated the same day and covering the same shipment. In this second set, AMJ were named as the shipper, the consignee being to the order of a sub-buyer's bank with the sub- buyers themselves as the notify party. By virtue of the LOI AMJ requested the owners to deliver the goods to the sub-

buyer's upon production of this second set of bills (or a further LOI issued by the sub-buyers bank). This was usually countersigned by two authorised signatories of SBL.

125. In one sense, there can be no question that the whole scheme was dependent upon the issue of false bills of lading. SBL did not contend to the contrary. They gave rise to a potential fraud on Innovatsia, the third party buyer and the third party buyers' bank. This situation brings into focus the opening observation of Cresswell J in ***SCB v PNSC*** as approved by the Court of Appeal *[2001] Lloyds Rep. 218* p.221:- *"Ante-dated and false bills of lading are a cancer in international trade. A bill of lading is issued in international trade for the purpose that it should be relied upon by those into whose hands it properly comes – consignees, bankers and endorsees. A bank which receives a bill of lading signed by or on behalf of a shipper (as one of the documents presented under a letter of credit), relies upon the veracity and authenticity of the bill. Honest commerce requires that those who put bills of lading into circulation do so only where the bill of lading, as far as they know, represents the true facts."*

126. Here of course SBL did not directly put the second set of bills of lading into circulation. They simply allowed them, having been issued, to be relied upon. But notably SBL were not prepared to respond to a request for an LOI unless the proceeds of sale had in fact already been deposited with them (i.e. the second set of bills had been used to accomplish the sub-sale).

127. It is true that the motive was in one sense laudable – namely to "oil" the wheels of commerce to allow AMJ to on-sell in circumstances where, whether as a consequence of bureaucratic delays or inadequate preparation of documents, the presentation of compliant documents by Innovatsia was not being achieved. But however well intentioned the motive, it is not possible to discern any justification for such activity: see ***Brown Jenkinson v Percy Dalton*** *[1957] 2 QB 621.* Indeed the process was hardly unselfish since the outcome was for the sub-sale proceeds to be used to reduce AMJ's Facility but by the same token to allow any reduction of the APG to await the provision of a compliant set of documents (which themselves would include the original bills of lading.)

128. Put another way, the attraction from SBL's perspective was this scheme facilitated delivery of cotton, the proceeds of which were then used to reduce AMJ's loan but leaving the APG (expressed as security in the event that delivery obligations were not fulfilled) unaffected because there were deficiencies in the presented documents usually associated with a number of bills of lading in the first set. It is of course true that the APG made express provision for automatic reduction when compliant documents were presented. But by virtue of the LOIs, SBL were undertaking to deliver "the original bills of lading" when received. Was it free to reject the documents when presented despite the bills' practical utility as documents of title having already been eliminated?

129. By way of analogy Innovatsia relied on the decision in ***Mannesmann Handel AG V Kaunlavan*** *[1993] 1 Lloyds Rep. 8.* A Swiss bank issued a letter of credit in favour of a German company at the request of a Bermudan company. The bank's position was secured by the assignment of the proceeds of a second credit opened by a Hong Kong bank in favour of an associate company of the Bermudan company. The arrangement involved the same goods being used to perform the contracts under each credit so as to avoid difficulties in direct trade as between Russia and China.

130. The goods were shipped by the German company and what should have happened was that the documents should have been presented under the credit opened by the Swiss bank whereby the German company would have been paid and then re-presented under the second credit. However the Bermudan company jumped the gun and presented the documents under the second credit first. The goods were delivered to the buyers. Meanwhile however the German company had been pressing for amendments to the first credit. This would have made it plain to the Swiss Bank that it was not going to be possible to present conforming documents if the credit was unamended. With that knowledge and in the knowledge that the Bermudan company had acted dishonestly by activating the second credit first, the Swiss bank claimed and received the proceeds under the second credit as due to it under the assignment. The Bermudan company had become insolvent and the Swiss Bank wished to offset the proceeds of the second credit against the debt owed to it by the Bermudan company.

131. Saville J held that in these circumstances, applying Swiss law (being the governing law), the refusal of the Swiss bank to accept and pay for the discrepant documents in due course presented by the German company was contrary to the principle of good faith. The basis of this was his finding that the Bermudan company had acted dishonestly in preparing and using false documents while the true documents were still in circulation, something which the Swiss bank knew. Furthermore it could not be suggested that the discrepancies in the documents as presented to the Swiss bank were in fact of any significance whatever to the Bermudan company. Furthermore it was clear again as a matter of Swiss law that there was no question of the Bermudan company having any legitimate complaint if the Swiss bank did pay against non-conforming documents:- *"To my mind in these wholly exceptional circumstances the insistence by the Swiss Bank that it would withhold payment because the documents did not comply with the conditions of the letter of credit is, as a matter of Swiss law, bound to be regarded as contrary to good faith."*

132. The analogy is not a very direct one with the facts of the present case not least because Swiss law was the governing law. But the authors of ***Jack, Malek & Quest Documentary Credits 3rd Ed.*** observe that the same outcome (namely that the Swiss bank was not entitled to return the documents and had to pay the German company) should be achieved under English law, the likely route being a species of estoppel. In my judgment, the decision has little bearing on the question of whether Innovatsia are able to make good a case that the Demand made in

October 1998 was fraudulent in the sense that SBL consciously knew it was calling for more money than it was entitled to.

133. Indeed, the use of bogus bills of lading and the subsequent issue of LOIs is potentially a side-wind. It does not of itself form the basis of Innovatsia's claim in deceit. It is only directly relevant in two respects:-

a. it was said to evidence a propensity to pursue (or at least to acquiesce in) improper activity;

b. if a careful record and account had been held, it should have led to a full appreciation of the inconsistency between the realisation of sale proceeds on the part of AMJ and the rejection of documents presented by the sellers.

134. But it was Innovatsia's case that matters went beyond mere administrative carelessness and that there could have been no honest belief in the call. Put another way, where SBL issued an LOI and knew that they had received the proceeds of sale for the consignment of cotton by way of reduction of the syndicated loan, it was dishonest for SBL not to reduce the APG.

135. SBL's response was to the effect that it was bound to operate the APG as an autonomous contract without regard to performance of the sale contract. Delivery could only be established on the terms of the APG by presentation of compliant documents. It was for AMJ to decide whether to accept or reject non-compliant documents. The fact that the arrangement put AMJ in effective control of the level of any call was in the nature of the agreement. SBL could only persuade or cajole AMJ into making acceptance of discrepant documents. Any imbalance could in due course be recovered from AMJ under the Sale Contract.

136. Innovatsia's riposte in return was that AMJ only found itself in the position to have an effective veto on the level of the APG by reason of the steps taken, to which SBL was a party, to allow AMJ to obtain possession and control of some of the cotton prior to presentation.

False Statement

137. The starting point here has to be: was there a false statement in the Demand? The Demand read:- *"In accordance with the above guarantee we hereby give you notice that we are demanding US$37,773,636.04…in respect of the said guarantee. We hereby state that FBC Innovatsia have failed to fulfil their contractual delivery obligations under contract…"*

138. It is of course common ground that Innovatsia was indeed in breach of the delivery obligations at the material time. Did the Demand contain a false statement in assessing that it was, as regards its quantum, "in accordance with the guarantee"?

139. In one sense the answer is clear. No submission was as such made by Innovatsia that the Demand was excessive in accordance with the terms of the APG itself, that is to say that SBL was not contractually entitled to demand the sum it did. It is true that additional cotton had been delivered but the relevant documents were not compliant and thus for the purposes of the guarantee there had in fact been no established delivery. It is also true that this cotton may have obtained in part by AMJ by virtue of LOIs/releases to which SBL were a party. This might give rise to an estoppel as against AMJ and/or SBL to refrain from rejecting the documents. This as such was not the Claimant's pleaded case. In any event SBL had sought to settle its potential liability for any part of the call which was attributable to the LOIs/releases.

Institutionally corrupt

140. The suggestion that SBL was "*institutionally corrupt*" only came to be advanced during the trial and in the final speech on behalf of Innovatsia in particular. The basis of the submission was the LOI system introduced in January 1998. This was at a time when it is accepted that there was no conceivable motive for any attempt to defraud the Claimant. It is a most serious charge and I reject it.

141. The LOI system was initiated by Mr. Linger in January 1998. He appears to have consulted some of his colleagues but no one appears to have had any experience of LOIs (let alone ones issued against a second set of bills of lading). Notably, as more and more people became aware of LOIs, no-one appears to have taken the view that it was intrinsically unsound let alone dishonest.

142. It might be surprising that the system was not viewed with some scepticism by experienced bankers. But it is to be noted that AMJ's in-house lawyer had no qualms in disclosing the scheme in detail to solicitors and counsel. Nor were there any expressions of concern in response. Indeed there is some evidence of similar activity being undertaken by Kredietbank and HSBC.

143. Mr. Willman told the Court (and I accept his evidence) that he viewed the practice as a short term measure to get the cotton moving. On the one hand SBL were faced with a seller who had difficulty in presenting compliant documents, let alone with dispatch. On the other hand there was a well established cotton trader with a good track record anxious to perform the sale contract. In the result Mr. Willman's expectations were in fact duly met. Over the period up to late July 1998, about $15 million worth of cotton had been delivered, the documents presented (albeit with some degree of time lag) and the discrepancies waived by AMJ.

144. It strikes me that the SBL representatives might have perhaps hoisted in the inappropriateness of the LOI / release system but it is clear that the penny had not dropped even after the Demand. In any event, I am not remotely surprised that, when focusing on the proper call, they concentrated on the terms of the APG.

145. It was Mr. Kennedy who assumed responsibility for the call in September. Although Mr. Willman had had more exposure to the background it is difficult to conceive how the Claimants could establish a claim in deceit without implicating Mr. Kennedy. Mr. Linger and Mr. Scott had no involvement in the making of the Demand. Although Mr. Linger was Mr. Willman's line manager, it was never suggested that he had any involvement, let alone that he acted dishonestly. Mr. Scott was out of contact in Kenya in the lead up to the call. He returned from Kenya on 15 October and was at home on 16 and 17 October. I accept his evidence that he had no input into the timing or level of the Demand.

146. Mr. Kennedy came into the picture in about September 1998. He had earlier asked Mr. Scott to take an active role in monitoring the Facility as well as liaising with the Syndicate. At that stage the Facility was due for repayment by 31st July and it was apparent that AMJ would not meet the deadline. The immediate options were:

a. to extend the Facility

b. to restructure the loan

c. to make a call on the guarantee.

147. The immediate problem faded with the agreed extension. This followed from the meeting on 19 June between AMJ and the Syndicate. AMJ's presentation made it plain that repayment had been made by AMJ in respect of some cotton "prior to presentation of documents". This was categorised as "cash collateral".

Honest Belief

148. For this purpose I focus on the signatories to the Demand, Mr. Kennedy and Mr. Willman. I have concluded that the Claimant has fallen well short of proving to the necessary standard that either or both of them had no honest belief in the legitimacy of the figure demanded:

a. I listened carefully to the evidence during which they were skilfully and thoroughly cross-examined. Both witnesses struck me as honest and as genuinely seeking to help the Court. There was, I accept, a tendency for Mr. Kennedy to adopt the role of an advocate in SBL's cause but I was neither surprised nor concerned about this. The allegation of fraud against him had only been added to the pleaded case after the trial began and a vigorous response might be expected. Furthermore much of the cross-examination invited argument rather than factual narrative.

b. It is true that the LOIs represented an unsatisfactory backdrop to the Demand. But they had emerged early on in the performance of the sale contract in circumstances which attracted no criticism from any member of the bank who participated in the scheme or later became aware of it. Indeed from the very outset, SBL staff were expressing a clear understanding of the potential disparity between the sale process and the documentary process.

c. The documentation both internal and external disclosed by SBL contains no indication of any hesitation or reservation about the manner in which the Demand was to be calculated. Both Mr. Kennedy and more particularly Mr. Willman were aware of the odd consequence of sub-sales being achieved without a commensurate reduction the APG. Both in their own files and in communications with the Syndicate, they were entirely open about it and the members of the Syndicate expressed no reservations. To the contrary some were pressing for a call even if it meant arranging a rebate.

d. Considerable reliance was placed by the Claimant on the memorandum of 2 September which spoke of "requiring" AMJ to accept the documents relating to the Received Cotton. But the memorandum really did no more than recognise the unhappy implications of a failure to accept. The reality was that AMJ was in the "driving seat" and SBL had no idea how much impact on the potential call would result from the newly delivered documents.

e. Even greater emphasis was placed by the Claimant on the fax from Mr Kennedy to the Syndicate dated 14 October where the previous expectation of a reduction in the potential call of some $12-13 million was altered to $9-12 million. I am quite unable to treat that as part and parcel of a sudden decision to "go along with" a dishonest plan on the part of AMJ to accept only such documents as would leave the Ivanovo cotton as security for the working capital line. I accept Mr Kennedy's (and Mr Willman's) evidence that this idea did not occur to them until after the Demand had been made and the figures calculated.

f. If the proposed call was to be made dishonestly, this is difficult to reconcile with a decision to reduce the level of the call over the final week at all. The very fact that this was unsuccessful in respect of part of the $12.9 million worth of documentation where the discrepancies were not materially different is inconsistent with dishonest intent.

g. The Claimant had great difficulty in identifying any motive on SBL's part. The sum involved was a modest proportion of the Facility. It is difficult to discern any personal advantage to Mr. Kennedy or Mr. Willman in putting their careers at risk (let alone in risking the condemnation of the Syndicate) in adjusting the Demand.

h. In any event it was common ground that the level of the Demand was in effect at the mercy of AMJ. The suggestion that SBL suddenly took advantage of AMJ's reluctance to accept the balance of the documents so as to transfer the benefit of the Ivanovo cotton to the Working Capital Facility is not merely improbable in itself but wholly inconsistent with the determination to reduce the level of the Demand by $12.9 million if possible.

i. Even more strikingly, SBL sought legal advice on the express basis that $2.7 million worth of cotton had been sold but not matched with a reduction in the APG. The fact of seeking advice is not usually associated with a dishonest intention. Furthermore the advice in due course supported and confirmed SBL's approach.

It follows that for all these reasons the Claimant's claim in deceit must fail.

Quantum of the Fraud Claim

150. My conclusion makes it unnecessary to deal with this issue but since it was argued out I will express my views briefly. The Claimant put forward no less than four alternative ways of formulating this claim:

a. the entirety of the amount paid out;

b. the "actual loss" sustained by the Claimant said to be represented by the value of all the cotton delivered to AMJ and on-sold all the warehoused cotton whether recovered or not;

c. the "amount" of double receipts represented by the value of cotton in respect of which SBL received both the proceeds of the APG and the proceeds of sale;

d. the amount by which SBL knew the Demand was to be excessive.

151. This last mode of assessment is clearly the correct one. The whole basis of the claim is that SBL was aware that the Demand was excessive by reason of the provision of the LOIs and releases which it had executed. The sum involved is represented (subject to inaccuracies dealt with below) by the settlement figure. This figure constitutes the loss sustained by NBU in responding to the (excessive) Demand or, if it be the correct analysis, by way of payment under a mistake. The actual loss sustained by Innovatsia is not to the point: in any event this is in large part is attributable to the insolvency of AMJ. Nor in my judgment is it appropriate to undertake an account of "double receipts" which was based on transactions both before and after the Demand.

152. I ought to say a little more however about the contention that the Claimant as assignee of NBU is entitled to recover the full level of the Demand. The argument ran as follows:

a. the Demand was fraudulent;

b. it caused NBU to pay out the full US$37.7 million;

c. if NBU had been aware it was a dishonest demand then it would not have paid out any sum;

d. the measure of damages is that which puts NBU in the same position as if had not relied upon a false statement.

153. This outcome was, it was submitted further, consistent with public policy. In this respect an analogy was sought to be drawn with the position in relation to fraudulent insurance claims: see ***The Star Sea*** *[2003] 1 AC. 469 at p.499*. But as Mance LJ explained in ***AXA v Gottlieb*** *[2005] Lloyds Rep. IR 369* the rule relating to fraudulent insurance claims is a special common law rule. I see no basis for extending that special rule to claims under performance bonds or similar instruments.

154. It is true that the paying party has no opportunity to investigate the merits of the demand. But it is not suggested that a demand based on a failure to fulfil the contractual delivery obligations under the sale contract was not entirely legitimate. In that sense the Demand was valid (albeit assumed for present purposes to be fraudulently excessive). Given that damages for deceit are compensatory not punitive, it is difficult to see on what basis Innovatsia can recover the entirety of the Demand in circumstances where it failed to ship some cotton (in breach of the contract) or recovered some cotton and in both cases sold it elsewhere.

Implied term

155. It was the Claimant's alternative case that the APG was subject to an implied term relating to repayment of any part of a demand which later was found to have been excessive. The matter was pleaded in this way:-

"9. There was a term implied into the Advance Payment Guarantee (whether by operation of law or to give business efficacy to the same or to reflect the obvious intentions of the parties thereto) that, in the event that any demand thereon should ultimately be found to have exceeded the loss sustained by AMJ and/or the Defendant or was otherwise found to have been excessive, Defendant should repay to the NBU the amount exceeding such loss or the amount by which such demand was excessive."

156. The measure of such an excess was said to be represented by the extent which SBL received both the proceeds of the APG and the proceeds of the cotton to which it relates.

157. In this respect the Claimant placed reliance upon ***Cargill International S.A. v Bangladesh Sugar & Foods Industries*** *[1996] 2 Lloyds Rep. 524* in which Morison J held that where monies paid under a bond exceeded the buyers actual loss they were recoverable by the seller. This decision was correctly summarised by Christopher Clarke J in ***Tradigrain S.A. v State Trading Corporation of India*** *[2006] 1 Lloyds Rep. 216* at p.221:

> *"26. In my judgment **Cargill International SA v Bangladesh Sugar & Food Industries Corporation** [1996] 2 Lloyd's Rep 524 (and the citations in it) are authority for the proposition that there is an implied term in the contract of sale that the buyers will account to the sellers for any amount that has been paid under the bond to the extent that the amount paid exceeds the true amount of the buyers' loss. The amount is due to the sellers as a debt, whether or not the sellers have indemnified either the paying bank or the indemnifier of the paying bank. In essence this is because, by calling for too much under the bond, the buyers have procured payment to themselves from the paying bank (acting, for this purpose, on the sellers' behalf) of an amount that is not due, and must, obviously, return it to their contractual counterparty from whom they should not have procured it in the first place. Otherwise they will have retained a windfall in the form of money to which they were not entitled since, to the extent of the overpayment, there has been either no breach or no loss entitling them to retain it. This conclusion appears to me to be correct in principle and has been approved by the Court of Appeal."*

For present purposes this is of limited value to the Claimant as the term urged on the Court is not to be implied in the underlying sale contract but in the performance and itself. The Claimant contends, however, that where, as it was suggested here, the APG was given for the benefit not of the buyer but of its bank, an equivalent term must be implied in the APG.

158. I am afraid I cannot accede to this submission:-

i. The suggested implied term subverts the principle of autonomy as regards the APG. It would convert the APG into a guarantee of losses under the sale contract

ii. Any subsequent account should be as between the parties to the sale contract. The machinery for this purpose is either expressly provided by Clause 8.6 of the contract or by an implied term to that effect. The "justice of the matter" prayed in aid by the Claimant and which is said to require implication of the term simply arises from AMJ's subsequent insolvency.

iii. The requirement for clarity and certainty in relation to performance bonds greatly limits the scope for implication of terms. Thus the fact that there were various formulations of the implied term advanced by the Claimant itself somewhat undermined its existence. Indeed the implied term had in the event to be tailored to the particular facts of the present case but there may be many reasons why a claim may be excessive – double recovery is only one.

iv. The implied term which was eventually urged on the court was dependent on a "finding" that the Demand exceeded the loss. It remains wholly uncertain as to who is to make the ruling or finding let alone when. Even, for example, a conclusion reached in arbitration between Innovatsia and AMJ would presumably be inadequate for the purpose.

v. It is also important to note that the suggested implied term would result in the recipient bank being unable to distribute the proceeds of the call until the actual loss sustained by the buyer had been assessed. This might take some years and against the background of a syndicate (as here) it would be inconsistent with the obligation to make an immediate account to the members of that syndicate.

I accordingly reject this alternative claim.

Claim in conversion

159. This claim pertains to the "unsold" received cotton in warehouses at the time of the Demand. A threshold issue emerged during the trial and it became SBL's case that title to that cotton had passed to AMJ and thus Innovatsia had no title to sue in conversion.

160. The thrust of the competing cases on this issue can be summarised as follows:-

a. On SBL's case Innovatsia was fully aware as to how AMJ was obtaining possession of the cotton because it was itself subverting the documentary procedures by furnishing warehouse receipts to AMJ to speed up the process. By accepting the cotton AMJ was waiving any discrepancies in the documents thereafter presented and accordingly obtained title to the cotton.

b. Innovatsia contends that whilst indeed cotton was delivered to AMJ against warehouse receipts it was a procedure expressly authorised by the terms of the sale contract in the event that cotton remained warehoused for more than 21 days. In some cases cotton covered by the receipts was shipped and the bills of lading were sent on via Innovatsia in the conventional manner. It is true that those examples apart, warehouse receipts were later presented at SBL's counters which were not compliant because they were in the name of AMJ (as required by the receipt procedure) and not SBL (as required by the documentary procedure). AMJ may have been dishonest in not waiving the discrepancies but, having failed to do so, the price was not in effect paid by way of reduction of the APG and thus AMJ did not obtain property in the cotton.

161. I propose to deal with this dispute shortly. Certainly SBL's position was entirely contrary to the way SBL had initially presented its case. Furthermore it is inconsistent with the evidence of Mr. Ismailov whose evidence was in my judgment thoroughly reliable. Furthermore:-

a. It was clear that the mechanics of the sale involved the passing of property upon payment against documents and not on delivery. Until payment it is to be inferred that Innovatsia had retained a right of disposal: see ***Benjamin: Sale of Goods para 20-083***.

b. AMJ may have obtained possession and control of the goods by virtue of the warehouse procedure but thereby did not obtain title. It may be that both parties were anxious to expedite the delivery schedule but no alteration in the underlying mechanism is to be inferred: see ***Ginzburg V Barrow Haematite Steel Company*** *[1966] 1 Lloyds Rep. 343*.

c. The mere fact that AMJ was precluded or estopped from rejecting the documents is not material.

On this basis, it is accepted, as I understand it, that SBL is liable in conversion.

Quantum

162. The issues were as follows:

a. Whether Innovatsia unreasonably failed to mitigate its loss by accepting SBL's proposal for selling the cotton made on 9August 2000.

b. Whether the correct starting date for assessing the Claimant's loss is 17 April 2000 as contended by Innovatsia (or 17 May 2000) or alternatively 17 June 2000 as contended by SBL.

c. Whether the legal fees of US$130,000 incurred by Innovatsia in relation to the cotton at Jebel Ali are too remote to be recoverable.

d. How much should be deducted from Innovatsia's claim for the value of the Liepaja cotton in respect of storage charges accrued prior to 17 April 2000 (or 17 June or 17 May).

Mitigation

163. The focus of this dispute is an exchange of correspondence between the solicitors acting for Innovatsia and SBL in which SBL pressed for consent to a sale of the cotton on terms that the proceeds were paid into a joint account pending resolution of the dispute over title. It would be wearisome to set out the whole run of this correspondence which began in May 2000 and was not resolved until March 2001. However, in the interim, together with exposure to market fluctuations, the cotton was at risk of deterioration. Of more immediate financial consequence was the continuation of storage charges throughout.

164. Not surprisingly, Innovatsia's attitude was coloured by a lack of faith and confidence in SBL and, more importantly, by a belief in their own stance of being entitled to the cotton as their own property. Thus Innovatsia proposed in August 2000 that SBL should release the relevant documents to Innovatsia to enable it to sell the cotton against an undertaking to remit the proceeds to their solicitors. This proposal was rejected by SBL no doubt motivated by concern as to whether Innovatsia could be trusted to conduct the sale in accord with these terms. SBL proposed that Innovatsia should obtain offers, submit the highest bid to SBL and, if accepted, the documentation would be released by SBL to the buyer's bank on payment against documents. Innovatsia rejected these alternative proposals of SBL as being "impractical". It was not until February 2001 that Innovatsia reversed its stance and accepted a proposal broadly along the lines originally suggested by SBL. In the event, the arrangement was never implemented since, following further negotiations, the Claimants withdrew their instructions to their solicitors.

165. In my judgment the storage charges (and other losses) that accrued during the period in which Innovatsia refused to accept SBL's proposals for sale are not recoverable because the refusal was unreasonable:

i. The obvious way forward to avoid further losses was to effect a sale and pay the proceeds into a joint account.

ii. Whilst Innovatsia asserted (quite correctly as it has transpired) that it had property in the goods and that SBL had no proprietary interest, the position was by no means straightforward. In the circumstances, this did not entitle them simply to "stand on their rights".

iii. Notably, the stance adopted by Innovatsia at the time was that the scheme proposed by SBL was unworkable in the sense that no sale could be achieved without the original warehouse receipts being transferred to Innovatsia. This was later recognised to be unsupportable in a volte-face which was unexplained.

166. In his second witness statement made shortly before the trial, Mr. Chanychev raised a further reason why the proposal canvassed by SBL was unacceptable at the time. He claimed that any agreement for sale associated with payment of the proceeds into an overseas escrow account would not have been authorised by the Uzbek authorities. I am unable to accept this proposition:

a. It is clear that it was not an objection that was appreciated at the time. Indeed, Innovatsia itself began pressing for such an arrangement and such was duly agreed in March 2001.

b. I have seen no independent material supporting the existence of any such restriction.

167. Innovatsia were entitled to some latitude. But I accept SBL's submission that any decline in value or other loss sustained after mid-September 2000 was caused by Innovatsia's unreasonable want of mitigation.

Starting date of the Claim

168. The question arises as to when the cotton would have been delivered to a purchaser in the event that SBL had not converted the cotton. There can be no more than a rough assessment in this regard. The Claimants submitted that the appropriate date was 17 April 2000 being the date on which the freezing order obtained by AMJ was lifted. I agree.

169. I do not regard the circumstances as calling for any material period to conduct an investigation into the situation. The documents had been released from the freezing order and SBL had made it plain that it was only the freezing order that was justifying their retention. The accompanying court order anticipated release yet no guidance was sought as to whether another course of action was justified.

170. It is true that some time would be needed to realise the value of the goods by an on- sale. The measure of damages is by reference to market value and the relevant date in my judgment is the date of conversion not the date of realisation.

Forseeablity of legal fees at Jebel Ali

171. Innovatsia incurred substantial legal fees in the attempt to recover and sell cotton at Jebel Ali. I see no reason to regard the incurring of legal fees as unforeseeable.

Storage charges for Liepaja prior to 17 April

172. There was a difficult dispute as to the relevant figure as the evidence was sparse and inconsistent. I have concluded that the most reliable evidence is the fax dated 27 October 2000 from the storage company to SBL from which the figure of US$230,000 is attributed to the period before 17 April.

Constructive Trust

173. The claim in constructive trust was added on the second day of the trial and was pursued in place of the claim for restitution and/or unjust enrichment. The claim is advanced as against the proceeds of the Received Cotton paid to SBL (in contrast to the conversion claim directed at the cotton which was not sold by AMJ).

174. The case advanced was as follows:

i. AMJ held these proceeds of sale as constructive trustee for Innovatsia until the APG was reduced.

ii. This constructive trust arose because AMJ had sold the cotton and received the proceeds without accepting the shipping documents as well as without reduction of the APG.

iii. SBL (in the form of Mr. Willman, Mr. Scott and Mr. Kennedy) knew these matters and accordingly were liable to account to Innovatsia since it would be unconscionable to retain the proceeds of sale and the proceeds of the Demand.

175. The threshold point taken by SBL was to the effect that since AMJ had accepted and sold the goods they thereby i) waived defects in the documents tendered, ii) became liable for the price and iii) accordingly became owner of the goods (and thus by definition not constructive trustees of the proceeds of sale). But as I have already indicated earlier in my judgment, the passing of property here was subject to a documentary mechanism involving negotiation against a letter of credit and there was no alteration to that mechanism.

176. On this basis Innovatsia asserts that SBL was a constructive trustee of the proceeds of the sale on the basis that its knowledge rendered it unconscionable for the bank to retain the proceeds. In support of this proposition, the Claimant relied on all the same matters as were said to form the claim in deceit.

177. I am unable to accept this submission:-

i In fact, almost all the proceeds were received by SBL in its capacity as agent for the members of the Syndicate (including itself). Thus SBL would only be affected by a constructive trust in respect of these monies if it had acted dishonestly; see ***Agip Africa v. Jackson*** *[1990] Ch 265.*

ii I have already rejected the Claimant's case in deceit. It is true that the approach in this field in regard to dishonest assistance is somewhat different (see ***Barlow Clowes International v. Eurotrust International*** *[2005] UKPC 37,* ***Twinsectra Ltd v. Yardley*** *[2002] UKHL 12)* but I am not persuaded that even objectively viewed that SBL acted in a way contrary to acceptable standards of honest conduct.

iii It is common ground in any event that it is incumbent on Innovatsia to establish that SBL entertained a clear suspicion that AMJ was not entitled to the proceeds of sale such as would make it unconscionable for it to retain them. But leaving aside the proceeds associated with the LOIs and releases, no such case was advanced.

iv It has to be remembered that before distributing the proceeds, SBL sought and obtained legal advice which contained no suggestion that the existence of sub-sales which were not reflected in a reduction in the APG was in some respect improper.

v Even if some suspicion was or should have been aroused, SBL was not in a position to carry out a reconciliation of such proceeds as were not matched by a reduction in the APG. Indeed all that was known was that for a long time the sale proceeds exceeded the reduction in the APG but this disparity had been eliminated by the time of the demand.

Claims based on LOIs and releases

178. It is convenient lastly to turn to the issues that arose as to the scope of the settlement and, in particular, the extent, if any, the claims arising from LOIs and releases were not in fact encompassed by the settlement.

179. The situation was in large part agreed (subject to the constructive trust claim) as follows:-

i. Lot 138/127
This proved to be a duplicated lot number with a value of US$67,386 and is admitted.

ii. Release 16 – SBL to Ibrakom
This covered Lots 136-225, 138-112, 133-231, 133-354. The item is admitted in the sum of US$266, 353.

iii. Invoice 49(a)
This was added by an amendment sought on 12th March 2007. The parties were at issue as to whether the LOI was issued by SBL or by AMJ. I conclude that the Claimants have not established their claim in the sum of US$62,032.

Conclusion

180. There may be other issues which need to be covered but I hope that it will be possible for the parties to draw up an agreed order in the light of this judgment. I must record my thanks to counsel for their elaborate but interesting written and oral submissions.

Jeffrey Gruder QC & Philippa Hopkins (instructed by Stitt & Co) for the Claimant
Ewan Mc Quater QC & Michael Lazarus (instructed by Jones Day) for the Defendant