Judgment 8 of 1978

IN THE PRIVY COUNCIL No. 43 of 1977

ON APPEAL

FROM THE SUPREME COURT OF NEW SOUTH WALES
COMMON LAW DIVISION

COMMERCIAL LIST IN ACTION No. 5925 of 1975

BETWEEN :

THE COMMERCIAL BANKING COMPANY OF SYDNEY LIMITED — Appellant

- and -

PATRICK INTERMARINE ACCEPTANCES LIMITED (IN LIQUIDATION) & ANOR. — Respondent

CASE FOR THE APPELLANT

Record

NATURE OF THE PROCEEDINGS

1. The Commercial Banking Company of Sydney Limited (the appellant) appeals from a decision of Mr. Justice Sheppard given in the Common Law Division (Commercial List) of the Supreme Court of New South Wales.

2. The action was originally commenced, as a matter of urgency, to protect the appellant's position in relation to a certain "money market" transaction in which the corporate defendants were all involved. The appellant, which originally occupied a somewhat marginal position in the transaction found itself facing liability upon a letter of credit it issued and confronted by a threat of action which, if taken, might render worthless the security which it held to cover its contingent liability. The other parties to the transaction, Patrick Intermarine Acceptances Limited (PIAL), First Leasing and Finance Limited (First Leasing), First National Bank of Boston (the Boston Bank) and the State Electricity Commission of Victoria (SECV) were all joined as defendants. The cause of the problem was the insolvency and imminent liquidation of PIAL, and the provisional liquidator of PIAL, who subsequently became the p.100

Record

liquidator, Mr. Hosking (the liquidator), was also joined as a defendant. The relevant facts were not in dispute in any significant respect.

Reasons p. 261 11.18-23

Interlocutory arrangements were made to preserve the status quo but these were due to expire, and did expire, a few days after His Honour gave judgment on the final hearing of the action. The action failed against all defendants.

3. This appeal is limited to the judgment entered for the defendants PIAL and the liquidator. No appeal is taken against the judgment for the other defendants. As appears below, the expiry of the interlocutory arrangements and the conduct of the defendants in the light of His Honour's decision in their favour in effect destroyed the subject matter of the claim against the other defendants.

4. In the proceedings before Sheppard J., the appellant sought, inter alia, -

(a) declrations that it was entitled to a sum of $1.5 million to be paid by First Leasing Australia Limited (Frist Leasing) to PIAL and

(b) orders that the fund should be paid to the appellant.

It is that claim which is pursued in this appeal.

5. PIAL carried on a business which was described as that of a merchant banker. Part of that business involved borrowing money and "on-lending" such money to its customers for profit. In the course of its business PIAL borrowed $A.1.5 million from the SECV for the purpose of "on-lending" those moneys for profit to First Leasing. It was that transaction which gave rise to these proceedings.

Reasons p. 253 l.34

p.11

6. A question had earlier arisen as to the securities for a previous transaction of the same kind. In that transaction the borrower from SECV, which on-lent to First Leasing was Patrick & Company, a firm of stock brokers with which PIAL was associated. The security that First Leasing offered to Patrick & Company was a letter of credit issued by the Boston Bank. (First Leasing was partly owned by the Boston Bank). However, the security that SECV required was a letter of credit from an Australian Bank. The appellant bank was introduced into the transaction for the purpose of satisfying that requirement of SECV.

Reasons p. 253

p.89 l.39 - p.90 l.2

Reasons p.254 l.7

7. Prior to the establishment of the appellant's letter of credit Patrick & Company furnished the appellant with a requisition for the letter of credit (Exhibit "A"). The requisition took the

p.94

form of a printed document in which blank spaces had been completed. There was added to the document a typed additional clause, as follows:- Record

> "J. We undertake that in the event of drawing(s) being made under this credit, we will immediately lodge with the Bank a draft and accompanying documents in terms of First National Bank of Boston, Boston, Letter of Credit No. S10971 for an amount not less than that required to meet the drawing(s) under the credit requested in this requisition." p.94

8. In August 1969 a further loan was made by SECV to Patrick & Company and the moneys were on-lent to First Leasing. The parties adopted exactly the same manner of dealing as in the earlier transactions and used similar documents. Patrick & Company furnished the appellant bank with a letter of credit requisition in the same form as the earlier requisition (Exhibit "D"), including Clause J. p.25 p.97

9. The loans made in August, 1969, became due for repayment in August 1973. It was then agreed that the loans should be extended or "rolled over". By this time the money market operations of Patrick & Company, or Patrick Partners, as it was then called, had been transferred to PIAL. Reasons p.258 ll. 6-27 Transcript p.26 p.68 l.42, p.72 ll. 22-42

10. On 16 August 1973 the appellant established a fresh letter of credit to cover the extension of the loan, but this time the letter of credit was to secure the indebtedness of PIAL (Exhibit "G"). On the previous day Boston Bank had issued an amendment (Exhibit "H") to the letter of credit it had issued on 14 August 1969 (Exhibit "C"). The amendment noted that PIAL became the beneficiary and that the validity of the letter of credit was extended to 14 August 1975. p.73 l.30 p. 100 p.101 p.96

11. Prior to the issue by the appellant of its 1973 letter of credit PIAL furnished the appellant with a requisition in the form which had been earlier adopted (Exhibit "E"). p.98

The loan was actually repayed and was re-advanced a day or so later. The appellant, which was the banker of PIAL, Patrick & Company and First Leasing, granted First Leasing overnight cover to make the repayment. p.53 ll.20-33 p.91 ll.25-29 Reasons p.253 l.39

12. The loans from First Leasing to PIAL and from PIAL to SECV were then repayable on 14

Record

August 1975. Prior to 14 August 1975, it became clear that PIAL was insolvent and would not repay the loan to SECV.

13. These proceedings were commenced shortly before the debt became due for repayment.

14. After the proceedings were commenced the SECV made demand on the appellant under its letter of credit. The appellant paid PIAL's debt to SECV.

Reasons p. 261 ll.18-26

The parties then made an interlocutory arrangement under which the term of the loan from PIAL to First Leasing and the term of the Boston Bank letter of credit was extended to 14 August 1976. One of the appellant's objectives in the proceedings was to compel a drawing upon the Boston Bank letter of credit in its favour, for PIAL contended and contends, that whilst the appellant would be secured if there was a drawing on the Boston Bank's letter of credit, it is not secured, in the event of First Leasing paying PIAL direct. However, in order to succeed on this branch of its case, it was necessary for the appellant to establish rights against First Leasing and the Boston Bank.

A few days before the indebtedness of First Leasing to PIAL (as extended pursuant to the interlocutory arrangement) fell due for repayment His Honour Mr Justice Sheppard gave judgment against the appellant. As a result, this aspect of the case was overtaken by events. The debt was repaid, there was no drawing on the Boston Bank's letter of credit, and the appellant is now left, in this appeal, to its claims against PIAL and the liquidator. The fund constituted by the payment from First Leasing to PIAL is being held pursuant to an arrangement under which it is to abide the outcome of this appeal. If the appeal fails the fund will be distributed amongst unsecured creditors of PIAL and the appellant will rank as one of those unsecured creditors.

ANALYSIS OF THE TRANSACTION

15. It was of the essence of the transaction that the moneys lent by the SECV would be paid to First Leasing. A fund was constituted and was to be dealt with in a certain way. The fund was to pass from SECV through PIAL to First Leasing at the time it was lent and it was the intention of the parties that it would flow back to the SECV when it was repaid.

16. The appellant's role in the transaction was spelled out when application was made for the first letter of credit. The initial conversation leading up to the issue by the appellant of the first letter

of credit took place when Mr. T.R.W. Allen of Patrick & Company telephoned Mr. N.H. Blacket of the Commercial Banking Company of Sydney. Mr. Allen said: Record

> "We are considering a transaction under which $1 m. is to be borrwed from an Australian company and re-lent to another Australian company. The lending company is seeking security by way of a bank letter of credit in its favour. Would the Bank be prepared to issue a clean letter of credit in favour of the lending company? The Bank will receive by way of security a letter of credit in its favour from the First National Bank of Boston." p.11 ll. 14-19

In a later conversation Mr. Blacket told Mr. Allen that the Bank would agree to the request. He said, in part:

> "Before the Bank issues the local letter of credit we will require that the letter of credit from the First National Bank of Boston is established in our favour and it will have to be in the nature of a "back-to-back" letter of credit." p.11 ll 28-31

17. In the event, the Boston Bank's letters of credit were issued in favour of Patrick & Company and PIAL, not the appellant. However it is important to note that the problem in the present case has not arisen by reason of the fact that the Boston Bank's letter of credit is in favour of PIAL. Even if the Boston Bank's letter of credit had been in favour of the appellant, PIAL would still have been able to argue that because it received payment direct from First Leasing the Boston Bank's letter of credit simply became irrelevant. Substantially the same dispute would have arisen.

18. The appellant entered into the transaction to accommodate its customer PIAL by adding to the security offered by the ultimate borrower (which could only offer a letter of credit from an overseas bank) a letter of credit from an Australian bank, thereby satisfying the requirements of the original lender. The appellant was offered, and was intended to have, "security".

19. Clause J was included in the requisition for the letter of credit as a means of protecting the position of the appellant.

Record

The following submissions are made as to that clause:-

(a) The event referred to in Clause J was an event the direct cause of which could only be default on the part of PIAL in repaying the $1.5 million to SECV. The machinery provided by Clause J to protect the appellant in that event indicates that the parties expected that PIAL's default would be accompanied by, and possibly even caused by, default on the part of First Leasing. That might have been a reasonable enough expectation but it is unlikely that the clause was intended to leave the appellant unsecured in the event that PIAL became insolvent even though First Leasing did not.

(b) It is implicit in Clause J that if the event there referred to should occur and PIAL should come into possession of the fund secured by the Boston Bank's letter of credit it would apply that by repaying the appellant or would deal with the fund as directed by the appellant.

(c) The whole purpose of a "security" is to give the creditor a right which is not merely ancillary to the personal obligation to pay but will be available in the event that the personal obligation is of no - or at least insufficient - avail. (Re Lind (1915) 2 Ch. 345 at pp. 360-1) Paragraph J was unnecessary and otiose if PIAL could pay the appellant. It only had a field of operation if PIAL could not pay. The possibility that PIAL could pay the sum of $1.5 million, but would not pay it, was not covered by any express provision. Clearly the parties dealt on the basis that if PIAL could pay the sum it would.

(d) The express terms of Clause J seem to leave considerable room for implication. The clause does not state in terms, for example, that the appellant is to retain the benefit of any drawing on the Boston Bank letter of credit if there has been a drawing on the appellant's letter of credit. Y et that was plainly the intention of the parties. It was the very purpose for which PIAL was to take the steps required by the clause. It is submitted that it is just as plain that the parties intended that in the event that SECV drew on the appellant's letter of credit and First Leasing paid PIAL direct the moneys would be handed over to the appellant.

Record

(e) On a drawing on the appellant's letter of credit PIAL would be liable to the appellant for the amount of that drawing both under the general law and pursuant to the express terms of Clause G. of the requisition ("Exhibit "E"). It may be for that reason that the parties regarded it as unnecessary in Clause J to state the obvious, that is to say that if PIAL received the $1.5 million from First Leasing PIAL would pay that sum to the appellant. The fact that the parties in their written agreement did not expressly stipulate against PIAL's receiving payment from First Leasing and applying the fund so received otherwise than towards indemnifying the appellant does not mean that it was intended that PIAL should be able to do this, but rather that it was unthinkable that it should attempt it. p.98

(f) The obligation under Clause J to lodge a draft and accompanying documents is one which on its face is required to be performed even though First Leasing has paid PIAL. However, if First Leasing has paid PIAL performance of that obligation is futile. In fact, it is impossible in that one of the accompanying documents referred to is a statement that PIAL has not been paid. Clause J ought to be read to mean "We will, if necessary to enable the fund to be paid to the CBC Bank, lodge with the Bank etc.". If Clause J is read in that way it is not difficult to conclude that under the arrangement between the parties it went without saying that if all that was necessary to enable the fund to be paid to the appellant was for PIAL to hand it over then it would do so.

20. When regard is had to the terms of the original conversations which led to the appellant's participating in the transactions between the SECV, First Leasing and Patrick & Company (later PIAL), the nature of those transactions, the role played by the appellant and the terms of the relevant requisition for a letter of credit, it appears contrary to the whole basis upon which PIAL dealt with the appellant to permit PIAL to receive the $1.5 million direct from First Leasing without paying it to the SECV or, if the SECV had already been paid by the appellant, to the appellant. Much the same problem would have arisen if, for exampe, PIAL, having received payment of the sum of $1.5 million from First Leasing had

Record

threatened to apply the fund for the general purposes of its business. To the extent to which it is necessary to rely upon implication in addition to what the parties expressly stated in order to find a contractual obligation upon PIAL to apply the fund in satisfaction of the appellant's claim then such implication is a proper one. (cf. Heimann v. Commonwealth of Australia (1938) 38 S.R. (N.S.W.) 691 at p. 695; Scanlan's New Neon Ltd. v. Tooheys Ltd. (1943) 67 C.L.R. 169 at pp. 194-5; Trollope & Colls Ltd. v. North West Metropolitan Regional Hospital Board (1973) 1 W.L.R. 601 at pp. 609-610; Shirlaw v. Southern Foundries (1926) Ltd. (1939) 2 K.B.206 at p. 227).

21. An important feature of the transaction was the course or channel along which moneys were intended to flow. The funds were to flow from the SECV through PIAL to First Leasing and, ultimately back again. They would flow through the appellant, which was banker to First Leasing and PIAL. Clause J established a procedure to enable the appellant to look direct to the Boston Bank by taking the benefit of PIAL's security.

THE APPELLANT'S RIGHTS

22. There is now in existence a fund of $1.5 million paid by First Leasing to PIAL (or the liquidator). The appellant submits that it is entitled to look to that fund as security for the debt of $1.5 million which PIAL owed it as a result of the drawing on its letter of credit. The circumstance that this fund came direct to PIAL from First Leasing as a result of the appellant's failure at the hearing to compel a drawing upon the Boston Bank's letter of credit does not destroy the appellant's rights. Those rights were based upon the substance of the transaction and did not depend upon form or procedure.

23. The appellant relies upon, but its rights are not, as the learned trial judge appears to have considered, limited to, the contractual arrangements between the parties. It is submitted that equity would regard PIAL as bound in conscience to pay to the appellant the $1.5 million paid to it by First Leasing and that equity would fasten upon the fund itself treating PIAL as a trustee. (cf. Palette Shoes Pty. Limited v. Krohn (1937) 58 C.L.R. 1 at p. 27, per Dixon J.).

24. It is submitted that the arrangements between the parties are binding and the terms of the requisition for the letter of credit, and in particular of Clause J, give rise to an equitable assignment by way of charge which operates to give

the appellant security over the fund.

25. (a) There can be little doubt that if PIAL had simply directed First Leasing and the Boston Bank that in the event of a drawing upon the appellant's letter of credit First Leasing or the Boston Bank should pay the $1.5 million direct to the appellant that would have constituted an equitable assignment of the debt by way of charge. (In re Kent & Sussex Sawmills Limited (1947) 1 Ch. 177; In re F.B. Warren (1938) 1 Ch. 725; Arkron Tyre Co. Pty. Limited v. Kittson (1951) 82 C.L.R. 477; Walter & Sullivan Ltd. v. J. Murphy & Sons Ltd. (1955) 2 Q.B. 584; Sandford v. D.V. Building & Constructions Co. Pty. Ltd. (1963) V.R. 137).

(b) The learned trial judge simply said, in relation to this argument, that in certain cases referred to the words which were alleged to constitute a charge were construed strictly and that he was unable to construe the words of Clause J as a charge or equitable assignment of anything. His Honour disposed of the point on that basis.

(c) It is respectfully submitted that in the application of principles developed by Courts of Equity on this subject nothing could be further from the true position than the proposition that the matter rests upon a strict construction of the language of the parties. In Tailby v. Official Receiver (1888) 13 App. Cas. 523 at p. 543, Lord Macnaghten stated:

> "The mode or form of assignment is absolutely immaterial provided the intention of the parties is clear."

In William Brandt's Sons & Co. v. Dunlop Rubber Co. Ltd. (1905) A.C. 454 at p. 462 Lord Macnaghten said:

> "The language is immaterial if the meaning is plain. All that is necessary is that the debtor should be given to understand that the debt has been made over the by creditor to some third person."

The fundamental principle which applies was stated by Lord Macnaghten in Tailby v. Official Receiver (1883) 13 App. Cas. 523

Record

at pp. 547, 548, as follows :-

> "The truth is that cases of equitable assignment or specific lien; where the consideration has passed, depend on the real meaning of the agreement between the parties. The difficulty, generally speaking, is to ascertain the true scope and effect of the agreement. When that is ascertained you have only to apply the principle that equity considers that done which ought to be done if that principle is applicable under the circumstances of the case."

(cf. Palette Shoes v. Krohn (1937) 58 C.L.R. 1; Holroyd v. Marshall (1862) 10 H.L.C. 191; re Lind (1915) 2 Ch. 345).

(d) It is only if the "true scope and effect" of the agreement to give the bank security is confined so as to make it depend entirely upon a matter of procedure that the learned Judge's rejection of this argument is justified. For reasons given above it is submitted that it ought not to be so confined.

(e) The matter may be tested by asking what the result would have been if, when the time for repayment arrived, First Leasing, being short of funds, borrowed the $1.5 million from Boston Bank which chose to lend the money directly rather than suffer a drawing on its letter of credit. To suggest that in that event the appellant's position would become unsecured is to deprive the word "security" to most of its effect.

26. (a) The appellant further submits that the equitable principles which underly the cases on subrogation are equally applicable to the present case. Cases of subrogation depend not upon contract but upon principles of equity. Lord Blackburn stated the fundamental principle as being that "where a creditor has a right to come upon more than one person or fund for the payment of a debt, there is an equity between the persons interested in the different funds that each shall bear no more than its due proportion." (Duncan, Fox & Co. v. North & South Wales Bank (1880) 6 App. Cas. 1 at p. 19). The equities as between such persons are worked out independently of the accidental circumstance that a third party, having the right to do so, chose to look to only one of them to meet the obligation.

(Aetna Life Insurance Co. v. Middleport (1887) 124 U.S. 534 at pp. 548-9; Royal Exchange Assurance Co. v. Gimshaw Bros. (1928) 2 D.L.R. 412; Morris v. Ford Motor Co. (1973) 1 Q.B. 792; In re Miller, Gibb & Co. (1957) 1 W.L.R. 703). The principle applies equally where ultimately one person is primarily liable for the whole debt and the other is ultimately liable for none of it. (in re Downer Enterprises (1974) 1 W.L.R. 1460 per Pennycuick V.C. at pp. 1468-9).

(b) There was in existence a fund which was primarily liable to meet the obligation to repay the SECV. It was the money which was on-lent to First Leasing and was subsequently repaid to PIAL. That money should have flowed back through PIAL to the SECV. The appellant ought to be able to look to that fund for indemnity having paid the SECV itself.

(c) The learned trial judge found the subrogation cases inapplicable to the present case, pointing out that there was no security held by SECV to which the appellant could be subrogated. In this regard his Honour should have sought to identify and apply the principles underlying those cases. It was upon those principles, rather than their particular manifestation in the rules of subrogation, that the appellant was relying.

27. The appellant further submits that the standard printed clauses in the form of requisition for the letter of credit, originally drawn for use in a sale of goods transaction, but here used for a different transaction, ought, as a matter of construction to be moulded so as to apply to the circumstances of the case and, so read, expressly create a charge over the debt. (cf. Hillas & Co. Ltd. v. Arcos Ltd. (1932) 147 L.T. 503 at p. 514 per Lord Wright; Cohen & Co. v. Ockerby & Co. Ltd. (1917) 24 C.L.R. 288 at pp. 299-300 per Isaacs J.; Gray v. Carr (1871) L.R. 6 Q.B. 522 at p. 549 per Bramwell B.).

28. (a) The appellant also relies upon the principles formulated by James L.J. in ex parte James; re Condon (1874) L.R. 9 Ch. 609, at p. 614:

Record

"I am of opinion that a trustee in bankruptcy is an officer of the Court. He has inquisitorial powers given him by the Court and the Court regards him as his officer, and he is to hold moneys in his hands upon trust for its equitable distribution among the creditors. The Court, then, finding that he has in his hands moneys which in equity belongs to someone else ought to set an example to the world by paying it to the person really entitled to it. In my opinion the Court of Bankruptcy ought to be as honest as other people."

(b) The appellant submits that the liquidator of PIAL ought to act in accordance with this principle and that so doing he would pay the Bank in satisfaction of the debt owing to it the amount he received from First Leasing.

(c) The learned trial judge was in error in confining the application of this principle to cases of personal fraud or trickery on the part of a liquidator or trustee in bankrutpcy. The principle is a general principle of administration in cases of insolvency and it obliges the Court's officer to observe the same standards of commercial integrity as would have obliged the directors of PIAL, had they been in control of its affairs to pay the sum of $1.5 million when received, into an account with the appellant bank.

29. The appellant therefore submits that the appeal should be allowed for the following, amongst other,

R E A S O N S

(a) That his Honour erred in paying insufficient regard to the true nature of the arrangements between the appellant and the other parties to the transaction in question and in particular to the true scope and nature of the arrangements between the appellant and PIAL:

(b) That having regard to the nature of those arrangements, to the contract between the appellant and PIAL, and to the dealings in question his Honour should have held that the appellant has an equitable interest in and charge over the sum of $1.5 million paid by First Leasing to PIAL to secure PIAL's indebtedness to the appellant.

(c) That his Honour should have held that PIAL is bound in contract, or alternatively in

conscience, to pay the said sum of $1.5 million to the appellant.

(d) That his Honour failed properly to identify and apply the equitable principles underlying the cases on subrogation.

(e) That his Honour erred in construing the terms of the relevant requisition for a letter of credit.

(f) That his Honour should have held the principle laid down in ex parte; James re Condon to apply to the facts of the case.

A.M. GLEESON, Q.C.

G.K. DOWNES.

No. 43 of 1977

IN HER MAJESTY'S PRIVY COUNCIL

ON APPEAL

FROM THE SUPREME COURT OF NEW SOUTH WALES

BETWEEN:

THE COMMERCIAL BANKING COMPANY OF SYDNEY LIMITED

Appellant

- and -

PATRICK INTERMARINE ACCEPTANCES LIMITED (IN LIQUIDATION) & ANOR.

Respondent

CASE FOR THE APPELLANT

WEDLAKE BELL,
5 Breams Building,
Chancery Lane,
London, EC4A 1NN.

Solicitor for the Appellant