

The Commercial Banking Company of Sydney Limited

Appellant

v.

**Patrick Intermarine Acceptances Limited (in liquidation)
and Another** — — — — —

Respondents

FROM

**THE SUPREME COURT OF NEW SOUTH WALES
COMMON LAW DIVISION**

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE
OF THE PRIVY COUNCIL, DELIVERED THE 20TH MARCH, 1978

Present at the Hearing:

LORD DIPLOCK
LORD FRASER OF TULLYBELTON
LORD RUSSELL OF KILLOWEN
LORD SCARMAN
SIR JOHN PENNYCUICK

[Delivered by LORD DIPLOCK]

The respondent company ("P.I.A.L.") is insolvent; it owes the appellant ("the Commercial Bank") \$1,500,000; it is owed by First Leasing Australia Ltd. ("First Leasing") \$1,500,000. In the instant appeal from a judgment of Sheppard J. sitting in the Common Law Division of the Supreme Court of New South Wales the appellant seeks to establish that it is entitled to a proprietary interest by way of charge on the debt of \$1,500,000 due by First Leasing to P.I.A.L. as security for P.I.A.L.'s indebtedness to it in the same amount. First Leasing is ready and able to pay its debt to P.I.A.L. So what this case is about is whether the Commercial Bank is a fully secured creditor for £1,500,000 in the liquidation of P.I.A.L. or an unsecured creditor for that sum.

In addition to P.I.A.L. there were originally three other defendants to the action: viz: First Leasing, First National Bank of Boston ("the Boston Bank") and the State Electricity Commission of Victoria ("S.E.C.V."). They too were involved in the transactions out of which P.I.A.L.'s debt to the Commercial Bank arose. The history of those transactions is set out in considerable detail in the judgment of Sheppard J.—as it had to be, because at that stage the Commercial Bank were relying upon five or six alternative grounds upon which they claimed to be entitled to avoid being relegated to the status of unsecured creditors of P.I.A.L. Their claims on each and all of these grounds were unsuccessful before the learned judge. He gave judgment for the defendants. The appeal is brought against dismissal of the claim against P.I.A.L. and its liquidator; the claims against the other defendants have been

dropped. This enables their Lordships for the purposes of this appeal to reduce to its bare bones an account of the transactions out of which it is claimed that there arose in favour of the Commercial Bank an equitable charge on the debt of \$1,500,000 owed by First Leasing to P.I.A.L. by way of security for P.I.A.L.'s indebtedness to the Commercial Bank in the same amount.

First Leasing is an Australian company associated with the Boston Bank which owns a little less than 50% of its capital. The Boston Bank carries on banking business in the United States of America and elsewhere. Its correspondent in Australia is the Commercial Bank. First Leasing's business was mainly that of leasing machinery and equipment. P.I.A.L. carried on a business described as merchant bankers, but so far as the relevant transactions are concerned it was that of money-lenders. The Commercial Bank was its banker. In August 1973 P.I.A.L. borrowed from S.E.C.V. \$1,500,000 for a term of two years in order to lend it on to First Leasing for the same term at a rate of interest higher by $\frac{3}{4}\%$. S.E.C.V. required its loan to P.I.A.L. to be secured by a letter of credit from an Australian Bank. At the request of P.I.A.L., the Commercial Bank, for a commission of $\frac{1}{4}\%$, issued its irrevocable letter of credit in favour of S.E.C.V. authorising S.E.C.V. to draw upon the credit for any unpaid principal of its loan of \$1,500,000 to P.I.A.L. Drafts on the credit were to be accompanied by a statement of S.E.C.V. that payment of the principal of the loan had been demanded of P.I.A.L. and not received.

P.I.A.L. required its loan to First Leasing to be secured by a letter of credit from the Boston Bank upon which it could draw in Australia. The Boston Bank accordingly issued its irrevocable letter of credit in favour of P.I.A.L. authorising it to draw on the credit for any unpaid principal of its loan of \$1,500,000 to First Leasing. Drafts under the credit were to be drawn on the Commercial Bank and were to be accompanied by a statement by P.I.A.L. that payment of the principal of the loan had been demanded of First Leasing and not received.

There were thus two quite separate irrevocable letters of credit to which the only common party was P.I.A.L. as requisitioner of one and as beneficiary of the other. The only link between the two was provided by a special clause inserted in the letter of requisition addressed by P.I.A.L. to the Commercial Bank pursuant to which the irrevocable letter of credit in favour of S.E.C.V. was issued. It was additional to the ordinary undertaking by P.I.A.L. to indemnify the Commercial Bank for any payments made under the credit, and was in the following terms:—

“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. for an amount not less than that required to meet the drawing(s) under the credit requested in this requisition”.

The Commercial Bank was thus secured against any default by P.I.A.L. in the repayment of its loan from S.E.C.V., if such default was occasioned by the failure of First Leasing to repay its matching loan from P.I.A.L. Drafts under the Boston Bank credit would be drawn upon the Commercial Bank itself as agent for the Boston Bank, by whom it would be entitled to be reimbursed. But, at any rate as a matter of contract, Clause J gave no security to the Commercial Bank if P.I.A.L.'s default in repaying S.E.C.V. were occasioned by its own insolvency without any default by First Leasing in repaying P.I.A.L. It is true that in that event P.I.A.L.'s undertaking to lodge with the Commercial Bank a draft

and accompanying documents in terms of the Boston Bank's credit would become impossible of performance, because the accompanying documents had to include a statement by P.I.A.L. that payment of the principal of its loan to First Leasing had been demanded and not received. P.I.A.L. would be in breach of its contract with the Commercial Bank; but in respect of its claim to damages for the breach the Commercial Bank would rank as an unsecured creditor. It would be no better off than under the indemnity clause.

The reason for the omission to make any contractual provision for security for the Commercial Bank in the event of P.I.A.L.'s own insolvency was, as the learned judge found, that "nobody really contemplated the possibility of insolvency on the part of P.I.A.L.". However this un contemplated possibility was what in fact occurred. P.I.A.L. became insolvent and went into liquidation before its loan to First Leasing and its matching loan from S.E.C.V. became repayable. On the due date for repayment of its loan from S.E.C.V. P.I.A.L. defaulted. S.E.C.V. drew on the Commercial Bank for \$1,500,000, the unpaid principal of the loan and the Commercial Bank paid that sum to S.E.C.V. First Leasing was ready, willing and able to repay its loan from P.I.A.L. on the due date. By agreement between all parties to the original action, however, repayment of the \$1,500,000 by First Leasing has not been made to P.I.A.L.; but a fund representing it is being held to abide the result of the instant appeal.

Their Lordships are at a loss to see how any equitable assignment to the Commercial Bank of any kind of proprietary interest in the debt owing by First Leasing to P.I.A.L. can be spelt out of the various contracts between the five original parties to the action. The two irrevocable credits were, as Sheppard J. pointed out, being used in a way that was uncommon in Australia. An irrevocable banker's credit is generally used as the stipulated means of payment under a contract for the sale of goods. The liability which the banker assumes to the seller who is the beneficiary of the credit to honour drafts presented in accordance with its terms, is unqualified; it is not contingent upon non-payment by the buyer. In the instant case, however, the obligation of the issuing bank under each of the credits was contingent only. It arose if the principal debtor defaulted in repaying the loan upon demand at its due date, but not otherwise. The essential nature of the contract between the bank and the beneficiary is that of guarantee, though whether it attracts all the incidents of a contract of guarantee, particularly in relation to dealings between the beneficiary and the principal debtor, is not a matter that it is necessary for their Lordships to consider.

The only relevant contract between the Commercial Bank and P.I.A.L. is that of which the terms are to be found in the letter of requisition pursuant to which the irrevocable credit in favour of S.E.C.V. was issued. The Commercial Bank thereby undertook with P.I.A.L. that if P.I.A.L. should default in the repayment of its loan from S.E.C.V. the bank would pay to S.E.C.V. the amount due; P.I.A.L. for its part undertook with the Commercial Bank, that if that event occurred it would indemnify the bank for the payments it had made to S.E.C.V. and (by Clause J) that it would lodge with the bank documents which would enable it to obtain reimbursement of those payments from the Boston Bank under the credit issued by the Boston Bank of which P.I.A.L. was the beneficiary.

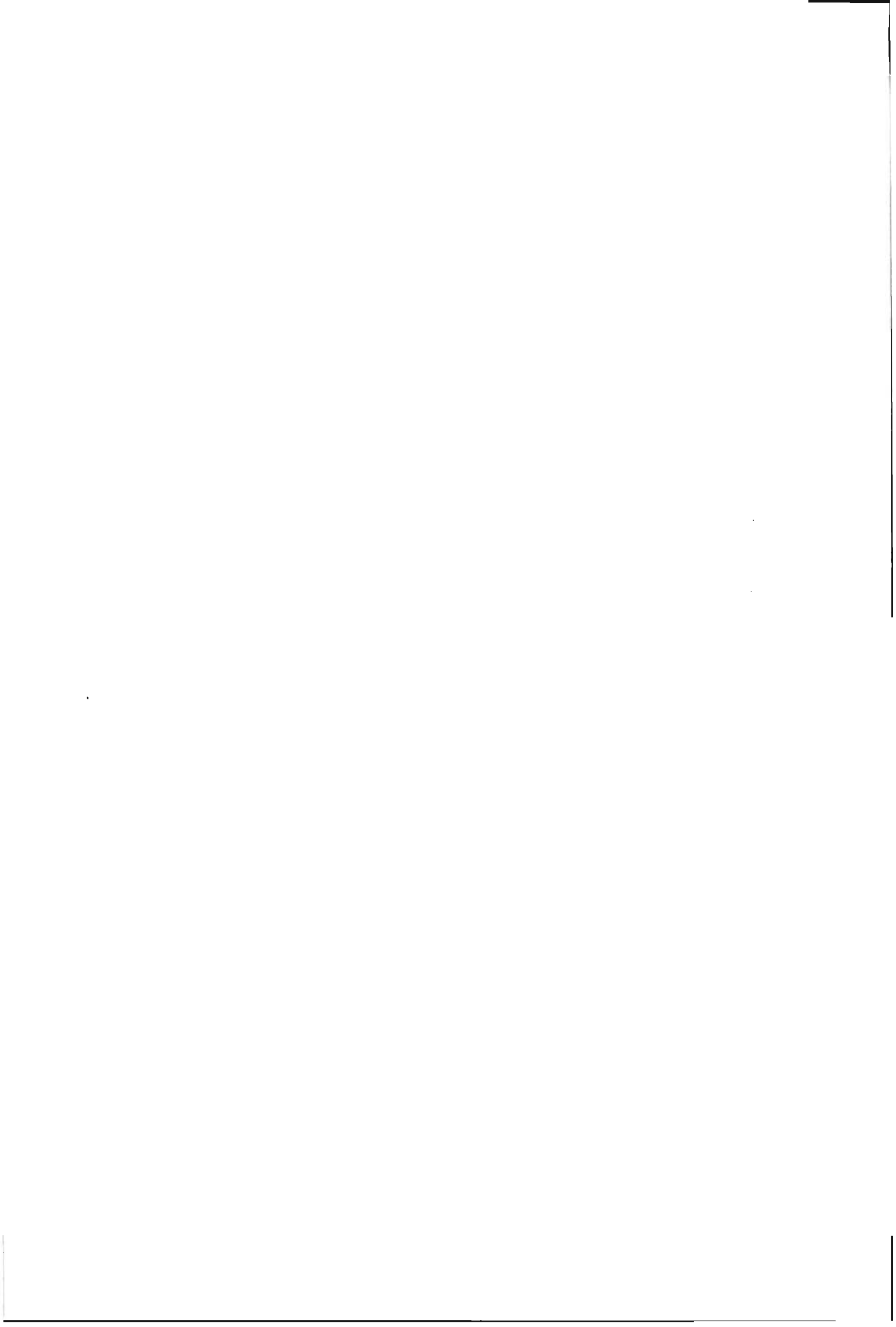
It may be that Clause J could be construed as constituting an equitable assignment to the Commercial Bank of P.I.A.L.'s contingent right against the Boston Bank to draw upon it for any unpaid part of P.I.A.L.'s loan

to First Leasing, if **First Leasing** should make default in repaying it. The learned judge expressed some doubt as to this; and since the question does not require to be decided in this appeal their Lordships need express no final view upon the matter; the only contingency on which the right that was the subject of any equitable assignment would come into existence never occurred.

It would have been possible for the parties to agree that P.I.A.L.'s obligation to reimburse the Commercial Bank for any payments that it was called upon to make to S.E.C.V. under the letter of credit should be paid out of the monies coming to P.I.A.L. from First Leasing in repayment of its loan from P.I.A.L. Had this been done there might have been some doubt as to whether it could operate as an immediate equitable assignment of P.I.A.L.'s rights against First Leasing to the future repayment of its loan, since *ex hypothesi* P.I.A.L. would not be parting with its own right to receive such repayment except on the occurrence of the contingency that it had itself defaulted on repayment of its own loan from S.E.C.V. Some rather more elaborate provisions would probably have had to be negotiated between the parties if it were intended to give the Commercial Bank some form of security if P.I.A.L.'s default were caused by its own insolvency.

However, the plain fact is that nothing of the sort was done. There is nothing in the letter of requisition to oblige P.I.A.L. to satisfy any liability it may incur to the Commercial Bank under the indemnity clause out of the monies received from First Leasing in repayment of its loan. The contingency against which some security is provided for the Commercial Bank is a default by P.I.A.L. on its loan from S.E.C.V. that is consequent upon a corresponding default by First Leasing on its loan from P.I.A.L. Security against the contingency of default by P.I.A.L. from any other cause including its own insolvency is simply not provided for at all. What form of security (if any) would have been agreed on by the parties if they had applied their minds to the matter can only be a matter of speculation. Their Lordships find it impossible to imply, from a provision that in a certain event the Commercial Bank should have a proprietary interest in Boston's liability to P.I.A.L., a provision that, if that liability should never arise, the Commercial Bank should have a proprietary interest in a different liability of a different person to P.I.A.L.

Their Lordships will humbly advise Her Majesty that this appeal should be dismissed with costs.



In the Privy Council

**THE COMMERCIAL BANKING
COMPANY OF SYDNEY LIMITED**

v.

**PATRICK INTERMARINE
ACCEPTANCES LIMITED
(IN LIQUIDATION)
AND ANOTHER**

DELIVERED BY
LORD DIPLOCK