

*2009] O.J. No. 4553; 2009 ON.C. LEXIS 4254, \*;  
2009 ONCA 764*

Between Nareerux Import Co. Ltd, Plaintiff (Respondent), and Canadian Imperial Bank of  
Commerce, Defendant (Appellant)

**INDEXED AS:** Nareerux Import Co. v. Canadian Imperial Bank of Commerce

Docket: C47914

Ontario Court of Appeal  
Toronto, Ontario

**JUDGES:** M. Rosenberg, J.M. Simmons and R.A. Blair JJ.A.

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**DATE INFORMATION:** June 30, 2009 Judgment: November 4, 2009.

**JUDGMENT DATE:** November 4, 2009

## **INTRODUCTION**

[1] One of the purposes of a letter of credit is to provide some measure of protection to a seller of goods that the seller will be paid in a timely fashion upon delivery of the goods to the buyer. In this case, Thai Fisheries Co. Ltd. accepted letters of credit from Canadian Imperial Bank of Commerce in an attempt to ensure payment for shipments of large quantities of Thai shrimp to Douglas R. Robertson International Inc. in the United States. The shrimp were destined for ultimate purchase by Sam's Club, a division of Wal-Mart Stores Inc.

[2] In the end, however - in circumstances I shall outline below - the letters of credit proved to be of little comfort to Thai Fisheries. It is short approximately \$ 10.4 million on the shrimp it supplied to Robertson.

[3] Robertson was a customer of CIBC, and financed the purchase of the shrimp through a credit facility arranged with the Bank. Upon arrival in the United States, the shrimp were stored in large warehouses - known as Customer Distribution Centers ("CDC's") - where they awaited purchase from the various Sam's Club outlets. Payment was to be made under the letters of credit upon presentation to CIBC of purchase orders and receipts showing that the shrimp had been taken down by Sam's Club.

[4] Although Thai Fisheries has not been paid for all of the shrimp it supplied under the letters of credit, the proceeds of sale from the shrimp were used by Robertson and the Bank to reduce the Robertson line of credit that had been arranged to finance the trade transaction.

[5] Thai Fisheries says that CIBC and Robertson colluded to reduce Robertson's line of credit - and therefore the Bank's exposure - by arranging for shrimp to be sold without documentation from Sam's Club and then relying on non-compliance with the letters of credit to refuse payments, while at the same time directing the monies received to reduce Robertson's overdraft instead of ensuring that the monies were used to pay Thai Fisheries under letters of credit, as should have been done. CIBC says that it did nothing improper,

that it complied with the provisions of the letters of credit, which were not honoured because the requisite documentation was not presented, and that Thai Fisheries knowingly ran the risk of such an eventuality when it accepted the letters of credit in the first place.

[6] The trial judge ruled in favour of Thai Fisheries and granted judgment in its favour in the amount of \$ 10,381,035<sup>1</sup>, together with pre-judgment interest and costs. In my view, he was correct in arriving at this disposition, and I would dismiss the appeal for the reasons that follow.

## **FACTS**

[7] In the early 1990s, Robertson concluded that there was a commercial opportunity for the supply of large quantities of shrimp to the North American market and, in particular, to Sam's Club. It secured a contract with the Wal-Mart division for that purpose and then entered into an agreement with Thai Fisheries<sup>2</sup> [See Note 2 below] for the purchase and shipment of shrimp (both raw and cooked) from Thailand in order to satisfy the Sam's Club contract.

[8] This led to the creation of a network of financing arrangements between CIBC, Robertson and Thai Fisheries to give effect to their commercial relationship. The particulars of these arrangements, and the circumstances giving rise to the dispute in these proceedings, are clearly described in the thorough and careful reasons of the trial judge. Much of what follows is taken from those reasons.

[9] Thai Fisheries required some assurance that it would be paid for the shrimp it was delivering to Robertson. Robertson needed to bridge the time between when it would have to pay Thai Fisheries for the shrimp delivered and when the shrimp would be accepted and paid for by Sam's Club. To that end, Robertson approached CIBC and arranged a line of credit - ultimately exceeding \$ 20 million -- to enable it to bridge this gap. The Bank then issued letters of credit to facilitate payment to Thai Fisheries.

[10] These arrangements were first made in 1993 (a year in which the shrimp was supplied and paid for to everyone's satisfaction) and continued in a different form in 1994 (the year in which the problems giving rise to this lawsuit arose). The differences in form are significant only for an understanding of the evolution of the financing arrangements.

### **The 1993 Arrangements**

[11] In 1993, CIBC issued two documentary letters of credit which specified that payment would be made to Thai Fisheries once the Bank had received documentary proof confirming that the shrimp had cleared the United States Food and Drug Administration Inspection ("FDA Inspection"). The Bank was permitted, under the terms of the 1993 letters of credit, to release the title documents provided by Thai Fisheries to Robertson for purposes of the FDA Inspection. CIBC's payment to Thai Fisheries was made from a drawdown on

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<sup>1</sup> All figures referred to in these Reasons are in U.S. dollars.

<sup>2</sup> Thai Fisheries - which ultimately went bankrupt - is a predecessor company to the plaintiff and respondent in these proceedings, Nareerux Import Co. Ltd. I shall refer to this entity as Thai Fisheries throughout these Reasons.

Robertson's line of credit with the Bank. Once Robertson was paid by Sam's Club, Robertson would pay down its line of credit.

[12] As indicated, the dealings between the parties under the 1993 arrangements are not the subject of this dispute. The 1993 letters of credit expired in January 1994, at which time the parties began to negotiate another set of terms to govern their financing relationship.

### **The 1994 Arrangements**

[13] CIBC was not satisfied with the 1993 arrangements. Although it had a general security agreement from Sam's Club and an additional stand-by letter of credit in its favour from Nationbank - issued on the account of Wal-Mart Stores, Inc. (Sam's Club) - CIBC still felt over-exposed. It was concerned about the length of time between its obligation to pay Thai Fisheries under the letters of credit, and Sam's Club's acceptance of the shrimp and subsequent payment to Robertson.

[14] CIBC sought to address the problem through changes in the letters of credit. A number of alternatives were considered and rejected. Finally, it was agreed that payment to Thai Fisheries would be delayed under the provisions of the letters of credit until a purchase order had been delivered by Sam's Club, when a store required the shrimp, along with a delivery receipt (together, "the Receipts").

[15] A new letter of credit was issued on June 9, 1994, containing the following "Special Condition" to give effect to the foregoing:

Payment of drafts or drafts drawn hereunder will be effected when accompanied by required documents and after receipt from the applicant of a signed purchase order(s) issued by Sam's Club and related delivery receipt(s) showing container number(s), number of cartons and evidencing that goods have been received by Sam's Club Distribution Centre(s).

Documents may be delivered to the applicant, if requested by them, against their signed receipt and prior to payment in order to provide clearance of the merchandise to secure inspection by the U.S. FDA authorities and to effect delivery of merchandise to Sam's Club when approved.

[16] As the trial judge noted, the Special Condition created an arrangement that "was not typical" because the seller no longer "control[led] the satisfaction of conditions necessary for payment." This differed from the standard letter of credit requirements that call for payment to be made upon delivery of the title documents to the Bank. While the new arrangements provided added protection for CIBC, they created a potential difficulty for Thai Fisheries, which the trial judge described in this fashion:

Accordingly, [the letter of credit] included the condition that no payments would be made under the Letter of Credit until a purchase order and receipt had been delivered by Sam's Club. *This provided the CIBC with the protection it sought.* The gap in time between payment under the Letter of Credit and receipt by Robertson of payment from Sam's Club would be reduced. *The difficulty that this presented for Thai Fisheries was that, by entering into this arrangement, it ceded control over when it would receive payment to a third party*

- Sam's Club. If Sam's Club did not require the shrimp, it would not issue the purchase orders that were a prerequisite for payment. *Moreover, by delaying the delivery of the receipts, Robertson and the CIBC could control the flow of money to Thai Fisheries.* [Emphasis added.]

[17] The trial judge found, nonetheless, that all three parties - Robertson, CIBC and Thai Fisheries - understood the impact of these changes. Robertson and CIBC, in particular, understood that Robertson "[could] control payments by when [it] provides delivery slips." At the same time, Dr. Marut, the commercially sophisticated President of Thai Fisheries, also understood the implications of the changes leading to the Special Conditions. He knew that under the new terms, the documentation provided to the Bank would be delivered to Robertson both to assist in clearing FDA Inspection and for delivery to the CDC's utilized by Sam's Club, where they would remain until the Receipts were provided from Sam's Club; only then would Thai Fisheries be paid.

[18] In October 1994, two new letters of credit were issued<sup>3</sup>. Both contained the first part of the Special Conditions in the letter of credit dated June 9, 1994, cited in para. 15 above, but not the entirety of the second clause (i.e., the provision for release of the documents to Robertson "to effect delivery of merchandise to Sam's Club when approved"). Instead, the October 1994 letters of credit simply provided that "prior to payment, documents may be delivered to the applicant [Robertson], if requested by them, against their signed receipt."

[19] The parties conducted themselves, however, as if there were no difference in the language of the 1994 Letters of Credit, and no one made an issue of that difference at trial. Indeed, in every case involving shipments under the Letters of Credit, CIBC required Robertson to sign a specific undertaking to deliver the Receipts prior to releasing the bills of lading. As Mr. Purvis testified, "the original intended structure" under the Letters of Credit was that the bills of lading would be provided to Robertson for the purposes of delivery to Sam's Club so that the additional documents - the purchase orders and receipts - would be obtained and payment made.

[20] The typical undertaking referred to the Letter of Credit in question and was entitled "L/C Text *and Amendments*." [Emphasis added.] It was signed by Robertson, and stated:

We hereby acknowledge receipt of documents relating to the above drawings(s).

We undertake to deliver to Canadian Imperial Bank of Commerce a signed purchase order issued by Sam's Club and related delivery receipt as per terms of the credit.

[21] Mr. Purvis testified that if the Bank believed there were receipts and purchase orders outstanding for product that had been delivered to and purchased by Sam's, but for which receipts had not been given to the Bank, CIBC would have enforced the undertaking. It turned out, as I shall explain later, that the Bank did not do so, but it seems clear, nonetheless, that the provision permitting title documents to be released to Robertson prior to payment only to effect delivery of the shrimp to Sam's Club was consistent with the nature and purpose of the new arrangements negotiated between the parties with respect to the 1994 shipments.

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<sup>3</sup> I shall refer to the June 9 and the October 1994 letters of credit, together, as the "Letters of Credit."

[22] Each of the letters of credit contained a reference to the Uniform Customs and Practice for Documentary Credits in the following form: "This cable is the operative instrument and subject to U.C.P. 1993 revision ICC Publication No. 500 and engages us in accordance with the terms thereof."

[23] The Uniform Customs and Practice for Documentary Credits ("Uniform Customs") are a non-governmental codification of customs and practices promulgated by the International Chamber of Commerce, and are very widely adopted by financial institutions issuing letters of credit. Frequently, the parties incorporate the provisions of the Uniform Customs into the letter of credit by reference. For purposes of this case, the relevant Uniform Customs is the 1993 version, known as "UCP 500". Whether the parties incorporated its provisions into the Letters of Credit in this case is an issue to which I will return.

### **The Breakdown of the Relationship**

[24] Problems began to arise between Robertson and Thai Fisheries respecting the shrimp in the fall of 1994 and into 1995. Neither the precise nature of the problems, nor their cause, is clear from the record, partly because - as the trial judge observed - no one from either Robertson or Sam's Club was called to give evidence. The particulars matter little for purposes of the appeal, however. Whatever the details of the disputes, the Receipts were not delivered by Robertson to the Bank and, as a result, Thai Fisheries did not receive payment for substantial amounts of shrimp supplied. It complained, but continued to make shipments, apparently believing that the problems with respect to the delivery of the Receipts were being addressed by Robertson. CIBC agreed to make partial payments covering the cooked shrimp but not the raw shrimp and the relationship sputtered along for some time<sup>4</sup>.

[25] The last shipment under the Letters of Credit was in December 1994 and the last payment received by Thai Fisheries (\$ 533,387) was in February 1995. In total, Thai Fisheries supplied shrimp valued at almost \$ 40 million under the 1994 Letters of Credit and it received payments amounting to approximately \$ 29.5 million. The unpaid balance remaining was \$ 10,381,035 - the amount awarded by the trial judge.

[26] Sam's Club continued to draw down on the Thai Fisheries' shrimp that had been delivered to its warehouses, however. In February 1995, it indicated that it would continue to order cooked shrimp from its warehouse operations until the end of March 1995. Orders for cooked shrimp supplied by Thai Fisheries were delivered from Robertson to Sam's Club from January until April 1995. The value of those orders totalled \$ 6,964,417.30. Except for the last \$ 533,387 payment in February 1995, Thai Fisheries was never paid for these shipments.

[27] Under the Letters of Credit arrangements, the foregoing shipments would have resulted in delivery of the Receipts from Sam's Club to Robertson and from Robertson to the Bank. CIBC would, in turn, have released payment to Thai Fisheries and debited Robertson's

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<sup>4</sup> Thai Fisheries continued to deliver shrimp to Robertson until at least June 1995. These shipments were done under "documents against payment" and "documents against acceptance", which are financing mechanisms similar to letters of credit but without the same level of security provided to the seller. The shipments under these arrangements are not in issue on the appeal.

line of credit accordingly. In fact, however, no Receipts were ever provided to CIBC for that shrimp and Thai Fisheries did not receive payment for the remaining \$ 6,431,030.30. Those proceeds of sale were used by Robertson and CIBC, nonetheless, to pay down Robertson's line of credit at the Bank.

[28] At a meeting in June 1995, Robertson advised CIBC that there were no outstanding delivery receipts from Sam's Club and that there would be no further shipments to Sam's Club. Mr. Purvis admitted the Bank had been told that Robertson "might withhold these documents." Thai Fisheries was not advised of these developments at the time, although the Letters of Credit were left open and not cancelled for more than another year (thus inducing Thai Fisheries to take no steps to recover the shrimp in the meantime, as Robertson's other major supplier, Magnate, had done).

### **The Pay-Down of Robertson's Line of Credit with CIBC**

[29] In the meantime, CIBC and Robertson were working together to reduce Robertson's indebtedness to the Bank, which at one point exceeded \$ 19 million. The reduction of this debt was admittedly the Bank's primary concern during this period. The plan was successful. By year-end 1995, the Robertson overdraft had been reduced to approximately \$ 450,000, and by February 29, 1996, it stood at \$ 6.

[30] Monies received by Robertson in payment for shrimp supplied by Thai Fisheries were used to pay down the Robertson line of credit, without any reciprocal payment being made to Thai Fisheries under the Letters of Credit. CIBC knew this was happening and that Sam's Club had taken Thai Fisheries shrimp from its warehouses for which Thai Fisheries had not been paid. The trial judge made the following important finding, which appellant's counsel concedes is supported by the evidence:

David Purvis was very clear in his evidence. The CIBC's principal concern was in ensuring that it was paid the money that it was owed. No money was paid to Thai Fisheries, under the Letters of Credit, after February 6, 1995. The CIBC knew from its review of the Reconciliation prepared as of April 1, 1995 that between January 28, 1995 and April 1, 1995, Sam's Club took delivery of (US)\$ 6,964,417.30 worth of shrimp ... CIBC's records show the payments made to Thai Fisheries, pursuant to the Letters of Credit. The CIBC would have known that the last payments made were on February 6, 1995 and that those payments were valued at (US)\$ 533,387 ... Accordingly, there ought to have been purchase orders valued at (US)\$ 6,431,030.30 ((US)\$ 6,964,417.30 - (US)\$ 533,387.00) forthcoming.

[31] Moreover, in collaboration with Robertson, CIBC permitted Robertson inventory to be sold to others, with the proceeds used to pay down the Robertson overdraft. As the trial judge noted, this inventory included Thai Fisheries shrimp that had been delivered to Robertson for sale to Sam's Club under the Letters of Credit. Thai Fisheries was never told of the agreement between Robertson and the Bank that the shrimp it supplied was to be taken, sold to purchasers other than Sam's Club, and the revenue utilized to reduce Robertson's debt to the CIBC. The trial judge found that:

By proceeding in this way, *the CIBC was a party to an arrangement that ensured that the*

*beneficiary to the Letters of Credit it had issued would not be paid.* The potential draws on the Letters of Credit those shrimp represented would never take place because the shrimp would never be delivered to Sam's Club and the purchase orders from Sam's Club that were a prerequisite to Thai Fisheries being paid would never be presented. [Emphasis added.]

[32] In June 1996 - after the Robertson debt to CIBC had been eliminated - Robertson wrote to Thai Fisheries enclosing what it said was a letter the CIBC intended to send to Thai Fisheries' bankers in Bangkok. The proposed CIBC letter was to advise that the Letters of Credit had expired because the conditions for payment would not be met. Robertson suggested that if the letter were sent it might cause Thai Fisheries some difficulties with their bankers and proposed that these difficulties could be avoided if Thai Fisheries were willing to give Robertson the appropriate releases.

[33] As the trial judge observed, Thai Fisheries' response was "to the point":

With regard to your 25 June, 1996 letter concerning CIBC letters of credit, we will not release the L/C's or any party, including CIBC. Unless satisfactory arrangements made for payment of debts to TFC, no release.

[34] In October 1996, Thai Fisheries received from its bank in Bangkok a copy of a letter from CIBC advising that the Letters of Credit had expired. This lawsuit followed.

## **THE TRIAL JUDGMENT**

[35] The trial judge held that by accepting the monies in payment of the loans it had made, CIBC acted as a lender seeking satisfaction of what it was owed. But, in so doing, it failed in its duty as the issuer of the Letters of Credit, and breached the separate and independent contract it had entered into with Thai Fisheries. To hold otherwise, he explained, "would encourage the CIBC to act with the buyer to sell to someone other than Sam's Club, bypass the Letters of Credit under which the product was delivered (since no purchase order could ever be forthcoming), and use the money to pay down the debt rather than pay for the goods." Such an interpretation would defeat the security offered to the seller by issuing the Letters of Credit in the first place.

[36] In addition, the trial judge was satisfied that CIBC had breached an implied term in the contractual relationship between CIBC and Thai Fisheries - an implied duty of good faith. In its role as lender, CIBC had applied monies paid for the purchase of the goods to pay down its loans, rather than holding them on account for the seller. In doing so, CIBC acted to defeat the purpose of the letters of credit and in violation of its duty to consider Thai Fisheries' draw on the credit independently, in accordance with the principle of autonomy of letters of credit. In view of the terms of the Letters of Credit - permitting release of the title documents to Robertson only for purposes of FDA Inspection and subsequent delivery to Sam's Club, and subject to the "amending" undertaking - this is even more clearly the case when CIBC, in its role as a lender, arranged with its customer/buyer for the sale of shrimp outside the terms of the Letters of Credit, under which the product was already delivered. To suggest that CIBC's stepping in to realize on its loan represented the intention of the parties when they entered into the Letters of Credit is to propose that there was no intention to supply any comfort or security to Thai Fisheries. Such a conclusion would remove the contractual link to Thai Fisheries, which would in turn have no assurance of payment.

[37] In the result, the trial judge awarded Thai Fisheries - the predecessor of Nareerux Import Co. Ltd - damages in the amount of \$ 10,381,035, representing the amount outstanding on the 1994 Letters of Credit for the shrimp delivered.

## **THE APPELLANT'S POSITION**

[38] CIBC takes the position that using the purchase monies for these shrimp to reduce Robertson's indebtedness to it, without corresponding payments being made to Thai Fisheries, was justified because the Special Conditions for payment under the Letters of Credit were not complied with - that is, the Receipts from Sam's Club, which would have triggered payment, were never provided.

[39] CIBC argues, in substance, that the Bank protected itself by the Special Conditions negotiated in the Letters of Credit, and that Thai Fisheries - a large, sophisticated commercial enterprise presided over by an experienced, sophisticated businessman fully familiar with the operation of letters of credit - assumed the risk of what happened as the price of continuing its lucrative business with Wal-Mart in North America. The Bank submits that title in the shrimp passed to Robertson upon delivery of the title documents by Thai Fisheries to the Bank, and that both Robertson and the Bank acquired an interest in them at that time - Robertson as owner and the Bank as a secured creditor. The use of the sale proceeds from the shrimp supplied by Thai Fisheries to reduce Robertson's line of credit with the Bank was justified when the documentary requirements for payment under the Letters of Credit failed to materialize. What the trial judge did, Mr. Richler and Mr. Prestage contend, is to negate CIBC's security, reallocate the risk from Thai Fisheries to CIBC, and write out the Special Conditions in the Letters of Credit.

[40] I do not accept these submissions.

## **LAW AND ANALYSIS**

### **Summary**

[41] I agree with the trial judge's well-considered disposition of this case and - save for two caveats - with his conclusions. The caveats relate (a) to his view that the parties did not incorporate the provisions of UCP 500 into the Letters of Credit (which I think, respectfully, is erroneous, but an error that works in favour of the respondent, and is therefore of little consequence to the outcome of the appeal) and (b) to his resort to language of conversion, agency and trust in his analysis of the payments concerned (which I do not think is necessary or, from the trial judge's perspective, used by him in their formal traditional sense).

[42] My view of the case may be summarized, briefly, as follows.

[43] CIBC raises one defence only: Thai Fisheries failed to comply with its obligation imposed by the Special Conditions in the Letters of Credit since the Receipts from Sam's Club, through Robertson, were never delivered to the Bank. Consistent with that obligation is the principle that letters of credit must be strictly construed. On a strict construction of the contract, the Bank asserts, the delivery of the Receipts from Sam's Club was a pre-condition to payment. No receipts were provided for the shrimp in question, and therefore CIBC contends, it was not liable to pay.

[44] In my view, CIBC is disentitled to rely upon the defence of non-compliance because, on the trial judge's findings, it knowingly contributed to, or acquiesced in, the circumstances that undermined the prospect of strict compliance, then used that non-compliance to justify the refusal of payment. It did so in collaboration with its customer, Robertson, in order to ensure that the proceeds of sale of the shrimp sold under the Letters of Credit were used to reduce the Bank's significant exposure on the Robertson line of credit without corresponding payments being made to Thai Fisheries under the Letters of Credit. Whether this conduct is characterized as a direct breach of the principle of autonomy underpinning letter of credit transactions or as a breach of CIBC's implied duty of good faith not to act in a fashion meant to defeat or eviscerate the purpose of the Letters of Credit, matters little, in my view. On either scenario - both of which were justifiably found by the trial judge to exist on the facts - CIBC, as issuer of the Letters of Credit, is precluded from raising the defence of non-compliance. Equity will not permit it to do so.

[45] There is a further basis for concluding that CIBC may not rely on the defence of non-compliance. The Bank failed in its obligation to give timely notice of dishonour to Thai Fisheries when it held back on notifying the seller for more than a year that no Receipts would be forthcoming and that the Letters of Credit would be cancelled. In doing so, CIBC placed Thai Fisheries in a position where it reasonably believed that the Letters of Credit would be honoured when the problems with the Receipts had been resolved. Consequently, Thai Fisheries took no steps to protect itself by seeking return of the shrimp until it was too late and the shrimp had all been sold.

[46] Finally, it is my view that whether title to the shrimp did or did not pass to Robertson upon or at some time earlier than the release of the title documentation to Robertson is not material to the disposition of the appeal. The *lis* here is not between the Bank and Thai Fisheries as secured or unsecured creditor of Robertson; the *lis* is as contractual parties to the Letters of Credit. The Bank's position as secured creditor of Robertson does not immunize it from its obligations to Thai Fisheries as issuer of the credits.

## **Preliminary Observations**

[47] Turning now to my analysis giving rise to these conclusions, I begin with the following observations.

[48] Letters of credit are an important and unique type of financial instrument designed to facilitate the flow of goods and trade. They are frequently resorted to in transactions with international dimensions, where buyer and seller are strangers to, and distanced from, each other and are looking for some assurances to reduce the risks of dealing with each other. In his text, *Letters of Credit: The Law and Current Practice*, 3d ed., looseleaf (Toronto: Thomson Canada Limited, 2009), at pp. 1-2.1 to 1-3 and 1-5, Lazar Sarna describes the need for letters of credit to reduce the uncertainty in international transactions, and the benefits to those involved:

An importer places an order for the purchase and shipment of goods with a foreign seller. The importer has no reason either to trust or mistrust the solvency, reliability or efficiency of the foreign seller; he has no means of ascertaining whether in this specific transaction the foreign seller will ship the number and quality of goods ordered at the place and on the dates set out in the purchase order. Similarly, the foreign seller has little assurance upon

receipt of the purchase order that the importer is solvent or will pay the full amount of the purchase order without deductions, set-offs or counter-claims once the goods are delivered. ... In order to accommodate the expectations of both parties, it is often agreed that the importer will supply the foreign seller with a letter of credit which the former obtains upon application to his bank in his own jurisdiction.

...

The practical effect of financing the underlying contract by way of letter of credit is beneficial for all parties concerned. The importer dispenses with the problem of advance payment, loss of interest while awaiting shipment, and fear of loss resulting from inadequate or late shipment. Subject to the problem of fraud and subterfuge, the importer is assured that payment will only be made if the foreign seller strictly complies with the terms of the credit. On the other side, the foreign seller, prior to shipment, has in hand a promise to pay for the shipment from a reputable foreign financial institution, or in the event of the intervention of a confirming bank, from a native bank. From the point of view of the issuer, it is paid a remuneration for the opening of the credit and retains the bills of lading and other shipping documents presented with demand of payment as security for reimbursement by the customer of the amount of credit extended and paid.

[49] Thus, letters of credit are an important mechanism for ensuring that international commerce flows smoothly, effectively, and with some degree of assurance. As one American authority has put it, albeit colourfully, letters of credit are intended "to grease the wheels of trade and commerce": *Alaska Textile Co., Inc. v. Chase Manhattan Bank, N.A.*, 982 F.2d 813 (2d Cir. 1992), at p. 824. Care is required, therefore, to ensure that they are not interpreted and enforced in a way that might jeopardize their uniqueness and commercial efficacy or the relative certainty that must surround their use. Hence the doctrines of autonomy, strict compliance and strict construction that will be discussed below.

[50] At the same time, however, letters of credit are not completely divorced from the general rules and principles of contract law, including those invoking notions of fairness and equity: see *Mutual Export Corporation v. Westpac Banking Corporation*, 983 F.2d 420 (2d Cir. 1993), at p. 423; *Exxon Co. v. Banque de Paris et des Paysbas*, 889 F.2d 674 (5th Cir. 1989), at p. 678, *cert. denied*, 496 U.S. 943 (1990); *Timber Falling Consultants, Inc. v. General Bank*, 751 F. Supp. 179 (D. Or. 1990), at p. 181; *Karpassia Shipping Co., S.A. v. Chase Manhattan Bank, World Trade Center Branch No. 232*, 1980 U.S. Dist. LEXIS 17285 (S.D.N.Y. 1980), at \*18.

[51] For example, in *Karpassia Shipping*, at \*18-19, the U.S. District Court for the Southern District of New York acknowledged the following notions of contractual interpretation in the context of a letter of credit:

A construction that will sustain an instrument will be preferred to one that will defeat it; if an agreement is fairly capable of a construction that will make it valid and enforceable, that construction will be given it. *The same general principles which apply to other contracts in writing govern letters of credit. Where a letter of credit is fairly susceptible of two constructions, one of which makes it fair, customary and one which prudent men would naturally enter into, while the other makes it inequitable, the former interpretation must be preferred to the latter*, and a construction rendering the contract possible of performance will be preferred to one which renders its performance impossible or *meaningless*. Moreover, as between the beneficiary of a letter of credit and the issuer ... if ambiguity

exists, the words are taken as strongly against the issuer as a reasonable reading will justify. [Citations omitted; emphasis added.]

### **Documentary Letters of Credit and the Principles of Autonomy and Strict Compliance**

[52] The type of documentary letter of credit in question on this appeal is one that is issued by a bank at the buyer's request in favour of the seller of goods. It generally provides for payment by the bank to the beneficiary upon presentation to the bank of title and shipping documents and compliance with all terms as specified in the letter of credit. The purpose is to ensure prompt payment to the beneficiary (the seller) upon satisfaction of the stipulated conditions, without interference from, or ultimate non-payment by, the bank's client (the buyer). The "chief virtue" of such letters of credit has been described as their "predictable reliability as a payment mechanism": *Voest-Alpine International Corporation v. The Chase Manhattan Bank, N.A.*, 707 F.2d 680 (2d Cir. 1983), at p. 682.

[53] A good general description of how such documentary letters of credit are designed to work is found in *Halsbury's Laws of England*, 4th ed., vol. 41 (London: Butterworths, 2005), at para. 375:

It is often made a condition of an international sale contract that the buyer must pay for the goods by means of a confirmed, irrevocable letter of credit. It is then his duty to procure his bank, known as the issuing or originating bank, to issue an irrevocable credit in favour of the seller by which the bank undertakes to the seller, either directly or through another bank in the seller's country known as the correspondent or negotiating bank, to pay an agreed sum of money against tender by the seller of the shipping documents. The contractual relationship between the issuing bank and the buyer is defined by the terms of the agreement between them under which the letter opening the credit is issued. As between the seller and the bank, the issue of the credit duly notified to the seller creates a new contractual link and renders the bank directly liable to the seller to pay the purchase price or to accept the bill of exchange on tender of the documents. The contract thus created between the seller and the bank is, by reason of the bank's absolute undertaking to the seller, separate from the original contract between the buyer and the seller. Having undertaken to pay the seller under the letter of credit, the bank will protect itself against non-payment by the buyer either by taking security from the buyer or by retaining the document of title, typically the bill of lading, tendered by the seller under the letter of credit. [Footnotes omitted.]

See also I.F.G. Baxter, *The Law of Banking*, 4th ed. (Toronto: Thompson Canada Limited, 1992), at pp. 158-159.

[54] A letter of credit thus exists in the context of three separate and distinct agreements: (i) the underlying contract between the buyer and seller; (ii) the contract between the buyer (the bank's customer) and the bank to provide the credit; and (iii) the contract between the bank and the beneficiary seller that constitutes the letter of credit itself. It is a fundamental principle of letters of credit - known as the principle of "autonomy", or "independence" - that these contracts are separate and independent from each other. The issuing bank's obligation to pay under the letter of credit arises upon presentation of the requisite documentation and compliance with the terms of the credit by the beneficiary; it is not affected by extraneous factors. As the trial judge noted:

This obligation to pay is a duty that the bank owes the seller:

The obligation of the issuing bank (or the confirming bank) is to pay if the terms and conditions of the letter of credit have been carried out by the seller. *This obligation must be carried out irrespective of any dispute between the buyer and seller or between bank and customer.* This has been referred to as the autonomy of the credit transaction.

(I.F.G. Baxter, *The Law of Banking*, 4th ed. (Toronto: Thompson Canada Limited, 1992) at 161)

[Emphasis added.]

See also Sarna at p. 5-1.

[55] The corollary of the issuer's obligation to pay, however, is another fundamental concept relating to letters of credit: the beneficiary's obligation of strict compliance with the terms and conditions of the credit. This includes the responsibility of the beneficiary to inspect the terms of the credit before accepting it in order to determine whether it meets the needs of the underlying commercial transaction, and to request any changes if the terms of the credit cannot be strictly adhered to: see *Tradax Petroleum American, Inc. v. Coral Petroleum, Inc.*, 878 F.2d 830 (5th Cir. 1989), at p. 834; *Mutual Export* at 423.

[56] As noted above, the only defence raised by CIBC is that Thai Fisheries failed to comply with its obligation of strict compliance.

### **CIBC Is Disentitled To Rely Upon the Doctrine of Strict Compliance**

[57] The central issue on this appeal, however, is whether CIBC had become disentitled by its conduct to rely upon the doctrine of strict compliance in the circumstances. Courts have held that the equitable doctrines of waiver and estoppel apply in letter of credit cases: see e.g. *Morguard Trust Co. v. Royal Bank* (1988), 60 Alta. L.R. (2d) 99 (Q.B.), at p. 117, varied on other grounds, (1989), 70 Alta. L.R. (2d) 242 (C.A.), at p. 244; *Dibrell Brothers International S.A. v. Banca Nazionale Del Lavoro* 38 F.3d 1571 (11th Cir. 1994) at p. 1581; *Barclays Bank D.C.O. v. Mercantile Nat'l Bank*, 481 F.2d 1224 (5th Cir. 1973), at p. 1237, cert. dismissed, 414 U.S. 1139 (1974).

[58] Thus, the issuer of a letter of credit may be precluded from relying on the doctrine of strict compliance in certain situations. Examples of circumstances in which an issuer of a letter of credit has disentitled itself to do so include those in which the issuer (i) has waived strict compliance, either expressly or by its conduct;<sup>5</sup> (ii) has delegated its duty to evaluate a beneficiary's documentary presentation independently<sup>6</sup>; (iii) has been unjustly enriched by the credit transaction<sup>7</sup>; (iv) has engaged in improper consultations with its customer

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<sup>5</sup> *DBJJJ, Inc. v. National City Bank*, 123 Cal. App. 4th 530 (Cal. Ct. App. 2004), at p. 535.

<sup>6</sup> *E & H Partners v. Broadway National Bank*, 39 F. Supp. 2d 275 (S.D.N.Y. 1998), at pp. 284-285.

<sup>7</sup> *Lectrodryer v. Seoulbank*, 77 Cal. App. 4th 723 (Cal. Ct. App. 2000), at p. 726.

concerning whether to accept or refuse the documents tendered<sup>8</sup>; (v) has induced the beneficiary to believe the credit would be honoured until after its expiry date, when it was too late for the beneficiary to correct the situation<sup>9</sup>; and (vi) has failed to provide prompt notice of dishonour to the beneficiary<sup>10</sup>.

[59] Setting aside the straight waiver situations and those involving untimely notice of dishonour for the moment, these authorities - albeit primarily American in origin - are instructive. Their common rationale is that the conduct of the issuing bank has put it in a position where its obligation under the letter of credit to act independently of the underlying relationships between it and its customer, or between its customer and the beneficiary, has been compromised. As the Baxter and Sarna texts cited above both affirm, the obligation of the issuing bank must be carried out *irrespective of any dispute* between the buyer and seller or *between bank and customer*. Here, the trial judge found that CIBC permitted its conflicting concern respecting its financial over-exposure in the creditor/debtor relationship with Robertson, to interfere with its payment obligation to Thai Fisheries under the Letters of Credit. In these circumstances, the issuing Bank was not entitled to permit those conflicting interests to prevail.

[60] Although there appear to be very few authorities where the question of *the issuing bank's* own conduct in advancing its own interests at the expense of the beneficiary has been in issue, the following decisions are helpful by way of analogy.

[61] In *E & H Partners*, the issuing bank, Broadway National, took the position that it did not have to honour a standby letter of credit issued in favour of E & H Partners because the documentation submitted by the beneficiary did not conform to the terms of the credit. The Bank was found to be estopped from asserting nonconformity, however, because it had improperly consulted and colluded with its customer, Astro International, regarding the decision not to honour the letter of credit - beyond any permissible discussion regarding the possible waiver of discrepancies<sup>11</sup>. The U.S. District Court for the Southern District of New York held that this conduct was both a breach of the autonomy/independence concept and a violation of the issuer's duty of good faith. Broadway National was estopped from claiming non-conformance with the terms and conditions of the letter of credit. At pp. 284-285, the Court stated:

However, it is clear in this case that the purpose of the multiple communications between Broadway National and Astro regarding the letter of credit was not to discuss waiver of the alleged discrepancies. In fact, the opposite seems to be true. It appears from the record that Astro played an active part in the bank's initial decision to dishonour E & H's draft. Not only did Astro repeatedly urge Broadway National to dishonour the draft, it also hired a lawyer to find errors in E & H's submissions. *This type of communication between the issuing bank and the payor of the letter of credit cannot be allowed. First, such contact clearly violates the independence principle inherent in the UCP and in letter of credit law. A bank has an independent obligation to the beneficiary; to permit the payor to pressure or collude with the bank* to dishonour the draft destroys the very principle upon which the

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<sup>8</sup> *E & H Partners* at pp. 284-285; *Lectrodryer* at pp. 727-728 ; *DBJJJ* at p. 544. It is clear, however, that the issuer is entitled to consult with its customer to determine whether the customer is prepared to waive discrepancies in the documentation.

<sup>9</sup> *Morguard* at para. 54.

<sup>10</sup> *DBJJJ*; *Amwest Surety Insurance Co. v. Concord Bank*, 248 F. Supp. 2d 867 (E.D. Mo. 2003), at p. 877; *Bank of Cochlin, Ltd. v. Manufacturers Hanover Trust Company*, 808 F.2d 209 (2d Cir. 1986), at p. 212.

<sup>11</sup> See footnote 8 above.

commercial utility of letters of credit rests. See *Voest-Alpine Int'l Corp.*, 707 F.2d at 682 ("Since the great utility of letters of credit arises from the independent obligation of the issuing bank, attempts to *avoid payment premised on extrinsic considerations* - contrary to the instruments' formal documentary nature - tend to compromise their chief virtue of predictable reliability as a payment mechanism.") ...

Furthermore, under the law of New York, letters of credit, like other written contracts, imply good faith and fair dealing. See *Clark Oil Trading Co. v. J.Aron and Co.*, 172 Misc. 2d 552, 561, 659 N.Y.S. 2d 426, 432 (1997). [Emphasis added.]

[62] To a similar effect is the decision of the Court of Appeal of California in *DBJJJ*. Although the main issue in that case was whether the issuer was precluded from raising discrepancies in the documentation presented by the beneficiary because the issuer had failed to provide timely notice of its refusal to dishonour the documents, the court also concluded that the bank and the buyer had improperly colluded together to dishonour the claim, relying upon *E & H Partners* to do so. With respect to the seller's argument that the issuer bank had improperly colluded with the buyer, the Court explained, at p. 544:

Therefore, the contact with the Applicant is not justifiable if it is designed to allow the Issuing Bank and the Applicant to make a joint decision on the discrepant documents. The decision to honor or refuse the documents must be the Issuing Bank's.

[63] Finally, in *Lectrodryer v. SeoulBank*, the Court of Appeal for California permitted Lectrodryer, the beneficiary under a letter of credit, to recover on unjust enrichment grounds notwithstanding arguments based on non-compliant documentary presentation. Lectrodryer had manufactured and delivered a molecular sieve dryer used in refining oil into gasoline to its buyer, a California exporter of industrial equipment. The purchase price of \$ 493,000 was to be paid by irrevocable letter of credit. SeoulBank issued the letter of credit in favour of Lectrodryer at the request of the buyer, one of its largest customers, but a customer that was in serious financial difficulties at the time. SeoulBank insisted on payment up front from the buyer in the amount to be paid under the letter of credit - an amount which the buyer was able to provide from the proceeds of sale of the dryer because it had pre-sold the equipment to a Japanese company at a significant profit. Certain other cheques provided to SeoulBank by the customer - in approximately the same amount - bounced, however. When Lectrodryer submitted its documentation, SeoulBank asserted there were fatal discrepancies and, despite waiver of the discrepancies by the buyer, refused to pay.

[64] Notwithstanding the discrepancies, and the argument that the letter of credit had expired before presentation of the documentation, the California Court of Appeal upheld Lectrodryer's claim. It did so on two grounds. First, it rejected SeoulBank's argument that the cause of action for unjust enrichment was an impermissible attempt to enforce a letter of credit indirectly by resort to equity. The Court stated, at p. 726, that "even accepting the premise that a bank's obligation to pay a letter of credit is determined by applying strict legal guidelines to the terms and conditions of the letter of credit without reference to equitable principles, such premise is irrelevant here" (citations omitted). SeoulBank was unjustly enriched when it retained for itself the funds the buyer used to purchase the letter of credit for the purpose of paying Lectrodryer. Secondly - even if letter of credit principles applied to the case and the claim for unjust enrichment were rejected - the Court held that SeoulBank had waived any right to rely on notions of strict compliance as a result of its

dealings with the buyer with respect to payment under the letter credit.

[65] There is little Canadian authority that I have been able to find touching the type of situation presented by the case before us. However, in *Morguard* the Alberta Court of Queen's Bench applied equitable principles of waiver and estoppel - as did the foregoing American authorities - to permit recovery by the beneficiary of a letter of credit, in spite of documentary non-compliance and expiry of the credit.

[66] At issue in *Morguard* was a standby letter of credit provided by Royal Bank to secure the performance of the terms of certain mortgages. Default occurred under the mortgages but there was a dispute as to whether the demand letters submitted to the Bank under the letter of credit properly described the lands covered by the mortgages. The trial judge agreed that the demand letters were not in compliance with the terms of the letter of credit. However, he permitted the beneficiary to recover on equitable grounds<sup>12</sup>. At p. 117, he said:

The question of expiry of the letter of credit was never raised until after that expiry date passed. In reliance upon these representations *Morguard*, to its detriment, did not deliver an acceptable letter of presentation within the time when the bank would still have paid. It would be inequitable for the bank to be allowed to withhold payment of the moneys in the circumstances.

[67] I have little difficulty in applying the themes emerging from the foregoing authorities to the circumstances of this case. Those themes are rooted in the failure to comply with the principle of autonomy and independence, buttressed by principles of equity and fairness, including the U.S. duty of good faith. Whether the purpose of the joint participation between bank and customer is to reject discrepant documents with a view to advancing the customer's interests (as in *E & H Partners* and *DBJJ*) or to thwart the very presentation of the requisite documentation in the first place in order to advance the interests of both bank and customer by reducing the customer's indebtedness to the bank (as in the case before us), or whether broader equitable principles are being applied (as with unjust enrichment in *Lectrodryer* and *Morguard*) makes little difference, it seems to me. The inappropriate character of the issuing bank's conduct is the same: it places its interest as lender ahead of its duty as contracting party under the letters of credit, thereby interfering with the guiding principle of autonomy and independence, as well as the contractual duty of good faith (to which I will return momentarily). I agree with Mr. Berkow's submission that, in the circumstances of this case, the use of the Letters of Credit by the issuer and its customer as a tap for payment, depending upon when the Bank and its client wanted to effect such payment - in order to better their own positions *vis-à-vis* each other as debtor and creditor - nullifies the entire autonomy principle and the independent role required of the Bank under the Letters of Credit.

## Good Faith

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<sup>12</sup> On appeal, the Alberta Court of Appeal arrived at the same result, but on a different basis. The appeal court concluded that there had been documentary compliance in the circumstances. Accordingly, it found it unnecessary to consider whether the beneficiary could rely on waiver or estoppel or untimely notice of dishonour on the part of the bank. It did not say the trial judge had erred in applying those principles. The judgment was varied accordingly.

[68] The jurisprudence cited above, together with principles of equity and the underlying terms and conditions to be found in UCP 500, all justify the trial judge's findings respecting a direct violation of the doctrines of autonomy and independence. Furthermore, Canadian jurisprudence supports his finding of an implied duty of good faith in the performance of the Letters of Credit in the circumstances.

[69] Although Canadian law has not yet recognized a stand-alone "duty of good faith" in the performance of a contract that is independent from the terms of the contract, as the United States has done, the jurisprudence establishes that there is an implied contractual duty of good faith not to act in a way that defeats or eviscerates the very purpose and objective of the agreement: see *Transamerica Life Canada Inc. v. ING Canada Inc.* (2003), 68 O.R. (3d) 457 (C.A.), at paras. 53 and 87; *GATX Corp. v. Hawker Siddeley Canada Inc.* (1996), 27 B.L.R. (2d) 251 (Ont. Ct. Gen. Div.), at para. 72. See also *CivicLife.com Inc. v. Canada (Attorney General)* (2006), 215 O.A.C. 43 (C.A.), at para. 49; *LeMesurier v. Andrus* (1986), 54 O.R. (2d) 1 (C.A.), at p. 7; *Greenberg v. Meffert* (1985), 50 O.R. (2d) 755 (C.A.), at p. 763; *Gateway Realty Ltd. v. Arton Holdings Ltd.* (1991), 106 N.S.R. (2d) 180 (N.S.T.D.), at para. 60, aff'd (1992), 112 N.S.R. (2d) 180 (C.A.); John D. McCamus, *The Law of Contracts* (Toronto: Irwin Law, 2005), at p. 792. The trial judge was correct, in my view, in holding that the Letters of Credit were infused with an implied duty of good faith of that nature.

[70] His conclusion in that regard is well-supported on the record. As the Bank contends, and the trial judge found, the 1994 letters of credit were structured in such a way that Thai Fisheries ceded control over the timing of documentary compliance - and thus the timing of payment - to Robertson and Sam's Club, and, indirectly, to the Bank. I say "indirectly to the Bank" because, as Mr. Purvis acknowledged in his internal memorandum dated July 14, 1994:

The terms of payment of the L/C's based on the presentation of delivery receipts ***allows us and the client to control the release of funds and therefore we can control our actual exposure within the US \$ 15 MM facility.*** Payments under the L/C's will therefore be tied to cash flow. [Emphasis added.]

[71] This is precisely what happened when the Bank became concerned about its exposure on the Robertson indebtedness. It gave the Bank the opportunity to exert what was tantamount to a discretionary control over documentary compliance and the timing of payment to Thai Fisheries. Contracts in which performance is dependent upon the exercise of discretion on the part of one of the parties are contracts that are particularly characterized by the implied duty of good faith performance. In such circumstances, the discretion must be exercised reasonably and in good faith: see *CivicLife.com* at para. 49; *Greenberg v. Meffert* at p. 763; McCamus at p. 788.

[72] Breach of a duty of good faith in the performance of a contract may be found where there is "evidence that some sort of bad motive - *such as self-interest, ill will or a dishonest purpose - underlay a decision*" (emphasis added): *Hembruff v. Ontario Municipal Employees Retirement Board* (2005), 78 O.R. (3d) 561 (C.A.), at para 116. Here, the Bank acted out of self-interest, as the trial judge found.

[73] The trial judge ultimately found that CIBC had breached its contractual obligations to Thai Fisheries both directly (by descending into the arena and participating in the

arrangement with Robertson to frustrate the Special Conditions and using that non-compliance to refuse payment, while nonetheless applying the proceeds from the sale of shrimp supplied under the Letters of Credit to reduce Robertson's overdraft) and indirectly (by breaching an implied contractual duty of good faith not to act in a way that defeated the purpose of the contract). Having reached those conclusions, he was entirely justified in rejecting CIBC's attempts to rely upon the doctrine of strict compliance.

## **Risk Allocation**

[74] The Bank argues, nonetheless, that by accepting the Special Conditions in the Letters of Credit, Thai Fisheries accepted the risk of non-payment if Sam's Club failed to take up all of the shrimp or to provide the Receipts, or if Robertson acted dishonestly. The Bank points out that Thai Fisheries opted to take no security from Robertson and, as noted above, ceded control over the timing of payments to Robertson (and, indirectly, to the Bank). The Bank therefore relies on what it says is clear law respecting the allocation of risk in letters of credit transaction: the risk falls on the supplier who accepts the letter of credit as written - and therefore must examine and either accept or reject the credit in advance - even where performance turns out to be impossible: see *Tradax Petroleum* at p. 833. In *Mutual Export*, the U.S. Court of Appeals for the Second Circuit explained, at p. 423: "The law in disputes such as this one is clear: The beneficiary must inspect the letter of credit and is responsible for any negligent failure to discover that *the credit does not achieve the desired commercial ends*" (emphasis added).

[75] However, none of the allocation-of-risk cases are situations in which "the credit [did] not achieve the desired commercial ends" because the issuer and its customer colluded to undermine the very purpose of the letter of credit and to undermine the principle of autonomy and independence, as the trial judge found to be the case here.

[76] In my view, acceptance of the Letters of Credit with the Special Conditions in them did not eradicate CIBC's obligation to adhere to the principle of autonomy and independence and to its implied duty of good faith in the performance of its obligations under the Letters of Credit. At most, it cast the Bank's obligations to be carried out in the crucible of those Special Conditions. Nor did it have the effect of transferring to Thai Fisheries the risk of collusion between the Bank and its customer in a way that violated those obligations, as CIBC contends.

[77] Thai Fisheries did indeed agree to assume the risk of delayed acceptance of the shrimp and delayed payment by Sam's Club and, therefore, of delayed delivery of the Receipts and delayed payment to it under the Letters of Credit. It agreed to accept the risk that Sam's Club would not take up all of the shrimp - although in such a case, the terms of the Letters of Credit did not permit the Bank to release the documents of title respecting the unaccepted shrimp to Robertson because that shrimp would not be for delivery to Sam's Club. It agreed to accept the risk, even, that Robertson would act dishonestly and fail, for whatever reason, to provide the Receipts.

[78] But Thai Fisheries did not assume the risk that *CIBC* - the issuer of the Letters of Credit - would participate in a ploy with Robertson, its customer, to frustrate compliance with the Special Conditions, then rely upon such non-compliance to deny payment under the Letters of Credit, while at the same time knowingly accepting the proceeds from the sale of the very shrimp shipped under those Letters of Credit, to improve its lending position *vis-à-vis* its customer. To interpret the Letters of Credit in a way that would give credence to the

view that Thai Fisheries agreed to accept such a risk would be - as the trial judge said - to render the Letters of Credit commercially meaningless. It is well-established that "[w]here ... the document to be construed is a negotiated commercial document, the court should avoid an interpretation that would result in a commercial absurdity. Rather, the document should be construed in accordance with sound commercial principles and good business sense" (footnotes omitted): *Kentucky Fried Chicken Canada v. Scott's Food Services Inc.*, (1998) 41 B.L.R. (2d) 42, at para 27. See also *Toronto (City) v. W.H. Hotel Ltd.*, [1966] S.C.R. 434, at p. 440; *Plan Group v. Bell Canada*, 2009 ONCA 548, at para. 37, citing *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust* (2007), 85 O.R. (3d) 254 (C.A.), at para. 24. In such circumstances the Letters of Credit would offer no protection to the beneficiary at all.

### **Conclusions Regarding Strict Compliance Defence**

[79] In the end, then, CIBC is simply disentitled to rely upon the defence of strict compliance. That is so because by its conduct in participating with its customer, Robertson, in an arrangement that prevented the delivery of the Receipts from Sam's Club for Thai Fisheries' shrimp (or from others to whom the shrimp was sold), CIBC permitted its conflicting interest as a secured lender of the buyer to influence and interfere with its contractual obligation to Thai Fisheries as beneficiary under the Letters of Credit. However, in this case, the Bank was driven by its desire to eliminate its existing exposure on the Robertson indebtedness (which it succeeded in doing just prior to Robertson's bankruptcy); its motive was to resolve a dispute between it and its customer. This, it was not permitted to do at the expense of the beneficiary, when it was in part its own conduct that generated the documentary non-compliance it relied on to justify non-payment under the Letters of Credit. As Respondent's counsel put it - bluntly and succinctly - in their factum, at para. 1: "CIBC cannot hide behind the principle of strict compliance in circumstances where, by its own conduct, it thwarted such compliance and defeated Thai's rights under the Letter of Credit." It would simply be inequitable to permit it to do so.

[80] Respectfully, the trial judge was correct in disposing of the case on these bases. His resolution transcends the rigour and technicalities of strict compliance in letter of credit law, but is justified in the particular circumstances of this case because it in no way interferes with the uniqueness of letter of credit transactions. Had the trial judge not made the factual findings he did, the result might be quite different. However, the trial judge made the following crucial findings, amongst others:

- a) CIBC knew Sam's Club had accepted shrimp valued at \$ 6.9 million and delivered by Thai Fisheries under the Letters of Credit, but there were no Receipts for those purchases; and
- b) CIBC had a signed undertaking from Robertson to deliver the Receipts from Sam's Club to the Bank (recall that the undertaking was said to be an "amendment" to the Letter of Credit)<sup>13</sup>; but nonetheless

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<sup>13</sup> Consequently, even though Thai Fisheries may have had difficulty enforcing the Undertaking itself, the Undertaking remained a part of what Mr. Purvis referred to as "the original structure" of the Letters of Credit, and the Bank could not turn a blind eye to it in the circumstances.

- c) CIBC "closed its eyes to the prospect that [the Receipts] ought to exist and then accepted from the buyer in payment of its debt, money that might otherwise be owing to the seller;" and, moreover,
- d) CIBC acted "carelessly, recklessly or knowingly" in accepting the proceeds of sale from Robertson and in permitting Robertson to put those proceeds "to its own use to the benefit of the CIBC;"
- e) With respect to the balance of the Thai Fisheries' shrimp, CIBC was "party to an arrangement to sell shrimp to others [that it knew] should be subject to the [Receipts]", thus ensuring that it would be "impossible for the conditions in the Letters of Credit to be met"; and in that respect
- f) CIBC "worked actively to defeat the payments to Thai Fisheries that CIBC would, if those conditions had been met, have been obliged to make"; and finally,
- g) Although CIBC was precluded from involving itself in the contractual relationship between the buyer and the seller, it did exactly that, in its role as lender, thereby "[breaching] its separate and independent responsibilities to the seller under the Letters of Credit" by "[entering] into the issue and, without advising the seller, [acting] with the buyer so that the shrimp was sold to others and the money used to pay off the buyer's debt to the CIBC."

[81] These findings were all amply supported on the evidence and are unassailable. They are fatal to CIBC's position in the action.

### **Timely Notice of Dishonour**

[82] There is an additional basis that the trial judge could have used to support his decision, in my opinion, but did not. The issuer of a letter of credit has an obligation to give timely notice that it is refusing to pay when it is asserting non-compliance. CIBC failed to comply with this obligation when it failed to notify Thai Fisheries for more than a year after it first learned from Robertson that the Receipts requirement would not be fulfilled.

[83] Both custom and the provisions of the UCP 500 impose on the issuer of a letter of credit a duty to give timely notice of dishonour. This duty is the flip side of the strict compliance coin: see *Morguard* at paras. 56-60, citing *Paramount Export Company v. Asia Trust Bank, Ltd.*, 193 Cal. App. 3d 1474 (Cal. Ct. App. 1987), at p. 1482; *Bank of Cochlin* at p. 212.

[84] Articles 13(b) and 14(d) and (e) of the UCP 500 provide, amongst other things, that:

13(b) The Issuing Bank ... shall ... have a reasonable time, not to exceed seven banking days following the day of the receipt of the documents, to examine the documents and determine whether to take up or refuse the documents and to inform the party from which it received the documents accordingly.

14(d) (i) If the Issuing Bank ... decides to refuse the documents, it must give notice to that effect ... without delay but no later than the close of the seventh banking day following the

day of receipt of the documents...

(ii) Such notice must state all discrepancies in respect of which the bank refuses the documents and must also state whether it is holding the documents at the disposal of, or is returning them to, the presenter.

14(e) If the Issuing Bank ... fails to act in accordance with the provisions of this Article and/or fails to hold the documents at the disposal of, or return them to [the presenter] it shall be precluded from claiming that the documents are not in compliance with the terms and conditions of the Credit.

[85] I need at this point to turn briefly to the issue of whether the provisions of the UCP 500 were incorporated by reference into the Letters of Credit here. As I have noted above, the trial judge held they were not. Respectfully, I am not persuaded that he was correct in so holding. To repeat, the Letters of Credit included the following stipulation: "This cable is the operative instrument *and subject to* the U.C.P. 1993 revision ICC Publication No. 500 and engages us in accordance with the terms thereof" (emphasis added).

[86] Focusing on the last wording of this term - "and *engages us* in accordance with the terms thereof" - and after reviewing dictionary definitions of the word "engages", the trial judge determined that the language was insufficient to incorporate the provisions of the UCP 500 into the Letters of Credit. Instead, he concluded that the UCP 500 "provides guidance to or presents a general framework to which the Letters of Credit are to conform" and that in fact "the general direction in UCP 500 has been conformed with." While it may be that not much turns on the distinction for purposes of the appeal, I do not agree. It is apparent from the authorities and texts dealing with letters of credit that the parties customarily make their agreement subject to the Uniform Customs, i.e., they incorporate the UCP into the letter of credit by reference: see Sarna at pp. 2-25 and 2-27. The wording "subject to the UCP" appears to have been considered sufficient for these purposes. See e.g. *Morguard* at p. 117; *Bank of Cochlin* at p. 210.

[87] Here, the trial judge concentrated on the wording "engages us" to the exclusion of the clear language that the Letters of Credit were "subject to" the UCP 500 and *thus* "engaged" the parties in accordance with its terms. When the words "engages us in accordance with the terms thereof" are read together with the "subject to" language of the provision - and when they are considered in the context of what appears to be the prevailing custom of referring to the Uniform Customs in letters of credit - the only interpretation that makes sense is that the parties here intended by their language to incorporate the provisions of UCP 500 by reference into their agreement.

[88] This conclusion has two implications for the appeal. First, it places the underpinnings of the American authorities referred to above on a more or less equal footing with the Letters of Credit at issue on the appeal. Secondly, it opens the door to the further basis for disentitling CIBC to rely upon its defence of non-compliance.

[89] The provisions of the UCP 500 cited above, and the authorities referred to, deal with situations in which the issuing bank is responding to the documentation presented in support of the intended draw-down on the letter of credit. Here, there is a distinction from such circumstances because the required documentation was not all presented for review by the Bank. However, I see no difference in principle, for purposes of the issuer's responsibility to provide timely notification of its intention not to honour the draw. The purpose of requiring the issuer to provide prompt notification of dishonour is to enable the

notified party to respond by curing the discrepancies, if possible, or otherwise protecting its interests: see *Morguard* at p. 117; *Paramount Export* at 1482; *Bank of Cochlin* at p. 213. In *Morguard*, the court ruled that the beneficiary did not deliver an acceptable letter of presentation within the appropriate time limits because it relied on representations made by the issuer. In *Bank of Cochlin*, the issuer's delay prevented the confirming bank from taking steps expeditiously to recover funds before they had been removed from the fraudster beneficiary's account.

[90] Here, the Bank was aware by July 7, 1995, that the Receipts from Sam's Club and Robertson would not be forthcoming. It had before it at the time Thai Fisheries' draws on the Letters of Credit, awaiting delivery of those Receipts. Yet it did not notify its beneficiary that it could not honour the draws because there would be no documentary compliance. Nor did it take any steps to enforce Robertson's undertaking to provide those Receipts for \$ 6.9 million worth of shrimp that it knew Sam's Club had accepted from Thai Fisheries' supply. Nor did it cancel the Letters of Credit until October 1996 - some 15 months later - after Thai Fisheries' shrimp had all been sold. The prejudice to Thai Fisheries in these circumstances is clear: it was deprived of the opportunity to take any steps to protect its interests by demanding the return of the title documents and/or taking court proceedings - as Robertson's other supplier, Magnate had successfully done - to seize the remaining shrimp. The trial judge found that Thai Fisheries had been "misled into believing that [the Receipts] might still be forthcoming." The inference is irresistible that the Bank's silence in this regard was motivated by its desire, and Robertson's, to ensure that Thai Fisheries took no Magnate-like steps until Robertson's indebtedness had been paid down from the proceeds of sale of the shrimp.

[91] CIBC is not entitled to rely upon non-compliance with the Special Conditions in such circumstances.

### **The Passing of Title**

[92] Finally, CIBC argues that the trial judge erred in determining that title to the shrimp had not passed to Robertson upon the delivery of the bills of lading and shipping documents to the Bank by Thai Fisheries's Bangkok bankers or, at least, upon the delivery of those documents to Robertson under the Letters of Credit. The Bank submits that title did pass and that two things flow from this for purposes of the appeal. First, Robertson owned the shrimp and was therefore free to sell it and to use its own funds to pay down its line of credit at the Bank. Secondly, once title had changed hands to Robertson, the Bank itself acquired an interest in the shrimp as a secured lender of Robertson - in priority to Thai Fisheries' interest as an unsecured creditor of Robertson - and therefore was justified in its actions on the basis that it was simply exercising its rights as a secured creditor.

[93] The ownership argument is, in my view, misconceived. Like the trial judge, I do not think it matters for purposes of the disposition of this action whether title passed, or did not pass, to Robertson. CIBC's rights as a secured creditor are irrelevant. As the trial judge noted,

[A] change in ownership at the time of the delivery of the documents would not relieve the CIBC of the obligations it had to Thai Fisheries following from the independent contractual link between the CIBC and Thai Fisheries arising from the Letters of Credit it issued.

[94] I agree. Contrary to the Bank's submissions, Thai Fisheries is not seeking to re-transfer the risk of Robertson's default in payment from itself to the Bank, thereby usurping the Bank's position as secured creditor. Thai Fisheries is not seeking to assert its rights as an unsecured creditor of Robertson at all. As noted above, it is seeking to enforce its contractual rights against the Bank under the Letters of Credit. CIBC's secured rights *vis-à-vis* Robertson and Robertson's unsecured creditors do not trump its contractual obligations to Thai Fisheries - and the principles of autonomy and independence that infuse those obligations - under the Letters of Credit. It cannot breach its obligations, including its implied duty of good faith, by acting in a way that defeats the purpose of the credit, and then seek to take cover behind its status as a secured creditor, under an entirely separate contractual arrangement with its customer, to immunize it from breach of its Letter of Credit obligations.

### **CONCLUSION AND DISPOSITION**

[95] This appeal raises the interesting - and difficult - question of the role, if any, to be played by principles of fairness and equity in letter of credit transactions. Given the uniqueness and importance of letters of credit as a mechanism for the financing of commercial transactions worldwide, as much certainty as possible in their interpretation and application is essential. That is not to say, however, that principles of fairness and equity play no role in that regard.

[96] When judges and legal writers say that letters of credit operate independently of the equities, they may mean "independently of the equities surrounding the performance of the underlying contracts" (a proposition about which there can be no doubt - the *quid pro quo* principles of autonomy and independence, on the one hand, and strict compliance with the documentary requirements and terms of the letter of credit, on the other hand, ensure that result). Or they may mean "independent of equitable considerations in favour of the beneficiary where the beneficiary has accepted the terms of the credit but cannot meet the terms of compliance" (a proposition that generally follows from the autonomy/strict compliance dichotomy). As the jurisprudence and basic principles of fairness and equity show, however, the latter proposition cannot always carry the day. This is one of those cases.

[97] Accordingly, for the foregoing reasons, I would dismiss the appeal.

[98] The Respondent is entitled to its costs of the appeal, fixed at \$ 62,815.97 inclusive of GST and disbursements.

R.A. BLAIR J.A.

M. ROSENBERG J.A.:-- I agree.

J.M. SIMMONS J.A.:-- I agree.