IN THE COURT OF APPEAL OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

Hawker Siddley Power Engineering Ltd,
No. 18 / 1, Alfred Place,
Colombo 03.

Plaintiff

Vs.

National Insurance Corporation Ltd,
No. 47, Muttiah Road,
Colombo 02.

C.A. No. 351 / 95 F

Defendant

D.C. Colombo No. 10455 / MR

And Now Between

National Insurance Corporation Ltd,
No. 47, Muttiah Road,
Colombo 02.

Defendant-Appellant

Janashakthi Insurance Co. Ltd.,
No. 47, Muttiah Road,
Colombo 02.

Substituted Defendant-Appellant

Vs

Hawker Siddley Power Engineering Ltd,
No. 18 / 1, Alfred Place,
Colombo 03.

Plaintiff -Respondent

BEFORE : SISIRA DE ABREW J. and
UPALY ABEYRATHNE J.

COUNSEL : Nigel Hatch PC with Ms. P. Abeywickrema for the Substituted Defendant Appellant
Harsha Amarasekera for the Plaintiff Respondent

ARGUED ON : 26.07.2010
DECIDED ON : 28.01.2011

UPALY ABEYRATHNE, J.

The Plaintiff instituted an action in the District Court of Colombo seeking a judgment, on the first cause of action, for recovery of a sum of Rs. 3 million with interest thereon and on the second cause of action, for recovery of a sum of Rs. 1 million with interest and for a mandatory interim injunction directing the Defendant to pay the Plaintiff a sum of Rs. 3 million forthwith. The Defendant has filed his answer praying for a dismissal of the Plaintiff's action. The case proceeded to trial upon 07 issues. The learned District Judge after trial delivered judgment in favour of the Plaintiff. Being aggrieved by the said judgment dated 24.02.1995 the Defendant Appellant (hereinafter referred to as the Appellant) preferred the instant appeal to this court.

The facts of the case are briefly as follows; The Plaintiff Respondent (hereinafter referred to as the Respondent) had entered in to a contract with B.L. Power Construction Ltd. (BLPC) as per purchase order No S 1174 dated 07.10.1988 for installation of underground power cables in the city of Colombo for a sum of Rs. 30 million. The Respondent required BLPC to furnish the Respondent with an On Demand Bank Guarantee prior to the entering of the agreement. On the request of BLPC the Appellant had agreed to furnish the Respondent with an on demand Advance Payment Bond and a Performance Bond. The Respondent had agreed to accept the Appellant's guarantee and indemnity in lieu of Rs. 3 million being 10% of the total value of the order payable as advance to BLPC in terms of the said order No S 1174. Accordingly the Appellant had entered in to an Advance Payment Bond (APB) bearing No. AB/4906 dated 16.11.1988 with BLPC. The said APB was valid from 16.11.1988 to 15.11.1989 and subsequently, by an endorsement dated 29.01.1990, the validity of the said APB had been extended up to 15.11.1990. Also the Appellant, as surety of a Performance Bond No CB/4889 dated 31.10.1988, had agreed to pay Rs.01 Million to the Respondent. The said Performance Bond was valid from 31.10.1988 to 30.10 1989 and subsequently, by an Endorsement dated 29.01.1990, the validity of the said Performance Bond had been extended up to 30.10.1990.

The Respondent, in paragraph 19 and 20 of the plaint, has pleaded that BLPC has defaulted in the terms and conditions of its contract with the plaintiff" and "in consequence of the said default by BLPC the plaintiff has suffered loss and damages exceeding Rs. 4 million." According to the paragraphs 8 and 21 of the plaint by letters dated 03.09.1990 and 22.10.1990, the Respondent had made a demand on the APB and the Performance Bond to pay the said sum of money, namely Rs 3 million and Rs 1 million, to the Respondent.

The Respondent's position was that according to the terms and conditions of the said APB the Appellant has to pay the Respondent on demand to the extent of Rs.3 million and Respondent's decision as to the amount payable by the Appellant to the Respondent under and in terms of the APB shall be final and conclusive upon the Appellant. The learned counsel for the Respondent further contended that the said APB is an 'On Demand Performance Bond' to an extent of 3 million and the decision of the Respondent would be on any matter contained therein or as to the amount due shall be final and conclusive on the Appellant. The learned counsel heavily relied upon the following phrases of the APB. Namely;

> ".....your having agreed to accept our guarantee and indemnity in lieu of Rs. 3 million being 10% of the total value of the order payable as advance to the contractor in terms of the said order. We, National Insurance Corporation, hereby agree and undertake that we shall indemnify you on demand to the extent of Rs. 3 million ....."
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> "We National Insurance Corporation hereby agree that your decision on any of the matters herein or as to the amount payable by us hereunder shall be final and conclusive upon us."

Relying on the said terms the learned counsel for the Respondent contended that on a reading of document D 1 (APB), it is abundantly clear that the Appellant has to pay the Respondent on demand the sum claimed by him.

I now advert to the said submission. With regard to the said demand, the relevant part of the said APB is as follows;

> "M/S. Hawker Siddley Power Engineering Ltd.
> In consideration of your having placed an order No. S 1174 dated 07.11.1988 (a copy of which is enclosed and which may be treated as a part of document) upon M/S BL Power Construction Ltd. hereinafter called (the Contractor) for a sum of Rs.30,000,000/- Rupees Thirty Million only) for 'the Laying of Underground Cables (law & High Tension) in the City of Colombo' project and your having agreed to accept our guarantee and indemnity in lieu of Rs Three Million being 10% of the total value of the order payable as advance to the contractor in terms of the said order. We, National Insurance Corporation hereby agree and undertake that we shall indemnify you on demand to the extent of Rs. 3,000,000/- (Rupees Three Million only) against,
>
> 1. Any loss or damage or costs, charges or expenses suffered or incurred by you due to the breach or non-fulfilment or non-observance by the contractor, of any of the terms and conditions of the said order and all claims, demands and proceeding which may be made by or against you in connection therewith."

The Appellant, relying on the said terms and conditions of the APB, contended that he had agreed and undertaken to indemnify the Respondent on demand to the extent of Rs.3 million to cover only the mobilisation sum which was granted to the Respondent in order to commence the work and therefore the APB is restricted to the recovery of the advance payment. The Respondent's contention was that a demand under the APB is not restricted to the recovery of the advance payment. It is enforceable against any loss or damage or costs, charge or expenses suffered or incurred by the Respondent due to a breach or non-fulfilment or non-observance of any of the terms and conditions of the contract by BLPC.

The Respondent further submitted that upon the letters P 1 and P 2 in which BLPC had agreed to maintain the APB and the Performance Bond to cover any purpose, the

APB is not restricted to the recovery of the advance payment. In this regard the Appellant submitted that he had no knowledge about P 1 and P 2. They were communications between the Respondent and BLPC. Hence the APB could not be unilaterally altered by any private arrangement between the Respondent and BLPC. The Appellant drew the attention of court to the words "without affecting our liabilities and obligations" in Clause 3 of the APB. Clause 3 of the APB is as follows;

> '3. You may without affecting our liabilities and obligations hereunder grant time or other indulgence to or compound with the Contractor or enter in to any agreement or composition or agree to forbear to enforce any of the terms and conditions of the said order against the Contractor or agree to vary any of the terms and conditions of the said order.'

P 1 is a letter dated 27.03.1990 which has been sent by the Respondent to BLPC. From the said letter the Respondent has informed BLPC as follows;

> 'BL Power Ltd. must maintain the Advance Payment Bond at Three Million Rupees and Performance Bond at One Million Rupees. A written guarantee is required from BL Power that these bonds may be used for any purpose.'

Accordingly, BLPC in clear terms, by their letter dated 27.03.1990 (P 2) has confirmed that the APB at Three Million Rupees and Performance Bond at One Million Rupees would be maintained to cover any purpose. Hence it is manifestly clear that the APB has been maintained to cover any purpose. In view of the said circumstances the Appellant cannot now contend that the APB is restricted to the recovery of the Advance Payment. Although the Appellant contended that P 1 and P 2 are in contrary to Clause 3 of the APB, I cannot find any such disagreement in P 1 and P 2 with Clause 3 of the APB.

The Appellant further contended that since the Advance Payment of Rs. 3 million has been recovered from BLPC by the Respondent the demand made by the Respondent would amount to a fraud. In proof of that the Appellant has led evidence of Shiran Sebastian de Soysa, Company Chairman, BLPC to show the deductions which were made by the Respondent to

recover the Advance payment. Witness de Silva in his evidence has stated that on each occasion BLPC tendered an invoice to the Respondent for the work done, the Respondent deducted 10% from each payment made to BLPC to recover the sum paid by the Respondent as an Advance Payment. According to the witness the total sum so deducted as at 3rd August 1990 was Rs.4,411,632.33. In proof of these recoveries the Appellant has produced the books of account maintained by BLPC marked D 4. Folios 31 and 32 of D 4 which contain the recoveries on the Advance Payment, has been marked D 4 (c). According to D 4(c) the total sum that has been recovered by the Respondent is Rs.4,411,632.33. It is more than the Advance Payment granted to the Appellant. The total gross payment made to BLPC by the Respondent as at 03.08.1990 was Rs.29,410,882.14.

The learned counsel for Appellant cited the following passage in Sujan's LAW RELATING TO BUILDING CONTRCTS (2nd Edition 1993) at page 245 – 246 in support of his contention. Said passage is as follows; "The catena of cases cited above while laying down the general proposition that bank must honour the guarantee on demand without demur in terms of the guarantee bond recognises the exception in case of fraud (special equities). It is difficult to define the parameters of fraud. The decision on the point would depend on the facts of each case but an endeavour is made to clarify the point by giving obvious illustrations. Apart from the bank guarantee furnished by the builder to cover his obligation of performance of contract in general, in actual practice banks guarantees are also furnished by the builder (i) in lieu of earnest money; (ii) in lieu of security deposit and (iii) to cover the payment of mobilisation advances. In the case of (i) and (ii) in the event of the tender of the builder not accepted obviously attempt to enforce the bank guarantee, would be a fraud. In the case of (iii) if a mobilisation advance of say 20 lakhs have been given to the builder which according to the agreement is proportionately deducted from the running bills and while the construction has reached a stage of 50 per cent and half of the amount of the mobilisation advance has been recovered from the running bills the owner on some ground or the other rescinds the contract and seeks to enforce the bank guarantee to the full extent of 20 lakhs from the bank in terms of the guarantee, this would obviously be a case of fraud. In such an event the bank would be within its rights to refuse to honour the bank guarantee"

I cannot see any relevance of the said passage to the case before me. It has dealt with a situation where the amount of the mobilisation advance had been recovered from the running bills. Facts of the present case are not same as of the given illustration. In the present case there are terms included in the APB to cover any loss or damage incurred or suffered by the Respondent. Hence I cannot agree with the contention that the APB is restricted to the recovery of the Advance Payment. It is important to note that the witness Shiran Sebastian de Soysa, Chairman BLPC, who had been called by the Appellant to give evidence on his behalf, has admitted in his evidence that the Advance Payment Bond would be used not only for Advance Payment but for any purpose.

In the evidence of Shiran Sebastian de Soysa, he has further admitted that BLPC did not work as per schedule, the tiles they used were not up to the standard, since the jointing of cables were not being done properly the cables got damaged and thereby the cost of the project went up by about Rs. 10 million. (At pages 274,275 and 276 of the brief) At the cross examination of witness Shiran Sebastian de Soysa, the Respondent has produced the documents P 6, P 7 and P 8. The P 6 is a letter dated 27.09.1989. It has been sent to the Respondent by BLPC. It refers to a discussion they had with regard to quality of cable tiles. BLPC has stated therein as follows; "We confirm that we shall maintain strict quality control of all cable tiles manufactured by our suppliers. A quality assurance certificate shall be issued for all cable tiles to be used on this project. Our Engineers and Supervisors have also been given strict instructions in this regard and we assure you that the question of substandard cable tiles would not arise in the future."

P 7 too is a letter dated 06.10.1989. It also has been sent to the Respondent by an institution called Ewbank Preece. P 7 states as follows; "It is observed that quality of cable protection tiles has deteriorated considerably. We wish to stress that the quality of cable protection tiles should be up to the standard of original sample provided by HSPE (the Respondent) otherwise will be subject to rejection."

It is apparent from P 6 and P 7 that there had been a breach or non-fulfilment or non-observance of the terms and conditions of the contract by BLPC and thereby a loss or damage has been caused to the Respondent.

In the case of Edward Owen Engineering Ltd Vs Barclays Bank International Ltd [1978] Q.B. 159 Lord Denning examined the nature of the business transaction called a performance guarantee or a performance bond issued by a bank and the legal implications of such transaction. In this case a contracting party who caused a bank to issue a performance guarantee sought to restrain the bank by injunction from making payment on that guarantee. On the facts, the contracting party to whom payment was to be ultimately made (a Libiyan customer of the Plaintiff) was in default on the main contract but it was held that an injunction could not issue to restrain payment on the guarantee on that basis. Lord Denning, on an examination of parallel transactions opined as follows at page 983;

"So, as one takes instance after instance, these performance guarantees are virtually promissory notes payable on demand. So long as the Libiyan customers make an honest demand, the banks are bound to pay and the banks will rarely, if ever, be in a position to know whether the demand is honest or not. At any rate they will not be able to prove it to be dishonest. So they will have to pay. All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit. A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice."

In the case of Indica Traders (Pvt) Ltd. Vs Seoul Lanka Constructions (Pvt) Ltd. and Others [1994] 3 SLR 387 (CA) it was held that "The proper approach of a court to a consideration of an ex parte application for an interim injunction restraining a bank from paying under an irrevocable letter of credit (LC), a performance bond or guarantee should be to ask whether there is any challenge to the validity of the letter, bond or guarantee itself. If there is not or if the challenge is not substantial, prima facie no injunction should be granted and the bank should be left free to honour its contracted obligation although restrictions may well be imposed on the freedom of the beneficiary to deal with the money after he has received it. The wholly exceptional case where an injunction may be granted is where it is proved that the bank knows that any demand for payment already made or which may thereafter be made will clearly be

fraudulent. But the evidence must be clear, both (1) as to the fact of fraud and (2) as to the bank's knowledge. It would certainly not normally be sufficient that this rests on the uncorroborated statement of the customer, for irreparable damage can be done to a bank's credit in the relatively brief time which must elapse between the granting of such an injunction and an application by the bank to have it discharged.

Business transactions between a bank and a beneficiary, constituted in the nature of a performance bond, a performance guarantee, letter of guarantee or irrevocable letter of credit, whereby the bank is obliged to pay money to a beneficiary, are not tripartite transactions between the bank (surety) the beneficiary (creditor) and the party at whose instance the bond, guarantee or letter is issued (the principal debtor) but, simply transactions between the bank and the beneficiary. A bank thereby guarantees to the beneficiary payment of money and is obliged to honour that guarantee according to its terms. Any dispute that may arise between the beneficiary (creditor) and the party at whose instance the guarantee or letter is given (the principal debtor), on the underlying contact, cannot be urged to restrain the bank from honouring the guarantee or letter according to its terms."

In the case of Bolivinter Oil SA v. Chase Manhattan Bank and others (1984) 1 All ER 351 Sir John Donaldson MR stated as follows: "Judges who are asked, often at short notice and ex parte, to issue an injunction restraining payment by a bank under an irrevocable letter of credit or performance bond or guarantee should ask whether there is any challenge to the validity of the letter, bond or guarantee itself. If there is not or if the challenge is not substantial, prima facie no injunction should be granted and the bank should be left free to honour its contractual obligation, although restrictions may well be imposed on the freedom of the beneficiary to deal with the money after he has received it. The wholly exceptional case where an injunction may be granted is where it is proved that the bank knows that any demand for payment already made or which may thereafter be made will clearly be fraudulent. But the evidence must be clear, both as to the fact of fraud and as to the bank's knowledge. It would certainly not normally be sufficient that this rests on the uncorroborated statement of the customer, for irreparable damage can be done to a bank's credit in the relatively brief time which must elapse between the granting of such an injunction and an application by the bank to have it discharged."

When I consider the facts of this case on the above context I am of the view that the Appellant has failed to adduce evidence to establish any fraud on the demand that has been made upon the APB and the Performance Bond. Therefore the demand that has been made upon the APB and the Performance Bond will not amount to a fraud. The learned trial judge has considered the said circumstances in the correct perspective. Hence I dismiss the appeal of the Appellant with costs.

Appeal dismissed.

Judge of the Court of Appeal

SISIRA DE ABREW, J.

I agree.

Judge of the Court of Appeal