

IN THE COURT OF APPEAL OF THE

DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

*In the matter of an Application for
Leave to Appeal in terms of Section 754
(2) of the Civil Procedure Code (as
amended) from the Order dated 2005-
10-20 made by Hon. District Judge of
Colombo in DC Colombo Case No. 7172/
Spl*

C A (L A) No. 455 / 2005

D C Colombo Case No.

7172 / Spl

Galle Multipurpose Co-operative Society

Limited

No. 67,

W D S Abeygunawardena Mawatha,

Pettigala Watte,

Galle.

PLAINTIFF

-Vs-

1. Morawakkoralage Gajeru Waluwe Anton
Buddhika Abayakoon,
2. Morwakkoralage Gajeru Waluwe Charith
Ranga Abayakoon,
3. Morawakkoralage Gajeru Waluwe
Himanthi Merina Abayakoon,
of, No. 139/10,
Pagoda Road,
Pitakotte
4. Pan Asia Bank Limited
No. 450,
Galle Road,
Colombo 03
5. Seylan Bank Limited
Ceylinco Seylan Towers,

No. 09,
Galle Road,
Colombo 03.

DEFENDANTS

AND

Pan Asia Banking Corporation Limited
(previously known as Pan Asia Bank
Limited)

No. 450,
Galle Road,
Colombo 04

4th DEFENDANT-PETITIONER

Vs

1. Galle Multipurpose Co-operative Society
Limited, No. 67,

W D S Abeygunawardena Mawatha,

Pettigala Watte, Galle.

PLAINTIFF - RESPONDENT

2. Morawakkoralage Gajeru Waluwe Anton

Buddhika Abayakoon,

3. Morwakkoralage Gajeru Waluwe Charith

Ranga Abayakoon,

4. Morawakkoralage Gajeru Waluwe

Himanthi Merina Abayakoon,

of, No. 139/10,

Pagoda Road,

Pitakotte

1st-3rd DEFENDANT- RESPONDENTS

5. Seylan Bank Limited

Ceylinco Seylan Towers,

No. 09,

Galle Road,

Colombo 03.

5th DEFENDANT- RESPONDENT

Before: Vijith K. Malalgoda PC J (P/CA)

P. Padman Surasena J

Counsel: S A Parathalingam PC with Varuna Senadhira for the 4th
Defendant- Petitioner

Ikram Mohamed PC for the Plaintiff-Respondent

Hiran de Alwis for the 5th Defendant - Respondent

Argued on: 2016-03-08 and 2016-06-06

Written submissions for the 5th Defendant Respondent on: 2016-06-22

Written submissions for the Plaintiff Respondent on: 2016-07-01

Written submissions for the 4th Defendant Petitioner was not filed up until
2016-07-05 (*time granted was 3 weeks since 2016-06-06*)

Decided on: 2016-07-26

JUDGMENT**P Padman Surasena J**

The Plaintiff Respondent was appointed as a dealer for the distribution of "Lakcow" milk powder, for the district of Galle for a period of 01 year, as per the agreement dated 2002-09-17 marked **P 1 (b)**.

Under and in terms of the said agreement, the Plaintiff Respondent and the 1st - 3rd Defendant Respondents agreed inter alia,

- I. that in respect of the said appointment the Plaintiff Respondent should furnish a bank guarantee for a sum of Rs 01 million in favour of the Manager of the Bambalapitiya branch of the 4th Defendant Petitioner,
- II. that in the event of the termination of the said agreement which can be done by giving a notice of 30 days, 1st - 3rd Defendant Respondents are entitled to appoint another distributor for the said area and the said bank guarantee would be discharged.

After furnishing the said bank guarantee the Plaintiff Respondent was appointed as a dealer by the 1st - 3rd Defendant Respondents and the

Plaintiff Respondent functioned in that capacity. On 2003-02-05 the Plaintiff Respondent requested 1st - 3rd Defendant Respondents to terminate the said agreement. Plaintiff Respondent further requested the 5th Defendant Respondent to discharge the said bank guarantee.

In the meantime the Plaintiff Respondent instituted case No. 2973 / Spl in the District Court of Galle against the Respondents and obtained an enjoining order preventing the Plaintiff Respondent claiming from the said bank guarantee.

By order dated 2004-10-01 learned Additional District Judge of Galle dismissed the said action of the Plaintiff Respondent holding that the court has no jurisdiction to hear and determine that action.

In the meantime plaintiff Respondent filed the instant case in the District Court of Colombo praying *inter alia*,

- a) for a declaration that the bank guarantee marked **P 1 (c)** is a bank guarantee only in respect of monies due to the 1st - 3rd Defendant Respondents from the Plaintiff Respondent and / or,

- b) for a declaration that the said Bank guarantee is not a bank guarantee issued in respect of the monies due to the 4th Defendant Petitioner from the 1st - 3rd Defendant Respondents,
- c) for a declaration that no monies are due to the 1st - 3rd Defendant Respondents from the Plaintiff Respondent on the said bank guarantee
- d) for a declaration that Petitioner is not entitled to claim from the 5th Defendant Respondent on the said bank guarantee any money due to the Petitioner from 1st - 3rd Defendant Respondents and / or 5th Defendant Respondent its servants, agents and officers are not entitled to pay the Petitioner its servants, agents and officers on the said bank guarantee.
- e) for a permanent injunction, preventing the 4th Defendant Petitioner its servants, agents and officers recovering any money from the 5th Defendant Respondent on the said bank guarantee,
- f) for a permanent injunction, preventing the 5th Defendant Respondent its servants, agents and officers paying any money to the Petitioner on the said bank guarantee,

g) enjoining order/ interim injunction preventing the 5th Defendant Respondent from paying any money to the Petitioner its servants, agents and officers on the said bank guarantee.

The learned District Judge of Colombo by the order dated 2005-10-20 issued an interim injunction preventing the 4th Defendant Petitioner from claiming and preventing the 5th Defendant Respondent from paying the 4th Defendant Petitioner any money from the said bank guarantee. The said order is marked and produced as **P 6**.

Thereafter the 4th Defendant Petitioner filed this application in this court seeking leave to appeal from the said order dated 2005-10-20 of the learned District Judge of Colombo.

This court on 2006-07-27 has granted leave to appeal to the 4th Defendant Petitioner on the following questions:

- I. has the learned District Judge misdirected himself with regard to the terms and conditions and the purpose of the bank guarantee marked **P 1 (c)** and annexed to the Petition
- II. in all circumstances of this case did learned District Judge err in law in issuing interim injunction preventing the 4th Defendant Petitioner

claiming from the 5th Defendant Respondent and / or preventing the 5th Defendant Respondent in making payment to the 4th Defendant Petitioner under the said bank guarantee marked **P 1 (c)**.

III. has learned District Judge erred in law and in fact by holding that in the event an interim injunction is issued no loss will be caused to the 4th Defendant Petitioner¹.

Therefore the task before this court at this moment is to find answers to the above 3 questions.

Letter of guarantee dated 2003-01-13 issued by the 5th Defendant Respondent (Seylan Bank) addressed to the Manager, Pan Asia Bank Bambalapitiya Branch (4th Defendant Petitioner) is marked and produced as **P 1 (c)** .

According to the said letter of guarantee,

I. 1st - 3rd Defendant Respondents (who carry on a business in partnership) have requested from 4th Defendant Petitioner (Pan Asia Bank) for credit facilities amounting to Rs 1 million for the distribution

¹ Journal entry dated 2006-07-27 of the docket maintained in this Court pertaining to this case.

of "Lakcow" milk powder to Galle Multipurpose Co-operative Societies Limited (Plaintiff Respondent).

II. The 4th Defendant Petitioner (Pan Asia Bank) has agreed to grant the said facilities on condition that 1st - 3rd Defendant Respondents furnish a bank guarantee from a reputed bank to the value of Rs 01 million in favour of the Manager Pan Asia Bank, Bambalapitiya branch Colombo 04, for the purpose of distribution and sale of "Lakcow" milk powder.

III. the 5th Defendant Respondent (Seylan Bank) has guaranteed and undertaken to pay the 4th Defendant Petitioner (Pan Asia Bank) a sum not exceeding Rs. 01 million in the event the Plaintiff Respondents fails or neglects to pay the said sum of money on the due date under a credit agreement between the 4th Defendant Petitioner (Pan Asia Bank) and the 1st - 3rd Defendant Respondents

IV. that this guarantee would be in force from 2003-01-13 to 2004-01-12

Learned District Judge of Colombo in his Order dated 2005-10-20 has held

a) that the 1st - 3rd Defendant Respondents had agreed to discharge the bank guarantee on payment of Rs 244,440.00 by the Plaintiff Respondent as the total payment due

- b) that there is no money due to the 1st - 3rd Defendant Respondents from the Plaintiff Respondent,
- c) that the said bank guarantee was continued to be retained as a security for the credit facilities obtained by 1st - 3rd Defendant Respondents,
- d) that the Plaintiff Respondent has no connection in the said credit facilities obtained by the 1st - 3rd Defendant Respondents and hence the Plaintiff respondent is not responsible for the said credit facilities
- e) that the action filed in the District Court of Galle in this regard under No. 2973 / Spl has been dismissed and the appeal lodged there to has also been withdrawn
- f) that the 4th Defendant Respondent bank is not entitled to retain the bank guarantee as a security for the credit facilities obtained by the 1st - 3rd Defendant Respondents as there is no payment due from the Plaintiff Respondent
- g) that in these circumstances the Plaintiff Respondent is entitled *prima facie* to get the bank guarantee discharged.

Some of the clauses relevant to the bank guarantee [**P 1 (C)**] referred to in the agreement [**P 1 (b)**] between 1st - 3rd Defendant Respondents and the Plaintiff Respondent are reproduced below.

Clause 2: "The distributor shall be appointed as the sole distributor to sell and distribute the said merchandise in Sri Lanka in an area specified in writing by the Marketing Manager which is explained in the annexed schedule."

Clause 3: "For the aforesaid purpose the distributor shall have a bank guarantee of Rs 1 million only for the purpose of distribution and sale of "Lakcow" milk powder in favour of the Manager Pan Asia Bank, Bambalapitiya branch Colombo 04."

Clause 11: "If the distributor furnishes a bank guarantee of Rs one Million the supplier shall at the cost and expense of the supplier make available a sales representative for the purpose of distribution and marketing the merchandise."

Clause 12: "At time of collecting the merchandise the distributor shall issue a cheque of the person giving the bank guarantee for the entire value of the merchandise so collected in favour of the supplier."

Clause 18: "If the distributor wishes to terminate this agreement before the expiry of the agreed period shall give notice in writing and 30 days thereafter the supplier shall appoint another distributor that area and release the bank guarantee of the distributor."

Clause 19: "This agreement shall be valid and in force for 1 year from the date of signing."

The condition that has been agreed upon between the 4th Defendant Petitioner (Pan Asia Bank) and the 5th Defendant Respondent (Seylan bank) is for the 5th Defendant Respondent to guarantee and undertake to pay the Petitioner a sum not exceeding Rs 1 million in the event the 1st - 3rd Defendant Respondents fail or neglect to pay the said sum of money on the due date under a credit agreement between the 4th Defendant Petitioner (Pan Asia Bank) and the 1st - 3rd Defendant Respondents for the purpose of distribution and sale of "Lakcow" milk powder in a specified area.

The purpose as to why this credit facility was granted by the 4th Defendant Petitioner (Pan Asia Bank), is mentioned in the Letter of Guarantee as "**for the distribution of "Lakcow" milk powder to Galle Multi Purpose**

**Co-operative Society Ltd. of No. 67, W D S Abeygunawardane
Mawatha, Pettigala watta, Galle."**

Therefore the liability of the 5th Defendant Respondent (Seylan Bank) to pay the guaranteed amount arises "in the event the principle fails or neglects to pay the said sum of money on the due date under a credit agreement between the beneficiary and the principle." "Principle" here means 1st - 3rd Defendant Respondents. "Beneficiary" in this agreement means the 4th Defendant Petitioner (Pan Asia Bank). The credit agreement referred to in the above phrase means the credit facility granted by the 4th Defendant Petitioner (Pan Asia Bank), for the purpose of distribution of "Lakcow" milk powder to Galle Multi Purpose Co-operative Society Ltd .

The said Letter of Guarantee revolves around four parties. They are 4th Defendant Petitioner (Pan Asia Bank), 5th Defendant Respondent (Seylan Bank), 1st - 3rd Defendant Respondents, Galle Multi Purpose Co-operative Society Ltd (Plaintiff Respondent).

In the case of Indica Traders (Pvt) Ltd v Seoul Lanka Constructions (Pvt) Ltd. and others, S N Silva J President Court of Appeal as he then was, has stated as follows:

"It is thus clear that business transactions between a bank and a beneficiary, constituted in the nature of a performance bond, a performance guarantee, letter of guarantee or a 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 contract cannot be urged to restrain the bank from honouring the guarantee or letter according to its terms, In an application for an injunction to restrain the bank from making payment, the Court has to consider whether there is a challenge to the validity of the bond, guarantee or letter itself, upon which payment is claimed and whether the conditions as specified in the writing are satisfied. If the challenge to the validity is not substantial and the conditions as specified in the writing are

met, prima facie no injunction should be granted and the bank should be left free to honour its obligation.

The only exception to this general rule is where it is established by the party applying for the injunction that a claim for payment upon such bond, guarantee or letter is clearly fraudulent. A mere plea of fraud put in for the purpose of bringing the case within this exception and which rest on the uncorroborated statement of the applicant will not suffice. An injunction may be granted only in circumstances where the Court is satisfied that the bank should not affect payment. Therefore, an injunction may be granted on the ground of fraud only where there is clear evidence as to:

(i) the fact of fraud and,

(ii) the knowledge of the bank as to the facts constituting the fraud."²

It must be remembered that in that case this Court has taken in to consideration the fact that there is payment due from the Plaintiff in that case³.

² (1994) 3 SLR 387

³ (Ibid) at paragraph 2 of page 395

This has been followed in the subsequent case of Hemas Marketing (Pvt) Ltd. V. Chandrasiri and others⁴ in which case also this Court had taken in to consideration the fact that a sum, far in excess of the bank guarantees was due to Hemas Marketing (Pvt) Ltd⁵.

As per the above judgment in Indica Traders (PVT) LTD v Seoul Lanka Constructions (Pvt) Ltd. and others⁶, In an application for an injunction to restrain the bank from making payment, the following questions namely,

- I. whether there is a challenge to the validity of the bond, guarantee or letter itself, and
- II. whether the conditions as specified in the writing are satisfied.

must be considered by Courts. Further, the Court should issue no injunction and the bank should be left free to honour its obligation, only if the challenge to the validity is not substantial and the conditions as specified in the writing are met, prima facie.

It is the view of this Court that in the instant case, there exists serious challenges,

⁴ (1994) 2 SLR 181

⁵ (Ibid) at paragraph 2 of page 185

⁶ (Supra)

- I. to the validity of the Letter of Guarantee in particular, the purpose it is sought to be used, and
- II. whether the conditions as specified in the Letter of Guarantee are satisfied.

Two of the judgments pronounced by this Court namely, Pan Asia Bank Ltd Vs. Bentota MPCs Ltd and another⁷ which was decided by this Court in the year 2005 and Pan Asia Bank Ltd Vs. Kandy Multipurpose Co-operative Society and others⁸ which was decided by this Court in the year 2007, need to be mentioned here as they have been brought to our notice. In both these cases, the facts

- I. that each of the respective Co-operative was not indebted to their supplier
- II. that the purpose of the bank guarantee is for the appointment as a distributor of "Lakcow" milk powder

were not disputed.

Hence a question arises as to why each of those Co-operatives should still pay a further sum of money to their respective suppliers and as to how and

⁷ (2012) 1 SLR 50

⁸ (2012) 1 SLR 78

on what basis could each of those Co-operatives be made liable to pay such additional sum. The position taken up by the 1st - 3rd Defendant Respondents is that the bank guarantee was kept as a security for the credit facility provided to them by the 4th Defendant Petitioner. If that is the case this Court is unable to find any acceptable answer to the question as to why a Co-operative would want to keep a bank guarantee from their bank to secure a transaction which it has no connection taking the full risk of its encashment. Further, such a move on the part of the 1st - 3rd Defendant Respondents if they had done so, would be a clear indication of a possible fraud also. Indeed it was the position of the Plaintiff Respondent that there exists such a fraud.⁹ This aspect of the case appear to have not been considered in the above two judgments and that prompts us to desist ourselves from following those two judgments.

As shown before, a distinguishable feature in the cases of Indica Traders (Pvt) Ltd Vs. Seoul Lanka Constructions (Pvt) Ltd. and others¹⁰ and Hemas

⁹ Paragraph 16 of the affidavit dated 2004-10-21 filed in DC on behalf of the Plaintiff Respondent marked P 2.

¹⁰ (Supra)

Marketing (Pvt) Ltd. Vs. Chandrasiri and others¹¹ is the existence of the undisputed fact that the money is due to the beneficiary.

In these circumstances, and for the foregoing reasons, this Court answers,

- 1) the 1st issue for which leave to appeal was granted by this Court, holding that the learned District Judge has not misdirected himself with regard to the terms and conditions and the purpose of the bank guarantee marked **P 1 (c)** and annexed to the Petition.
- 2) the 2nd issue for which this Court has granted leave to appeal, holding that in all the circumstances of this case the learned District Judge did not err in law in issuing the interim injunction preventing the 4th Defendant Petitioner claiming from the 5th Defendant Respondent and / or preventing the 5th Defendant Respondent in making payment to the 4th Defendant Petitioner under the said bank guarantee marked **P 1 (c)**.

In view of the answer provided by this Court to the question No. (ii) above answering the issue No. (iii) would not arise. That is because this Court has taken the view that it is justifiable in all the circumstances of this case for the learned District Judge to have an interim injunction issued.

¹¹ (Supra)

For the reasons set out above, we direct that this appeal be dismissed with costs.

We further direct that the learned District Judge of Colombo should be free to decide on the issues pertaining to this case after considering the evidence that would be adduced in the trial pending before him. The conclusions arrived at by this Court in this judgment should be treated as those necessitated for the purpose of disposal of this appeal which is restricted only to the question of issuance of interim injunction.

JUDGE OF THE COURT OF APPEAL

Vijith K. Malalgoda PC J

I agree,

PRESIDENT OF THE COURT OF APPEAL