HEMAS MARKETING (PVT) LTD.
V.
CHANDRASIRI AND OTHERS

COURT OF APPEAL.
S. N. SILVA, J. (P/CA),
R. B. RANARAJA, J.
C.A. (REV.) 1012/93.
D.C. COLOMBO 3818/SP.
C.A. (REV.) 1013/93.
D.C. COLOMBO NO. 3819/SP.
C.A. (REV.) 1014/93.
D.C. COLOMBO NO. 3820/SP.
(TAKEN TOGETHER)
SEPTEMBER 09, 1994.

Injunctions – Bank Guarantees – Duty of Bank under guarantees.

In the absence of a *prima facie* case being made out an injunction should not have issued restraining payment on the bank guarantees given against due performance.

A guarantee is an accessory contract by which the promisor undertakes to be answerable to the promisee for the debt, default or miscarriage of another person

whose primary liability to the promisee must exist or be contemplated. Bank Guarantees were established as a universally acceptable means of payment equivalent to cash in trade and commerce, on the basis that the promise of the issuing bank to pay was wholly independent of the contract between the buyer and seller and the issuing bank would honour its obligations to pay regardless of the merits or demerits of the dispute between the buyer and the seller.

When a bank has given a guarantee, it is required to honour it according to its terms and is not concerned whether either party to the contract which underlay the contract was in default. The whole purpose of such commercial instruments was to provide security which was to be readily, promptly and assuredly realisable when the prescribed event occurred.

The only exception to the rule is where fraud by one of the parties to the underlying contract has been established and the bank had notice of the fraud. A mere plea of fraud put in for the purpose of bringing the case within this exception and which rests on the uncorroborated statements of the applicant will not suffice.

An injunction may be granted only in circumstances when the court is satisfied that the bank should not effect payment.

Per Ranaraja, J: "It is only in exceptional circumstances that courts will intefere with the machinery of obligations assumed by the banks. They are the lifeblood of international commerce. Such obligations are regarded as collateral to underlying rights and obligations between merchants at either end of the banking chain. Courts will leave the merchants to settle their disputes under the contracts by litigation."

Cases referred to:

1. *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.* (1978) 1 All ER 976, 981.
2. *Power Curber International Ltd. v. National Bank of Kuwait* SAK [1981] 3 All ER 607.
3. *Siporex Trade SA v. Banque Indo Suez* (1986) 2 Lloyd's Law List Reports 146.
4. *Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd.* [1977] 2 All ER 862.
5. *Boliventer Oil SA v. Chase Manhattan Bank* [1984] 1 All ER 351, 352.
6. *Indika Traders v. Seoul Lanka Construction (Pvt) Ltd.* CA 916/93.

APPLICATION in revision of the Orders of the District Court of Colombo.

K. Kanag-Iswaran, P.C. with *K. M. Basheer Ahamed* and *Ajit Perera* for 1st defendant-petitioner.

E. D. Wikramanayake with *D. Phillips* for plaintiff-respondent.

S. Sivarasa P.C. with *S. R. de Livera* for 2nd defendant-respondent in C.A. 1012/93.

S. A. Parathalingam with *L. R. Vitharna* for 2nd defendant-respondent in C.A. 1013/93.

Cur. adv. vult.

October 20, 1994.

RANARAJA, J.

When these three applications came for hearing on 24.6.94, Counsel for the respective parties agreed that the matters to be argued were substantially the same and that they could be decided in one order. They also agreed that the issue before this court was whether the learned District Judge was correct in granting an interim injunction restraining and/or stopping the 1st defendant receiving and/or demanding any sum of money whatsoever on the bank guarantees marked "E", "F" and "G" and produced in the respective applications.

The 1st and 2nd plaintiffs-respondents who are husband and wife were partners in the business known as "Erandis". They instituted action No. 3818/sp in the District Court, Colombo, against the 1st defendant-respondent, Hemas Marketing (Pvt) Ltd. to recover a sum of Rs. 6 million and interest thereon, for unlawfully and wrongfully acting in violation of the agreement marked "B" entered into by them. By that agreement, Erandis were nominated as the agent for the re-distribution for the products of Hemas listed in annexure 1 thereto, in the areas given in annexure 11. The goods were to be issued up to the value of the credit limit determined on the basis of security provided by Erandis. The complaint of Erandis appears to be that Hemas without taking steps to terminate the agreement as provided in clause 14 therein, by letter dated 17.8.93 (which date it is submitted by Hemas should read as 17.8.93), delivered on 17.9.93, had requested

Erandis to transfer the balance stocks in their stores to Ranveli Traders. Clause 14 provides for the termination of the contract by either party by giving one months clear notice to the other. Erandis also prayed for an enjoining order and interim injunction restraining the Hemas from demanding and/or receiving any money on the bank guarantee "E" from 2nd defendant Seylan Bank. Actions Nos: 3818/sp and 3820/sp were for injunctive relief restraining Hemas from demanding and/or receiving any money on bank guarantee "F" and "G" from the respective 2nd defendant banks.

Hemas filed objections admitting the agreement with Erandis and relied on clauses 12 and 13 therein to justify their action. These clauses permitted Hemas to make alternative arrangements regarding the distribution of their goods in the event Erandis were not in a position to comply with the provisions of the agreement. The cause for Hemas taking the steps they did, was that Erandis were unable to pay for the goods supplied by Hemas on schedule. At a discussion held on 9.8.93 between the parties, on several cheques issued by Erandis being dishonoured by the banks, a settlement, which was subsequently confirmed by letter dated 10.8.93, was arrived at whereby Erandis agreed to pay a total sum of Rs. 2,058,826.72, outstanding at that date, in instalments over the period 14.8.93 to 1.10.93. Pursuant to this settlement Hemas issued to Erandis goods to the value of Rs. 238,682.00 on 11.8.93. In terms of the settlement these purchases were to be paid within a period of one month. Admittedly, up to 17.9.93, Erandis had paid only a sum of Rs. 256,312.22 in terms of the settlement. Three cheques for Rs. 201,831.14, Rs. 298,882.89 and Rs. 205,889.98 respectively had been returned dishonoured. Hemas have filed a statement of accounts marked X3, which shows that a sum of Rs. 2,069,852.21 was due to them from Erandis as at 30.9.93. Thus it is the position of Hemas that Erandis had failed to abide by the conditions of the settlement of 9.8.93 and therefore they were within their rights when they made other arrangements to distribute their products through Ranweli Traders. They do not concede that there was a termination of the agreement "B" between the parties.

The learned District Judge in three orders given in the respective actions on 9.12.93 has concluded that Hemas had terminated the

agreement "B" without giving 30 days notice and that they acted unreasonably in so doing, "within a few days of the settlement on 9.8.93", despite the fact that Erandis had paid a sum of Rs. 286,312.22 on 14.8.93. He also concluded that the bank guarantees were not payable on demand and in any event, no demand could be made as Hemas had not established that any money was due to them from Erandis.

It is clear that the learned District Judge has not based his orders on a proper consideration of the pleadings, documents and written submissions before him. The main issue that was before the Judge was whether Erandis had established a *prima facie* case. It is significant that none of the orders refers to the claim of Rs. 6 million by Erandis against Hemas. In the plaints there is no reference to the termination of agreement "B". What is stated is that Hemas acted in violation of the terms of the agreement in requesting Erandis to hand over the stocks in their custody to Ranveli Traders. Hence the question of 30 days notice did not arise. Admittedly, Erandis had paid only a sum of Rs. 286,312.22 to Hemas between 9.8.93 and 17.9.93. It is not denied that three other cheques issued by Erandis had been dishonoured during this period. It is also admitted that Erandis had instructed their bank to stop payments on cheques issued by them. This is a clear breach of the settlement arrived at between the parties on 9.8.93. A total sum of Rs. 2,069,852.21 was due to Hemas as at 30.9.93. This is not disputed. This sum is far in excess of the three bank guarantees which totalled Rs. 1,100,000.00. The Plaints filed in the three actions did not disclose the basis on which the loss of Rs. 6 million claimed by Erandis was quantified. In the circumstances, there was no material sufficient to establish a *prima facie* case before court on which the interim injunctions could have issued.

Learned President's Counsel for the 1st defendant-petitioner submitted that the learned District Judge was in error when he issued the interim injunctions. He cited several authorities in support. The principles which emerge from these authorities could be summarised as follows. Bank guarantees are not guarantees as understood in the common law. A guarantee is an accessory contract by which the promisor undertakes to be answerable to the promisee for the debt,

default or miscarriage of another person whose primary liability to the promisee must exist or be contemplated. (Halsbury's Law of England (4th Ed) Vol. 20). Bank guarantees like letters of credit and performance bonds are a "new creature" of the commercial world. (per Lord Denning *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.*[1]. They were established as a universally acceptable means of payment equivalent to cash in trade and commerce, on the basis that the promise of the issuing bank to pay was wholly independent of the contract between the buyer and the seller and the issuing bank would honour its obligations to pay regardless of the merits or demerits of the dispute between the buyer and the seller. *(Power Curber International Ltd. v. National Bank of Kuwait* [2]). When a bank has given a guarantee, it is required to honour it according to its terms and is not concerned whether either party to the contract which underlay the contract was in default. *(Edward Owen – (supra))*. The whole purpose of such commercial instruments was to provide security which was to be readily, promptly and assuredly realisable when the prescribed event occurred. No bank is obliged to give such a guarantee unless they wished to and no doubt when they did so they properly exacted commercial terms and protected themselves by suitable cross indemnities. *Siporex Trade SA v. Banque Indo Suez* [3]. It is only in exceptional circumstances that courts will interefere with the machinery of obligations assumed by the banks. They are the lifeblood of international commerce. Such obligations are regarded as collateral to underlying rights and obligations between merchants at either end of the banking chain. Courts will leave the merchants to settle their disputes under the contracts by litigation.The courts are not concerned with the difficulties to enforce such claims. These are risks which merchants take *Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd.*[4]. If court interferes with a bank's undertaking it will undermine its greatest asset – its reputation for financial and contractual probity. Sir Donaldson MR. – *Boliventer Oil SA v. Chase Manhattan Bank* [5]. The only exception to that rule is where fraud by one of the parties to the underlying contract has been established and the bank had notice of the fraud. *(Edward Owen – supra, Boliventer – supra)*. A mere plea of fraud put in for the purpose of bringing the case within this exception and which rests on the uncorroborated statements of the applicant will not suffice. An injunction may be granted only in

circumstances when the court is satisfied that the bank should not effect payment. (S. N. Silva, J. – *Indika Traders v. Seoul Lanka Construction (Pvt) Ltd.)*[6].

On the face of guarantees "F" and "G" they are payable on demand. The guarantee X5 for Rs. 500,000/- issued by Seylan Bank gives the undertaking to pay the beneficiaries that sum in the event the principal fails or neglects to pay the said sum of money on the due date under the credit agreement between the beneficiary and the principal. It is clear that Erandis had failed to pay the sums due on goods delivered by Hemas on credit as at 17.9.93. This satisfies the condition in the guarantee. The court in any event did not have to concern itself with the merits or demerits of the beneficiary's claim as there was no fraud alleged.

An allegation has been made that the three defendant banks were acting in collusion with Hemas to enable the latter to receive the sums due on the three guarantees. There is no material to support this allegation.

The fact that Seylan Bank had not objected to the interim injunction issuing does not preclude this court from discharging the interim injunctions which have been improperly granted. (*Harbottle – supra).*

The orders of the District Judge dated 9.12.93 in the three actions DC 3818/sp, 3819/sp and 3820/sp are accordingly set aside. The applications Nos. CA 0112/93, CA 1013/93 and CA 1014/93 are allowed with costs.

S. N. SILVA, J. – I agree.

Applications allowed.