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

In the matter of an Appeal in terms of Sec. 754(1) Of the Civil Procedure Code read together with Sec. 5(1) of the High Court of the Provinces (Special Provisions) Act No. 10 of 1996.

SC (CHC) Appeal No. 18/09
H.C.(Civil) Case No. 140/2003(1)

People's Bank,
No. 75, Sir Chittampalam A Gardiner Mawatha, Colombo 2.

Plaintiff

Vs

Sri Lanka Insurance Corporation Ltd.,
No. 21, Vauxhall Street, Colombo 2.

Defendant

AND NOW

Sri Lanka Insurance Corporation Ltd.,
No. 21, Vauxhall Street, Colombo 2.

Defendant Appellant

Vs

People's Bank,
No. 75, Sir Chittampalam A Gardiner Mawatha, Colombo 2.

Plaintiff Respondent

BEFORE **: S. EVA WANASUNDERA PCJ,**

UPALY ABEYRATHNE J, &

K. T. CHITRASIRI J.

COUNSEL **:** Nihal Fernando PC with Ms. Rhadeena De Alwis and K.U. Gunasekera for the Defendant Appellant.

Kushan D'Alwis PC with Rajiv Wijesinghe and Thilani Seneviratne for the Plaintiff Respondent.

ARGUED ON **: 08. 08.2016.**

DECIDED ON **: 17.03.2017.**

S. EVA WANASUNDERA PCJ.

In this matter, at the end of the hearing on 08.08.2016, Judgment was reserved by Hon. Justice K.T. Chithrasiri. Thereafter, I had the benefit of reading the draft judgment written by my brother Hon. Justice K. T. Chithrasiri with which I do not agree. As such I am writing this judgment in the following manner.

This Appeal arises **from two Guarantees** issued by the Defendant Appellant, the Sri Lanka Insurance Corporation Ltd., (hereinafter referred to as the Appellant SLIC), to the Plaintiff Respondent , the People's Bank (hereinafter referred to as the Respondent Peoples' Bank) on behalf of a company by the name of BAT International S.P.A. (hereinafter referred to as BAT International). **The Appellant SLIC is the Guarantor** and the Respondent Peoples' Bank is the receiver of the Guarantee.

The facts in brief are as follows. The Road Development Authority had awarded a contract to BAT International to perform road rehabilitation work on Galle – Matara, Matara – Akuressa and Matara – Hakmana sections of the road. BAT International was a customer of the Respondent Peoples' Bank and had maintained a current account at the Corporate Branch of the Respondent Peoples' Bank. BAT International had applied for over draft facilities on **two occasions**. The Respondent Bank had granted those facilities for **Rs. 15 million and Rs. 3 million** to the BAT International on the undertaking that all the payments that are to be made to BAT International by the Road Development Authority will be deposited into the current account maintained by BAT International in the Respondent Bank and **also on the condition that BAT International should provide a Guarantee from the Appellant, the Sri Lanka Insurance Corporation Limited,** for the repayment of the overdraft facilities as aforementioned amounting to **Rs. 18 million**. Accordingly two Guarantees were issued by the Appellant .

BAT International fell into arrears on payment. It made use of the overdraft facilities. The money due to them from the Road Development Authority kept on coming into the account but **at a particular time, BAT International had overdrawn the facilities over and above the limit of Rs. 18 million.** The Respondent Bank had to make the demand on the Guarantee within the guarantee period and so it did. The Appellant failed to honour the guarantee. Therefore the Respondent Bank filed action in the Commercial High Court against the Gaurantor, the Appellant. The Commercial High Court granted the reliefs as prayed for by the Plaintiff, the Respondent Peoples' Bank. Being aggrieved by the judgment of the High Court the Appellant SLIC has appealed to this court.

The contention of the Appellant SLIC is that the Respondent Bank should have filed action against the company BAT International first and then only the Bank gets the right to file action against the guarantor on the Guarantee. **The contention of the Respondent Peoples' Bank** is that the Guarantee is in place for the Guarantor to pay on demand and therefore the Appellant is duty bound to pay when the company whose payment was guaranteed by the Appellant, failed to perform its duty to make payments to the Respondent Bank.

The Respondent Bank filed action on 03.06.2003 praying for judgment in favour of the Bank and against the Appellant , the Sri Lanka Insurance Corporation in a sum of Rs. 18 million to be paid to the Bank on account of the two Guarantee Bonds. The Insurance Corporation filed answer on 29.09.2003. At the trial, the Guarantee Bonds were admitted. The statement of accounts pertinent to the current account of BAT International was produced in evidence marked as X2 in proof of the amount of Rs.18 million due and owing from BAT International since the overdrawn amount exceeded Rs.18 million thus paving way for the Bank to demand the same from the Insurance Corporation who guaranteed such payment by way of the Guarantee Bonds. **The cause of action was non payment on demand according to the Guarantee Bond.** The statement of accounts showed the fact that it was overdrawn by amounts over and above Rs. 18 million. The true factual amount due and owing from BAT International was much more than 18 million rupees but the Plaintiff could only demand from the Insurance Corporation only the amount it had guaranteed which is Rs. 18 million. The Bank closed its case reading in evidence documents marked P1 to P12. The Insurance Corporation did not lead any evidence

but submitted to court that as the Plaintiff Peoples' Bank had admitted that it had not filed action against BAT International, the Defendant Insurance Corporation would close its case without leading any evidence. **The position of the defense was that the Bank should go against the principal debtor before filing action against the guarantor.**

When the demands were made on the two guarantee bonds, the Insurance Corporation had sent certain letters in reply. They were marked as X5, X8 and X9. The letter X5 stated that the Insurance Corporation was waiting for the outcome of an expected settlement between the BAT International and the Road Development Authority. The letter X8 contained material to state that the dispute between BAT International and the RDA had been referred to arbitration and therefore the Insurance Corporation was unable to proceed to pay as guaranteed till the arbitration is over. The **final letter X9** dated 30.07.2002 stated that the **Insurance Corporation is in the process of attending to the claims,** which are the guaranteed amounts of Rs. 15 million and Rs. 3 million.

I fail to see any of these letters as a denial to pay the amounts demanded. Instead they seem to be letters conveying the message that the Insurance Corporation needs a little time to pay. None of these letters can be taken to be interpreted as directing the Bank to go against the company before demanding from the Insurance Corporation. None of the letters claim that the Insurance Corporation is not liable to pay. In fact letter X9 gives an assurance that it will pay the amount demanded according to the guarantee.

The demands were made within the stipulated time. The Appellant never denied liability.Reading through the Guarantee Bonds, the wording is clear in paragraph 6 which reads as follows:

" Now Know Ye And These Presents Witness that the said surety is now firmly bound to the said Bank to pay a sum of Rupees 15 million **when demanded** by the said Bank, in the event of the said Principal not repaying the said facility obtained from the said Bank either directly or through the said Road Development Authority."

The only time money can be demanded is when the Principal was not paying directly or through RDA. The statement of accounts was proof of that fact. The account of the Principal was overdrawn by amounts over and above Rs. 18 million which was the guaranteed amount.

There was no condition contained in the Guarantee Bond that the Peoples' Bank should first demand from the Principal before demanding from the guarantor. When any party grants an assurance to another party guaranteeing to pay on demand, **it is accepted that if the principal does not pay that the guarantor shall pay. It is only on that assurance that the Bank grants the facility which the principal requests from the Bank.** That is the norm and accepted practice in the business world. If any Bank takes it to mean that it has to first demand from the principal, then file action against the principal and then only the Bank can demand and file action against the guarantor, **there will be no bank who would want to grant any facility to any principal on such a guarantee.**

In this era when trade and commerce all over the world is proceeding in a balanced manner to serve the society in a just and fair manner, the Guarantee Bonds which have the clause 'to pay on demand' play a very big role. If not for the system of guarantee bonds by which one party assures the other party that if the principal is in arrears and or in default, the party giving the guarantee shall pay on demand, the trade and commerce prevailing in the society for the benefit of the people will surely crash down.

Law of Guarantees by Geraldine Andrews and Richard Millet 2nd Edition at page 192 reads as follows:

" The fact that the obligations of the guarantor arise only when the principal has defaulted in his obligations to the creditor **does not mean that the creditor has to demand payment from the principal or from the surety, or give notice to the surety, before the creditor can proceed against the surety**. "

At page 194 it reads as follows: " There is **no obligation on the part of the creditor to commence proceedings against the principal, whether criminal or civil**, unless there is an express term in the contract requiring him to do so……"

At page 195 it reads as follows: " Thus in the absence of any condition precedent in the contract, all that the creditor needs to establish to **complete his cause of action against the guarantor is that the principal has defaulted…"**

In the case of ***Hemas Marketing (Pvt.)Ltd. Vs Chandrasiri and Others (1994) 2 SLR 181*** Jutice S.N.Silva (P/CA) as he then was, stated thus:

" A guarantee is an **accessory contract** by which the promisor undertakes to be answerable to the promise for the debt, default or miscarriage of another person whose primary liability to the promise 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 dependent 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 realizable when the prescribed event occurred."**

Accordingly, in the case in hand, the Respondent Peoples' Bank was assured by the Guarantee Bond provided by the Principal debtor who received overdraft facilities from the said Bank where the guarantor was the Appellant Insurance Corporation. The Sri Lanka Insurance Corporation provided security on behalf of BAT International 'to pay on demand' the amounts agreed by the guarantees when BAT International was in default. Such was the security readily and promptly realizable provided by the Appellant Insurance Corporation. **Therefore the Guarantor should pay on demand when the Principal failed to pay.**

In the case ***of Indica Traders (Pvt.) Ltd. Vs Seoul Lanka Constructions (Pvt.) Ltd. 1994, 3 SLR 387***, it was held that, " 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 honor 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 honoring the guarantee or letter according to its terms."**

In the case in hand, the Appellant, Sri Lanka Insurance Corporation cannot urge anything in the contract between the BAT International and the RDA and/or any contract between the BAT International and the Respondent Peoples' Bank and restrain from honouring the guarantee. According to the Guarantee Bond, the Appellant Insurance Corporation is duty bound to pay on demand because the only terms are that the BAT International has to be in arrears, which was proven by the statement of accounts, P3 and the demand has to be made within the guarantee period. Both conditions were fulfilled but the Appellant Sri Lanka Insurance Corporation Limited failed to pay on demand.

I hold that the Appellant is duty bound to pay on demand and it has failed to do so. The Respondent Peoples' Bank is therefore entitled to the reliefs prayed for in the Plaint.

This Appeal is hereby dismissed with costs.

Judge of the Supreme Court

Upaly Abeyrathne J.

I agree.

Judge of the Supreme Court.

CHITRASIRI, J.

Facts of this case are briefly as follows. Rural Development Authority (RDA) awarded a contract to a company named BAT International SPA to perform rehabilitation works in respect of Galle-Matara, Matara-Akuressa, and Matara-Hakmana roads under the Contract bearing number WB 3/3. Having succeeded in obtaining the said contract for road rehabilitation work, BAT International applied for two overdraft facilities from the Plaintiff-Respondent Bank (hereinafter referred to as the plaintiff) with the view of carrying out the aforesaid rehabilitation work. The plaintiff bank having granted the said facility, BAT International was permitted to overdraw funds by debiting the account bearing No.03206429 which was maintained by it in the plaintiff bank. The amount so authorized to overdraw was for Rs.18 million. (Rs.18,000,000/-) Accordingly, the plaintiff did release the money

to BAT International. Admittedly, Bat International, it being the principal debtor had failed to repay the plaintiff bank, the money so overdrawn.

Prior to the money being released, the Defendant-Appellant (hereinafter referred to as the defendant) namely, Sri Lanka Insurance Corporation Limited had agreed to secure the repayment of the money that was to overdraw by Bat International from the plaintiff bank. Securing the repayment of money had been assured by the defendant corporation by issuing two guarantee bonds. Those two guarantees were for a value of Rs.18 million and those were marked as P2 and P7 in evidence.

As mentioned before, granting of the said facility by the plaintiff bank to Bat International was subject to the condition that BAT International provides a guarantee from the defendant insurance corporation for the re-payment of the money released on the overdraft facility. Accordingly, the two guarantees marked P1 dated 31.07.1997 and P7 dated 24.11.1997 for the values of Rs.15 million and for Rs.3 million respectively had been issued by the defendant at the request of BAT International.

Accordingly, Road Development Authority had agreed to pay for the work done by BAT International, by depositing the money in the aforesaid Account bearing No.03206429 maintained by BAT International at the plaintiff bank. These two Bank Guarantees were executed to ensure the payments due to BAT International SPA from the Rural Development Authority.

Admittedly, neither the BAT International SPA nor the Rural Development Authority had paid the monies due to the plaintiff. As a result, the plaintiff Bank made claims on the two Guarantees, from the defendant namely, Sri Lanka Insurance Corporation Limited. The Bank had made several demands from the defendant to honour the guarantees issued by it. Defendant had failed to comply with those requests made by the plaintiff bank. Consequently, the plaintiff bank filed this action in the High Court Holden in Colombo exercising its civil jurisdiction, against the Sri Lanka Insurance Corporation Ltd to recover a sum of Rs.18 million under the aforesaid two guarantees. It is important to note that the plaintiff bank had not made the BAT International, as a party to this action though that company was the borrower of the money. No evidence is forthcoming to establish that the bank had even made a demand from Bat International to recover its dues either.

Upon filing the answer by the defendant, the case proceeded to trial. At the trial, evidence for the plaintiff was led and then the plaintiff closed its case reading in evidence the documents marked P1 to P12. No witnesses were called on behalf of the defendant. At the closure of the plaintiff's case, learned Counsel for the defendant submitted that the defendant is not calling any witnesses on its behalf. Such a decision was taken by the defendant due to the reason that the plaintiff has not filed any action against the BAT International which is the entity benefitted, having borrowed the money from the Plaintiff bank. Thereafter, learned High Court Judge, by the judgment dated 20.03.2009 decided the case granting the reliefs as prayed for by the plaintiff.

Circumstances show that the reason for not leading evidence at the trial by the defendant was due to a question of law depended upon by it. The said question

of law had been raised as an issue as well, [issues 24 and 33] at the trial held in the High Court and it reads thus:

> *Could the creditor (plaintiff bank) file and maintain action against the guarantor (defendant-Insurance Corporation) to recover dues under the two Guarantee Bonds, without first instituting action against the principal debtor (BAT International)?*

It seems that the learned High Court Judge has not addressed this issue of law when she decided the case in favour of the plaintiff. It is the only issue that was argued before this Court. Accordingly, the issue before this Court is to ascertain whether or not the plaintiff is entitled to institute action against the defendant on the Guaranteed Bonds marked P2 and P7 without taking steps to recover the dues from the principal debtor namely, BAT International SPA. Since, it is question of law; I will straight away refer to the authorities relevant thereto.

The law applicable in this connection is the Roman Dutch Law which is our residual Law that applies to Contracts of Surety-ship which are also termed as Contracts of Guarantee. English Law does not apply in this regard since it has not been introduced by statute or even by tacit introduction by a line of judicial decisions.

In the early Case of GURUSIN APPU vs. CARLINA HAMINE, [02 NLR 307] the Court applied the Roman Dutch Law (which was stated to apply in Scotland as well) when determining a question relating to the liability of a Surety.

Therefore, the issue before this Court will have to be decided applying the Roman Dutch Law principles and not under the English Law. In the Roman Dutch Law, a Surety has the right to require the Creditor to exhaust his legal remedies against the Principal Debtor before proceeding against the Surety – i e: to insist on the "excussion" of the Principal Debtor before the Creditor proceeds against the Surety. [Wille at Pg.619 and Maarsdorp at Pg. 357]

Wille's Principles of South African Law [8th Edition] at page 619, states thus:

> "The surety may claim that the principal debtor be first 'excused', i.e. that the creditor, before suing the surety, exhaust his legal remedies against the principal debtor for performance or payment, right up to execution against his property." [Grotius 3.3.27; Voet 46.1.14].

Maasdorp, The Institutes of Cape Law [Volume I, The Law of Obligation, at page357] states thus:

> "The benefit of excussion, as known to our law, is the right of exception to which a security is entitled, who is being sued before the principal debtor, to demand that the principal shall first be sued and excused; [Voet 46:1:14; G 3:3:27'Schorer, note 303] and, where there are more than one principal debtor, that all shall be excused. [Westhuizen v. Pope and Devenish, 2 Menzies,60] It further entitles the surety, where an obligation has been secured as well by the giving of sureties as by a mortgage on immovable property, to claim that the immovable property shall also be excused before he is himself proceeded against. [Serrurier Vs.Langeveld,1Menzies,316;Voet,46:1:15;20:4:3;G.3:3:32,V.D.K.,Th.507.508; Schorer,Note 303,par.1;V.L.,vol.2.p.42.]

In Gurusin Appu vs. Carlina Hamine, (supra) a Surety's right of excussion was recognized. This right of a Surety is known as the *beneficium excussionis sue ordinis.*

However, if the Surety has renounced this right either expressly, by agreeing to a specific renunciation of this right or impliedly, by accepting liability as a Principal Debtor and agreeing to be sued without the Debtor excussing the Principal Debtor, the Surety cannot claim this right or insist that, the Creditor must proceed against the Principal Debtor before proceeding against the Surety.
[Wille at p.619-620 and Maarsdorp at Pg.365]

The leading case of WIJEWARDENE vs. JAYEWARDENE [19 NLR 198 at pg.452-455.] contains a discussion on the rights of a Surety, the effect of renunciation of these rights and also the manner in which such renunciation should be done. In that decision Wood Renton J held thus:

> *"That the defendant was not debarred from relying on the beneficium ordinis. The ordinary privileges of suretyship must be specially renounced. In that case the renunciation by the defendant in deed no.5,279 of his rights as a surety would clearly be inoperative. But even if we adopt the view of Van der Keessel, the present appeal would still fail. For the efficacy of the general renunciation depends on whether the surety, not being peritus juris is proved affirmatively to have understood the nature of the right or rights renounced ……. I would hold that the surety's knowledge on that vital point must appear on the face of the deed of suretyship itself".*

This principle had been applied in WIJEWARDENE vs. JAYEWARDENE [24 NLR 336] and also in the Privy Council decision in WIJEWARDENE vs. JAYEWARDENE [26 NLR 193]

It has been discussed by Prof. C.G.Weeramantry in his book "The Law of Contracts" as well. [Volume I, at pg. 198] In that book he states as follows:

> *"Contracts of Guarantee must be distinguished from Contracts of Indemnity. In a guarantee, a promise is made by the guarantor to the creditor which is collateral to the contract already existing between the creditor and the debtor. The obligation of the guarantor is conditional on the failure of the principal debtor to pay. It will be seen that in cases of guarantee there are two contracts and three parties.*
>
> *In cases of Indemnity, on the other hand, there is only one contract the contract between the person indemnifying and the creditor. It is a promise to see that the promise does not suffer by entering into the transaction. To illustrate the difference – if two persons enter a shop and one buys goods and the other promises the seller "if he does not pay you I will", this is a contract of guarantee. If on the other hand he says "let him have the goods – I will pay you," this is a contract of indemnity. There is only one contract and it is not dependent on the existence of another."*

For completeness, I will briefly refer to the English Law principles as well particularly because both Counsel has referred only to the English Law principles in this instance.

In the book "Paget's Law of Banking" (12th Edition) Section 33.2 at pages 701-702, it states thus"

> *"A guarantee obligation is secondary and accessory to the obligation the performance of which is guaranteed; the guarantor undertakes that the principal debtor will perform his (the principal debtor's) obligation to the creditor and that he the (guarantor) will be liable to the creditor if the principal debtor does not perform. Therefore, the guarantor's liability for the non-performance of the principal debtor's obligation is co-extensive with that obligation. If the principal debtor's obligation turns out not to exist, or is void, diminished or discharged so is the guarantor's in respect of it".*

Geraldine Andrews and Richard Millett, Law of Guarantees, (Sixth Edition) at page 5 states as follows:

> *"The essential distinguishing feature of a contractor of guarantee is that the liability of the guarantor is always ancillary, or secondary, to that of the principal, who remains primarily liable to the creditor. There is no liability on the guarantor unless and until the principal has failed to perform his obligations…"*

At page 271, it states thus:

> *"A contractor of guarantee is an accessory contract, by which the surety undertakes to ensure that the principal performs the principal obligation. It*

has been described as a contract to indemnify the creditor upon the happening of a contingency, namely the default of the principal to perform the principal obligation (citing Sampson v Burton (1820) 4 Moo CP 515). The surety is therefore under a secondary obligation which is dependent on the default of the principal and which does not arise until that point ….”

Halsbury’s Laws of England, Secondary liability of the guarantor, Volume 20, (Fourth Edition) at page 180 states thus:

“There are two different kinds of guarantee. One is a promise by the guarantor which becomes effective if the principal debtor fails to perform his obligations. The other is a promise that the principal debtor will perform his obligations. In both cases, the guarantor’s liability is secondary. The guarantor is under no liability if the principal debtor’s obligation is discharged, by performance or otherwise, on or before the date of performance. In the one case, the conditional promise never becomes effective; in the other, there is no breach by the guarantor.

Consequently, a creditor may not, before any default has been committed, bring an action quia timet against a guarantor to force him to set apart money to provide for the possibility of a debt becoming due from the principal debtor and the principal debtor making default. Nor can the creditor obtain a Mareva injunction against the guarantor, because he has no accrued cause of action

to support it. On the other hand, a guarantor is no more justified in placing the whole of his property out of the reach of liability to pay the guaranteed debt than if he were the principal debtor."

English Law authorities referred to above too, show that the guarantors' liability would become effective only when the principal debtor fails to perform his duty towards the lender. However, as I have mentioned earlier in this judgment, it is the Roman Dutch Law that is applicable to the issue in hand.

Accordingly, the question on which this appeal should be decided is to ascertain whether the Surety has, in fact, renounced the aforesaid right of excussion and/or accepted liability as a Principal Debtor and/or agreed that the Creditor may sue the Surety for the recovery of the monies due without proceeding against the Principal Debtor, knowing the effect of the renunciation.

I do not see any material in this instance to show that the surety namely the defendant Insurance corporation has made such a renouncement of its right of excussion and/or accepted liability as a Principal Debtor and/or agreed that the Creditor may sue the Surety for the recovery of the monies due, without proceeding against the Principal Debtor, knowing the effect of the renunciation. Therefore, the Plaintiff Bank will have to first file action against the principal debtor namely BAT International Company, before proceeding against the Insurance corporation, it being the guarantor. In the circumstances, the question of law raised in this case is to be answered in favour of the defendant Insurance Corporation Ltd.

Moreover, I believe it also may leave room for the two main parties, namely the person who advanced the money and the borrower, to connive and to allow the borrower to avoid payment though the borrower is in fact, in a position to service the facility obtained. However, I must emphasize that the decision arrived at in this case shall not be a reason to escape liability under the guarantee bonds, after the proper cause of action is taken against the borrower, BAT International.

For the reasons set out hereinbefore, it is my opinion that it is incorrect to have filed action by the plaintiff bank against the defendant insurance corporation, it being the guarantor, without taking steps against the principal debtor namely Bat International to recover moneys due to it, on the overdraft facility extended to Bat International.

Accordingly, the judgment dated 20.03.2009, of the learned High Court Judge of the High Court (exercising its civil jurisdiction) Holden in Colombo is set aside. The plaint dated 04.06.2003, filed by the plaintiff bank is dismissed. Having considered all the circumstances, I make no order as to the costs of this appeal.

Appeal allowed.

JUDGE OF THE SUPREME COURT