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

SC Appeal No. CHC 22/11
case no: HC (Civil) 36/2007/MR

1. Union Bank of Colombo Ltd,
   No. 15A, Alfred Place, Colombo 03.

Plaintiff

~Vs~

1. Emm Chem (Pvt) Ltd
   No. 16, Flower Terrace, Colombo 07.

2. Kodduru Arachchige Don Adrin Lakshman Perera,
   No. 25/4A, Jayapura Mawatha, Baddegana, Kotte South, Pitakotte.

3. Mailwaganam Surendran,
   No. 53A, Maradana Road, Hendala, Wattala.

Defendants

AND NOW

In the matter of an Appeal to the Supreme Court from the judgment of the High Court of the Western Province Holden in Colombo (exercising Civil/Commercial Jurisdiction dated 01/06/2011) in terms of the provisions of the High Court of Provinces (Special Provisions) Act No.10 of 1996

1. Kodduru Arachchige Don Adrin Lakshman Perera,
   No. 25/4A, Jayapura Mawatha, Baddegana, Kotte South, Pitakotte.

(2nd Defendant-Appellant)

-Vs-

1. Union Bank of Colombo Ltd,
   No. 15A, Alfred Palce, Colombo 03.

(Plaintiff-Respondent)

2. Emm Chem (Pvt) Ltd
   No. 16, Flower Terrace, Colombo 07.

3. Mailwaganam Surendran,
   No. 53A, Maradana Road, Hendala, Wattala.

(Defendant – Respondents)

Before: Buwaneka Aluwihare PC. J

H.N.J. Perera J

Vijith K. Malalgoda PC. J

Counsel: Hiran De Alwis with Kalpa Virajith for the 2nd Defendant- Appellant instructed by Prasanna Ekanayake

Sandamali Munasinghe for the Plaintiff-Respondent instructed by Nirosha Kannangara.

Argued on: 27/06/2017

Decided on: 07/03/2019

Aluwihare PC. J.,

The 2nd Defendant- Appellant (Hereinafter referred to as the 2nd Defendant) in this case was the 2nd Defendant in the case originally filed at the Commercial High Court. The initial case was filed by the Plaintiff-Respondent to recover a sum of Rs. 5, 162,341.53/= and the interest as claimed in the plaint dated 06/02/2007, from the 2nd Defendant and the 3rd Defendant of the original case (hereinafter referred to as the 3rd Defendant), who were the directors of the 1st Defendant company.

At the request of the 2nd and 3rd Defendants, the Plaintiff-Respondent (Hereinafter the "Plaintiff Bank") extended certain credit facilities (including term loan facilities, bank overdraft, lent and advanced monies etc.) to the 1st Defendant company. The offer letter sent by the Plaintiff Bank in this regard dated 11/ 03/1998 is marked "P5." This Offer letter, *inter alia*, required a personal guarantee from two directors for Rs. 7 million. The 2nd and 3rd Defendants, signed and accepted the contract and executed a Joint and Several Personal Guarantee ("P15") on 16/03/1998.

In the year 2000, the 1st Defendant company began defaulting in its monthly repayments which prompted the Plaintiff Bank to send reminders to settle the overdue amounts. On 25th October 2000, by way of letter marked "P6", another director of the 1st Defendant Company appealed to the Plaintiff Bank "*to consider granting a suitable facility merely for survival of the organization so that we are confident that we could commence settling your dues.*" Considering this request, the Plaintiff Bank sent another offer letter on 19/ 06/ 2001, marked "P7", *restructuring the outstanding amount*. The 2nd Defendant signed and accepted this offer on 16/ 07/ 2001. Underneath his signature was also an assurance, authenticated by his own signature, stating "*We could settle according to our fax dated 27/ 03/ 2001.*"

However, the 1st Defendant company continued to fail in their timely repayments. Subsequently, the Plaintiff Bank sent notices on 24/04/2002 and 08/07/2002 to the 2nd and 3rd Defendants reminding them of the overdue payments and requiring prompt settlement of the same. These letters are marked "P8" and "P9". Again on 27/08/2002, through the letter of demand marked "P14", the Plaintiff Bank demanded the 1st Defendant Company to settle their outstanding amount. Similar letters of demand were sent to the 2nd and 3rd Defendants which are marked as "P14", "P14(a)", "P16", and "P16(a)". These letters were not responded to by the Defendants and no attempts appears to have been made to settle the outstanding sum, which gave rise to the cause of action in the Commercial High Court.

At the trial, the Plaintiff Bank abandoned their claim against the 1st Defendant company and pursued only the claim against the 2nd and 3rd Defendants for the recovery of the said sum on the strength of the guarantee bond executed on 16/03/1998 to pay all monies due and owing from the 1st Defendant company to the Plaintiff Bank.

During the trial, the 2nd Defendant-Appellant resisted the claim on the basis that the Plaintiff Bank's cause of action has prescribed. He contended that, contrary to what the Plaintiff Bank states, in 2001 the 1st Defendant company *did not reschedule the existing loan repayments but obtained a new credit facility*. This credit facility was provided by the Plaintiff-Bank without obtaining a personal guarantee. The 2nd and 3rd Defendants only became sureties for the 1998 loan and not for the loan obtained in 2001. Their guarantee bond having been executed in 1998, the claim for recovery of money in respect of the same in 2007 was prescribed.

At the end of the trial, the learned High Court judge entered the judgment in the favour of the Plaintiff Bank. The 2nd Defendant-Appellant aggrieved by the said judgment invoked the appellate powers of this Court.

It is the contention of the 2nd Defendant-Appellant that the guarantee bond which he executed along with the 3rd Defendant only extends to the 1998 loan. The arrangement that took place in 2001 between the 1st Defendant Company and the Plaintiff Bank was a new loan and not a continuation of the former. It was further pointed out that for this last loan, (*i.e.*, 2001) the Plaintiff Bank did not obtain any personal guarantee nor was there any guarantee bond. The liability of the 2nd Defendant-Appellant, therefore, if at all would only extend to the 1st loan obtained in 1998. Even in respect of the said loan, the 2nd Defendant-Appellant disputed his liability on two grounds; firstly, that the claim is prescribed and secondly that there was no outstanding amount due from the Company. The 1998 loan, according to the 2nd Defendant-Appellant, had been settled in full and the same is reflected in the Bank ledgers (marked "P12") As such, there was no liability accruing to the 2nd Defendant-Appellant to settle it as a surety. It was further submitted that the Plaintiff-Bank has exploited the 1998 guarantee bond which was executed for a specific loan and has extended its application for future uncertain monies.

The learned counsel for the 2nd Defendant, drew our attention to the case of ***Hatton National Bank v Rumeco Industrial Limited*** (SC Appeal 99A/2009, SC minutes 8th June 2011) and submitted that it has been held that guarantee bonds cannot be enforced for future and antecedent debts. Even if that had been the case, it would not help the Defendant since the 2001 credit facility was not a "new loan" but a continuation of the former.

While there is no doubt about the accuracy of the said position of law, it must be noted that the said position of law will apply to the present case, only if the 2001 credit facility was a 'new loan'. If the 2001 credit facility was not a 'new loan' but a continuation of the former, the position in the ***Rumeco*** case cannot be made applicable to the present case. Concomitantly, if the 2001 credit facility was in fact a continuation, then the 2nd Defendant-Appellant's defence of prescription too will become untenable.

As stated on page 713 of **Paget's Law of Banking (12th Edition)** Courts must consider the factual background known to the parties at or before the date of the contract and ascertain the objective of the transaction when interpreting the Guarantee Bond.

It is common ground that the 1st Defendant-Company obtained credit facilities in the year 1998 from the Plaintiff Bank. It is also common ground that in or around 2000, the 1st Defendant Company defaulted in their payments. The arrangement in 2001 takes place pursuant to the said act of defaulting and pursuant to the letter of request forwarded by one director of the 1st Defendant company. In the said letter, the director of the 1st Defendant-Company admitted that "*a number of Import Loans/Bills have fallen due and the Company Current Account with you [the Plaintiff Bank] is also overdrawn excessively*". In the same letter, the 1st Defendant-Company appealed to the Plaintiff-Bank to grant a "*suitable facility merely for the survival of the organization so that we [the 1st Defendant-company] are confident that we could commence setting your dues in the following manner.*" Thereafter, the letter spells out three ways in which the 1st Defendant-Company proposes to settle their dues, namely;

> *"(a) to pay a sum of Rs. 55, 000/= monthly out of the already accrued interest component for the first six months beginning in January 2001*
>
> *(b) to pay monthly a sum of Rs. 55, 000/= together with reasonable amount from the capital of course at your discretion-commencing July 2001 till the completion of the outstanding.*
>
> *(c) to continue to deposit whatever the collection of monies to our current account with you, to help reduce the overdrawn balance*".

Thus, it appears that although the said letter refers to 'granting a facility', what the 1st Defendant-company intended to seek was a series of '*concessions*' to settle their dues. The three methods quoted above could only be construed as proposing ways to settle their outstanding amount. They do not disclose any intention to obtain a 'new loan'. Moreover, it is inconceivable that a company—which by their own admission—was "*not in a position to import the requisite materials as the bank has stopped granting any facilities, pending settlement of this outstanding*" and "*has* *come to a grinding half*", would venture to obtain further loans from the Plaintiff Bank.

There is no dispute that it was the abovementioned request letter marked "P6" that prompted the Plaintiff Bank to send a new offer letter in June 2001 marked "P7." In the said letter the Plaintiff Bank has clearly indicated that "*We, the Union Bank of Colombo, are pleased* <u>*to restructure the outstanding pertaining to Emm Chem (Pvt) Ltd on terms and conditions stipulated below*</u>." According to the said letter, the outstanding amount was restructured as "Term Loan 1" and "Term Loan 2". Even at the end of the letter "P7", the Plaintiff Bank has stated "<u>*Please note that this is the second re-schedulement of the outstandings and therefore request you to strictly adhere to the rescheduled payments*</u>".

It is also important to note that under the heading "Security", the Plaintiff-Bank has specifically referred to "*personal guarantee for Rs. 7, 000, 000/= of Mr. Lakshman Perera and Mr. Surenthiran together with net worth investments*". The 2nd Defendant-Appellant argued based on this reference that "P7" was a new and distinct loan which required a new personal guarantee. In contrast, the Plaintiff-Bank claimed that it was not a request for 'fresh guarantee' but a cross-reference to the already existing guarantee bond executed in 1998. I am inclined to believe that it was a cross-reference, as it specifically refers to the 2nd and 3rd Defendants who were the sureties in the 1998 Guarantee Bond. If the Plaintiff-Bank was requesting fresh guarantee, there would not have been any necessity to specifically refer to the 2nd and 3rd Defendants' names. The Plaintiff-Bank could have easily followed the requirements in the Board Resolution marked "P4" which only requires the signature of "*any two directors of the company.*"

Apart from these contentions, the 2nd Defendant-Appellant also sought to argue that the 2001 facility was a new loan based on the ledger accounts marked "P12." In the said ledger account, there is an entry to the effect 'full recovery of the loan granted'. According to the 2nd Defendant-Appellant, this entry proves that the 1998 loan had been fully repaid and nothing was remaining. If the 1998 loan was 'fully recovered", the 2nd Defendant-Appellant argued that there could be no continuation of the same. Thus, the 2001 loan could only be construed as a 'new loan'.

However, immediately underneath the said entry are two further entries to the effect: "Term Loan 1" and "Term Loan 2". When asked to explain the three entries, Mr. Ned Gomez – Head of Operations of the Plaintiff-Bank, in his evidence stated that the said entry "full recovery of the loan granted" was not made pursuant to any physical money being deposited by the 1st Defendant company. Instead, it has been made for accounting purposes and to cross-reflect that it was the same outstanding amount of the aforesaid loan, that had been rescheduled as "Term Loan 1" and "Term Loan II". He also gave evidence that no cash was released with regard to "Term Loan I" and "Term Loan II". All these clearly indicate that, contrary to what is claimed by the 2nd Defendant, the 2001 arrangement was not a new loan. What the 2nd Defendant-Appellant attempts to characterize as a 'new loan' is the amount which the 1st Defendant-Company was anyway duty bound to repay.

Throughout trial, the two witnesses on behalf of the Plaintiff-Bank have consistently maintained that no new loan was granted to the 1st Defendant-Company and that the action was instituted to recover the outstanding amount with interests of the same continuing loan.

The 2nd Defendant-Appellant's position is that "Term Loan I" and "Term Loan II" were two new loans granted to the 1st Defendant-Company and one for which the Plaintiff-Bank never obtained fresh security. It would be difficult to believe that, in the circumstances where there had been default and delay in paying the monies that were due, the plaintiff bank would have even considered making the restructured banking facilities available without security of the existing bank guarantee.

All these factors cumulatively indicate that there was only one continuing loan—i.e. the loan obtained in 1998. It was the same loan for which the 2nd Defendant-Appellant along with the 3rd Defendant had signed a guarantee bond.

I now turn to the issue of prescription. The 2nd Defendant-Appellant claims that the Plaintiff-Bank cannot maintain this action as the Guarantee Bond was entered into in 1998 –9 years prior to the institution of the action. However, the material point at which the time begins to run is not the date of the execution of the guarantee bond, but "*the date on which the payment became due*" [See. ***Hatton National Bank Limited v Sellers Sports (Pvt) Ltd and others (SC Appeal (CHC) No. 6/97(F))*** and ***Parr's Banking Co. Ltd v Yates [1898] 2 QB 460, CA***]

The Plaintiff-Bank instituted the action for recovery of money on 6th February 2007. As per the second offer letter "P7", the rescheduled loan payments were to be made by the 30th November 2001, which is well within the 6 year period under section 7 of the Prescription Ordinance. Moreover, we have before us another letter dated 24th April 2002, marked "P8" where it is stated that the Plaintiff-Bank has further extended the time to April 2002 on the request of the 2nd Defendant-Appellant. It states "*As per Offer Letter dated 19/ 06/ 01, the balloon payment was to be made by November 2001 but on your specific request we changed it to April 2002.*" This also indicate that the action has been instituted before the expiration of 6 years. In any event, in terms of "P7", the Plaintiff-Bank has reserved the right to make demand to make the payment if circumstances arise. They sent letters of demand dated 27th August 2002 to all the Defendants in the case. Having failed to secure their payments at each of these points, the Plaintiff-Bank resorted to legal action on 6th February 2007. It is clear that 6 years have not lapsed either from the point at which the payment became due or from the day the letter of demand was not honored. Therefore, the action is not prescribed.

The 2nd Defendant-Appellant also claimed that the Plaintiff Bank caused a material variation of the initial loan agreement with the 1st Defendant-Company by agreeing to provide further time to settle their outstanding amount by the second offer letter marked "P7." It was his contention that according to accepted legal norms, granting such extension results in discharging the guarantor from the guarantee.

Undoubtedly, equitable principles could intervene to protect a guarantor by discharging him from liability under the guarantee in a number of situations when there is evidence that his rights are prejudiced by the Creditor's conduct. This include, as correctly contended by the 2nd Defendant-Appellant, situations of granting further time which amount to material variations of the initial contract. **(Paget's Law of Banking, 12th Edn, p. 705)**. However, the mere fact of granting further time does not at all times amount to a situation warranting discharge. The material element is to see whether such extension/ variation of the contract was arrived at without the consent or the knowledge of the guarantor. Additionally, there must also be evidence demonstrating that such variations were substantial and caused prejudice to the rights of the guarantor. In ***Bank of India v Trans Continental Commodity Merchants Ltd. [1983] 2 Lloyd's Rep 298, CA*** it was held that an 'irregular' conduct will not *per se* amount to a material variation that discharges the guarantor from his bond.

In the present instant the 2nd Defendant-Appellant claims that providing an extension of time to settle the payments amount to a material variation that discharged the guarantor. However, this change, as reflected in "P7" was arrived with the full knowledge of the 2nd Defendant-Appellant. The 2nd Defendant-Appellant was a director of the 1st Defendant Company and was one of the two directors who authorized, signed and accepted the terms of the initial loan. He was a director of the said company during the time the Company sent "P6" to the Plaintiff-Bank requesting a re-structure of the outstanding amount. Moreover, he has himself signed and accepted the second offer letter marked "P7" and has assured by way of an extra line that "*they could settle according to the fax dated 27/03/2001*". Furthermore, the Plaintiff-Bank has produced the document "P8" which is a letter addressed to the 2nd Defendant-Appellant on 24th April 2002 reminding him to make arrangements to settle the overdue amount. In the said letter it is clearly stated "*As per Offer Letter dated 19/ 06/ 01, the balloon payment was to be made by November 2001 but on your specific request we changed it to April 2002. Further if you do recall the payment schedule was created by consulting you and according to the inflow projected by you*". In these circumstances, I do not think the agreement to extend time for settlement was arrived outside the knowledge of the 2nd Defendant-Appellant. The variation was mutually and openly agreed between the parties.

In this regard, it must be noted that it is the general practice of commercial banks to "***preserve the guarantor's liability in the event of the bank giving time or any indulgence to the principal debtor***" **(Paget's Law of Banking, 12th Edn, page. 722)** This preservation, if intended, would be communicated clearly to the stake holders. In this instant, the Plaintiff-Bank has made very clear reference to the existing personal guarantee of Mr. Lakshman Perera and Mr. Surenthiran in the second offer letter marked "P7." This indicate that the 2nd Defendant-Appellant's liability was preserved when the loan was restructured in 2001.

Furthermore, I also make it a point to state that the 2nd Defendant-Appellant cannot approbate and reprobate the status of the agreement arrived in 2001. If he contends that the 2001 facility was a 'new loan', he cannot at the same time maintain that there was a material variation of the former loan agreement. By taking the position that the Plaintiff-Bank materially altered the contract by granting an extension of time for repayment, the 2nd Defendant-Appellant has inadvertently conceded that no new loan was obtained in 2001.

Additionally, the 2nd Defendant-Appellant disputed receiving the letter of demand on the basis that the Plaintiff-Bank had sent it to the wrong address. Several authorities were cited before us to illustrate that a cause of action would not accrue to the creditor without first a demand being made. However, I observe that the circumstances in the present case are somewhat different to those in the said authorities. In ***L B Finance v Manchanayake (2000) 2 SLR 142,*** there was no demand at all made by the plaintiff to honour the obligation to pay. In ***Seylan Bank Ltd v Inter Trade Garments (Pvt) Ltd (2005) 1 SLR 80***, the Supreme Court concurred in Justice Nagalingam's observation in ***Sivasubramaniam v Alagamuthi (1950) 53 NLR 150*** that "*under our common law a demand is essential before it could be said that a cause of action accrues to a creditor to sue the debtor*".

However, in ***Seylan Bank Ltd.*** case, there was no dispute that a written demand was made. The question was to see at which point a cause of action would arise when the contract does not stipulate a deadline for repayment—whether it was at the point the loan was given or when the demand for repayment was made. Accordingly, it was held that where there is no specific time for repayment, the six-year period will not run till a demand is made from the debtor.

In the present case, the Plaintiff-Bank has expressly reserved the right to demand repayment where necessary. This is reflected in both "P5" (the first offer letter sent in 1998) and in "P7" (the second offer letter rescheduling the 1998 outstanding amount). Accordingly, the Plaintiff-Bank *did in fact make a demand*. The letters of demand, which the Plaintiff Bank sent to the 1st Defendant-Company, 2nd Defendant-Appellant and the 3rd Defendant dated 27th August 2002 and are marked "P14" and "P16". The Registered postal receipts are also attached marked "P14(a)" and "P16(a)". I do not observe any ground to challenge the validity of the demand that has been made. A working definition for a valid demand was given in ***Re Colonial Finance, Mortgage, Investment and Guarantee Corp; Ltd*** (1905) 6 SRNSW 6 where it was held that " *there must be a clear intimation that payment is required to constitute a demand; nothing more is necessary, and the word 'demand' need not be used; neither is the validity of a demand lessened by its being clothed in the language of politeness. It must be of a peremptory character and unconditional, but the nature of the language is immaterial provided it has this effect*". (p.9) All these characteristics are reflected in the letters of demand sent to the Defendants. The letter clearly intimates the total sum due to be paid, the credit facility from which the payment stems, the liability of the Defendants and the time before which the payment should be made.

The Defendant-Appellant claims that there was no letter of demand since it has been sent to the wrong address. However, the Plaintiff-Bank has stated that they forwarded all correspondence and letters to the Defendant-Appellant's last known residence in Nugegoda. In March 2001, the Defendant-Appellant had signed and accepted "P7" (the offer letter) which was sent to the same address. As such, when the Plaintiff-Bank sent the letter of demand by way of registered post in 2002 to the same address, they had no reason to believe that the Defendant-Appellant may have changed the address within one year. In those circumstances, I am unable to agree with the 2nd Defendant-Appellant's contention that there was no demand giving rise to the present cause of action.

The final point raised on behalf of the 2nd Defendant-Appellant was that the Plaintiff-Bank attempts to stretch the applicability of the 1998 Guarantee Bond to future debts of the company. However, as I have already addressed, there was only one continuing loan since 1998. In 2001, on the request of the 1st Defendant-Company, the Plaintiff-Bank only rescheduled the outstanding amount and granted further time to settle. They did not grant a new loan. In those circumstances, the guarantee bond which the 2nd Defendant-Appellant signed in 1998 continues to be operative.

As a general rule, contracts of guarantee are strictly construed in favor of the surety. As Lord Campbell said in ***Blest v Brown (1862) 4 De GF & J 367 at 376***: "*It must always be recollected in what manner a surety is bound. You bind him to the letter of his engagement. Beyond the proper interpretation of that engagement you have no hold upon him. He receives no benefit and no consideration. He is bound therefore merely according to the proper meaning and effect of the written engagement that he has entered into.*"

In terms of the guarantee bond marked "P15", the 2nd Defendant-Appellant has agreed to repay the "*loan together with interest thereon at such rates or rates as may be charged by [the Plaintiff-Bank] and all legal and other charges and expenses whether taxable or not occasioned by or incidental to the enforcement of this or any other security for the said Loan or the recovery thereof*".

In the letter of demand marked "P16", the Plaintiff-Bank has demanded the 2nd Defendant-Appellant to pay "*a sum of Rupees Five Million One Hundred and Sixty Two Thousand Three Hundred and Forty One and Cents Fifty Three (Rs. 5, 162, 341. 53) together with the interest thereon, all legal and other charges and expenses up to the date of settlement in full.*" The letter also specifies that the said sum was due as at 20th August 2002 for having failed to settle their credit facility. Accordingly, the Plaintiff-Bank has not used the Guarantee Bond in respect of any 'new' or 'future' debt. The Guarantee Bond remains valid and binding on the sureties since the original loan obtained by the 1st Defendant-company was never settled.

In the totality of the aforesaid circumstances, I see no reason to interfere with the findings of the learned High Court Judge.

Appeal dismissed.

JUDGE OF THE SUPREME COURT

JUSTICE H.N.J PERERA

I agree

CHIEF JUSTICE

JUSTICE VIJITH K. MALALGODA PC.

I agree

JUDGE OF THE SUPREME COURT