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

In the matter of an appeal in terms of Section 5(2) of the High Court of the Provinces (Special Provisions) Act No 10 of 1996 read with Article 118 of the Constitution.

SC / Appeal / 142/14

SC/ HC/LA/ 41/2014

HC (Civil) 329/2013 MR

Ace Containers (Pvt) Ltd.
315, Vauxhall Street,
Colombo 2.

Plaintiff

Vs.

Commercial Bank of Ceylon PLC,
Commercial House,
No. 21, Sir Razeek Fareed Mawatha,
Colombo 1.

Defendant

AND NOW BETWEEN

Commercial Bank of Ceylon PLC,
Commercial House,
No. 21, Sir Razeek Fareed Mawatha,
Colombo 1.

Defendant Appellant

Vs.

Ace Containers (Pvt) Ltd.
315, Vauxhall Street,
Colombo 2.

Plaintiff Respondent

BEFORE	:	CHANDRA EKANAYAKE, J. SISIRA J DE ABREW, J. UPALY ABEYRATHNE, J.
COUNSEL	:	Maithri Wickremasinghe PC with R. Jayatunga for the Defendant Appellant M.U.M. Ali Sabry PC with Shamith Fernando for the Plaintiff Respondent.
ARGUED ON	:	20.01.2015
WRITTEN SUBMISSION ON:		23.10.2014 (Appellant) 04.12.2014 (Respondent)

DECIDED ON : 08.07.2015

UPALY ABEYRATHNE, J.

This is an appeal from an order of the learned Judge of the High Court of the Western Province exercising commercial jurisdiction holden in Colombo dated 20.06.2014. By the said order the learned High Court Judge of the Commercial High Court has refused an application made by the Defendant Appellant (hereinafter referred to as the Appellant) seeking to add Lankem Development Ltd. as a necessary party to the action. This Court granted leave to appeal. It seems from the minutes of this Court dated 29.08.2014 that leave has been granted on the question of law; i.e. should the Lankem Development Ltd be added as a necessary party to the action.

According to the facts of the case the Plaintiff Respondent (hereinafter referred to as the Respondent) had entered in to a contract (A 1 and A 2) with Lankem Development Limited (Lankem) for the surfacing of the Respondent's container yard at Mabole. By the said contract the Respondent agreed to pay an advance payment equivalent to 30% of the estimated sum to be paid to the Lankem on submission of a valid Bank Guarantee from a Bank acceptable to the Respondent. Accordingly Lankem had furnished an Advance Payment Guarantee No DBUGTELKR0804390 dated 24.10.2008 (A 3) for a sum of Rs. 22,080,000/- from the Appellant Bank which was valid for 06 months. Thereafter the validity of the said Bank Guarantee was extended from time to time and finally by letter dated 07.06.2013 the validity of the said Bank Guarantee was extended from 22.06.2013 to 21.09.2013 (A 4 i to A 4 xv).

The Respondent by letter dated 14.08.2013 has preferred a claim for the full value of the said Bank Guarantee (Rs. 22,080,000/-) to the Appellant Bank on the basis that the Lankem has failed to return the advance paid to them in full. Upon the said claim the Appellant, by letter dated 16.08.2013, has forwarded their pay order No 846736 for a sum of Rs. 1,371,655.19 on the basis that the remaining balance of advance payment is Rs 1,192,743.64 with the applicable taxes of Rs 178,911.55. The Appellant has further informed the Respondent that they are in receipt of payment certificates issued by the Lankem and certified by the Respondent stating that the remaining balance of advance payment is Rs. 1,192,743.64. Said letter and the said payment certificate have been produced marked A 7 and A 8.

The Respondent, whilst contending that the Appellant was not entitled to rely on the said payment certificate A 8, set out a claim for a sum of Rs 14,485,325.75 as reflected in paragraph 16 to 24 of the plaint and prayed for a judgment against the Appellant. Upon the receipt of summons of the said action, the Appellant by way of a motion dated 13.12.2013 made an application to the Commercial High Court of Colombo seeking an order to add Lankem Dvelopment Ltd. as a party defendant to the action on the basis that the Respondent has failed to join Lankem Developments Limited as a defendant upon the averments contained in the plaint.

The Appellant contended that the advance payment guarantee A 3 was not the usual advance payment guarantee as the value of the guarantee was reduced by the value of every repayment of the advance guarantee by Lankem upon receipt of certificate signed by Lankem or the Respondent. In this regard the Appellant heavily relied upon the following paragraph of the advance payment guarantee (A 3) which is as follows;

> "Provided always that if any part of the advance payment under the said contract is repaid to you, the amount of this guarantee shall automatically be reduced and we shall accordingly be entitled to write down our liability in our books under the guarantee by the full value of all and every such repayment of the said advance payment made from time to time by Lankem Developtments Ltd to you, upon receipt from Lankem Developments Ltd or you of a certified copy of a certificate of payments issued showing the amount of such repayment/s made."

The Appellant whilst admitting A 3 as an advance payment guarantee issued in favour of the Respondent to be paid on first written demand has contended that it is not the usual advance payment guarantee. His position was that if any part of the advance payment under the main contract between the Respondent and Lankem is repaid to the Respondent, the amount of the guarantee is automatically reduced and the Appellant is entitled to reduce the liability under the guarantee. It seems from the averments contained in the plaint that the Respondent also has admitted the aforesaid position. That is why in paragraphs 18, 19 and 20 of the plaint the Respondent has set out a claim for an amount less than the amount indicated in the advance payment guarantee marked A 3 when he was informed of the payment certificate (A 8) issued by Lankem. Hence I am of the view that the contention of the Appellant that A 3 is not the usual advance payment guarantee, should necessarily fail because the guarantee A 3 falls clearly within the scope of demand guarantee.

Paget's Law of Banking [12th edition Chapter 34.3 page 730] described that "The construction of a guarantee under which a bank undertakes to pay on first written demand may raise three somewhat different issues. The first is

whether the contract is a suretyship or a demand guarantee. The second is whether, if the instrument is a demand guarantee, it requires the beneficiary to assert a breach of contract by the principal. This is a question of construing the guarantee. The third is whether the documents presented by the beneficiary comply with the terms and conditions of the guarantee. This raises the issue of the required degree of strictness of compliance".

In Esal (Commodities) Ltd and Reltor Ltd. Vs. Oriental Credit Ltd and Wells Fargo Bank NA [1985] 2 Lloyd's Rep 546, CA, the words 'we undertake to pay the said amount on your written demand in the event that the supplier fails to execute the contract in perfect performance' were construed not to require the beneficiary to prove a failure to perform.

In the case of Siporex Trade SA Vs. Banque Indosuez [1986] 2 Lloyd's Rep 146 the guarantee provided 'We hereby engage and undertake to pay on your first written demand any sum or sums not exceeding US $ 1,071,000 in the event that, by latest 7 December 1984 no bankers irrevocable documentary letter of credit has been issued in favour of Siporex Trade SA by Comdel. Any claim(s) hereunder must be supported by your declaration to that effect'. Hirst J made the observation that "The whole commercial purpose of a performance bond is to provide a security which is to be readily, promptly and assuredly realisable when the prescribed event occurs; a purpose reflected in the provision here that it should be payable 'on first demand'. The defendant's approach in this part of the case would frustrate that essential purpose". In this case the guarantee was construed to be a demand guarantee.

Upon the aforesaid legal context I find no merit in the submission of the Appellant on the said terms embodied in the guarantee bond A 3.

The Appellant further contended that in view of the averments contained in paragraphs 15, 16, 17, 18 and 19 of the plaint, the Lankem is a necessary party to the action since the Appellant made the payment of the value of the guarantee of Rs 22,080,000.00 less the value of the repayment certificate (A 8) relating to the payments made by the Lankem and certified by the Respondent and then the Respondent claimed a reduced sum but greater than the sum set out in the monthly interim payment certificate (A 8) relating to the repayments made by Lankem.

On the question of addition of party as necessary party to the action the Appellant submitted that the decisions in Arumugam Coomaraswamy Vs. Andiris Appuhamy and Others [1985] 2 Sri L. R. 219 has settled the law. In this case it was held that "In deciding whether the addition of a new party should be allowed under section 18 (1) of the Civil Procedure Code the wider construction adopted by English Courts is to be preferred. Whenever a Court can see in the transaction brought before it that the rights of one of the parties will or may be so affected that other actions may be brought in respect of that transaction the Court has the power to bring all the parties before it and determine the rights of all in one proceeding. It is not necessary that the evidence on issues raised by the new parties being brought in should be exactly the same. It is sufficient if the main evidence and the main inquiry will be the same. Even if the narrower construction is adopted a person who has to be bound by the result of the action, or has a legal right enforceable by him against one of the parties to the action which will be affected by the result of the action should be joined ; so also where the question raised by the party seeking to be added is so inextricably mixed with the matters in dispute as to be inseparable from them and the action itself cannot be decided without deciding it, then the addition should be made ; if the plaintiff can show that he

cannot get effectual and complete relief unless the new party is joined or a defendant can show that he cannot effectually set up a defence which he desires to set up unless the new party is joined, the addition should be allowed."

It must be noted that the facts of the said case is totally different to the facts averred in the present case before us. In the said case His Lordships have clearly stated therein that " ……. Whenever court can see in the transaction brought before it….". Said part of the decision clearly demonstrates that Their Lordships have arrived at the said conclusion solely upon the facts adumbrated before court. Hence the dicta in the said case cannot be applied to each and every case irrespective of the facts of the case upon which it becomes necessary for addition of parties. In this regard it is pertinent to reproduce Section 18(1) of the Civil Procedure Code which reads thus;

> "18(1) The court may on or before the hearing, upon the application of either party, and on such terms as the court thinks just, order that the name of any party, whether as plaintiff or as defendant improperly joined, be struck out; and the court may at any time, either upon or without such application, and on such terms as the court thinks just, order that any plaintiff be made a defendant, or that any defendant be made a plaintiff, and that the name of any person who ought to have been joined, whether as plaintiff or defendant, or whose presence before the court may be necessary in order to enable the court effectually and completely to adjudicate upon and settle all the questions involved in that action, be added."

When one looks at the said provisions it clearly appears that a party can be added as a necessary party to a pending action in order to enable the court effectually and completely to adjudicate upon and settle all the questions involved in that action. In the present case the cause of action has arisen upon an advance payment guarantee (A 3) issued by the Appellant in favour of the Respondent. Said advance payment guarantee (A 3) inter alia stipulates that "A demand here under shall be in writing and shall precisely specify the amount demanded and state that the above named Lankem Developments Ltd has failed to repay the advance made to it. Any such demand shall be conclusive evidence that Lankem Developments Ltd has failed to repay the said advance and we are liable to pay to you the sum demanded provided the same does not exceed the limit of LKR 22,080,000.00 (Sri Lanka Rupees twenty two million & eighty thousand only) as aforesaid."

Said clause is clear and unambiguous. It precisely specifies the parties involved in the transaction and also their liabilities towards each other and also the procedure how to discharge the liabilities cast upon them. The modus operandi is very clear. Lankem has no role to play in the said recovery procedure. However it appears that the liabilities under the guarantee (A 3) are subjected to certain rights of the Appellant. The last paragraph of the advance payment guarantee on which the Appellant heavily relied upon, has set out somewhat an exceptional circumstance wherein the Appellant can deny a claim preferred by the Respondent for the total value to the advance payment guarantee. At such an instance a burden would cast upon the Appellant to prove that upon the receipt of payment certificates issued by Lankem he was entitled to write down his liability according to the payment certificate issued showing the amount of such repayments. In the circumstances Lankem need not to be added as a necessary party to the pending action between the Appellant and the Respondent. As the learned High Court

Judge correctly stated, the Appellant is at liberty to list Lankem as a witness to his case if he wishes so to do.

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 Power Curber International Ltd. Vs. National Bank of Kuwait SAK [1981] 3 All ER 607 the court expressed the view that "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.

In Harbottle (Mercantile) Ltd. Vs. National Westminster Bank Ltd. [1977] 2 All ER 862 the court took up the view that "It is only in exceptional circumstances that courts will interfere 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.

In Boliventer Oil SA Vs. Chase Manhattan Bank [1984] 1 All ER 351, 352 it was observed that "If court interferes with a bank's undertaking it will undermine its greatest asset - its reputation for financial and contractual probity."

Paget's Law of Banking 12th edition Chapter 34.2 at page 730 describes the characteristics of Demand Guarantees as follows "The essential difference between a guarantee in the strict sense (i.e. a contract of suretyship) and a demand guarantee is that liability of a surety is secondary, whereas the liability of the issuer of a demand guarantee is primary. A surety's liability is co-extensive with that of the principal debtor and, if default by the principal debtor is disputed by the surety, it must be proved by the creditor. Neither proposition applies to a

demand guarantee. The principle which underlies demand guarantees is that each contract is autonomous. In particular, the obligations of the guarantor are not affected by disputes under the underlining contract between the beneficiary and the principal. If the beneficiary makes an honest demand, it matters not whether as between himself and the principal he is entitled to payment. The guarantor must honour the demand, the principal must reimburse the guarantor (or counter-guarantor) and any disputes between the principal and the beneficiary, including any claim by the principal that the drawing was a breach of the contract between them, must be resolved in separate proceedings to which the bank will not be a party."

The autonomy principal embodied in article 2b of the Uniform Rules for Demand Guarantees published by the International Chamber of Commerce (ICC publication 458 published in October 1992) reads thus; "Guarantees by their nature are separate transactions from the contract(s) or tender conditions on which they may be based, and the Guarantors are in no way concerned with or bound by such contract(s), or tender conditions, despite the inclusion of a reference to them in a Guarantee. The duty of the Guarantor under a Guarantee is to pay the sum or sums therein stated on the presentation of a written demand for payment and other documents specified in the Guarantee which appear on their face to be in accordance with the terms of the Guarantee."

In the above context I am of the view that the dispute between the Appellant and the Respondent should be confined to them. Lankem (Principal) cannot be a party to such an action since Lankem is an outsider to the advance payment guarantee between the Appellant and the Respondent. A 3 is an independent agreement outside the main contract between the Respondent and Lankem. Hence the Appellant has no option under the guarantee A 3 but to honour

the written demand of the Respondent since it falls within the jurisdiction of the guarantee and to pay the sum therein stated in accordance with the terms and conditions of the guarantee. If the Appellant relies upon the certificates of payments issued showing the amount of repayments, he must prove it. For the said purpose Lankem need not be added as a party to the present action.

In the aforesaid circumstances I see no reasons to interfere with the order of the learned High Court Judge of the Commercial High Court, Colombo dated 20.06.2014. Therefore I dismiss the appeal of the Appellant with cost.

Judge of the Supreme Court

CHANDRA EKANAYAKE, J.

I agree.

Judge of the Supreme Court

SISIRA J DE ABREW, J.

I agree.

Judge of the Supreme Court