REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA

AT NAIROBI (MILIMANI COMMERCIAL COURTS)

CIVIL CASE 89 OF 2008

CONCORD INSURANCE CO.LTD ….....….....……PLAINTIFF

- VERSUS-

KEWAL CONTRACTORS CO. LTD..... 1ST DEFENDANT

PARMINDER SINGH MANKU…...……2ND DEFENDANT

HARJEET SINGH MANKU……...……..3RD DEFENDANT

RULING

The plaintiff filed suit seeking a declaratory order of the court that the defendants, jointly and severally are entitled to indemnify it for the sum of Kshs.15,000,000 /= and the cost of defending civil suit Nairobi HCCC No.380 of 2006 at Milimani Commercial Court. When the defendants were served with summons to enter appearance together with copies of the plaint, they filed an amended defence denying the plaintiff's claim that they were legally obliged to indemnify the plaintiff as claimed in the plaint. On 21st July, 2008, the plaintiff filed an application pursuant to the provisions of Order XXXV rules 1 and 2 of the Civil Procedure Rules seeking summary judgment to be entered in its favour as against the defendants. The application is supported by the annexed affidavit of David Njogu, the legal officer of the plaintiff and on the grounds stated on the face of the application. The application is opposed. Parminder Singh Manku, the 2nd defendant swore a replying affidavit on behalf of the defendants in opposition to the application.

At the hearing of the application, I heard submissions made by Mr. Maondo on behalf of the plaintiff and by Mr. Odhiambo on behalf of the defendant. I have carefully considered the said submissions. I have also read the pleadings filed by the parties in support of their respective opposing positions, including the cited authorities. The issue for determination by this court is whether the plaintiff established a case to entitle this court enter summary judgment in its favour as prayed in the plaint. The principles to be considered by this court in determining whether or not to enter summary judgment are well settled. In Nairobi Golf Hotels (K) Limited vs. Lalji Bhimji Sanghani Builders and Contractors CA Civil Appeal No. 5 of 1997 *(unreported)*, the Court of Appeal held at page 2 of its judgment that:

"*It is trite law that in an application for summary judgment under Order XXXV Rule 1 of the Civil Procedure Rules, the duty is cast on the defendant to demonstrate that he should have leave to defend the suit. His duty in the main is limited to showing, prima facie, the existence of bona fide triable issues or that he has an arguable case. On the other hand, it follows, a plaintiff who is able to show that a defence raised by a defendant in an action falling within the purview of Order XXXV, is shadowy or a sham is*

entitled to summary judgment. This court so held in the case of Continental Butcher Ltd vs. Samson Musila Nthiwa, Civil Appeal No. 35 of 1977 (CA) in which Madan JA (as he then was) stated the principle thus:

"*With a view to eliminate delays in the administration of justice which would keep litigants out of their just dues or enjoyment of their property, the court is empowered in an appropriate suit to enter judgment for the claim of the plaintiff under the summary procedure provided by Order 35 subject to there being no triable issue which would entitle a defendant to leave to defend. If a bona fide triable issue is raised the defendant must be given unconditional leave to defend but not so in a case in which the court feels justified in thinking that the defences raised are a sham."*

The learned Judge of Appeal was restating the words of Lord Halsbury in the English case of Jacob vs. Booths Distillery Co. 85 LTR at page 262, in which he said:

"*There are some things too plain for argument, and where there were pleas put in simply for the purpose of delay, which only added to the expense and where it was not in aid of justice that such things should continue Order XIV was intended to put an end to that state of things, and to prevent sham defences from defeating the rights of parties by delay, and at the same time causing great loss to plaintiffs who were endeavouring to enforce their rights." "*

In the present application, certain facts are not in dispute. It is not disputed that on 7th July 2005, the plaintiff issued a performance guarantee to Coastal Kenya Enterprises Limited at the request of the 1st defendant in respect of a subcontract agreement for the improvement and gravelling of a certain road. The plaintiff undertook that it would pay, on demand, the sum of Kshs.15,000,000 /= upon demand being made by the said Coastal Kenya Enterprises Limited. In particular, the plaintiff gave the following guarantee:

"*..And whereas it has been agreed by both parties that the Sub contractor shall provide with an Insurance Guarantee as a security for the compliance with his obligations in accordance with the contract…therefore we Concord Insurance Company Ltd of P.O. Box 30634, Nairobi (Hereinafter called the insurance) hereby affirm that we the Guarantor and responsible to you on behalf of the sub contractor up to a total of Kshs.15,000,000 /= (Kenya Shillings fifteen Million only) such sum being payable in types and proportions of currencies in which the contract price is payable and undertake to pay, upon your first demand and without cavil or argument any sum or sums within and up to a limit of Kshs.15,000,000 /= as foresaid without your needing to prove or show grounds or reasons for your demand for the sum specified therein. We hereby waive the necessity of your demanding the said debt from the sub contractor before presenting us with the demand."*

To secure its interest, the plaintiff in turn secured a general counter guarantee from the 1st defendant and counter indemnities from the two directors of the 1st defendant (the 2nd and 3rd defendants). In the counter guarantee executed by the 1st defendant, on the material, part the 1st defendant undertook to:

"*… indemnify the surety against all claims and liabilities under any or all of the said bonds and if the surety is called upon to pay any monies together with all costs and expenses incurred by the surety in respect thereof. In pursuance of the counter indemnity the surety shall be entitled whenever notification of claim or potential claim is received in respect of any one or more of the said bonds to call upon the indemnitor to deposit with the surety the full amount of the said bond such deposit or deposits shall be paid by the indemnitor to the surety within 7 (seven) days after requests in writing and surety may use such monies to settle such claim or claims together with costs and expenses in connection therewith. If there is a surplus in the hands of the surety after settling all such claims, costs and expenses such surplus shall be refunded forthwith to the indemnitor but if there is a deficiency then the amount of such deficiency shall be paid by the indemnitor to the surety forthwith upon request in writing."*

In the counter indemnity, the 2nd and 3rd defendants gave the following undertaking:

"*that we hereby further guarantee and counter-indemnify the payment to you by your client of all or any sum or sums that you may be obliged to pay to the said principals under or by reason of your having issued the said bond and to indemnify you and keep as indemnified against all demands, losses, liabilities, charges, expenses and costs (including your advocate's costs on an Advocate and client basis) which you may suffer, sustain, incur or be put to under or by reason of your having issued the said bond."*

On 23rd May 2006, the advocate of Coastal Enterprises Kenya Limited wrote to the plaintiff demanding payment of the sum of Kshs.15,000,000 /= due in respect of the performance guarantee. In the said letter, the said company alleged that the 1st defendant had been in persistent breach of the agreement by failing to comply with its obligations under the contract. The said company complained that the 1st defendant had abandoned the construction site. The plaintiff failed to honour the demand within the period stipulated in the performance guarantee.

Coastal Kenya Enterprises Limited being aggrieved, filed suit against the plaintiff vide Nairobi HCCC No.380 of 2006 Coastal Kenya Enterprises Limited vs Concord Insurance Company Limited. In the suit, the said company sought to enforce the performance guarantee. The plaintiff herein filed defence by which it pleaded that it could not honour the performance guarantee, *inter alia*, on grounds of fraud, concealment and misrepresentation. The plaintiff enjoined the defendants in this suit as third parties in the said proceedings. Coastal Kenya Enterprises Limited applied for the defence filed by the plaintiff in the suit to be struck out and judgment entered in its favour as prayed in the suit. The application was allowed and judgment was entered for the said company as prayed in its plaint. Okwengu J, in her considered ruling, stated as follows in regard to the defence which had been filed by the plaintiff:

"*In this case although the defendant has alleged fraud, concealment and misrepresentation, the particulars of the alleged fraud and misrepresentation given in paragraph 13 (a) to (b) of the defence, clearly show that the allegations are nothing more than an attempt to rely on the dispute between the plaintiff and the 1st third party. That cannot however provide any defence to the defendant, as the dispute cannot be used to absolve it from its liability on the performance guarantee."*

The plaintiff did not appeal against the decision. From affidavit evidence on record in this case, it is apparent that the plaintiff has already paid to the said company the amount adjudged as due in respect of the said performance guarantee.

It was after the plaintiff had honoured its obligation under the performance guarantee that the plaintiff mounted the present suit against the defendants seeking the court to compel the 1st defendant to honour the counter guarantee and the 2nd and 3rd defendants to honour the counter indemnity to indemnify the plaintiff for the sum that the plaintiff was obliged to pay to Coastal Enterprises Kenya Limited on account of the performance guarantee. The defendants filed an amendment defence to the suit in which they denied the plaintiff's claim that it was entitled to indemnity. In the said defence, the defendants pleaded, *inter alia,* that the plaintiff was not entitled to any indemnity on account of fraud by the said Coastal Enterprises Kenya Limited on account of negligence by the plaintiff in failing to vigorously and robustly defend the suit which had been filed by Coastal Enterprises Kenya Limited seeking to enforce the performance guarantee.

Having heard the submissions made by the counsel for the parties herein, and further having set out the principles which ought to be considered by this court in determining whether summary judgment should be entered against the defendants as sought in the application, it is imperative that this court weighs whether the defendants have a defence to the plaintiff's claim. The defendants urged the court to dismiss the plaintiff's application on grounds that their defence raises several triable issues, including the fact whether or not the main contractor was entitled to recall the performance bond upon breaching the terms of the underlying contract between it and the 1st defendant, whether or not the main contractor had forfeited the performance bond in favour of the 1st defendant, whether or not the main contractor committed acts of fraud under the underlying contractor between it and the 1st defendant, and whether or not the plaintiff was negligent in the conduct of the proceeding in HCCC No.380 of 2006 by failing to

defend an application for summary judgment filed therein.

Are the above issues as pointed out by the defendants to the court triable issues which can lead this court to deny the plaintiff's application for summary judgment? I am in agreement with the Court of Appeal dictum in CA Civil Appeal No.216 of 1996 Provincial Insurance Company of East Africa Limited vs Lenny M. Kivuti (*unreported*) where the Court of Appeal held that where a defendant establishes even one bona fide triable issues, he will be entitled to unconditional leave to defend. In the submissions made by counsel for the parties to this application, it was common ground, and indeed there was no dispute as to the position of the law in regard to under what circumstances a performance guarantee or bond is payable on demand. In Edward Owen Engineering Limited vs Barclays Bank International Ltd [1978] 1 All ER 976, Lord Denning MR held at page 981 as follows:

"*The law as to performance bonds.*

A performance bond is a new creature so far as we are concerned. It has many similarities to a letter of credit, with which of course we are very familiar. It has been long established that when a letter of credit is issued and confirmed by a bank, the bank must pay it if the documents are in order and the terms of the credit are satisfied. Any dispute between buyer and seller must be settled between themselves. The bank must honour the credit. That was clearly stated in Malas (trading as Hamzeh Malas & Sons) vs British Imex Industries Ltd. Jenkins LJ, giving the judgment of this court, said:

"*…it seems to be plain that the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes on the banker an absolute obligation to pay, irrespective of any dispute which there may be between the parties on the question whether the goods are up to contract or not. An elaborate commercial system has been built up on the footing that banks' confirmed credits are of that character, and, in my judgment, it would be wrong for this court in the present case to interfere with that established practice."*

To this general principle there is an exception in the case of what is called established or obvious fraud to the knowledge of the bank. The most illuminating case is of Sztejn vs J Henry Schroder Banking Corporation which was heard in the New York Supreme Court in 1941. After citing many cases Shientag J said this:

"*It is well established that a letter of credit is independent of the primary contract of sale between the buyer and the seller. The issuing bank agrees to pay upon presentation of documents, not goods. This rule is necessary to preserve the efficiency of the letter of credit as an instrument for the financing of trade."*

At page 983 Lord Denning quoted with approval the decision of Kerr J in R D Harbottle (Mercantile) Ltd v National Westminister Bank Ltd [1977] 2 All ER 862 at p 870 where he held that:

"*It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations by banks. They are the life-blood of international commerce. Such obligations are regard as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration as available to them or stipulated in the contracts. The courts are not concerned with their difficulties to enforce such claims; these are risks which the merchants take. In this case the plaintiffs took the risk of the unconditional wording of the guarantees. The machinery and commitments of the banks are on a different level. They must be allowed to be honoured, free from interference by the courts. Otherwise, trust in international commerce would be irreparably damaged."*

In the Edward Owen Engineering Limited case (Supra) Browne LJ held at page 984 as follows:

"*As Lord Denning MR has said, it is well established that in the case of a confirmed irrevocable credit in respect of a contract for the sale of goods the confirming bank is not in any way concerned with disputes*

between the buyers and the sellers under the contract of sale which underlies the credit. But I agree also that it is established that there is at any rate one exception to this rule. Lord Denning MR has already referred to the New York case of Sztejn vs J Henry Schroder Banking Corporation and has quoted what I said in Bank Russo-Iran vs Gordon Woodroffe & Co. Ltd. That exception is that where the documents under the credit are presented by the beneficiary himself and the bank knows when the documents are presented that they are forged or fraudulent, the bank is entitled to refuse payment. But it is certainly not enough to allege fraud; it must be established and in such circumstances I should say very clearly established. In Discount Records Ltd vs Barclays Bank Ltd this was one of the grounds of which Megarry J distinguished the New York case of Sztejn vs J Henry Schroder Banking Corporation. Kerr J drew the same distinction in the Harbottle case where fraud was alleged but not established."

The above decision of Edward Owen Engineering Limited *(Supra)* was cited with approval by the Court of Appeal in a recent decision of Kenindia Assurance Co. Ltd vs First National Finance Bank Ltd [2008] eKLR. It is evident from the above decisions that a court of law, unless fraud is established, will invariably enforce a performance guarantee. In the present case, there is no doubt that the 1st defendant gave a counter guarantee by which it agreed to indemnify the plaintiff from all claims and liabilities that would arise in the event that the plaintiff was called upon to honour the performance guarantee given in respect of the construction agreement. The 2nd and 3rd defendants gave a counter indemnity that they would indemnify the plaintiff in the event that a demand would be made to the plaintiff to pay the amount in the performance guarantee.

In the present suit, the defendants pleaded in their defence that they ought to be excused from being held liable to honour the counter guarantee and the counter indemnity on the grounds that the main contractor had breached the contract and further that the main contractor had committed fraud. I have carefully perused the particulars of breach and fraud pleaded by the defendants in their defence. It is clear to this court that the said particulars of breach and particulars of fraud, if proved, while constituting proper grounds for payment of damages for breach of contract, cannot constitute proper grounds to disentitle the plaintiff from holding the defendants liable on the counter guarantee and the counter indemnity. A counter guarantee and a counter indemnity are separate contracts from the underlying contract. The breach of the underlying contract cannot, I think, lead the court to entertain a plea by a party who wishes to be discharged from the counter guarantee or counter indemnity. The court will only consider whether the condition precedent to the demand of the counter guarantee or counter indemnity has been fulfilled. What the plaintiff was required to establish, and which burden it has discharged, was to prove to the required standard of proof on a balance of probabilities, that pursuant to a legitimate demand made for the performance guarantee to be paid it made such payment.

The defendants cannot run away from the legal obligation imposed on them to honour the counter guarantee and counter indemnity by making allegation of negligence on the part of the plaintiff to defend the suit in which the plaintiff had been called upon to honour the performance guarantee that it had issued on behalf of the 1st defendant. Like Okwengu J, I hold that whether the plaintiff defended the suit or not, the court would not have reached a different decision than the one it did i.e. that once a legitimate demand had been made, the plaintiff had no option but to honour the performance guarantee. The defendants are at liberty to pursue the main contractor in the underlying contract for breach of contract. Their defence, in reality raises triable issues against the main contractor and not against the plaintiff in this case.

In the premises therefore, I hold that the plaintiff has established a case to entitle this court enter summary judgment in its favour as against the defendants. The defendant's defence does not raise any triable issues that would enable this court give the defendants unconditional leave to defend the suit. The defence is sham and meant to delay the just determination of this suit. Summary judgment is entered in favour of the plaintiff as against the defendants, jointly and severally, in terms of prayer (a) of the plaint. The defendants are ordered to indemnify the plaintiff the sum of Kshs.15,000,000 /= that the plaintiff paid to Coastal Enterprises Kenya Limited in terms of the performance guarantee dated 7th July 2005 and in terms of the decree of the court in Nairobi HCCC No.380 of 2006 (Milimani Commercial Courts). The plaintiff shall be paid the costs of the application together with the costs of the suit.

It is so ordered

DATED AT NAIROBI THIS 19TH DAY OF JUNE 2009.

L. KIMARU

JUDGE