REPUBLIC OF KENYA

IN THE HIGH COURT OF KENYA
AT NAIROBI (NAIROBI LAW COURTS)
Civil Case 94 of 2007

MEA LIMITED……..…..…….PLAINTIFF

VERSUS

ECHUKA FARM LIMITED ……..…...…1st DEFENDANT

NATIONAL INDUSTRIAL CREDIT BANK ...…2ND DEFENDANT

IMPERIAL BANK LIMITED …….....….3RD DEFENDANT

RULING

There are two applications for my determination, namely the application dated 19th February, 2007 by the plaintiff and the one dated 22nd February, 2007 by the 1st defendant. The application by the 1st defendant is essentially in response to the plaintiff's application for injunction. The 1st defendant wants the suit and/or all proceedings in the suit be stayed and the dispute be referred to arbitration. I will revert to the application of the 1st defendant after making a determination on that of the plaintiff.

The plaintiff seeks orders of injunction restraining the 2nd defendant from debiting its account and paying to the 3rd defendant the amount of US Dollars 246870 on account of a performance bond issued to the 3rd defendant herein by the 2nd defendant on behalf of the plaintiff dated 18th January 2007. The other prayer is that the 3rd defendant, its agents and/or servants or anybody acting through it be restrained from executing, giving effect, suing for, calling up or demanding or enforcing the corporate guarantee, executed on its favour by the plaintiff herein until the dispute is heard and determined.

The case of the plaintiff is that it entered into a sales contract with the 1st defendant. That it undertook to supply 12500 metric tones of fertilizers to the 1st defendant for onward transmission to a 3rd party **National Cereals and Produce Board**. The plaintiff was to give a performance bond through its bank **National Industrial Credit Bank**. On its part the 1st defendant was to give a workable letter of credit acceptable to the plaintiff on or before 29th January, 2007. The sales contract between the plaintiff and 1st defendant was based on self explanatory proforma invoice which sets out the conditions of the contract. As a consequence the plaintiff gave out a corporate guarantee and performance bond through its bank.

The performance bond stated the plaintiff had undertaken to supply fertilizers to the 1st defendant, in other words the performance bond was allegedly pegged upon the contract of sale between the parties. It is alleged that the 1st defendant did not send a workable letter of credit, which was to be done on or before 29th January, 2007. As a result the plaintiff could not supply fertilizers worth US Dollars 4937,510/=

without a letter of credit from the 1st defendant. It is contended by the plaintiff that the 1st defendant breached, repudiated and/or frustrated the contract by its refusal to avail a letter of credit acceptable to the plaintiff.

In view of the conduct of the 1st defendant, the plaintiff instructed its bank to cancel and recall the performance bond which was valid until 31st March, 2007. That was allegedly done on 30th January, 2007. In an attempt to show its good faith in playing within the rules, the plaintiff even allegedly paid for the 1st defendant US Dollars 39,500/= as a commission to the 3rd defendant to open a letter of credit, which shows the plaintiff had taken an extra mile not known in the business world.

Mr. Njuguna learned counsel for plaintiff filed extensive written submission with various authorities. It is difficult to reproduce the whole material presented before me in this ruling. However the gist of his submission is as follows:- that the 1st defendant has not sent an amended letter of credit, which was an essential requirement for the fulfillment of the contractual obligations of the parties. And that time was of essence and that the plaintiff wanted to close business by 29th January, 2007 upon receipt of a valid and duly amended letter of credit. The 1st defendant failed to supply the plaintiff with a proper and valid letter of credit on or before 29th January, 2007. In answer to the default of the 1st defendant, the plaintiff on 30th January, 2007 wrote to the 2nd defendant to cancel the bond because the 1st defendant refused to return or to give a workable letter of credit.

The defendants refused to accede to the request and insisted the 2nd defendant is bound to pay for goods never procured and never supplied to a 3rd party. In any case the 3rd party has not sought to enforce the contract. According to **Mr. Njuguna** Advocate it is incumbent upon this court to determine;

(1) Were the performance bonds independent contract capable of enforcement without regard to the underlying sales contract of 18th January, 2007;

(2) Was the demand for payment or enforcement of the bond made by the 1st defendant to the 3rd defendant honest and/or enforceable;

(3) Is this proper matter for reference to arbitration;

(4) Is fraud established on the part of the 1st defendant or defendants jointly and severally;

(5) Has the plaintiff/applicant on the materials before the court established a prima facie case with a probability of success to warrant a grant of the orders sought?

(6) Would damages be an adequate remedy;

Mr. Njuguna Advocate submitted that the matter will solely depend on the interpretation of the performance bond issued on 18th January, 2007. In his view the performance bond was not irrevocable instrument but was pegged on a contract for supply of fertilizers dated 17th January, 2007 as read together with the proforma invoice of 21st December, 2006. The two instruments were incorporated in the said performance bond at the very beginning and no amount of words can change that state of affairs. He contended that the performance bond was issued pursuant to clause 7 of the sales contract dated 17th January, 2007, hence the performance bond is not an independent contract and must be read and interpreted in relation to the sales contract. The result being that the breach of the sales contract by the 1st defendant rendered the performance bond otiose and therefore the 1st defendant cannot seek to enforce it and by that the 2nd defendant cannot honour it. It is submitted that the 3rd defendant has readily admitted that the performance bond was part and parcel of the sales contract.

Mr. Njuguna Advocate further submitted that there was no consideration flowing from the 1st defendant

to the plaintiff in the contract dated 17th January, 2007. The 3rd party who was to be the recipient of the fertilizer has not lodged any claim or complaint to either 1st, 2nd or 3rd defendants therefore the 1st defendant could not be compensated for no damages incurred or anticipated. In any case there is no evidence to show that the 1st defendant had supplied any goods to the **National Cereals and Produce Board** from another source, where it incurred loss or damages. And the 1st defendant should not be rewarded for its failure to give a workable letter of credit to the plaintiff who was willing even to facilitate the issuance of letter of credit by even paying for the 1st defendant's commission to 3rd defendant bank.

It was the contention of **Mr. Njuguna** Advocate that performance bond is essentially supposed to cover losses incurred as a result of non-performance of the contract. And in the instant case the non performance was occasioned by the party seeking to enforce the bond. The bond presupposes a situation where it is the plaintiff who has failed to perform and therefore the party in whose favour the bond was issued has suffered a loss. And since the 1st defendant has not suffered any loss, its demand is dishonest and fraudulent, as it seeks to benefit from a transaction, which it was the author of the failure, by seeking to make US Dollars 246870/= for supplying nothing and for no loss at all. He relied on various authorities to support his position and in particular case of **Solo Industries U. K. Ltd v Canara Bulk (2001) EWCA C W 1041 – 1WLR** where it was held that performance of bond could be refused on the ground that the bank had a real or reasonable prospect of success in justifying avoidance of the bond. And that the court was entitled to refuse summary judgement as a beneficiary's claim under a bond where the defendant bank had a good arguable case, that the only realistic inference was either the demand was dishonest or that the bond in issue had been obtained by fraud or misrepresentation. That there was no legal or commercial justification for extending the cash principle to defeat challenges against the validity of the instrument itself as well as those to the propriety of the demand or at least there was some other compelling reasons for a trial. In essence where the challenge is to the validity of the bond rather than to the propriety of any demand under it the principles of performance bond obligation are strictly followed. And in absence of fraud on the part of the beneficiary, the bank is obliged to pay under the credit against presentation of documents appearing on their face to be in order. The court held at page 1806;

"**If there is not or if the challenge is not substantial, prima facie no injunction should be granted and the bank should be left free to honour its contractual obligation, although restrictions may well be imposed upon the freedom of the beneficiary to deal with the money after he has received it. The wholly exceptional case where an injunction may be granted is where it is proved that the bank knows that any demand for payment already made or which may thereafter be made will clearly be fraudulent. But the evidence must be clear both as to the fact of fraud and as to the bank's knowledge… In general for the evidence of fraud to be clear, we would also expect the buyer to have been given an opportunity to answer the allegation and to have failed to provide any or any adequate answer in circumstances where one could properly be expected. If the court considers that on the material before it that the only realistic inference to draw is that of fraud, then the seller would have made out a sufficient case of fraud".**

The sentiments expressed by **Mr. Njuguna** was that where the demand is dishonest or actuated by fraud an injunction ought to issue to maintain the status quo. And that the plaintiff has demonstrated beyond any shadow of doubt and laid before court material to prove that the 1st defendant's intentions are fraudulent, which assertions or depositions the 1st defendant has chosen not to respond by way of affidavit evidence. He therefore urged me to allow the application for injunction and refuse the referral of the matter to arbitration.

The reply of the 1st defendant through its Advocate **Mr. Ohaga** is as follows: That the plaintiff's cause of action is premised on an agreement dated 17th January, 2007 made between the plaintiff and the 1st defendant for the sale of 12,500 metric tones of fertilizers. The contract required the plaintiff, as the seller to provide a performance bond to the 1st defendant as the buyer for the equivalent of 10% of the bid value of the contract in the form of a bank guarantee and a corporate guarantee. The bond was to be issued in favour of the 3rd defendant which was acting as the 1st defendant's banker.

Mr. Ohaga Advocate submitted that no orders are sought against the 1st defendant therefore the plaintiff cannot fall back to section 7 of the arbitration which provides an interim measure of protection. He contended that since clause No.11 of the subject agreement provides for an arbitration, the matter ought to be referred to arbitration. The agreement clearly provided that any dispute that arises between the parties should be determined by arbitration. And since no impediments exist in the present case the suit should be stayed and the matter referred to arbitration between the plaintiff and 1st defendant.

According to **Mr. Ohaga** Advocate it is self-serving for the plaintiff to on the one hand rely on the agreement in its attempt to demonstrate breach but on the other hand attempt to resist the 1st defendant's reliance on the arbitration clause, on the premises that the same agreement has been repudiated. **Mr. Ohaga** Advocate further submitted that the primary issue in this dispute is whether or not there was a breach of the contract between the plaintiff and 1st defendant. And that the suggestion that this dispute cannot be settled by arbitration as this would involve bringing into the arbitral proceedings, parties that were not party to the arbitration clause is unsustainable.

On performance bond **Mr. Ohaga** stated that the document is like a letter of credit. He relied on the case of **Edward Owen Engineering Ltd vs Barclays Bank International Ltd (1978) 1 All ER 976 (1978) 1 Lloyds 166,** where **Lord Denning** held at page 170;

"**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 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 Hamzeh Malas & Sons v British Innex Industries (1958) 2 B. B 127 at page 129;**

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

Again at page 171 it was held;

"**the performance guarantee stood on a similar footing to a letter of credit so that a bank which gave a performance guarantee had to honour that guarantee according to its terms; the bank was not concerned with the relations between the supplier and the customer nor with the questions whether the supplier had performed his contractual obligations or not or whether the supplier was in default or not; the bank had to pay according to its guarantee on demand without proof or conditions and the only exception was when there was a clear fraud of which the bank had notice".**

Mr. Ohaga Advocate also cited the case of **Howe Richardson Scale co. Ltd vs Polmex (1978) 1 Lloyds Rep. 161,** where the court enunciated the position taken by **Lord Denning** in the above case. The court held;

"**The obligation of the bank was to perform by the particular contract and that obligation did not depend on the correct resolution of a dispute as to the sufficiency by the seller to the buyer or the buyer to the seller as the case might be under the contract".**

In essence **Mr. Ohaga** asserted that as between banks, the performance guarantee must be honoured irrespective of the nature of the dispute between the primary parties. And the courts are not concerned with the difficulties to enforce claims against each other. The plaintiff took the risk of unconditional wording of the guarantee, while the machinery and commitments of banks are on a different level. They must be allowed to honour the transaction, free from interference by the courts. He also relied on the case of **Bolinvinter Oil S. A. vs Chase Manhattan Bank, Commercial Bank of Syria and General**

Company of Homs Refinery (1984) 2 Lloyds Rep 251, where **Sir Donaldson M. R.** held;

"**the unique value of such a letter, a bond or guarantee is that the beneficiary can be completely satisfied that whatever disputes may thereafter arise between him and the bank's customer in relation to the performance or indeed existence of the underlying contract, the bank is personally undertaking to pay him provided that the special conditions are met. In requesting his bank to issue such a letter, bond or guarantee the customer is seeking to take advantage of this unique characteristic. If save in the most exceptional cases, he is to be allowed to derogate from the bank's personal and irrevocable undertaking, given be it noted at his request by that undertaking he will undermine what is the bank's greatest asset, however large and rich may be namely its reputation for financial and contractual probity. Furthermore if this happens at all frequently, the value of all irrevocable letters of credit and performance bonds and guarantees will be undermined".**

The position of the 1st defendant is that the plaintiff and its bank, 2nd defendant must pay according to the terms of the performance bond upon demand being made without any cavil or argument. And that the issue of fraud is only exceptional which cannot displace the rights of the 1st defendant in the performance bond. It is certainly not enough to allege fraud, it must be established and established clearly by the party alleging fraud. In other words the circumstances upon which it is alleged that the demand upon the performance bond is made is fraudulent must be circumstances that are known to the bank and are clearly established.

Mr. Ohaga Advocate further submitted that the wholly exceptional case where this court can grant an injunction is where it is proved that the bank knows or had knowledge that any demand for payment already made or which may thereafter be made will clearly be fraudulent or in aid of fraudulent designs by the parties or one of the parties.

Mr. Kimondo learned counsel for the 2nd defendant supported and cemented the position taken by **Mr. Ohaga** Advocate. He started by saying that the 2nd defendant issued an unconditional or open guarantee as per instructions from the plaintiff. The 2nd defendant issued the performance bond in favour of the 3rd defendant which set out clear rights and duties between the 2nd and 3rd defendant, the principal object being to pay US Dollars 246870 to the 3rd defendant on demand without argument or demand for reasons for the demand on payment.

In essence the contract between the 2nd and 3rd defendants is independent of any other contractual relationships between the plaintiff and 1st defendant. More fundamentally the 2nd and 3rd defendants became total strangers and were removed from dealings between the plaintiff and the 1st defendant and were bound only by the terms of the performance bond. In short **Mr. Kimondo** contended that there is no privity of contract between the 2nd defendant and the plaintiff. And to that extent the 2nd defendant has been improperly joined in the suit.

In conclusion **Mr. Kimondo** asserted that the plaintiff has come to court with unclean hands and has not brought itself within the corridors of granting or benefiting from the discretionary powers of the court. And since the issue is a clear sum of US Dollars 246870/= (two hundred and forty six thousand, eight hundred and seventy), which sum is measurable in monetary terms, then damages are adequate which the defendants are able to foot or pay promptly.

Mr. McCourt on his party supported the submissions of the 1st and 2nd defendants. He submitted that the performance bond issued by the 2nd defendant to the 3rd defendant is in accordance with the plaintiff's instructions. The said document is clear as to its purpose and full import. He contended that the bond was not issued fraudulently negligently and/or by mistake of facts or law by the 2nd defendant to the 3rd respondent. And that the plaintiff's assertion that the performance bond was to be issued on condition that the 1st defendant provides a workable letter of credit contradicts its letter of instructions on the issuance of the same to the 2nd defendant.

The Advocate also disclosed that the arrangements for the supply of fertilizer by the plaintiff to the 1st defendant seem to have failed sometime between 29th January, 2007 and 8th February, 2007. He also contended that there was never any requirement or stipulation that the performance bond be issued only upon provision by the 1st defendant of a letter of credit. And that the issuance by the plaintiff of the corporate bond before the condition had been met on issuing a workable letter of credit on or before 29th April, 2007 defeats the logic and substance of the plaintiff's case.

In conclusion **Mr. McCourt** learned counsel for the 3rd defendant submitted that the performance bond serves to ensure that the party instructing its issuance performs its obligations under the contract. It is not issued in payment for services or goods delivered as alleged by the plaintiff. It secures due performance of the underlying sale contract by the issuing party. And the applicant in instructing the 2nd defendant to issue the performance bond in question knew or ought to have known of the import of its actions. The instructions were explicit to the 2nd defendant as it intended to be, therefore the clear and precise wording of the performance bond in question leave no room for the plaintiff's assertion that it is conditional. The said assertion is a ploy to distort the performance bond to fit into the plaintiff's scheme to obtaining the orders it seeks. He therefore urged me to disallow the plaintiff's application for injunction.

I have considered the two applications, the materials in support of the said application. I have also read the written submissions presented by the four Advocates and the various authorities in support of the said submission. Having extensively and thoroughly read all the material meant for my consideration, I think it is time to put the rival positions of the parties into proper perspective. I must confess that the applications are not meant to determine the dispute finally and conclusively. And due to that inherent handicap, I may not consider the submissions and the legal positions taken by the parties in detail. That notwithstanding I have a duty to determine whether the plaintiff has brought itself within the province in **Giella's** case and whether the 1st defendant is entitled to refer the matter to arbitration.

The conditions set out in the grant of interlocutory order of injunction is well known. The well trodden path has to be followed and it was established in the famous case of **Giella vs. Cassman Brown & Co. Ltd** and the conditions are;

(1) An applicant must show a prima facie case with a probability of success

(2) An injunction will not normally be granted unless the applicant might otherwise suffer irreparable injury,

(3) When the court is in doubt, it will decide the application on the balance of convenience.

In my understanding an injunction is meant to protect a right which has been or is about to be infringed by the opposite party. It is usually an interim measure before the full hearing of the dispute between the parties, or that the order is intended to protect a party so that the right is not dislodged and/or displaced by the acts or omission of the defendant. In doing so the court exercises discretionary powers, which are equitable. An equity being the basis for the grant of the injunction, the parties to the dispute are required and/or expected to do equity to each other and more so to come to court with clean hands.

No doubt the plaintiff's cause of action is predicated on an agreement dated 17th January, 2007 made with the 1st defendant for the sale of 12500 metric tones of fertilizers to a 3rd party. The said contract required the plaintiff as the seller to provide a performance bond to the 1st defendant in the form of a bank guarantee and a corporate guarantee. The bond was issued by the 2nd defendant in favour of the 3rd defendant which was acting as the 1st defendant's banker.

According to clause No.7 of the said agreement, the plaintiff was to provide the buyer a performance bond of US Dollars 246875/= on or before 19th January, 2007. The plaintiff did provide a bank guarantee and a corporate guarantee for the said sum.

The 1st defendant on its part was to issue a letter of credit in favour of the plaintiff not later than 29th January, 2007. It is important to restate clause No.8 of the agreement dated 17th January, 2007 between the plaintiff and 1st defendant;

"**By a confirmed L. C. payable on 180 days to Mea Ltd P. O. Box 44480-00104 Nairobi, Kenya to be issued not later than 29th January 2007".**

While the plaintiff issued a performance bond dated 18th January, 2007 the 1st defendant is alleged to have not provided a letter of credit within the stipulated time leading to a dispute between the parties. It is essential to note that the performance bond was to cover the plaintiff's undertaking to supply to the 1st defendant 12500 metric tones at a cost of US Dollars 395 per metric ton. It is contended that the plaintiff herein duly fulfilled its obligation under the contract but by 29th January 2007 the 1st defendant herein had not given the plaintiff a workable letter of credit. And that failure frustrated and/or breached the contract between the parties, wherein the plaintiff wrote to the 2nd defendant informing it to cancel and recall for cancellation of the performance bond dated 18th January, 2007 as it was no longer necessary and/or of any use.

The plaintiff also contends that it was not possible for it to supply fertilizer under the contract without a workable letter of credit from the 1st defendant and as no such letter was received, there is no basis for seeking to enforce the performance bond at all. In short the bond ceased to have any legal effect when there was failure of consideration from the 1st defendant rendering the entire contract void.

In my understanding the sales contract had apportioned their responsibility, duties, rights, interest and obligation between the plaintiff and 1st defendant. So that what each party was to undertake or perform is duly and clearly indicated in the sales contract. The plaintiff agreed to sell or furnish to the 1st defendant 12500 metric tons of fertilizer, hereinafter called the commodity. Secondly the plaintiff was to supply the commodity within the months of January/February and March, 2007 and that the commodity to be delivered on F.O.T. Nakuru- Kenya.

Thirdly the plaintiff was to provide to the buyer a performance bond on or before 19th January, 2007 in the form of a bank guarantee for US Dollars 246875/= to be issued by the 3rd defendant, bankers of the alleged buyer. Equally the 1st defendant was to give a confirmed letter of credit in favour of the plaintiff to be issued not later than 29th January, 2007. The seller was empowered to terminate the contract according to clause 10 (c) if in its opinion such event or condition had occurred which may materially impair the benefits of the contract to itself or the buyer.

In a letter dated 29th January, 2007 the 1st defendant enclosed a letter of credit for approval or amendment by the plaintiff. The said letter states;

"**Attached is a draft L/C, could you kindly but very urgently make any amendments you may deem necessary/add information required e.g. your bankers and return to our offices or bankers – Imperial Bank Ltd, Upper Hill branch before the close of banking business today. Please note that our bank is ready to issue the required letter of credit today 29th January, 2007".**

The plaintiff got the above letter plus the alleged letter of credit and immediately replied through a letter dated the same day and which was delivered to the bankers of the 1st defendant on the same day. The plaintiff cited various and numerous problems in the letter of credit in its favour and suggested extensive amendment to the document. It also stated that the letter of credit should be made not later than 29th January, 2007 close of business. In the last paragraph the said letter states;

"**Please note that your transmission and advice of the letter of credit should be channeled through our bankers, N.I.C. Bank Ltd City Centre Branch and a workable letter of credit must be sighted by close of business today failure to which the sales contract will lapse".**

It is also clear that the plaintiff paid a sum of US Dollars 39500/= being the costs of the letter of credit opening commission. The money was paid to facilitate the preparation of the letter of credit. In business practice the gesture of the plaintiff to pay such a substantial sum of money being commission which ought to have been paid by the 1st defendant looks and/or appears unprecedented. The plaintiff sent the cheque to the 3rd defendant through a letter dated 23rd January, 2007 but on condition that the cheque should be banked after issuance of letter of credit in favour of the plaintiff.

Now let me say that performance is essentially supposed to cover losses incurred as a result of non-performance of the contract by one party. The law is that performance bond must be honoured unless the bank has clear notice of fraud. **Mr. Njuguna** Advocate stated that the plaintiff has demonstrated beyond any shadow of doubt and laid before the court materials, to prove the 1st defendant's intentions are fraudulent, which assertions or depositions the 1st defendant has chosen not to respond by way of affidavit evidence. In my view where the demand is dishonest and actuated by fraud, an injunction would issue to maintain the status quo and with a view to preserve the subject instrument till finalization and/or determination of the dispute between the parties.

In the instant case, the non-performance was largely occasioned by the party seeking to enforce the bond, which may be termed as inequitable since no loss was occasioned by the failure of the contract. The bond presupposes a situation where it is the plaintiff who has failed to perform and therefore the party in whose favour the bond was issued has suffered a loss.

There is a contention that the 1st defendant seeks to benefit from a transaction which it was the author of the failure, seeks to make US Dollars 246875/= for supplying nothing and for no loss. Such act is alleged to be dishonest and fraudulent which a court of equity cannot enforce. That may sound valid but the allegation of fraud leveled against the 1st defendant has not been proved and/or established. What makes this matter difficult especially on whether to sustain the payment of the performance bond is that the transaction looks unique.

It is unique because while the plaintiff is the seller of the goods, the 1st defendant is not legally and factually the buyer of the goods. Literally speaking the 1st defendant appears to have won a tender to supply fertilizer to **National Cereals and Produce Board of Kenya**. The transaction is worth about US Dollars 4 million and while the seller of the goods kept a performance for US Dollars 246870/= the buyer is alleged to have failed to put a valid and workable letter of credit to secure the payment of the purchase price to the plaintiff. The 1st defendant nevertheless wants to enforce the terms of the contract and is demanding payments from the 3rd defendant bank. That is what brought the two banks into this dispute.

The relevance of the two banks is that in the practice of modern commercial business, the sale of goods is arranged by means of confirmed credits by the banks on behalf of their clients usually the seller and buyer. The buyer requests his banker to open a credit in favour of the seller and in pursuance of that request, the bank issues a confirmed credit in favour of the seller. This credit is in the nature of a promise by the bank to pay money to the seller in return for the delivering the goods. The seller when he presents the documents gets paid the contract price without any argument or restrictions depending on whether the document is an irrevocable credit which has been confirmed by the parties through the intervention of their banks. The banks have an obligation to abide by the request in compliance with the terms and conditions stipulated in the document. In order to avoid non-compliance by banks, credit instruments must be complete and precise as this would guard against confusion and misunderstanding. It is therefore my humble view that issuing banks should discourage any attempt by the applicant for the credit to include excessive details or not to include the vital and essential issues.

A letter of credit and performance bond is like an undertaking by a bank to meet drafts drawn pursuant to it by the beneficiary of the credit in accordance with the conditions laid down therein. In short the instruments of credit is designed to facilitate trade. No dispute that the sale contract and subsequent delivery of the fertilizers had aborted.

It is my position that a letter of credit and a performance bond comes into being as a result of a formal

written application by the applicant usually the buyer of goods or seller, which is at the same time a request, a mandate and an indemnity. Thus instructions are the foundation on which the credit itself is based. It is essential that it should be couched in precise and unambiguous language. It is of course, the actual wording of the credit, no matter what its label, which determines its effect, since a performance bond or a letter of credit is usually restricted in its operation to a particular purpose. The performance bond in question was intended to secure the delivery and sale of the 12500 metric tones of fertilizer through a tender won by the 1st defendant. The plaintiff requested the 1st defendant to put in position a workable letter credit before 29th January, 2007. To facilitate that transaction the plaintiff paid US Dollars 39500/= being the commission for the grant of the letter of credit by the 3rd defendant.

The point of departure between the parties is that time was not of essence to the agreement between the plaintiff and 1st defendant.

The court's approach to the enforcement of obligations under instruments such as promissory notes, bills of exchange, letter of credit and performance bond has equal force and application in relation to issues going to the validity of such instruments and the nature of transaction itself without unnecessarily impeding the flow of benefits of commerce. The court would significantly not allow challenges to the propriety of demands made under instruments but the only recognized exception has been in cases of fraud. It is inappropriate for a party to be allowed to gain substantial benefits when allegations of fraud and misrepresentation is leveled against him. One issue that has heavily weighed in my mind is the conduct of the plaintiff in facilitating the preparation and securing of the letter of credit. It shows the plaintiff was acting in good faith to ensure the completion of the sales agreement dated 17th January, 2007. By putting in place a performance and a corporate guarantee, the plaintiff's conduct also gives an indication of its willingness to see through the supply of the goods.

The plaintiff was to supply goods worth US Dollars 4 million to a recipient who was not a party to the sales contract. The tender to supply the 12500 metric tones of the fertilizers was given to the 1st defendant but it sub-contracted the plaintiff to supply the fertilizers. The conduct of the 1st defendant in failing to secure the letter of credit on or before 29th January, 2007 as per the sale contract may be termed as not diligent. The plaintiff recalled and/or cancelled the performance bond because the 1st defendant, who was required to issue a workable letter of credit from a reputable commercial bank not later than 29th January, 2007 failed to do so.

The letter of credit was to secure payments for the supply of fertilizers by the plaintiff to the 1st defendant for onward transmission to National Cereals and Produce Board Nakuru. The payments terms were clear in the sales contract signed by the parties on 17th January, 2007. It gives no room for interpretation or confusion. It states;

"**Payments by a confirmed letter of credit payable on 180 days to Mea Ltd, P. O. Box 44480-00100 Nairobi Kenya to be issued not later than 29th January, 2007".**

This was followed by the letter dated 29th January, 2007 which required the 1st defendant to provide a workable letter of credit before the close of business on that day. The plaintiff is seeking an equitable remedy of an injunction to stop the party who has failed to conform to the sales agreement to take some advantage out of it. The dispute has to be determined on oral evidence to be tested through cross examination. And in order to determine the dispute, the substratum has to be preserved.

The task of the court is to penetrate any disguise presented by the language of the sales contract to identify any monetary transaction which that language was intended to conceal and to refuse to enforce the contract in so far as it would give effect to the monetary transaction that there was no difficulty in identifying the monetary transaction that was sought to be concealed by the language used in the documentary credit and underlying contract of sale. It is of fundamental importance to consider and determine the language of the sales agreement in order to understand the intention of the parties. It is also essential to take into consideration the draft letter of credit which was rejected by the plaintiff and other

correspondences in order to understand who is responsible for the alleged breach. To determine the validity and relevance of those documents at this stage would needlessly predetermine the real issues in contest between the parties at the hearing. I do not intend to prejudice the case of the parties at this preliminary stage. But let me say that the challenge to the contents and validity of the documents is substantial. Fraud is alleged and fraud is such as to entitle a bank to refuse to pay under a letter of credit or performance bond notwithstanding the strict general rule requiring payment when the documents were in order on their face. In my view the 1st defendant is not an innocent seller or beneficiary exercising his right against the confirming bank. The document presented may have no legal basis, at the end of the day depending which way the matter goes. The central foundation to the transaction is the consideration flowing from one party to other. It is unfortunately radically missing in this matter. It is only in the absence of fraud on the part of the beneficiary presenting documents under a credit, the confirming bank was obliged to pay. However in this case the plaintiff contends substantial amount of fraud was committed by the 1st defendant. In my view a request for payment is fraudulent when there is no right to payment by the beneficiary.

My opinion is that the enforcement of any right under a contract must ordinarily result from an infringement of a right known under the law or stipulated in the contract agreement. The subject contract stipulates that the 1st defendant was to perform certain acts in order to derive some benefits from the agreement. It is alleged and the material points out that it did not perform its part of the bargain, so that a party cannot have a cause of action in respect of a claim falling outside the contract. I cannot accept a party can circumvent his own part of the contract and at the same time apply to obtain and sustain benefits under that contract. One may be tempted to conclude that by failing to perform its side of the sales contract, the 1st defendant may have lost any legitimate right to rely on the terms of the contract. Such a debate needs the support of oral evidence, which can only be done at a full hearing.

On the other hand, one may argue quite rightly so that the performance bond created an obligation which is completely and distinctly independent from the obligation that was to be performed by the 1st defendant. It may also be contended that the performance bond had no relation or relevance to the validity or otherwise of the disputes between the plaintiff and 1st defendant in so far as it concerns the sale contracts and in that it created an irrevocable obligation in which the 2nd and 3rd defendants are bound to fulfill.

The plaintiff has disclosed real or reasonable prospect of success in justifying avoidance of the bond and when a party has a choice of remedies in law, he is entitled to use it as an attack and/or defence. I think this court cannot approve of the procedure adopted by the 1st defendant in the subject transaction i.e. the sales contract vis a vis the performance bond and letter of credit when parties have embodied the terms of their contract in a written document anything else cannot be used to vary or qualify the written contract. I am content to say that it convinces me to hold that the performance bond and the obligation thereunder are inseparable from the obligations of the parties under the sales contract. The basis for the plaintiff providing performance bond was in furtherance or satisfaction of the sales agreement dated 17th January, 2007. Practical good sense, with justice in mind and with the support of the law and facts, I have come to the conclusion that the plaintiff has demonstrated a wealth of material to entitle it a prima facie case. My decision is anchored on the material presented by the parties especially the inescapable conclusion that the performance bond cannot be regarded and/or treated as separate, independent and distinct from the sales contract which required the 1st defendant to avail a letter of credit within a stipulated time.

There is evidence to show that the 1st defendant somewhat deliberately refused to honour its part of the bargain and the question is whether it should be allowed to benefit from the sales contract which obliged the plaintiff to provide a performance bond of US Dollars 246875/=. The plaintiff has demonstrated that the sales contract and incidental performance bond were intertwined with the letter of credit. By incorporating the performance bond and letter of credit in the sales contract, the parties intended to go in one direction. In my view no party would be prejudiced by maintaining the status quo, as the money would be in the safe hands of the 2nd defendant. The court would have the opportunity to determine whether or not the performance bond was an independent contract capable of enforcement

without any reference to the underlying sales contract.

The court would also determine whether the instrument was intended to be irrevocable or revocable credit and whether the plaintiff is entitled to cancel or recall for cancellation. In my considered view it would be wholly inequitable for a party who had given an undertaking to remove himself from the obligations arising from their said undertaking at their own will and to the peril of the opposite party. If that were made possible the essence of performance bond and other forms of credit would have no tangible meaning.

However, the central question is whether the court should allow a party to benefit from his own default and his lack to fulfill his part of the bargain to the detriment of the other side. I think a court of equity cannot allow that to happen. I cannot accede to **Mr. Ohaga's** argument that a defendant can deprive a plaintiff of his right when it has not performed its part of the transaction and at the same time wants to obtain the full benefits of the subject transaction. That would mean equity aiding a fraudulent conduct which would be dangerous to justice and equity. I hold the view that there must be reference to the contract and the exact point of reference is whether the 1st defendant has fulfilled its obligations towards the completion of the sale contract, which it aggressively wants to benefit.

It is my decision that the plaintiff has brought itself within the realm of **Giella vs Cassman Brown** and is entitled to an order of injunction as prayed. That is what an officious by-stander would have said he understood the parties to this agreement had in mind when they incorporated the issue of the performance and letter of credit. The duties and obligations of the parties were defined in the sale agreement and I do not think the conduct of the 1st defendant would entitle it to draw a sum of US Dollars 246875/= for no work done.

In my humble view the 1st defendant has openly demonstrated commercially unacceptable practice. That needs to be canvassed and determined at full hearing and to do so the plaintiff's property must be protected from jaws of the briefcase business entity, the 1st defendant. In all probability the conduct of the 1st defendant sounds like what is nowadays referred to as **briefcase businessmen**. I do not think the briefcase of the 1st defendant can be trusted to hold safely a sum of US Dollars 246875, when there is a serious allegation of fraud made against its conduct. The second limb for the grant of injunction is therefore satisfied and ofcourse I am not in doubt, as the balance of convenience tilts in favour of the plaintiff who is desirous of safeguarding its money from certain peril.

The only question that remains is whether to give some effect to clause No.11 of the sales agreement. I appreciate that this court has powers to refer the dispute to arbitration. However, the subject contract is what brought the present dispute and there are two other parties who are not a party to the arbitration clause. I do not wish to address my mind whether the contract is inoperative or incapable of being performed.

Mr. Ohaga Advocate submitted that there is a dispute between the plaintiff and 1st defendant concerning the sales contract and the performance bond, therefore, the dispute is one which falls under clause No.11 of the sales agreement. I agree there is a dispute between the 1st defendant and plaintiff. However, the performance bond is held by 3rd parties who are not involved in the arbitration agreement. To refer the dispute to arbitration would involve bringing into the arbitral proceedings parties that are not a party to the arbitration clause.

I do not think this matter should be referred to arbitration because it is alleged by the plaintiff that the sales contract dated 17th January, 2007 ceased to have effect on 29th January, 2007 when the 1st defendant failed to provide what is alleged to have been a workable letter of credit. There is an allegation that the contract had been repudiated and there is nothing to refer to arbitration. I do not wish to determine whether the arbitration is inoperative or otherwise because that would destroy the substance of the 1st defendant's case. But it suffices to say that this matter is not one which can be referred to arbitration. That would create confusion and contradiction, as one party even before the dispute was filed had

allegedly repudiated the central contract, which is the basis why arbitration is sought. I therefore see no reason to refer the matter to arbitration.

In conclusion the application for injunction dated 19th February, 2007 is allowed in terms of prayers No. 3 and 4. And the application dated 22nd February, 2007 is dismissed. The plaintiff shall have the costs of the two applications to be borne by the 1st defendant. The peripheral parties, defendant No. 2 and 3 shall have to wait for another day and determination to be entitled to any costs.

Dated and delivered at Nairobi this 8th day of June, 2007.

M. A. WARSAME

JUDGE