



**REPUBLIC OF KENYA**  
**IN THE HIGH COURT OF KENYA AT NAIROBI**  
**COMMERCIAL & ADMIRALTY DIVISION**  
**CIVIL SUIT NO. 487 OF 2015**

**SINOHYDRO CORPORATION LIMITED.....PLAINTIFF**

**VERSUS**

**GC RETAIL LIMITED.....1<sup>ST</sup> DEFENDANT**

**EQUITY BANK LIMITED .....2<sup>ND</sup> DEFENDANT**

**RULING**

1. Before the court is the Plaintiff's Notice of Motion dated 5<sup>th</sup> October, 2015 brought under the provisions of Section 7 (1) of the Arbitration Act, 1995, Rule 11 of the Arbitration Rules 1997, Order 51 of the Civil Procedure Rules, 2010 together with sections 1A and 1B of the Civil Procedure Act, as well as Section 3A and 3B of the Civil Procedure Act Cap 21 Laws of Kenya and all other enabling provisions of the law.
2. The Applicants application is for a temporary injunction to issue to restrain the 1<sup>st</sup> Respondent or agents from recovering or making any claim arising from Performance bond reference number PGB 000066313 in the sum of USD 5,946,886.25 issued by the 2<sup>nd</sup> Respondent pending the hearing and determination of this case.
3. The application also seeks to restrain the 2<sup>nd</sup> Defendant from honoring the demand by the 1<sup>st</sup> defendant for the payment of the performance bond reference number PGB 000066313. The Applicant also prays for an order for the costs of the application.
4. The grounds of the application as set out in the Notice of Motion are that at all material times relevant to this suit, the 1<sup>st</sup> defendant engaged the Plaintiff to construct Garden City Retail Mall Phase I at the contract value of USD. 49,557,385.00 Inclusive of VAT for the execution and completion of the works.
5. Pursuant to Clause 4.2 of the contract executed by the Plaintiff and the 1<sup>st</sup> Defendant, the Plaintiff was under contractual obligation to provide a Performance Bond from Prime Bank as security for performance of the contract. The Plaintiff however instructed the 2<sup>nd</sup> Defendant to issue the said bond in irrevocable terms. The 2<sup>nd</sup> Defendant thereafter issued the said bond of USD 5,946,886.25 on 29<sup>th</sup> July, 2013, whereby the 1<sup>st</sup> Defendant was named as the beneficiary, the Plaintiff as the Principal and the 2<sup>nd</sup> Defendant as the agent of the Plaintiff. A dispute arose as to the completion of the works between the parties to the construction contract.
6. The 1<sup>st</sup> Defendant alleged breach of the contract and issued a demand dated 25<sup>th</sup> September, 2015 to the 2<sup>nd</sup> Defendant, for the payment of the said bond. The terms of the subject bond specified

that it was payable within 5 days of the demand having been received.

7. It is the Plaintiff's contention that the 1<sup>st</sup> defendant act of calling for and demanding for the payment of the performance is not only premature, but the same is motivated by fraud, misrepresentation or deliberate suppression of material facts.

### **THE PLAINTIFF'S CASE**

8. The application was supported by the affidavit, further affidavit and supplementary affidavit of Zhang Haifeng, described as the Deputy regional Manager of the Plaintiff, sworn on 5<sup>th</sup> October, 2015, 9<sup>th</sup> November, 2015 and 14<sup>th</sup> December, 2015 respectively. The supplementary affidavit sworn by Xia Anquan on 20<sup>th</sup> January, 2016 was also filed in support of application. The Plaintiff also filed consolidated submissions on 9<sup>th</sup> February, 2016.
9. The Plaintiff contended that it faced several challenges, such as late approvals by the project manager, variations and delays by nominated subcontractors that led to delays in the works not being completed within the contractual period. The Plaintiff's case was that there was a dispute as to who or what led to the failure of the completion of the works within the contractual timeframe.
10. That to arrest the situation, the parties had started a negotiation process as to the possible extension of the completion period. The said negotiations were at an advanced stage and were ongoing before the 1<sup>st</sup> Defendant decided to issue a demand for the payment of the performance bond.
11. According to the deponent, the said act was premature as clause 20 of the contract provides for alternative dispute resolution in the event of a dispute, an avenue that the 1<sup>st</sup> Defendant had not explored before calling up the performance bond. That in the foregoing, the case satisfies the principles upon which an injunction can be granted under section 7 of the Arbitration Act as granted.
12. The Plaintiff further alleges that the Project Managers and the Engineers, Mentor Management Limited, contracted to carry out the construction works as well as the 1<sup>st</sup> Defendants have common directorship. That therefore Mentor Management Limited could not objectively determine the dispute of extension of time and the alleged breach of contract, due to the likelihood of abuse.
13. It is the case of the Plaintiff that the failure to disclose the conflict of interest by the common directors of the aforementioned companies amounted to fraud against the Plaintiff. It was further contended that the delay was substantially caused by the 1<sup>st</sup> Defendant. That since the 1<sup>st</sup> Defendant was partly to blame for the delay complained of, it cannot therefore call for the payment of the bond having substantially contributed to the circumstances leading to the delay of the works.
14. The Plaintiff further stated that it had a good claim for extension of time, a fact that is not denied by the 1<sup>st</sup> Defendant.
15. Further to the above, it was the Plaintiff's case that it was not a stranger to the Performance bond as it is named as the Principal and the 2<sup>nd</sup> Defendant as its agent. That the terms of the said bond indicate that it can sue under the same. Additionally, it was the contention of the Plaintiff that the alleged financial obligation to third parties the 1<sup>st</sup> Defendant owes, cannot be used as a reason to demand payment under the performance bond.
16. The Plaintiff reiterated that the performance cannot be used as a collateral contract to any contracts with third parties. That it therefore goes without saying that the payment of the Performance Bond can only be done when the contractor fails to perform the terms, obligations and provisions of the contract.
17. The Plaintiff also told the court that dispute resolution vide negotiation, mediation and subsequent arbitration were intricately intertwined to the performance bond and the payment of the same would greatly prejudice the Plaintiff and would defeat the purpose of alternative dispute resolution.
18. The Plaintiff in the further affidavit, contended that its application for extension of time was never objectively considered by the Project manager, since the decision against extension of time was made by the 1<sup>st</sup> Defendant as opposed to the Project manager. It was therefore the Plaintiff's

position that the 1<sup>st</sup> Defendant's purported consideration was a usurpation of power of the project manager contrary to the terms of the contract.

19. That the same amounted to bad faith and dishonesty. Due to the foregoing reasons the Plaintiff sought that temporary orders for interim relief be granted in the interests of justice as it would suffer extensively and its rights under the Contract prejudiced if the injunctive orders were not granted pending the hearing and determination of the suit.

## **1<sup>ST</sup> DEFENDANTS CASE**

20. The application was opposed by the 1<sup>st</sup> Respondent who filed the Replying Affidavit, Supplementary Affidavit and 2<sup>nd</sup> Supplementary Affidavit of Michael Kingshott, sworn on 20<sup>th</sup> October, 2015, 30<sup>th</sup> November, 2015 and 4<sup>th</sup> February, 2016 respectively. The 1<sup>st</sup> Defendant's written submissions, further submissions and further supplementary submissions were also filed on 3<sup>rd</sup> December, 2015, 19<sup>th</sup> January, 2016 and 5<sup>th</sup> February, 2016 respectively.

21. The 1<sup>st</sup> Defendant's case was that the Performance Bond was between itself and the 2<sup>nd</sup> Defendant and was a distinct Contract from the main contract. That as a result, the Plaintiff had no right to stop payment of the same as it was irrevocable and payable on demand. That further the Bond could be called upon irrespective of any dispute between the Plaintiff and the 1<sup>st</sup> Defendant and was not subject to arbitration.

22. Further, the 1<sup>st</sup> Defendant states that by attempting to connect the performance bond with the contract, the Plaintiff was attempting to re-write the contract between the parties. The 1<sup>st</sup> Defendant went on to blame the Plaintiff for massively delaying the completion of the construction works despite revising the completion date from 21<sup>st</sup> October, 2014, then to 31<sup>st</sup> October, 2014 and finally to 30<sup>th</sup> January, 2015.

23. Further the 1<sup>st</sup> Defendant stated that as a result of the delay in completion of the project, it suffered an estimated loss of USD. 1,500,000.00. That in addition, the 1<sup>st</sup> Defendant requires the performance bond to be paid so that it can meet some of the obligations to third parties that include, sub-contractors, suppliers employed by the plaintiff but not paid by the Plaintiff; penalties due to the tenants under the agreements for lease delayed by the completion of the mall; management fees due to Broll as well as the repayment of loan facilities and interest charges.

24. The deponent also denied that it acted fraudulently, in bad faith or dishonestly as contended by the plaintiff. That the issues of common directorship between itself and Mentor Management Limited is a matter of public knowledge of which the Plaintiff knew about when it started dealing with the 1<sup>st</sup> Defendant. In the foregoing, the 1<sup>st</sup> Defendant argued that the Plaintiff cannot complain on something that it had acquiesced to by its conduct.

25. In short, it was the 1<sup>st</sup> Defendants' argument that the issue of common directorship was a non-starter and irrelevant in the determination of whether or not the performance bond should be paid. With regard to the issue of extension of time sought, it was the deponent's assertion that it had submitted the request of extension of time to an expert who opined that the extension request was not merited.

26. That this opinion informed the decision of the Project Manager, that is Mentor Management Limited, to deny the request for extension. That further, the deponent wrote a letter dated 5<sup>th</sup> June, 2015 wherein he informed the Plaintiff that the reason for the non-extension was that the Plaintiff had not completed the works strictly in terms of clause 8.2 of the contract. The 1<sup>st</sup> Defendant further contended that the process for dispute resolution as to whether or not there was breach of contract was a long process without any precise timelines yet the Performance Bond has an expiry date.

27. That had it been the express intention of the parties to peg the determination of the dispute on the payment of the performance bond, nothing would have been easier than to state so in either the underlying contract or the bond. The 1<sup>st</sup> Defendant therefore urged the court not to allow the Plaintiff's application.

## **2<sup>ND</sup> DEFENDANT'S CASE**

28. In rejoinder to the application, the 2<sup>nd</sup> Defendant filed the Replying Affidavit of John NyanjuaNjenga sworn on 12<sup>th</sup> November, 2015. The 2<sup>nd</sup> Respondent also filed its written submissions on 12<sup>th</sup> November, 2015.
29. It was the contention of the 2<sup>nd</sup> Respondent that it was aware of the subject dispute and that it was in no way involved in the contractual obligations and disputes between the 1<sup>st</sup> Defendant and the Plaintiff. The deponent averred that it has always been ready and willing to comply and effect the Performance Bond in question as per the terms.
30. That it had not done so, due to orders of the Court granted on 7<sup>th</sup> October, 2015 restraining it from paying up the said performance bond. Further, the 2<sup>nd</sup> Defendant clarified that it did not delay or settle or pay out the performance bond upon receiving the 1<sup>st</sup> Defendant's demand within the stipulated timelines.
31. The reason offered was that the 2<sup>nd</sup> Defendant had to first authenticate the demand sent to it by an entity known as CIM Corporate Services Limited in Mauritius which was not the entity upon which the performance bond was issued in favour of. The deponent also added that it informed the Plaintiff that the 2<sup>nd</sup> Defendant had received a demand from the aforesaid company.
32. But before the 1<sup>st</sup> Respondent could verify or respond to the 2<sup>nd</sup> Respondent's request for verification, the 2<sup>nd</sup> Respondent was served with court orders barring it from effecting the subject bond. That it was in obedience of this court orders that the 2<sup>nd</sup> Respondent did not pay the performance bond upon demand. The 2<sup>nd</sup> Defendant asserted that it was not averse to paying the performance bond and was ready and willing to abide by any orders made by this court with respect to effecting the Performance bond.

## ANALYSIS

33. I have given due consideration to the Applicant's application, the affidavit evidence, the submissions of Counsel and authorities availed to the court. I will commence by stating that though the instant application is brought under the provisions of Section 7 (1) of the Arbitration Act, I note that the dispute between the Plaintiff and the 1<sup>st</sup> Defendant is yet to be referred to arbitration pursuant to sub-clause 20.5 of the main contract between the Plaintiff and the 1<sup>st</sup> Defendant.
34. Thus, it is my opinion that the case of **Safaricom Limited –vs- Ocean Beach hotel Limited & 2 Others ( 2010)** should be distinguished from the instant case, since in that case the court of appeal was dealing with a matter that had been already been referred to arbitration by the respective parties. Further, in the aforementioned case the court held that for an injunction to issue, the subject matter of the arbitration must be under threat.
35. The subject matter under threat was further described as assets that need to be preserved until an arbitral tribunal can give its decision. In this matter, it is not clear what the subject matter of the arbitration would be, since the dispute is yet to be referred to arbitration. I also find that the Applicant has also failed to identify what the subject matter of the arbitration would be. It is highly unlikely that the monies of to be collected under the performance guarantee would be the basis of the arbitration.
36. Further, as this is a case with regard to interim orders against the payment of a performance bond the doctrines enounced under the **Giella –vs- Cassman Brown** may not be suited for this situation as I will discuss later on this ruling. Thus, it is my finding that the court in this matter will have to proceed to determine this application on whether the Plaintiff has presented an arguable case to warrant the grant of an injunction against the Defendants.
37. Before delving into the whether or not the Plaintiff has attained the aforementioned threshold, it is important to note that the Applicant's case raises substantial questions to be investigated, especially with regard to whether or not there was breach of the contract. A lot has been said about which party was responsible for any delay experienced with the performance of the contracted works as per the contract in question.
38. As matters stand now, I have to agree with the submissions of the respective parties that this court has no the jurisdiction to hear and determine the dispute between the Plaintiff and the 1<sup>st</sup> Defendant as no dispute had been placed before it for determination. Any dispute with regard to

- breach of the main contract must be referred to arbitration proceedings for hearing and determination, as was the intention of the parties.
39. Having said that, upon perusal of the pleadings, it is quite clear that the suit herein was merely to back up the Plaintiff's application seeking interim measures of protection. The arguments advanced by the Plaintiff are to the effect that determination of the contract for non-performance was caused by the 1<sup>st</sup> Defendant itself and it would be inequitable to liquidate the Performance Bond for the alleged default of the Applicant.
40. Secondly the Applicant's case is that the basis of making the demand for payment under the performance bond, is by itself tainted with actual bias and financial interest, since the 1<sup>st</sup> Defendant, and the Project Manager, Mentor Management Limited have common directorship. That in short there was fraudulent conduct on the part of the 1<sup>st</sup> Defendant when calling for the payment of the performance bond.
41. Further to this, the Applicant maintains that performance bond was part and parcel of the main contract and that the purpose of the bond was to secure the performance of the contractor and was therefore not intended to be of benefit to the 1<sup>st</sup> Defendant. Further, the Plaintiff urged that the 1<sup>st</sup> defendant cannot make a baseless demand with no justifiable cause.
42. In this breath, it was submitted that it has not been established that the Plaintiff failed to observe or perform any term, condition or provision of the main contract to warrant a demand for payment under the performance bond.
43. The 1<sup>st</sup> Respondent response to the above submissions was that it is clear that there exists a genuine dispute between the parties to the main contract that is subject to arbitration. The claims and cross claims between the Applicant and the 1<sup>st</sup> Respondent are quantifiable and the successful party will be adequately compensated by an arbitration award.
44. The 1<sup>st</sup> Respondent maintained that the parties were yet to commence the arbitration and there were no timeline for the same. It was urged by learned counsel to the 1<sup>st</sup> Respondent, that the express terms of the Bond are that despite the existence of a dispute between the parties, the same does not prevent the 1<sup>st</sup> Respondent from calling on the Bond nor does it require that payment must await final award.
45. That in fact, imposing such requirement would defeat the commercial imperatives behind the provision of an on demand guarantee such as the subject bond. As far as the law is concerned, the 1<sup>st</sup> Respondent's case is that in such cases, the principle of autonomy of contracts applies. That the only exception to the principle is where the Applicant advances a ground of fraud of the beneficiary to the bond.
46. The 1<sup>st</sup> Defendant in line with this denied that the claim under the bond is riddled with fraud. According to it, the allegations with regard to common directorship of the companies involved in the construction works are mere allegations that cannot suffice. The 1<sup>st</sup> Respondent therefore commended the court to dismiss the application and the prayers sought therein.
47. Having considered the rival arguments as above, I find that the following issues fall for determination;

- a. ***Whether the Plaintiff was party to the performance bond;***
- b. ***Whether the performance bond is part of the main contract;***
- c. ***Whether the demand for payment of the bond was fraudulent;***
- d. ***Whether the Plaintiff is entitled to interim injunction as prayed.***

I propose to address each of these issues as hereunder.

- a. ***Whether the plaintiff was a party to the performance bond;***

48. The 1<sup>st</sup> defendant stated that the Plaintiff is not a party to the Performance Bond and cannot therefore sue under it. The Plaintiff however rebutted this argument by stating that the Performance bond was issued for its benefit as per the main contract, otherwise it would have no right to sue under it. The case of **Karuri Civil Engineering (K) Ltd –vs – Equity Bank Limited Milimani Commercial & Admiralty Civil Case No. 694 of 2008 (UR)** was cited in support of

- this position.
49. Having considered the above arguments, it must be noted that a performance security bond is a three-party agreement between the principal, the obligee, and the surety in which the surety agrees to uphold, for the benefit of the obligee, the contractual obligations of the principal if the principal fails to do so.
50. If the principal fulfills its contractual obligations, the surety's obligation is void. However, if the principal defaults on the underlying contract, the obligee can make a claim against the surety under the surety bond. See the definition of **Performance Security Bond in Black's Laws Dictionary, 8th Edition**.
51. However, this definition only serves to illustrate how a performance bond is structured and secured. Due to the autonomy principle that I will discuss shortly, the subject performance bond was coached in specific terms making it an on-demand performance bond. It is therefore distinct from the main contract.
52. The parties to it are the 2 defendants/ respondents. Nevertheless it is my finding that despite the lack of privity, the plaintiff herein can approach this court to issue an injunction against the Defendants in this particular case since it has been alleged that the 1<sup>st</sup> Defendant acted fraudulently in calling up the performance bond.
53. In such a situation, the law applies the maxim "*ex turpicausa non oritur action*", or '*fraud unravels all*' and enables the 'fraud' rule to function as an exception to the privity rule. I therefore find that given the circumstances of the instant case, the Plaintiff can sue under subject the performance bond.

**b. Whether the performance bond is part of the main contract;**

54. The parties made extensive submissions on this particular issue with various authorities. It is difficult to reproduce the whole material presented before the court for the purposes of this ruling. However the gist of the submissions of the Plaintiff is that the performance bond is intricately intertwined to the main contract and that the two cannot be separated from each other.
55. The cases of **Mea Limited –vs- Echuka Farm Limited & 2 Others (2007) eKLR** and **Itabuild Imports Limited –vs- A.I.C Kijabe Hospital & Another (2015)** were cited in support of this position. Further to these arguments, the Plaintiff pointed out that clause 4.2 of the main contract reveals that the performance bond was issued as part of the main contract and therefore the Plaintiff cannot be said to be a stranger to the Performance bond contract.
56. On the part of the 1<sup>st</sup> Respondent, the performance bond contract is separate and distinct from the contract between the principal and beneficiary. The cases of inter alia **Edward Owen Engineering Ltd –vs- Barclays bank International Limited (1978) 1 AllER 976** and **Comdel Commodities Ltd –vs- Siporex Trade SA (1997) 1 Lloyd's Rep 424** were cited in support of these arguments.
57. I have considered the above submissions. According to Black's Law Dictionary Tenth Edition by Bryan A. Garner at Page 1319, the term Performance Bond is defined as follows :-

***“ A bond given by a surety to ensure the timely performance of a contract”***

58. In **Paget's Law of Banking (12th edition 2003)** at page 730 the learned authors stated as follows :-

***“The principal that underlies demand guarantee is \_\_\_\_\_ autonomous. In particular, the obligations of the guarantor are not affected by the disputes under the underlying contract between the beneficiary and the principal. If the beneficiary makes an honest demand, it matters not that between himself and the principal he is entitled to payment. The guarantor must honour the demand....” (emphasis added)***

59. Further in Halsbury's Laws of England, Fourth edition, Volume 41 at Page 819 on Performance Guarantees and Bonds states as follows ;

***“960. Nature and effect. Some commercial contracts include provision for one party, often the***

***seller, to procure a so-called performance guarantee or bond from a bank or an insurance or other company in favour of the other contracting party. A performance guarantee or bond commonly provides for payments to be made on the demand of the beneficiary. The contractual obligations arising under such guarantees or bonds are separate from and not dependent upon those existing under the sale contract between the seller and the buyer.***” (emphasis mine)

60. Further, in the leading case of **Edward Owen Engineering Ltd v Barclays Bank International Ltd [1978] 1 All ER 976**, concerned a performance guarantee. Lord Denning quoted American Practice in the case of **Sztejn v J Henry Schroder Banking Corp ((1941) 31 NY Supp 2d 631 at 633)** where it was held that:

***‘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. ... the principle of the independence of the bank’s obligation under the letter of credit should not be extended to protect the unscrupulous seller.....’*** (emphasis added)

61. Further at page 982, the Lord Denning stated thus;

***“All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit.”***

62. From the string of authorities and texts, it is clear that a performance bond is a separate and distinct contract between the principal and beneficiary. It is an on-demand bank security that is autonomous from the underlying contract and is a separate undertaking from the underlying contract. I hold so, despite the court decisions cited in the **Mea Limited (supra)** and **Itabuild (supra)** Case which I note are from courts of similar jurisdiction, therefore are only of persuasive value.

63. Further I have read sub clause 4.2 of the main contract and the same states as follows;

***“contractor shall obtain (at its cost) a Performance Security, in the amount set out in the Appendix to Tender. Contractor shall deliver the Performance security to Employer within 15 days following the issuance of the letter of Acceptance. The performance Security shall be issued by a Prime Commercial Bank in the form set out in Schedule 4 to this appendix or in another form approved by Employer .....*”**

64. From the above, it is clear that the Applicant was only obliged as part of the contract to secure the above-mentioned performance security/bonds. However the performance bond document speaks for itself. It was issued by the 2<sup>nd</sup> Respondent bank in favour of the 1<sup>st</sup> Respondent. The contract only gave the obligation to provide the guarantee. The guarantee itself is however an independent document and can stand on its own.

***c. Whether the demand for payment of the bond was fraudulent;***

65. Having held as above, it is important to note that it has been held in a number of cases that any dispute between the Applicant as the Contractor (the supplier of services) and the Respondent as the Employer (the consumer of services) does not have to affect the person who issued the Performance Bond or Advance Payment Guarantee. A bank which gives a performance guarantee must honor that guarantee according to its terms unless there is fraud of which the bank has notice of.

66. In the case of **Edward Owen Engineering Ltd (supra)** the court stated as follows;

***“A bank which gives a performance guarantee must honor 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; or 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”( emphasis added)**

67. Further in the case of *Kenindia Assurance Company Limited vs. First National Finance Bank Limited Civil Appeal No. 328 of 2002* the Court of Appeal also held as follows;

***“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 contractual 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 clear fraud of which the bank has notice.....As to the fulfilment of the conditions incorporated in the guarantee the statement of the beneficiary shall be taken at its face value unless the contractor can establish that the beneficiary’s stand is motivated by fraud, misrepresentation, deliberate suppression of material facts or the like of which would give rise to special equities in favour of the contractor. In absence of such elements the bank guarantee has to be honoured by the bank and the beneficiary cannot be restrained from enforcement..... The performance bond in the instant case is in the nature of a covenant by the appellant to pay upon the happening of a particular event. It is a form of security guaranteeing payment by a third party and in such cases the most important factor to consider before liability can attach is whether there has been default. Once default is established and that there has been a formal demand the other conditions are of a secondary nature and may not be used to defeat the security.....Performance bonds fulfil a most important role in international trade. If the seller defaults in making delivery, the buyer can operate the bond. He does not have to go too far away countries for damages, or go through a long arbitration. He can get damages at once, which are due to him for breach of contract. The bond is given so that, on notice of default being given, the buyer can have his money in hand to meet his claim for damages for the seller’s non-performance of the contract. The courts must see that these performance bonds are honoured. The courts always recognize that the bonds affected the ‘tempo’ of the parties’ obligations but not their substantive rights.....In the instant case the appellant’s obligation was to pay upon demand which the obligation was established when it was served with a notice of default and upon a demand of payment being made. Liability to pay in the circumstances is not and cannot be an issue.”( emphasis mine)***

68. Similarly in *Transafrica Assurance Co. Ltd vs. Cimbria (EA) Ltd [2002] 2 EA 627 (CAU)*, it was held:

***“A performance bond has many similarities to a letter of credit and it has long been 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 a buyer and seller must be settled between themselves and the bank must honour the credit.....A bank or institution giving a performance bond is therefore bound to honour it in accordance with the terms of the bond if it appears the papers are in order regardless of any dispute between the buyer and the seller arising from the contract in respect of which the bond was given. It is only excused where there is fraud of which it has notice.” (emphasis added)***

69. Again in *KamroAgrovot Limited vs. CevaSanteAnimale& Others Kisumu HCCC NO. 45 of 2008*, the Court held:

***“A performance guarantee was similar to a confirmed letter of credit. Where, therefore a bank had given performance guarantee it was required to honour the guarantee according to its terms and was not concerned whether either party to the contract which underlay the guarantee was in default. The only exception to that rule was where fraud by one of the parties to the underlying contract had been established and the banks had notice of the fraud. As to the fulfilment of the conditions incorporated in the guarantee the statement of the beneficiary shall be taken on its face value unless the contractor can establish the beneficiary’s stand is motivated by fraud,***

***misrepresentation, deliberate suppression of material facts or the like of which would give rise to special equities in favour of the contractor – In absence of such elements the bank guarantee has to be honoured by the bank and the beneficiary cannot be restrained from enforcement.”***

70. From the above cited authorities, it is clear that disputes between the parties to the contract should not concern the 2<sup>nd</sup> Respondent who has issued a performance security bond unless there is fraud by one of the parties of which the 2<sup>nd</sup> Respondent has notice.

71. Further I have also looked at the terms of the performance bond contained at page 67 of the Applicant's application. Paragraph 3 of the same states as follows;

***“ 3. Payments due under this Bond shall be made notwithstanding any dispute between the Beneficiary and the Principal and whether or not the Beneficiary and the Principal are or might be under any liability towards one another. For avoidance of any doubt proof of occurrence of a breach is not required. The Beneficiary shall not be obliged to pursue any means of recourse against the Principal before being entitled to enforce this Bond against the Surety and the Beneficiary shall be at liberty to compromise, release, waive, or neglect any Surety as it sees fit without impairment of its rights under this bond.”***

72. It is clear from the above terms of the performance bond that the liability of the 2<sup>nd</sup> Respondent under the bond is not dependent on any dispute between the 1<sup>st</sup> Respondent and the applicant arising from the contract in respect of which the bond was given. This is in line with the legal position regarding performance bonds. It is only in exceptional cases that the court will interfere with the payment of a performance bond/ guarantee.

73. The party seeking the injunction must show that the demand on the bond or guarantee is fraudulent and the bank knew it to be fraudulent. As held in the case of **Harbottle, [1978] 1 Q.B. at 155-56**. Kerr, J., said that;

***“It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international commerce. Such obligations are regarded 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 banks are on a different level. They must be allowed to be honoured, free from interference by the courts. Otherwise, trust in international commerce could be irreparably damaged.”***

74. The question that therefore falls for determination at this point is whether the Applicant has demonstrated that there was any fraud involved when the demand for the performance bond was made and more so, whether the 2<sup>nd</sup> Respondent had knowledge of it.

75. In trying to establish fraud, it was the Applicant's position that it had been dealing with the 1<sup>st</sup> Respondent and the Project manager, Mentor Management limited thinking that the two are independent of each other. That it however, later discovered that Mentor Management Limited and the 1<sup>st</sup> Respondent shared directors and were actually owned by one other company known as Actis Africa Limited.

76. That indeed the 1<sup>st</sup> Respondent acknowledged these facts through the affidavit of Michael Kingshott sworn on 4<sup>th</sup> February, 2015. It was therefore the Applicant's argument that Mentor management have financial interest in any dispute between the 1<sup>st</sup> Defendant/ Respondent and any other party. That there is a likelihood of bias in any decision made by Mentor Management limited in favour of the 1<sup>st</sup> Defendant/Respondent.

77. Further, it was the Applicant's argument that the basis of making the demand for payment of the Performance bond was a result of determination by the Mentor management limited. Further to this, the Applicant submitted that the Project manager, Mentor Management acted maliciously and without authority when adopting the Employer's assessment of the applicants claim for extension of time without making a fair determination in accordance with the contract.
78. That the contractor was never given a chance to be heard nor was the application considered on merits. According to the Applicant the Project manager thus failed to act impartially and within the terms of the Contract. That the determination therefore fails under sub clause 3.5 of the conditions of contract and the same was therefore motivated by fraud, misrepresentation, deliberated suppression of material facts.
79. In response to this submissions, it was the 1<sup>st</sup> Respondent's argument that the Plaintiff did not present any clear evidence of fraud, only mere allegation. That in essence, without material evidence in support of the allegation of fraud, mere words could not suffice. It was also the 1<sup>st</sup> Defendant's assertion that if fraud is alleged, the same has to be made by the bank (surety) and not the principal. That in this case, the 2<sup>nd</sup> Respondent has no issues with paying the demand on the Bond and no allegation of fraud against the 1<sup>st</sup> Respondent has been raised by the 2<sup>nd</sup> Respondent.
80. With regard to the common directorship of the Project Manager and the 1<sup>st</sup> Defendant, it was the 1<sup>st</sup> Respondent's argument that the same is baseless as the issue of directorship was known by the plaintiff. That further, it was public knowledge that the 1<sup>st</sup> Respondent was a subsidiary of Actis group of companies which was widely publicized as being the developer behind the Garden City mall.
81. Further to this, its acquisition of the Mentor management limited was also reflected in the annual returns filed at the companies' registry in Kenya for the year 2012. That in addition the common director of which the Plaintiff speaks of in the 1<sup>st</sup> Respondent Company and the Project manager was Michael Turner. The said person has been a director in Mentor management limited since 5<sup>th</sup> July 2011 a situation captured in the Notification of change of directors and secretaries dated on 26<sup>th</sup> august, 2011.
82. In sum, it was the 1<sup>st</sup> Respondent's assertion that it bears no general duty to disclose the sharing of one common director by the 1<sup>st</sup> Respondent to the Applicant when the same was a matter of public record at the relevant companies' registries. In the foregoing, it was the 1<sup>st</sup> Defendant's submission that the Applicant is merely clutching at straws in raising the issue of the relationship between the Mentor management limited and the 1<sup>st</sup> Defendant.
83. I have noted the arguments advanced by the rival parties. It is important to state that courts will not enjoin payment of a demand bond or bank guarantee unless the party seeking the injunction can show that the demand on the bond or guarantee is fraudulent and that the bank knew it to be fraudulent. So what then, constitutes fraud when a beneficiary calls for a performance bond? In my opinion, 'Fraud' essentially means presenting a claim which the beneficiary or in this case the 1<sup>st</sup> Defendant, knows to be an invalid claim.
84. In this case, the party alleging the fraud is not the bank but the Principal. I have noted the averments of the 2<sup>nd</sup> Respondent's replying affidavit. The issue of fraud does not arise. Be that as it may, this court will still have to examine the allegations of fraud brought forth by the Plaintiff/Applicant. Before doing so, it is important to note that the evidence of fraud must be clear, both as to the fact of fraud and as to the bank's knowledge.
85. The mere assertion or allegation of fraud would not be adequate. This was stated by **Ackner, L.J.** in the case of **United Trading Corporation S.A. v. Allied Arab Bank Ltd (C.A. July 17, 1984)** where it was held that;

***“The evidence of fraud must be clear, both as to the fact of fraud and as to the bank's knowledge. The mere assertion or allegation of fraud would not be sufficient ..... We would expect the court to require strong corroborative evidence of the allegation, usually in the form of contemporary documents, particularly those emanating from the buyer. 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 the only realistic inference to draw is that of fraud, then the seller would have made out a sufficient case of fraud.”***

86. Has the Applicant presented clear corroborative evidence of fraud on the part of the 1st Defendant at this stage? Bearing in mind that this is an interlocutory application for an order for an injunction restraining the 1<sup>st</sup> defendant from receiving moneys under the bank performance bond, there is no question of pleading or proof as such, but a question of the applicant placing sufficient affidavit evidence before the court, so as to enable the court to be satisfied, not necessarily beyond reasonable doubt, that a case of fraud or the likelihood of fraud being committed has been established to an extent sufficient for the court to be minded to order the injunction sought.
87. After examining the affidavit evidence presented by the respective parties, I find that the mere fact that there existed common directorship between the 1<sup>st</sup> Defendant and its project manager Mentor Management limited does not in itself point to fraud. In other words, the Plaintiff /Applicant ought to have clearly demonstrated to this court that the common directorship led to fraudulent conduct on the part of the 1<sup>st</sup> Defendant in calling for the performance bond.
88. That, the 1<sup>st</sup> Defendant acted impartially when it refused to give an extension of time as sought by the Plaintiff. In the circumstances, I would have to agree with the submission of the 1<sup>st</sup> Defendant that as things stand now, nothing has been presented to this court that would serve to demonstrate that the 1<sup>st</sup> Defendant acted fraudulently in calling for the performance bond.
89. Though the issue of common directorship may cause suspicion among certain quarters, it is vital to note that this court cannot restrain the 2<sup>nd</sup> Defendant from paying the guarantee based on mere suspicion. Moreover, the issue as to whether the 1<sup>st</sup> Defendant should have considered the Plaintiff's request for extension of time is a non – starter. I note that the 1st Defendant had granted two prior extensions of time in the main contract and no bias or impartiality can be imputed at this stage by the mere fact that the 1st Defendant refused to further extend the time of delivery of the contract.
90. The refusal for the extension of time does not prima facie point to the 1<sup>st</sup> Defendant acting in a fraudulent manner. I also note that the 1st Respondent does not dispute the fact that part of its reason in calling up the Performance Bond was to pay some third parties. In my view, the reason cannot amount to fraud as the 1<sup>st</sup> Respondent is not prohibited from doing so. The performance bond was couched in very specific terms.
91. The 1<sup>st</sup> Defendant seeks payment in accordance with the terms of the bond, the 2<sup>nd</sup> Defendant bank must pay, and regardless of how unfair that might be to the plaintiff. This is exemplified by the leading case of **Edward Owen Engineering Ltd case**. In view of the foregoing, I find that the Plaintiff has failed to establish that the 1<sup>st</sup> Defendant acted in a fraudulent manner in calling for the performance bond.

***d. Whether the Plaintiff is entitled to interim injunction as prayed.***

92. The only concern now left for this court is to establish whether or not the Plaintiff had demonstrated a good case for being granted an interim relief pending the hearing and determination of the dispute. As noted earlier on in this ruling, it is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks.
93. That is the fraud exception. The Plaintiff herein having failed to prove that fraud existed on the part of the 1<sup>st</sup> Defendant when calling up the performance bond, the court cannot issue interim orders against the Defendants as prayed. Accordingly, I order for the dismissal of the application dated 5<sup>th</sup> October 2015 by the Plaintiff with costs to the Defendants.

**Dated, signed and delivered in court at Nairobi this 5<sup>th</sup> day of April, 2016.**

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**C. KARIUKI**

**JUDGE**