Paramount Bank Limited v First National Bank Limited & 2 others (Civil Appeal 468 of 2018) [2023] KECA 1424 (KLR) (24 November 2023) (Judgment)

Neutral citation: [2023] KECA 1424 (KLR)

REPUBLIC OF KENYA

IN THE COURT OF APPEAL AT NAIROBI

CIVIL APPEAL 468 OF 2018

HM OKWENGU, JM MATIVO & GWN MACHARIA, JJA

NOVEMBER 24, 2023

BETWEEN

PARAMOUNT BANK LIMITED ..... APPELLANT

AND

FIRST NATIONAL BANK LIMITED ..... 1ST RESPONDENT

DG BHATTESSA ..... 2ND RESPONDENT

MR KHAN ..... 3RD RESPONDENT

(An appeal from the judgment and decree of the High Court of Kenya at Nairobi (Ochieng, J) (as he then was) dated 3rd September 2018 in Milimani HC. Commercial Case No. 813 of 2000)

JUDGMENT

1. A brief account of the dispute before the High Court is necessary in order to put the parties' diametrically opposed arguments presented in this appeal into proper perspective. By a plaint dated 30th April 2000, the 1st respondent sued the appellant and the 2nd and 3rd respondents claiming Kshs.16,814,592.55, interests thereon at the rate of 36% p.a. from 7th March 1997 until payment in full, costs and interests thereon, and any other or further orders the court could deem fit to grant.

2. The 1st respondent's claim against the appellant and the 2nd and 3rd respondents arose from two bank guarantee instruments for Kshs.10,000,000/= each, dated 5th January 1996 and 3rd September 1996 respectively. Both guarantees were issued by the appellant, Paramount Bank Limited, in favour of the 1st respondent (First National Bank Limited) in consideration of the 1st respondent granting or continuing to make available banking facilities to Gnanjivan Wire Galvanising Mills Limited (the borrower). D.G. Bhattessa and M.R. Khan (the 2nd and 3rd respondents respectively) signed the said guarantees.

3. Relying on the two guarantee instruments, the 1st respondent granted and continued to make available various banking facilities and financial accommodation to the borrower, and forbore to enforce its existing rights by suit or otherwise against the principal borrower. However, the borrower defaulted in repaying the said facilities. Consequently, by a notice of default dated 7th March 1997, the 1st respondent called upon the appellant as the guarantor under the said guarantees to pay or cause to be paid Kshs.16,814,592.55 due and owing from the principal borrower to the 1st respondent. Despite the said notice, the appellant failed to pay the said sum.

4. In its amended defence dated 12th January 2001, the appellant denied the 1st respondent's claim, maintaining that it never passed a resolution to issue the said guarantees nor did it authorize issuance of the guarantees. Its contestation was, that the 2nd and 3rd respondents were not authorized to sign the guarantees but that they fraudulently misrepresented themselves as its authorized signatories. It averred that the 2nd respondent admitted liability and obtained letters from the 1st respondent to the effect that the 1st respondent had no claim against the appellant. It also claimed that it never received any consideration for the guarantees. It also stated that the guarantees were not recorded in its books, and that the guarantees were not in the appellant's standard format. It also averred that the guarantees had no guarantee numbers nor, were they issued under the appellant's seal.

5. The appellant also averred that the 1st respondent acted negligently by accepting the said guarantees, and, that the 1st respondent granted further facilities premised on past consideration which were not backed by a company resolution. It asserted that the 1st respondent executed a loan agreement transferring the outstanding loan of Kshs.14,290,907.55 as at 31st August 1998 to Nalin Nail Works Ltd and that the said company made some repayments. It maintained that it cannot be held liable for the 2nd and 3rd respondents' unauthorized actions, and added that the 2nd respondent admitted liability for his acts. Lastly, it contended that even assuming that the guarantees were valid, there were substantial and material variations undertaken without its knowledge.

6. The 2nd and 3rd respondents filed substantially identical statements of defence dated 13th July 2000 and 14th July 2000 respectively, stating that they signed the guarantees in their respective capacities as the appellant's chairperson/directors. They denied that they were personally liable. They asserted that they ceased to be chairpersons/directors of the appellant in January 1997 after they resigned. They denied undertaking unconditionally to guarantee the borrower Galvanising Mills Limited and/or Nalin Nail Work Limited. Further, they denied being directors or shareholders of the said companies.

7. During the hearing, the 1st respondent's case stood on the testimony of only one witness, Narayana Murthi Sabesan who entirely adopted his witness statement dated 3rd July 2015. The statement is a replica of the averments in the plaint; therefore, it will add no value to reproduce its contents here. Upon cross- examination and re-examination, he maintained that the 2nd and 3rd respondents admitted signing the two guarantees, and that the suit is about the guarantees to the Bank and not about the underlying transactions.

8. The appellant called only one witness, Ayaz Merali, its Chief Executive Officer. He adopted his witness statement dated 15th October 2015 which is essentially a duplication of its amended defence. On cross-examination, he maintained that the dispute was essentially about bank guarantees, which he said, were executed before he became the CEO. He stated that the 2nd and 3rd respondents admitted signing the guarantees in their defence as directors of the appellant. He testified that the guarantees were unconditional and irrevocable, and payment was to be made within 15 days from date of demand, but the appellant did not honour the demand to pay. It was his evidence that the guarantee was not recorded in the appellant's books. He conceded that the appellant received the 1st respondent's demand.

Upon cross- examination, he maintained that the principal borrower did not have an account with the bank nor had the borrower provided security. He maintained that the appellant could not have issued a guarantee to a non-account holder. He claimed that the letter of offer was issued a day after the issuance of the guarantee and that the guarantees were not sealed by the bank. Further, there were no company resolutions authorizing the issuance of the guarantees.

9. The 2nd and 3rd respondents opted not to adduce evidence at all during the trial.

10. In the impugned judgment dated 3rd September 2018, Ochieng J. (as he then was) found in favour of the 1st respondent and ordered the appellant to pay the 1st respondent Kshs.14,290,917.55 together with interests thereon at court rates from the date of the judgment until payment in full. However, the court disallowed the 1st respondent's claim for interests on the said sum at the rate of 36% p.a. The claim against the 1st and 2nd respondents was dismissed. The appellant was ordered to pay the costs of the suit. Lastly, the 1st, 2nd and 3rd respondents were ordered to pay their respective costs.

11. The appellant seeks to overturn the above verdict citing 14 grounds of appeal, which we shall address in detail in our analysis and determination. For now, it will suffice to mention that the said grounds can be abridged into three. One, whether the 2nd and 3rd respondents were authorized to sign the two guarantee instruments. Two, whether the appellant was legally bound to satisfy the two guarantees. Three, whether the learned Judge erred in law and fact in entering judgment against the appellant and in holding that the 2nd and 3rd respondents were not liable under the guarantees.

12. Also aggrieved by the same judgment, the 1st respondent filed a Notice of Cross-Appeal dated 8th April 2019. It prays that part of the judgment disallowing it's claim for interest at the rate of 36% p.a. instead of awarding interests at court rates from the date of the judgment until payment in full be set aside, and in place thereof it be awarded interests on the principal sum of Kshs. 14,290,917.55 at the rate of 36% p. a. from 7th March 1997 until payment in full. Lastly, it prays for costs of this appeal and the cross-appeal.

13. The gravamen of the appellant's submissions is that the guarantee instruments were executed by unauthorized persons, therefore, they are invalid and unenforceable. Mr. Fred Ngatia, Senior Counsel on behalf of the appellant faulted the trial court for failing to appreciate that the 2nd and 3rd respondents were not the appellant's authorized signatories and for failing to appreciate the 2nd respondent's admission of liability. Learned counsel argued that the 2nd respondent admitted executing the guarantee without the knowledge and consent of the appellant. He argued that the 2nd and 3rd respondents never adduced evidence and cited this Court's decision in *Charterhouse Bank Limited (under Statutory Management v Frank N. Kamau* [2016] eKLR in support of the proposition that averments by parties do not constitute evidence. It was his submission that the appellant's evidence that the 2nd and 3rd respondents were not its authorized signatories was uncontroverted and therefore the trial Judge erred by holding that the 2nd and 3rd respondents were the appellant's authorized signatories. Counsel cited *Kenya Power & Lighting Company Limited v Pamela Awino Ogunyo* [2015] eKLR which underscored the requirement for a party who asserts certain facts exist to prove the existence of those facts.

14. Mr. Ngatia faulted the trial court for not appreciating that the 1st respondent did not adduce evidence to demonstrate that there was a debt due and owing. He argued that the 1st respondent testified that Gnanjivan Wire Galvanising Mills Limited had settled its debt with the 1st respondent as at 13th August 1997. In addition, Mr. Ngatia argued that the trial court failed to appreciate that the two guarantees were not part of the securities for the loan facility granted to Gnanjivan Wire Galvanising Mills Limited pursuant to the letter of offer dated 16th July 1997. It was his submission that the loan agreement dated 28th July 1997 and the variation of the banking facilities in respect of which the guarantees were issued

from Bills discounting facility to a loan facility discharged the appellant from its obligations under the guarantee. Counsel submitted that there was no legal basis for recalling the guarantees and added that the sum of Kshs.14,290,917.55 together with interests was not proved.

15. Mr. Ngatia submitted that because the bank guarantees were restructured to a loan facility pursuant to the loan agreement dated 28th July 1997, the two guarantees were not part of the securities in respect of the Kshs.14,738,436.95 loan. Further, the appellant was not involved in the restructuring of the Bills Discounting Facility to a loan facility, nor did it have a prior notice of the variation and that it never consented to the variation. Counsel submitted that the trial court despite finding that there was a variation, erred in holding that the variation did not discharge the appellant from its obligations. He cited *David Harris v Middle East Bank Kenya Limited & 3 Others* [2019] eKLR in support of his submission that a guarantor may be discharged from a guarantee where there has been a variation of the original facility to which he has not been privy to and has not consented.

16. Mr. Ngatia also submitted that the learned Judge failed to consider that the debt due from Gnanjivan Wire Galvanising Mills Limited was taken over by Nalin Nail Works Ltd, and that the trial Judge failed to appreciate that the appellant never issued guarantees in respect of facilities granted to Nalin Nail Works Limited by the 1st respondent. Counsel faulted the trial Court for failing to appreciate that the suit against the appellant was unmerited. He referred to an agreement dated 31st August 1998 which introduced Skyline Hardware & Glass Limited providing that the said company would pay Kshs.14,290,907.55 owing from Gnanjivan Wire Galvanising Mills Limited as at 31st August 1998, and argued that the appellant's liability was discharged by the introduction of the said company.

17. Lastly, Mr. Ngatia submitted that having held that it was the 2nd and 3rd respondents' actions which gave rise to the suit, the Court erred by directing the appellant to pay costs to the 1st respondent. Counsel cited *Farah Awad Gullet v CMC Motors Group Limited* [2018] eKLR, *Supermarine Handling Services Ltd v Kenya Revenue Authority* [2010] eKLR and *Mbogo & another v Shah* [1968] EA 93 all of which underscored that award of costs is a matter of judicial discretion to be exercised judiciously.

18. Mr. Ochieng Oduol, learned counsel for the 1st respondent in opposition to the appeal and in support of the cross-appeal submitted that the two guarantees were signed by the 2nd and 3rd respondents for and on behalf of the appellant. Further, pursuant to the guarantees, the appellant, in consideration of the 1st respondent granting or continuing to make available various banking facilities and any accommodation to Gnanjivan Wire Galvanising Mills Limited (the borrower), unconditionally and irrevocably undertook and agreed on the specific terms stated in the letter dated 3rd January 1996 and 3rd September 1996.

19. Mr. Oduol submitted that pursuant to the said guarantees, the 1st respondent granted and continued to make available to the principal borrower various banking and financial facilities. By a demand letter dated 7th March 1997, the 1st respondent called upon the appellant as a guarantor under the said guarantee to pay or cause to be paid Kshs.16,814,592.55 due and owing from the principal borrower to the 1st respondent. The said letter was served as a notice of default, but the appellant refused to pay prompting the 1st respondent to sue the appellant seeking recovery for Kshs.16,814,592.55 and interests at the rate of 36% per annum until payment in full.

20. Regarding the validity and enforceability of the two guarantees, Mr. Oduol cited *Mehta Electricals Limited v I & M Bank Limited & Another* [2017] eKLR in which the High Court identified the two categories of guarantees, namely, "on demand guarantees" and "conditional guarantees" and

emphasized that the guarantees in question were "on demand guarantees." Counsel cited clause 4 in both guarantees, which provides that

> " ..... the claim shall be settled immediately upon the receipt of the first demand letter..".

In addition, counsel cited *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1ALL ER 976 and *State Trading Corporation of India Ltd v Jainsons Clothing Corporation* [1996] 85 Comp. Cas. 470 (S.C.) in support of the proposition that a contract of guarantee is one of sticticciima juris rather than uberrimae fidei.

21. It was Mr. Oduol's submission that a Non-Demand Guarantee is independent from the underlying contract or any other contractual obligation. He described it as an autonomous contract, meaning that the guarantor must pay the guaranteed amount to the beneficiary in whose favour the bank guarantee has been issued on demand, irrespective of any pending disputes between the guarantor and the principal borrower.

22. Regarding the argument that the signatories to the two guarantees were not authorized to sign the guarantees and that the two guarantees were not recorded in its books, Mr. Oduol submitted that the 1st respondent was not legally bound to verify whether or not the two signatories were duly authorized or whether the guarantees were recorded in its books. It was counsel's position that the only requirement was that at the time of signing the guarantees, the 2nd and 3rd respondents were directors of and authorized signatories of the appellant. In addition, counsel submitted that the 1st respondent had no obligation to inquire into the appellant's internal arrangements. He relied on this Court's decision in *Saraf Limited v Augusto Arduin* [2016] eKLR in support of the proposition that where one is dealing with a limited liability company, he cannot probe into the internal affairs of a company. Mr. Oduol cited this Court's decision in *Kennindia Assurance Company Limited v First National Finance Bank Limited* [2008] eKLR in support of the holding that when it comes to fulfilment of conditions incorporated in guarantees, the beneficiary's statement shall be taken at its face value unless fraud, misrepresentation or deliberate suppression of facts is proved.

23. Regarding the question whether there was a debt due and owing to the 1st respondent, Mr. Oduol cited *Kennindia Assurance v Company Limited v First National Finance Bank Limited* (*supra*) in support of the holding that the most important factor to consider before liability can attach is whether there has been default and formal demand. Counsel argued that the two guarantees could only be triggered by default on the part of the principal borrower to pay either the bills ddiscounting ffacility or any other accommodation.

24. Mr. Oduol submitted that although the Bank guarantees were issued based on the Bills Discounting Facility, the principal borrower and the 1st respondent had restructured the Bills into a loan facility as provided by the letters of offer dated 16th July 1997 and 31st August 1997 and the Loan Agreements dated 28th July 1997 and 31st August 1998. Counsel maintained that the said documents restructured the pre-existing agreement on the guarantee; therefore, the trial court correctly entered judgment against the appellant for Kshs.14,290,917.55.

25. Regarding the argument that the variation of the guarantee discharged the appellant from its liability, counsel submitted that the conversion was contemplated under the guarantees, which provided "any other accommodation provided to the principal borrower." Counsel relied on *Paul Odhiambo Edward Gondi v National Bank of Kenya Ltd* [2015] eKLR in which this Court held that variation of a charge indicates that it is supplemental to the initial charge.

26. Regarding the award of costs, Mr. Oduol cited *Mbogo & Another v Shah* [1968] EA 93 and submitted that this Court can only interfere with the award on costs if it is demonstrated that the trial court has acted unreasonably or injudiciously in exercising its discretion.

27. Regarding the award of interests at the rate of 36%, Mr. Oduol submitted that the award was merited because the sum of Kshs. 14,290,917,55 was due from 7th March 1997, and, that, the interest was permitted under section 26 (1) of the *Civil Procedure Act*. Mr. Oduol relied on *Lwanga v Centenary Rural Development Bank* [1999]1 EA 175 in support of the holding that the rationale for awarding interest prior to filing suit is to compensate the plaintiff for being kept out of his money and to penalize the defendant for wrongfully withholding the plaintiff's money. Regarding the powers of the court to award interest from the date of filing suit, counsel cited *Gulam Husein v French Somaliland Shipping Co. Ltd* [1950] EA 25 in support of the said position and urged this Court to award interests on the principal sum as prayed in the Cross-Appeal.

28. On behalf of the 2nd and 3rd respondents, learned counsel Mr. Kihika submitted that the 1st respondent did not prove its case, and that the impugned judgment is contrary to the weight of the evidence. He argued that the sum of Kshs.14,738,436.95 was transferred to a loan account and a loan agreement signed. Further, the loan was secured by specified securities and it was taken over by a new entity, Nalin Nail Works Ltd. Therefore, the appellant was not involved in the variation of the facilities. Counsel cited a passage from Pagets Law of Banking, 14th Edition, page 894 in support of the proposition that a bare promise to pay on demand without reference to the principal obligation would leave the principal more exposed in the event of a fraudulent demand.

29. We start our analysis and determination by reiterating that this Court's mandate in a first appeal under rule 31(1) of the *Court of Appeal Rules*, 2022 is to independently re-appraise the evidence and draw our own conclusions. (See *Abok James Odera T/A A.J Odera & Associates v John Patrick Machira T/A Machira & Co. Advocates* [2013] eKLR). A first appeal is a valuable right of the parties and unless restricted by law, the whole case is therein open for rehearing both on questions of fact and law. A first Appellate Court is the final court of fact ordinarily and therefore a litigant is entitled to a full, fair, and independent consideration of the evidence at the appellate stage. Anything less is unjust. The first appeal has to be decided on facts as well as on law. While considering the scope of section 78 of the *Civil Procedure Act*, a first Appellate Court can appreciate the entire evidence and come to a different conclusion.

30. We will first address the appellant's contestation that the 2nd and 3rd respondents were not authorized to sign the bank guarantees and that they misrepresented themselves as its authorized signatories. Addressing this issue, the learned Judge had the following to say:

> " Taking into account the fact that the 2nd defendant was the chairman of the 1st defendant, and that he was also a director and a shareholder of the principal borrower, this court holds the view that the 2nd defendant's conscious decision to refrain from giving evidence during the trial deprived the court of the defendant's explanations.
>
> Of course, if he genuinely believed that the plaintiff had not made out any case to warrant an answer to (sic), the 2nd defendant had no obligation to offer any explanation.
>
> The 2nd defendant readily admitted having signed the guarantees in issue. He also said that he had done so in his capacity as a director of the 1st defendant. Thirdly, he said that he did so on behalf of the 1st defendant.

> Surely, by signing the guarantees on behalf of the 1st defendant, and in his capacity as a director of the 1st defendant, it must be understood that the 2nd defendant intended to have the plaintiff believe that he had the requisite authority to sign the guarantee on behalf of the 1st defendant."

31. Significantly, the two guarantees are dated 3rd September 1996 and 5th January 1996 respectively. Conspicuously, at page 52 of the record is a letter dated 30th December 1996 written by the appellant communicating its authorized signatories to the bank. Granted, the 2nd and 3rd respondents' names are not in the said list. However, the said letter is dated 30th December 1996, almost three months and one year respectively after the two guarantees were signed. Unmistakably, the said letter does not communicate the position as at the date of signing the guarantees.

32. In his submissions, Mr. Ngatia placed emphasis on a letter dated 14th February 1996 notifying the 1st respondent the names of the appellant's authorized signatories. Counsel submitted that the The submissions on the above letter is impressive considering the fact the fact that the cited letter was written prior to the guarantee instruments. However, there is the other side of the coin. The letter dated 14th February 1996 is a file copy unlike the letter dated 30th December 1996. It's not on official letter head. One Mumataz Mohammad who describes himself as a Senior Manager signed both letters. He was not called as a witness, at least to shed more light on the contents of the said letters and explain why the said letter was a file copy, contrary to the best evidence rule, which requires production of an original, or a certified copy. It was also for the author to clarify why one of the letters is dated after the issuance of the guarantee instruments.

33. In their statements of defence, the 2nd and 3rd respondents averred that they signed the guarantees as Chairperson/Directors of the appellant. In our considered view, to satisfy the required standard of proof on a balance of probabilities, the appellant should have, in the minimum produced a search from the Companies Registry confirming the particulars of the directors and secretaries as at the date of the two letters and more specifically, as at the time of signing the guarantees. If at all the 2nd and 3rd respondents were never directors of the company, then the search could have settled the matter conclusively. If they were directors and had ceased to be Chairman/Director as at the material time, then the applicant should have produced evidence of change of the particulars of directors. If any other, director(s) (other than the 2nd and 3rd respondents) had been appointed as at the period of interest, one wonders why a duly registered particulars of change directors' form, was not produced supported by the official search. In absence of such evidence, we find no reason to fault the learned Judge's finding that the 2nd and 3rd respondents were authorized signatories at the material time. The attempt to seek refuge in the letters cited above cannot supplement the requirement of an official search from the Companies Registry, which in our view would have been the best evidence in the circumstances.

34. As was held in *Ford v Hopkins* [1700] 91 Eng. Rep 250 (K.B.), no evidence will be admissible unless it is the best evidence that nature will allow. This means that no evidence, which is merely substitutionary in its nature, shall be received so long as original evidence can be had, and contents of document must be proved by producing the document itself.

35. The appellant's evidence that the 2nd and 3rd respondents were not authorized signatories at the material time is manifestly wanting. Two basic principles should be kept in mind whenever evidence is evaluated. Firstly, evidence must be weighed in its totality (and therefore not in a piece-meal fashion) and secondly, probabilities must be distinguished from conjecture or speculation. A very prominent role is therefore attached to the concept of 'probabilities' here. In the process of adjudication, two factors are constant, namely what must be proved and to what degree of persuasion. However, there

is a third factor, namely the quantum and quality of the probative material required so as to persuade the court. (See *Denning MR in Miller v Minister of Pensions* [1947] 2 ALL ER 372:374A). The two letters purporting to communicate the authorized signatories cannot suffice for the reasons explained above. The upshot is that the appellant's argument that the 2nd and 3rd respondents were not authorized signatories as at the material time collapses.

36. We now turn to the argument that the guarantees were executed without the appellant's consent and knowledge. Mr. Fred Ngatia, SC faulted the trial Court for failing to consider the 2nd respondent's admission of liability. He argued that the trial court failed to appreciate that the two guarantees were not part of the securities in respect of the loan facility granted to the borrower and that the banking facilities were varied without involving the appellant. Lastly, he argued that a new entity took over the loan.

37. It should be recalled that the 2nd and 3rd respondents averred in their statements of defence that they signed the guarantees as Chairperson and directors of the appellant. This Court in *East Africa Safari Air Limited v Anthony Ambaka Kegode & Another* [2011] eKLR held that a person dealing with a company need not inquire into its internal machinery in order to ensure that the person with whom he had dealings had actual authority.

38. In any event, the appellant's attempt to shift the blame to the 2nd and 3rd respondents in an effort to evade liability ignores the fact that a bank guarantee is an independent and distinct contract, between the bank and the beneficiary. It is not qualified by the underlying transaction and the validity of the primary contract between the person at whose instance the bank guarantee was given and the beneficiary. Subject to limited exceptions, the beneficiary of a guarantee cannot be restrained from encashing the guarantee even if the dispute, between the beneficiary and the person at whose instance the bank guarantee was given by the bank, had arisen in the performance of the contract. Both the bank and the beneficiary are bound by, and its invocation should only be in accordance with, the terms of the bank guarantee. The foregoing position has been restated in numerous court decisions.

39. In *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 Q.B. 159, Lord Denning, M.R. laid the foundations for virtually all performance bond law. Called the "locus classicus" of performance bond law, Edward Owen established the strict application of the fraud rule to performance bond cases, a rule which has been followed with little variance to date. Lord Denning, M.R., called the performance bond "a new creature" and compared it to the irrevocable letter of credit, citing the United States letter of credit case, *Sztejn v J. Henry Schroder Banking Corporation*, 177 Misc. 719, 31 N.Y.S.2d 631 (N.Y. Sup. Ct. 1941) for the proposition that "the bank ought not to pay under the credit if it knows that the documents are forged or that the request for payment is made fraudulently in circumstances where there is no right to payment. Lord Denning, M.R., stated that:

> "A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee, on demand if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice." (Emphasis added)

40. In *Loomcraft Fabrics CC v Nedbank Ltd and Another (Loomcraft)* [1996] 1 All SA 51 (A); 1996 (1) SA 812 (A) at 815GJ, the Supreme Court of Appeal of South Africa held that demand guarantee is akin to an irrevocable letter of credit, which establishes a contractual obligation on the part of the bank to pay the beneficiary on the occurrence of a specified event, and is wholly independent of the underlying

contract of sale between the buyer and the seller. The bank will escape liability only upon proof of fraud on the part of the beneficiary.

41. If the bank guarantee furnished is unconditional and irrevocable, it is not open to the bank to raise any objection for payment of the amounts under the guarantee. The duty of the bank under the guarantee is created by the document itself. Once the documents are in order, the bank giving the guarantee must, ordinarily, honour the same and make payment. (the Supreme Court of India in *U.P. State Sugar Corpn. v Sumac International Ltd.*, (1997) 1 SCC 568; and State of Maharashtra v National Construction Co. [1996] 1 SCC 735).

42. The Supreme Court of India in a catena of judgements has held that a bank guarantee is an independent and distinct contract between the bank and beneficiary and does not depend on the results of the decision in the dispute between the parties in case of breach. In *Ansal Energy Projects Limited v Tehri Hydro Development Corporation Limited and Anor* [1996] 5 SCC 450], the Supreme Court of India observed as under:

> " 4. It is settled law that bank guarantee is an independent and distinct contract between the bank and the beneficiary and is not qualified by the underlying transaction and the validity of the primary contract between the person at whose instance the bank guarantee was given and the beneficiary. Unless fraud or special equity exists, is pleaded and prima facie established by strong evidence as a triable issue, the beneficiary cannot be restrained from encashing the bank guarantee even if dispute between the beneficiary and the person at whose instance the bank guarantee was given by the bank, had arisen in performance of the contract or execution of the works undertaken in furtherance thereof. The bank unconditionally and irrevocably promised to pay, on demand, the amount of liability undertaken in the guarantee without any demur or dispute in terms of the bank guarantee. The object behind is to inculcate respect for free flow of commerce and trade and faith in the commercial banking transactions unhedged by pending disputes between the beneficiary and the contractor.
>
> 5. It is equally settled law that in terms of the bank guarantee the beneficiary is entitled to invoke the bank guarantee and seek encashment of the amount specified in the bank guarantee. It does not depend upon the result of the decision in the dispute between the parties, in case of the breach. The underlying object is that an irrevocable commitment either in the form of bank guarantee or letters of credit solemnly given by the bank must be honoured. The court exercising its power cannot interfere with enforcement of bank guarantee/letters of credit except only in cases where fraud or special equity is prima facie made out in the case as triable issue by strong evidence so as to prevent irretrievable injustice to the parties. The trading operation would not be jettisoned and faith of the people in the efficacy of banking transactions would not be eroded or brought to disbelief..."

43. The terms of the bank guarantee are material. Since the bank guarantee represents an independent contract between the bank and the beneficiary, both the parties would be bound by its terms. The invocation, therefore, should be in accordance with the terms of the bank guarantee. In the instant case, the bank guarantees contain a categorical undertaking and impose absolute obligations on the

bank to pay the amount, irrespective of any dispute, which may arise between the parties regarding the breach of contract. The two guarantees read as follows:

> "In consideration of your granting or continuing to make available banking facilities as present: Bills Discount Facility or any other accommodation to: Gnanjivan Wire Galvanising Mills Limited, of P.O Box No. [particulars withheld], Nairobi.
>
> We unconditionally and irrevocably undertake and agree as follows:
>
> a. To make good the payment of any bill outstanding for over fifteen (15) days after due date but subject to the limit on our aggregate liability herein after prescribed.
>
> b. Our maximum liability at any one time shall not exceed the sum of Kshs.10,000,000/= (Kenya Shillings Ten Million only) including commission and interest on outstanding bills.
>
> c. Our liability hereunder shall also include guaranteeing payment of cheques, promissory notes and bills of exchange drawn in your favour by Gnanjivan Wire Galvanising Mills Limited and the acceptors of their bills provided that such cheques do not exceed our aggregate liability.
>
> d. Your claim shall be settled immediately upon receipt of your first demand letter.
>
> e. This guarantee shall not be revoked at any time during the currency of the facilities.
>
> Signed by the duly authorized signatories of Paramount Bank Limited this 3rd day of September 1996.

44. The bank is always obliged to honour its guarantee as long as it is an unconditional and irrevocable Bank Guarantee. The liability of the bank is absolute and unequivocal. The bank has to only verify whether the amount claimed is within the terms of the Bank guarantee or letter of credit. The courts should not interfere with invocation and encashment of bank guarantee unless there is fraud of egregious nature of which the beneficiary seeks to take advantage and which vitiates the entire underlying transaction or a case where irretrievable injustice is likely to be caused to either of the parties. Since in most cases payment of money under a Bank Guarantee would adversely affect the bank and its customer at whose instance the guarantee is given, the harm or injustice contemplated under this head must be of such an exceptional and irretrievable nature as would override the terms of the guarantee. There has to be glaring circumstances of deception or fraud warranting interference.

45. The present case can be examined in the light of the principles laid down in the jurisprudence referred to herein, which can at the risk of repeating here be summarized as follows:

(a) The Bank Guarantee is an independent contract between the bank and the beneficiary thereof. The bank is always obliged to honour its guarantee as long as it is an unconditional and irrevocable Bank Guarantee.

(b) The dispute between the beneficiary and the party, at whose instance the bank has given the guarantee is immaterial and is of no consequence. The bank has to only verify whether the amount claimed is within the terms of the Bank Guarantee or letter of credit.

(c) The courts should not interfere with invocation and encashment of Bank Guarantee unless there is fraud of egregious nature of which the beneficiary seeks to take advantage and which vitiates the entire underlying transaction or a case where irretrievable injustice is likely to be caused to either of the parties. There must be special equities in favour of injunction such as when irretrievable injury or irretrievable injustice would occur if injunction were not granted. Nothing was presented before us to suggest that the amount claimed was not within the terms of the guarantee nor was anything suggested which could vitiate the guarantees.

46. The other important point to bear in mind is that the guarantees are unconditional and irrevocable. The nature of the two guarantees is that they were an undertaking by the appellant to be answerable for the debt or obligation of borrower if the borrower defaults. The essential feature is that liability under the guarantees depended on the defaulting party's liability under the guarantee. The guarantor does not have the benefit from the guarantee and therefore the argument that the appellant never benefited from the guarantees or the underlying contracts is immaterial. A bank's obligation to honour an unconditional demand guarantee arises only as and when the beneficiary seeks payment in accordance with the terms of the guarantee.

47. The other important question is whether there was a debt lawfully due and owing to the 1st respondent. Notably, the impugned guarantees were made in favour of companies in which the 2nd and 3rd respondents were directors. In their statement of defence, the 2nd and 3rd respondents claimed that they were Chairman/Director of the appellant. In its plaint, the 1st respondent had claimed Kshs.16,814,592.55. However, during trial, it was established that the principal debtor's account was credited with Kshs.1,167,808.30 leaving a balance of Kshs. 14,738,436.95. This balance was vide a letter of offer dated 16th July 1997 converted into a loan vide loan agreement dated 28th July 1997 and it was agreed that the entire balance would be paid in 8 monthly instalments of Kshs.2 million.

48. The appellant claimed the debt was settled because the account had a nil balance. However, on record is DW1's testimony that the nil balance was because the debit balance of Kshs. 14,738,436.95 was transferred to the loan account. We find no reason to disbelieve this explanation. In addition, the appellant argued that the transfer of the debit balance to the loan account was variation of the original contract, which it argued, entitles it to discharge the impugned guarantees. First, we find that the appellant is blowing both hot and cold air by insisting on one hand that no amount is due and owing to the 1st respondent and on the other hand disclaiming liability on grounds that the debit balance was converted into a loan. We agree with the 1st respondent as evidenced by the statements of account dated 1st April 1, 1999, Kshs.14,738,436.95 was converted into a loan facility and transferred on 31st July 1997.

49. We now address the issue whether there was variation of the terms of the guarantee, which discharged the appellant's liability. It is common ground that the outstanding balance was converted into a loan facility vide the letter of offer dated 16th July 1997, resulting into the loan agreement dated 28th July1997. The appellant maintains that they did not have notice and they were not involved in the restructuring of the bills discounting facility to the said loan facility as per the loan agreement dated 28th July 1997. Consequently, the conversion of the outstanding balance into a loan was a clear substantial variation of the banking facility in respect of which the impugned guarantees were issued as appreciated by the learned trial court. According to the appellant, the learned Judge erred in concluding that the guarantees were in respect of bill discounting facilities or any other accommodation.

50. We have thoroughly studied the impugned guarantees. We are in consonance with the trial Judge's finding that the variation was contemplated in the two guarantees which are both worded in identical terms as follows:

> " .... bill discounting facilities or any other accommodation."

The wording of the guarantee instruments was not limited to bills discounting facilities but it extended to "any other accommodation." Consequently, we find that the conversion of the outstanding, balance into a loan facility fell into the category of "any other accommodation" and, as a result, the efforts by the appellant to have its obligation under the impugned guarantees discharged is unmerited.

51. We find it necessary to comment on an issue which none of the parties addressed. In their submissions, the 2nd and 3rd respondents supported this appeal. Ordinarily, such a position would not have attracted this Court's attention considering the fact that a litigant has a right to advance his/her case. However, this case has its own uniqueness in that the 2nd and 3rd respondents filed statements of defence before the trial court asserting that they signed the two guarantees as Chairperson/director of the appellant. They effectively in their statements of defence supported the 1st respondent's case. However, they elected not to adduce evidence during the trial. Mr. Kihika representing the 2nd and 3rd respondents submitted that the 1st respondent did not prove its case, and that the impugned judgment is contrary to the weight of the evidence. He also argued that the loan was secured by specified securities, and that it was taken over by a new entity, Nalin Nail Works Ltd. Therefore, the appellant was not involved in the variation of the facilities.

52. Mr. Kihika's submissions in support of the appeal raises pertinent legal questions, which we cannot ignore. First, having opted not to adduce evidence before the trial Court, the 2nd and 3rd respondents cannot now purport to adduce evidence through submissions contradicting their defence on record. The general rule is that courts should determine a case on the issues that flow from the pleadings and the court may only pronounce judgement on the issues arising from the pleadings or such issue as the parties have framed for the court's determination. We are compelled to restate the time-honored principle of law that parties are bound by their own pleadings and that any evidence or submissions produced by any of the parties, which does not support the pleaded facts or is at variance with the pleaded facts must be ignored. Even if the 2nd and 3rd respondents had adduced evidence in the lower court, they cannot at this appellate stage purport to introduce unpleaded matters in their submissions nor is it open for them to introduce new evidence through submissions, more so, at this appellate stage.

53. Lastly, we now address the 1st respondents counter-claim challenging the trial Court's refusal to award it interests on the sum awarded at the rate of 36% p.a. The 1st respondent's grievance is that the trial Court awarded it interests at Court rates.

54. Section 26 (1) of the *Civil Procedure Act* vests courts with discretionary power to award interest on pecuniary judgments. This power, as with all discretionary powers, is to be exercised cautiously, judicially and in the interest of justice. The section reads:

> 1. Where and in so far as a decree is for the payment of money, the court may, in the decree, order interest at such rate as the court deems reasonable to be paid on the principal sum adjudged from the date of the suit to the date of the decree in addition to any interest adjudged on such principal sum for any period before the institution of the suit, with further interest at such rate as the court deems reasonable on the aggregate sum so adjudged from the date of the decree to the date of payment or to such earlier date as the court thinks fit.

55. It is trite that award of interest and the rate thereof is at the discretion of the trial court. A Court of Appeal should not interfere with the exercise of the discretion of a judge unless it is satisfied that the judge in exercising his discretion has misdirected himself in some matter, and, as a result, has arrived at a wrong decision, or unless it is manifest from the case as a whole that the judge has been clearly wrong in the exercise of his discretion, and, that as a result, there has been injustice. (See *Mbogo & Another v Shah* [1968] EA 98).

56. Decided cases are consistent that liability to pay interest prior to the date of judgment is a matter of evidence. For example, in Lesotho, the Constitutional Court in *Boliba Multipurpose Cooperative Society v Ramathibeli Joseph Mpoko*, CCT 37 of 2007, cited by this Court in *Alba Petroleum Limited v Total Marketing Kenya Limited* [2019] eKLR held that if no evidence is provided during the trial regarding the rate of interest claimed in the plaint, the claim must fail.

57. This Court in *New Tires Enterprises Limited v Kenya Alliance Insurance Company Limited* [1987] KLR 380 at page 384 stated:

> " The award of interest for any period prior to the filing of the suit is a matter of substantive law' (see *Gulsmhuddrin v French Somali-land Shipping Company Limited* [1959] EA 25) ... In the present case the liability of the respondent to pay for the appellant's loss was not determined until the date of judgment and that is the date from which interest should be payable. I am satisfied that the judge's order is perfectly in consonance with the normal practice and was a proper and fair exercise of his discretion".

58. We have evaluated the evidence on record. The 1st respondent did not lead any evidence to prove its claim of interest at the rate of 36% per annum. There is no evidence on record proving the said rate was the prevailing commercial rate of interest. Indeed, the trial court held that there was no basis for the 1st respondent to claim interest at 36% per annum. Accordingly, we find and hold that the 1st respondent's notice of cross appeal dated 8th April 2019 is unmerited and the same is hereby dismissed since the liability of the appellant to pay the guarantee sums to the 1st respondent was not determined until the date of judgment.

59. In any event, the issue of costs remains a matter of the court's discretion. We find no reason to interfere with the trial court's discretion refusing to award interest claimed at the rate of 36% p.a. On the contrary, by awarding interests at court rates, the trial court properly exercised its discretion and properly applied the law. The upshot is that this appeal and the cross-appeal fails.

Accordingly, we dismiss both the appeal and the cross-appeal. Each party shall bear its own costs for this appeal.

DATED AND DELIVERED AT NAIROBI THIS 24TH DAY OF NOVEMBER, 2023.

HANNAH OKWENGU

JUDGE OF APPEAL

.....

J. MATIVO

JUDGE OF APPEAL

.....

G.W. NGENYE-MACHARIA

JUDGE OF APPEAL

.....

I certify that this is a true copy of the original

signed

DEPUTY REGISTRAR