IN THE COURT OF APPEAL

AT NAIROBI

(CORAM: MAKHANDIA, OUKO & M'INOTI, JJ.A)

CIVIL APPEAL NO.285 OF 2015.

BETWEEN

SCOPE TELEMATICS INTERNATIONAL SALES LIMITED....APPELLANT

AND

STOIC COMPANY LIMITED.....1ST RESPONDENT

CO-OPERATIVE BANK OF KENYA.....2ND RESPONDENT

*(Being an appeal from the Ruling and Order of the High Court of Kenya at Nairobi (**Ogola, J**.) dated 31st July, 2015*

in

H.C. Misc. Appl. No. 115 of 2015.)

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JUDGMENT OF THE COURT

On 12th June 2014, the appellant and the 1st respondent entered into a contract for the supply of what is described in the parties' pleadings as **Mhub 846 units** *"Mhubs"*. In layman terms, that technical term is used by the parties to mean tracking devices used in fleet or vehicle management. To guarantee payment to the 1st respondent upon supply of the devices, the appellant arranged and opened a letter of credit dated 27th August 2014 with the 2nd respondent as the issuing bank for a sum of **Kshs.4,200,000/-**. Following receipt of the relevant documents from Allied Irish Bank, the advising bank, the 2nd respondent duly acknowledged receipt of the said documents which in effect meant authorization by the 1st respondent that the 2nd respondent was obligated to pay the supplier of the devices, the appellant, upon receipt of the relevant documents and would pay the amount guaranteed under the letter of credit on its maturity date being, 28th February, 2015.

The appellant duly delivered the Mhubs to the 1st respondent. It would appear that it was not long before it became apparent that the devices delivered did not meet the required standard in terms of quality and functionality. The parties therefore varied the initial contract vide an addendum dated the 14th October, 2014 to reflect the required specifications for the devices to work effectively. Despite that addendum and the new specifications, the devices delivered thereafter still failed to function as expected.

Correspondence on record shows that there was an unsuccessful attempt at negotiations, resulting in an impasse. The contract provided a clear dispute resolution mechanism in the event any dispute arose in its performance. To be specific and for ease of reference the contract provided *inter alia*:-

> "**If the parties are unable to resolve any dispute resulting from any agreement (excluding any disputes regarding Intellectual Property Rights) by means of joint co-operation or discussion between the individuals directly involved with the execution of this agreement within (1) one week after a dispute arises, or such extended periods of time as the parties may allow in writing, then such dispute shall be submitted to the most senior executives of the Parties who shall endeavor to resolve this dispute within 5 (five) days after it has been referred to them. If the senior executives are unable to resolve the dispute as above, either party may refer the dispute to arbitration in terms of the current rules of arbitration of the International Chamber of Commerce. The place of the arbitration shall be the Republic of Ireland.**"

The contract further provided that in case any dispute was not resolved in the manner provided above within 30 days, then such dispute was to be determined by the courts of Ireland.

It appears that even before the parties to the contract could resolve the dispute in the manner provided, the maturity date for the Letter of Credit, being 28th February, 2015 was fast beckoning. The 1st respondent in apprehension that the 2nd respondent would debit its USD Call Deposit account upon maturity of the Letter of Credit filed the application giving rise to this appeal on 26th February, 2015 in the High Court of Kenya at Nairobi. Noteworthy at this point is that the application was not anchored on any suit. It was a stand-alone application.

In that application, the 1st respondent sought an order to restrain the appellant from demanding payment on account of the supply of the Mhubs and from demanding release of the funds from the 2nd respondent pending the reference of the dispute between the parties to arbitration or the conclusion of the ongoing negotiations between the senior executives of the appellant and the 1st respondent. The application was expressed to be anchored on **Article 159** of the Constitution, **Section 3A** of the Civil Procedure Act, **Order 51 rule 1** and **Order 40 rule 2** of the Civil Procedure Rules as read together with **Section 7 (1)** of the Arbitration Act and all other enabling provisions of the law. The main grounds upon which the application was made were that despite the ongoing negotiations and or impending arbitration, the maturity date for the Letter of Credit had caught up with the parties and that the 2nd respondent had confirmed that it would pay the appellant the sum stated in the Letter of Credit on the maturity date; that should that happen, the 1st respondent would be occasioned grave injustice, immense prejudice and the ongoing negotiations and impending arbitration would be considered nugatory.

The affidavit in support of the application merely expounded and elaborated on the above main grounds.

In response to the application, the appellant filed a notice of preliminary objection as well as grounds of opposition dated 20th March, 2015. The preliminary objection was to the effect that there were no competent proceedings before court upon which the reliefs sought could be granted, there being no suit filed in the first place. That the application had been commenced through unprocedural means and contrary to the Civil Procedure Rules and was therefore fatally defective, oppressive and an abuse of the process of the court. The grounds of opposition reiterated the foregoing save to add that there had been no declaration of a dispute in accordance with the terms of the arbitration clauses in the contract between the appellant and 1st respondent. Secondly, that in any event, the 2nd respondent was not a party to the arbitration clauses in the contract and would necessarily not participate in the prospective arbitration. That the matter of irrevocable Letter of Credit issued by the 2nd respondent in favour of the 1st respondent was separate from the issues in dispute between the 1st respondent and the appellant that were due for submission to arbitration.

The 2nd respondent filed both grounds of opposition and a replying affidavit to the application. In the grounds of opposition, the 2nd respondent maintained that the application was misconceived, bad in law

and an abuse of the process of the court; that the application was contrary to the established legal principle enunciated in the cases of **R.D. Harbottle (Mercantile) Ltd & Another v. National Westminster Bank Ltd & Others [1977] 2 ALL E.R. 862** and **Intra Co. Ltd v Notis Shipping Corporation [1981] 2 Llyod's Rep.256 (C.A).** Finally, that the application as filed and prayers sought therein were unmeritorious and ought not to be granted.

In its replying affidavit sworn by **Lily Kiunjuri**, Trade and Sales Manager of the 2nd respondent where pertinent, deponed that the 2nd respondent through a letter advised the 1st respondent that the drawing of the amounts under the Letter of Credit would fall due on 28th February, 2015 and that it would debit the 1st respondent's account on maturity. That it was under duty to pay the sums under the Letter of Credit on maturity as the appellant had presented the requisite documents. That the 2nd respondent could only be prevented from honouring its obligation under the Letter of Credit in clear cases of fraud by the appellant in respect to the documents presented and that it must have notice of the said fraud. That in the circumstances of the case, no fraud had been notified to it or at all in respect of the documents furnished on to it in respect to the Letter of Credit. Accordingly, the orders sought were misconceived and the application therefore ought to be dismissed.

Parties thereafter and with the leave of the court agreed to canvass the application by way of written submissions.

In a reserved ruling dated 31st July, 2015, the High Court found in favour of the 1st respondent and granted an order restraining the appellant from demanding payment for the units delivered or demanding release of the funds from the 2nd respondent pending arbitration.

The appellant, aggrieved by that finding has proffered this appeal on 7 grounds which can be summarized as follows; that the application was not premised upon any suit; that there was no dispute between the parties that merited a referral to arbitration in accordance with the contract; that the learned Judge erred in failing to consider that the 2nd respondent was not a party to the contract; that the learned Judge failed to consider that the 2nd respondent could not participate in the arbitral proceedings in relation to the contract; failed to find that the issues in dispute between the appellant and the 1st respondent and the Letter of Credit were separate; failed to appreciate the principles associated with a Letter of Credit; and finally, erred in finding that the Letter of Credit issued by the 2nd respondent was part of the contract between the appellant and 1st respondent.

On 18th October, 2016 the appellant and the 2nd respondent's advocates, appeared before the Deputy Registrar of this Court for case management conference in the absence of the 1st respondent's advocates who had been duly served. At the conference, parties agreed to canvass the appeal by way of written submissions. The appellant and the 2nd respondent duly filed and exchanged their respective submissions and highlighted the same during the formal hearing of the appeal.

In its submissions, the appellant conceded that indeed **Section 7 (1) of the Arbitration Act,** *"the Act***"** accorded the High Court the power to grant an interim measure of protection before or during arbitral proceedings upon request by a party to the arbitration agreement. According to the appellant, a key component in considering whether such an interim measure should be granted is whether there is a chance that the intended arbitration will be defeated if the interim measure of protection is not granted. The appellant was of the view that the issue before the High Court was whether the 1st respondent had established a case entitling it to be granted an interim measure of protection as it had sought. It cited the case of **Safaricom Ltd v Ocean View Beach Hotel Ltd & 2 Others [2010] eKLR** where this Court set out the factors to be considered before issuing an interim measure of protection under **Section 7** of the Act. Relying on that case, the appellant submitted that an applicant under **Section 7** of the Act must establish that there are assets or a status quo that merits protection pending arbitration. However, and in its view, there was no 'subject matter' in the intended arbitration that merited protection by the interim order because the 1st respondent's claim against it in the intended arbitration lay in damages for breach of

contract on account of delivering defective or faulty Mhub units. The appellant argued that neither a prospective claim, the Letter of credit nor the secured sum of Kshs.4, 200,00/-could amount to a subject matter that would merit protection through an interim order.

To buttress this point further, the appellant submitted that if the 2nd respondent had in fact honoured the Letter of Credit, it would not have interfered or affected the 1st respondents claim for damages. That as it were, by the issuance of the interim order, the learned judge served to jeopardize the very arbitration he actually intended to facilitate or preserve. Citing **Section 10** of the Act, the appellant contented that it was never the intention of the Act that the High Court could intervene in a dispute between parties who had chosen arbitration as their mode of resolving disputes.

It was also the appellant's contention that the interim order issued had the effect of affecting the intended arbitration proceedings since according to the appellant it amounted to a preliminary determination of the issues in dispute between the parties. In the appellant's view, the learned Judge usurped the powers of the arbitrator and went beyond the powers granted by **Section 7** of the Act. It cited the case of **Celetem v Roust Holdings [2005] 4 All ER 52** for the proposition that where a court is called upon to grant interim measure of protection it must take great care not to usurp the arbitral process and to ensure substantive questions are reserved for the arbitrator. In the above case, it was held, orders for preservation of assets could only be invoked where the case was one of urgency and where the judge thinks that it is necessary to make the order. The case of **Anne Mumbi Hinga v Victoria Njoki Gathara [2009] eKLR** was also cited by the appellant for the proposition that the High Court could not intervene and consider matters to do with the merit of the dispute which was within the province of the arbitrator.

The appellant further impugned the interim orders on the ground that such orders were never meant to be of a permanent nature considering the fact that the interim orders had been in force for a period of almost two years since they were granted and the arbitration proceedings were yet to commence. Furthermore, that the said interim orders did not have timelines within which they were to subsist and did not require the 1st respondent to give an undertaking as to the damages that would be enforced against it in the event the interim orders in its favour turned out not to have been merited. The appellant went on to submit that failure to balance the parties' interests was an error by the High Court meriting a reversal of the orders.

The appellant also submitted that since the 2nd respondent was not a party to the contract between the appellant and the 1st respondent, then even if the court was of the view that the matter was deserving of interim orders of protection then the same were not enforceable against the 2nd respondent in line with the doctrine of privity of contract. That as it were, the interim order affected the 2nd respondent notwithstanding the fact that it was not a party to the arbitration contract.

The appellant conceded though that courts could in particular circumstances interfere with the Letter of Credit. For instance, where the documents presented by the seller were fraudulent and the Bank is notified of the said fraud or where allowing encashment of a Letter of Credit would result in irretrievable harm or injustice to one of the parties concerned. However, this was not the case here. Despite the appellants claim that the Letter of Credit was irrevocable and ought to have been treated as separate from the contract between the appellant and the 1st respondent, the Judge's view was that the letter of Credit was an integral part of the contract and was in essence a "subject matter" of the dispute meriting protection and could not be treated as distinct or separate from the contract. The appellant in faulting that view cites **Article 4 of the ICC Uniform Customs and Practice for Documentary Credits (UCP 600)** which provides that Letters of Credit were irrevocable once issued and were further not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary. It was submitted that as the appellant had fully complied with the terms of the Letter of Credit and the letter having matured on 28th February 2015, the learned judge erred in suspending the 2nd respondent's obligation to honour the same. It relied on the case of **Bolivinter Oil SA v Chase Manhattan Bank (CA) [1984] 1 WLR 393** for the proposition that an injunction restraining a bank from honouring an irrevocable letter of credit, performance bonds and guarantees would undermine their value and injure bank's reputation for financial and contractual probity.

The appellant also questioned whether the 1st respondent's application for an interim measure of protection was properly before the High Court. The applicant submitted that the procedure for making an order of interim measure of protection under **Section 7** of the Act was provided for under **Rule 2** of the Arbitration Rules, 1997 which provide that applications under **Sections 6** and **7** of the Act should be by summons in the suit. According to the appellant, the application ought to have been made in a suit which is the bedrock upon which such applications rest. The appellant cited **Section 19 of the Civil Procedure Act, Cap. 21** which provide that a suit has to be instituted in such manner as may be prescribed by rules. The appellant frowned upon Article **159 (2) of the Constitution** coming to the aid of the 1st respondent as a manner of commencing suit could not be deemed as a technicality of procedure. In the same vein, the appellant questioned the applicability of the overriding objectives under the Civil Procedure Act to the case, since, according to the appellant the Arbitration Act and Rules thereunder are a '*self-containing*' code of procedure that cannot import the Civil Procedure Act or its rules. On this score, the appellant submitted, the application before the High Court was fatally and incurably defective and ought therefore to have been dismissed.

The 2nd respondent supported the appeal and to a great extent aligned itself with the submissions and authorities of the appellant. According to the 2nd respondent the issue for determination by this Court was whether a Letter of Credit constitutes the subject matter of arbitration capable of protection as envisaged by the Act. The 2nd respondent relied on **Article 4 (a) of the UCP 600** and the authority of **Power Curber International Ltd v National Bank of Kuwait [1981] 3 All ER 607** (CA) for the proposition that a Letter of Credit is separate and independent of the underlying contract and had to be honoured irrespective of any claims or defences by an applicant resulting from its relationship with the issuing bank or the beneficiary. It further relied on the case of **Civicon Limited v Kivuwatt Ltd [2013] eKLR** for the submission that, a Letter of Credit which is similar to a performance bond was not subject to arbitration and orders cannot be granted in respect of such a bond pending arbitration. The respondent also contended that given the peculiar nature of a Letter of Credit, it is not capable of being dissipated or wasted for it to be preserved under **Section 7** of the Act as it further did not qualify to be a subject matter capable of protection under **Section 7** of the Act.

It was submitted that there was no dispute that the appellant complied with all the terms and conditions of the Letter of Credit and forwarded the requisite documents to the 2nd respondent. As such, it argued, the 2nd respondent was obligated to pay the Letter of Credit provided only that the conditions specified in the Letter of Credit were met. It cited, persuasively, the South African case of **Loomcraft Fabrics CC v Nedbank Ltd & Another, Case No. 70/94 mb** for that proposition. The 2nd respondent was also in support of the contention that in certain circumstances an issuing bank could refuse to honour a Letter of Credit; such as when the documents presented to it were fraudulent and the bank was notified of the fraud or where encashment of a Letter of Credit would result in irretrievable harm or injustice to one of the parties concerned which was not the case here. It pointed out that the reason the learned Judge granted an interim order of protection was that the quality and functionality of the products supplied were in question and the presumption that the 1st respondent had not realized the purpose and benefits of the Mhub units. Since there was no fraud alleged in this case, in the 2nd respondents view, the 1st respondent had not made out a case or tendered evidence to show that the appellant would not be in a position to reimburse it in the event that it succeeded in the arbitral proceedings to entitle it to an interim order of protection under the second limb, that is to say, irretrievable harm or injustice. That as it were, the 1st respondent only made a case of a mere apprehension and was undeserving of the interim orders.

In conclusion, the 2nd respondent submitted that in issuing the interim orders the learned judge stated that it would have been unfair and unjust for the appellant to receive payment while the 1st respondent was yet to receive the benefits under their contract. That it was appropriate for the 2nd respondent to hold on to the Letter of Credit pending arbitration. According to the 2nd respondent, the Judge based his decision on the underlying dispute between the appellant and the 1st respondent which he should not have. It relied on the cases of **Howe Richardson Scale Co. Ltd v Polimex Cekop [1978] 1 Lyolds Rep 161** and **Hamzeh Malas & Sons v British Imex Industries Ltd [1958] 1 All ER 264** where it was held that the obligation of the bank is to perform that which is required to perform by that particular contract. That the obligation

does not in any way depend on the resolution of a dispute as to the sufficiency of performance by the seller to the buyer or vice versa. Further, that a confirmed Letter of Credit constituted an absolute obligation to pay irrespective of any dispute there may be between the parties as to whether the goods meet the terms of the contract or not.

During the oral highlights, **Mr. Monari** and **Mr. Kiche,** learned counsel for the appellant and the 2nd respondent respectively reiterated in brief their written submissions as captured above.

From the application, grounds of appeal, the written and oral submissions as well as the law, we take the view that this appeal can be determined on the following three broad grounds:-

(i) Whether the 1st respondent's application was properly before the High Court;

(ii) Whether the Judge failed to correctly apply or appreciate the principles that attend Letters of Credit;

(iii) Whether the 1st respondent was entitled to an interim measure of protection under section 7 of the Act in the circumstances of this case.

The court in ordering an interim measure of protection was of course exercising judicial discretion. Judicial discretion must always be exercised judiciously and for reasons which are stated. The exercise of discretion is meant to further the cause of justice, and to prevent the abuse of the court process. Judicial discretion is never however exercised capriciously or whimsically. In **Mbogo & Another v Shah [1968] EA 93** it was held that,

> "**A Court of Appeal should not interfere with the exercise of the discretion of a single 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 misjustice.**"

Similarly, in **Matiba v Moi & 2 Others, 2008 1 KLR 670** the Court of Appeal held thus;

> "**The High Court was exercising discretion and the Court of Appeal was not entitled to substitute the Judges' discretion with its own discretion. It had to be shown that the Judges' decision was clearly wrong because he misdirected himself or because he acted on matters on which he should not have acted on or because he failed to take into consideration matters which he should have taken into consideration and in doing so, arrived at a wrong decision**".

In furtherance of the above, it behooves this Court to consider whether the Judge exercised his discretion properly. No doubt the power granted to court under **Section 7** of the Act is a delicate one. The court is called upon to strike a balance to ensure that the intended arbitration proceedings are not prejudiced either by failing to protect the status quo and or the subject matter of the intended arbitration and at the same time to ensure or avoid making an order that goes to resolving the dispute between the parties which ought to be left exclusively in the hands of the arbitrator.

The starting point on the first issue is to establish whether the 1st respondent's application dated was properly before the High Court. The appellant has argued that the application was fatally and incurably defective on the basis that it was not premised on a suit. That argument was based on **rule 2** of the Arbitration Rules, 1997 which provide that applications under **Sections 6** and **7** of the Act, "*shall*" be made by summons in the suit. The application the subject of this appeal was a bare notice of motion and as already stated, a stand-alone application.

The Judge in his determination held that the fact that the application was not anchored on a suit did not render it fatal so as to deny the 1st respondent the right to seek an interim relief. The Judge was of the

view that in some instances a party could be allowed to file a miscellaneous application without the basis of a suit where such a party was not seeking to enforce any rights or obligations and where there was no action being enforced or tried like in the present case. The Judge relied on the case of **Joseph Kibowen Chemjor v William C. Kisera [2013] eKLR** where it was held that in some instances, the court would be asked to exercise its discretion on procedural issues, for example, when a party was seeking leave to institute suit out of time or leave to commence judicial review proceedings. In our view, that authority was inapplicable and clearly distinguishable in the circumstances of this case since it dealt with the filling of a miscellaneous applications, which is a form of initiating a suit that is permitted by the Civil Procedure Act, and the rules made there-under, more so where no procedure is provided. In the present case, a procedure is provided for, which is that the application be mounted upon a suit.

It must be borne in mind that the substantive provision that the 1st respondent invoked was **Section 7** of the Act. The 1st respondent was seeing an interim measure of protection pending arbitration. The procedure applicable in such circumstances is clearly spelt out by **Rule 2** of the Arbitration Rules, 1997. Suffice it to say, that the rule is couched in mandatory terms. Our jurisprudence reflects the position that where there is a clear procedure for the redress of any particular grievance prescribed by the Constitution or Statute, that procedure should be strictly followed (See **Speaker of National Assembly vs. Njenga Karume [2008] 1 KLR 425**). The 1st respondent did not proffer any reason or excuse for its failure to premise its application upon a suit as was required by the rules. It however sought to rely on **Article 159** of the Constitution for the proposition that justice is to be administered without undue regard to technicalities. That Article also provides that alternative forms of dispute resolution mechanisms like arbitration should be promoted by the courts. There are however many decided cases to the effect that **Article 159** of the Constitution should not be seen as a panacea to cure all manner of indiscretions relating to procedure (See **Nicholas Kiptoo Arap Korir Salat v IEBC & 6 Ors [2010] eKLR;**

Dishon Ochieng v SDA Church, Kodiaga (2012) eKLR; Hunter Trading Company Ltd v Elf Oil Kenya Limited, Civil Application No. NAI. 6 of 2010). Despite the foregoing, the court still went ahead to exercise its discretion in favour of the 1st respondent by invoking that Article, the overriding objective under the Civil Procedure Act, and the interests of justice, to hold that failure to anchor the application on a suit did not render the application fatal or incurably bad. The manner of initiating a suit cannot be termed as a mere case of technicality. It is the basis of jurisdiction. Obviously, in overlooking a statutory imperative and the above authorities, the learned Judge cannot be said to have exercised his discretion properly. There can be no other interpretation of **Rule 2**. The application should have been anchored on a suit. It was not about what prejudice the appellant or and 2nd respondent would suffer or what purpose the suit would have served. Discretion cannot be used to override a mandatory statutory provision. For these reasons, we are in agreement with the submissions of the appellant that the application was fatally and incurably defective.

The remaining two grounds are interrelated and the determination of one ultimately will lead to determination of the other. What is the nature and effect of a Letter of Credit? **Black's Law Dictionary, 9th Ed.** defines a letter of credit as follows:-

> "**An instrument under which an issuer (usually a bank), at a customer's request, agrees to honour a draft or other demand for payment made by a third party (the beneficiary), as long as the draft or demand complies with specified conditions, and regardless of whether any underlying agreement between the customer and the beneficiary is satisfied.**"

In a bid to promote and facilitate the flow of international trade at a time when nationalism and protectionism posed serious threats to the world trading system, the International Chamber of Commerce, of which Kenya is a member, established the **ICC Uniform Customs and Practice for Documentary Credits (UCP 600)** to create a set of contractual rules that would establish uniformity in letters of credit and alleviate the confusion and uncertainty created by conflicting national regulations. Those rules inform the usage of letters of credit. **Article 2** of the rules provides that letters of credit or however named are irrevocable and constitute a definite undertaking of the issuing bank to honour a complying presentation. Further, **Article 4** of the said rules provides that,

> "**A credit by its nature is a separate transaction from the sale or other contract on which it may be based. Banks are in no way concerned with or bound by such contract, even if by reference whatsoever to it is included in the credit. Consequently, the undertaking of a bank to honour, to negotiate or to fulfil any other obligation under the credit is not subject to claims or defences by the applicant resulting from its relationships with the issuing bank or the beneficiary**."

That Article goes further to provide that an issuing bank should discourage any attempts by the applicant to include as an integral part of the credit, copies of the underlying contract. The import of that statement is clear to us, that a letter of credit exists separately and distinct from an underlying contract and it's not dependent or based upon such a contract in any manner. This also appears to be in line with many decided cases. In **Hamzeh Malas & Sons v British Imex Industries Ltd** (supra) the court refused to grant an injunction to the buyer, which would have prevented the bank from paying the seller upon receipt of the relevant documents. The buyer had alleged that the goods were substandard and wished to prevent the bank from paying the seller, similar to the scenario here. The court held that the documentary credit was an '*absolute obligation to pay, irrespective of any dispute there might be between the parties whether or not the goods were up to contract*' and that the court lacked the jurisdiction to prevent the payment, unless fraud had been established. Similarly, in **Power Curber International Ltd v National Bank of Kuwait** (supra) **Lord Denning MR** held that:-

> **"It is vital that every bank which issues a letter of credit should honour its obligations. The Bank is in no way concerned with any dispute that the buyer may have with the seller. The buyer may say that the goods are not up to contract. Nevertheless, the bank must honour its obligations. A letter of credit is like a bill of exchange given for the price of the goods. It ranks as cash and must be honoured."**

This appears to be the accepted position, custom and norm in many of the decided cases. See also **Loomcraft Fabrics CC v Nedbank Ltd & Another Case No. 70/94 mb;** and **Howe Richardson Scale Co. Ltd v Polimex Cekop [1978] 1 Lloyds Rep 161.** The rationale of the irrevocable nature of Letter of Credit was espoused in the case of **R. D. Harbottle (Mercantile) Ltd.** (supra) as below:-

> "**It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. <u>They are the life-blood of international commerce.</u> <u>Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain.</u> 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. <u>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</u>."** [Emphasis added].

So if this is the law as regards Letters of Credit, on what basis did the learned Judge proceed to grant an interim order in favour of the 1st respondent barring the 2nd respondent especially, from honouring its obligation as the issuing bank of a Letter of Credit? As already seen, a court can only interfere with a letter of credit where fraud has been established and the bank is notified of the same or where the encashment of a Letter of Credit would result in irreparable harm or injustice to one of the parties. In the present case, no fraud irreparable harm or injustice was alleged or established. This was never the 1st respondent's case though the Judge appears to have anchored his decision on the latter ground. He stated: -

> "**Allowing encashment of the Letter of Credit would result in irretrievable** (sic) **harm or injustice to one of the parties concerned. See; R D Harbottle (Mercantile) Ltd and Another vs. National Westminster Bank Ltd and Others [1977] 2 All ER 870**."

Of course, irreparable harm or injustice to a party would be a compelling reason to merit a court to exercise its discretion in favour of an applicant. However, no evidence in that regard was tendered before the learned Judge. What was before him was a mere apprehension, which is not a basis for the grant of interim orders of protection. There was no evidence that if the amount was paid over, the 1st respondent would not be able to recover it from the appellant in the event that it succeeded in the arbitration proceedings. Further, the learned Judge did not take into account the doctrine of privity of contract. The 2nd respondent was never a party to the contract between the appellant and the 1st respondent and yet the court went ahead to make an order adverse to it.

There was no iota of evidence on record to show that the 1st respondent would suffer harm, whether irreparable or not, or injustice for that matter, if the order of interim protection was denied. The burden of proof lay with the 1st respondent who however never made an attempt to discharge it. Ultimately, the Judge based his decision on the reason that it would not be just and fair that the 1st respondent receive payment while the appellant is yet to benefit from the Mhub units and it would be 'appropriate' for the 2nd respondent to hold on to the Letter of Credit for a while pending the resolution of the dispute. This was erroneous.

The Judge further went on to hold that the Letter of Credit was an integral part of the contract and as such a subject matter of the pending arbitration deserving to be temporarily preserved. As already seen, Letters of Credit exist separately and should be honoured irrespective of the underlying contract. In essence, the obligation of the 2nd respondent to pay the appellant crystallized the moment it received relevant documents from Allied Irish Bank, as the advising bank. No basis was laid to warrant the court's interference with the 2nd respondent's obligation to honour the Letter of Credit when it matured on 28th

February, 2015. This case did not contain any circumstances that would warrant the court to deviate from well accepted international norms and customs regarding the irrevocability of Letter of Credit or the circumstances under which the courts could interfere.

The 1st respondent's course of action lay in damage for breach of contract in the intended arbitration. This was regardless of whether the Letter of Credit was honoured or not. The 1st respondent's claim for breach of contract could not and cannot be jeopardized because of payment of the credit by the 2nd respondent. In our view, it is not the subject matter of the intended arbitration and it needs or needed no protection by court. Any challenges to be posed by either party in the arbitration to be conducted in Ireland are obviously risks such a party was prepared to take by executing the underlying contract.

The conclusion we have thus reached is that the appeal is merited. It is allowed with the consequence that the ruling and order dated 31st July, 2015 is set aside. In its place, we substitute an order dismissing the application filed in the High Court on 26th February, 2015. The appellant and 2nd respondent will have the costs of the application as well as this appeal.

Dated and delivered at Nairobi this 12th day of May, 2017.

ASIKE MAKHANDIA

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JUDGE OF APPEAL

W. OUKO

……..……

JUDGE OF APPEAL

K. M’INOTI

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JUDGE OF APPEAL

I certify that this is a true copy of the original

DEPUTY REGISTRAR