



REPUBLIC OF KENYA
IN THE COURT OF APPEAL
AT NAIROBI
(CORAM: GATEMBU, M'INOTI & MURGOR, JJ.A)
CIVIL APPEAL NO. 99 OF 2005

BETWEEN

ITAL IMPORTS LIMITEDAPPELLANT

AND

MOHAMED SALIM KARANJA T/A

MOSAL CLEANING ENTERPRISES.....1ST RESPONDENT

KENYA COMMERCIAL BANK LIMITED.....2ND RESPONDENT

(Appeal from the Judgment of the High Court at Nairobi **Hon. Mr. Justice J. W. Mwera**) dated
24th November 2003

in

HCCC No. 1832 of 1999)

JUDGMENT OF THE COURT

The appellant's claim is for a sum of US Dollars 16,100 (equivalent to Kshs. 1,207,500 at the rate of Kshs. 75 to the US Dollar), arising from a Contract of sale of laundry equipment made between the appellant and the 1st respondent, where it was agreed that payment to the appellant would be through an irrevocable letter of credit following the shipment and supply of the laundry equipment.

By way of proforma invoices dated 3rd December 1998, and an agreement dated 26th February 1999, (**the sale contract**) the 1st respondent agreed to purchase a Realstar dry cleaning machine and a pressing machine Ghidini GB-Matic with Air compressor, boiler, iron assembly and air spotting pistol (**the equipment**) from the appellant. Payment for the equipment was to be effected through a confirmed irrevocable, negotiable and divisible letter of credit to be opened in favour of the appellant by the 2nd respondent's Issuing bank on the instructions of the 1st respondent.

A letter of credit was opened by the 2nd respondent's Issuing bank on 22nd February 1999 the terms of which specified that the equipment would be delivered to the Inland Container Depot, Embakasi, Nairobi, and payment would be binding on the confirming bank once it had been confirmed to the appellant that it was opened, and that, the letter of credit would be payable after 90 days on sight against the presentation by the appellant of a full set of clean "On Board" bills of lading, signed invoices, a certificate of origin, a certificate of conformity, a certificate of insurance and a packing list. The payment currency was to be in US Dollars. Following the signing of the sale contract and the opening of the confirmed letter of credit, the appellant ordered the equipment from the suppliers, which it says was subsequently delivered to the port of Genoa, awaiting shipment instructions from the appellant.

On 8th April 1999, the 1st respondent terminated the sale contract claiming that the purchase price for the equipment was too high, and instructed the 2nd respondent to cancel the letter of credit. On the same date, the 2nd respondent's Kenyatta Avenue branch, requested the appellant to hold the matter in abeyance pending the resolution of three outstanding issues namely, the date and place of expiry of the letter of credit, the discrepancies between the amount on the letter of credit and the proforma invoices, and the currency quoted on the letter of credit. In the meantime, the appellant was requested to open a back to back foreign letter of credit for the benefit of the overseas suppliers, and to deposit with it, an amount equivalent to the import value of the equipment. The appellant was also advised not to proceed to import the equipment until the import letter of credit applications were approved by the 2nd respondent.

In a letter dated 19th April 1999, the 2nd respondent advised the appellant that it was informed that the 2nd respondent's Issuing bank had received instructions from the 1st respondent to cancel the letter of credit, but requested the appellant to contact the 1st respondent. Upon receiving the letter dated 19th April 1999 purporting to cancel the letter of credit, the appellant's Managing Director Dr. Uno Bono, advised the 2nd respondent that the letter of credit was not capable of cancellation without its consent. The appellant claimed that subsequent to the cancellation it had written severally to the 2nd respondent demanding the reinstatement of the letter of credit to enable the performance of contractual terms and conditions. As it received no response from the respondents' on the status of the letter of credit, the shipment was stopped and the equipment returned to Genoa. The appellant states that it suffered loss of its deposit and transport costs following cancellation of the contract and the letter of credit.

According to the appellant the 2nd respondent's Issuing bank was under a duty to pay the amount of the letter of credit on presentation of the requisite documentation irrespective of the status of the sale contract between the appellant and the 1st respondent.

The 1st respondent confirmed that a sale contract was entered into with the appellant and the 2nd respondent's Issuing bank was instructed to open a letter of credit in favour of the appellant. It was when the appellant failed to open a back to back foreign letter of credit, and the 2nd respondent's Kenyatta Avenue branch queried the discrepancies in the pricing on the proforma invoices and the declaration forms, that he sought to cancel the letter of credit through the 2nd respondent's Issuing bank. In his view, the letter of credit was not cancelled, but was insufficient to import the equipment without a foreign letter of credit in favour of the suppliers.

The 2nd respondent's also admitted opening a letter of credit in favour of the appellant, but considered this to be inadequate as a back to back foreign letter of credit required to be opened to secure payment to the suppliers against the delivery of the equipment shipped from overseas. According to the 2nd respondent's branch manager, Mr. Samuel Mburu, the appellant had refused to open a foreign back to back letter of credit, and also failed to deposit an amount equivalent to the import value of the equipment, or meet the account opening conditions specified by the 2nd respondent's Kenyatta avenue branch (the Advising bank). On 19th April 1999 they wrote to the appellant advising that they had received communication from their Issuing bank under instructions from the 1st respondent to cancel the letter of credit. It was the 2nd respondent's contention that, the letter was in all respects, a notification to the appellant informing it of the 1st respondent's instructions to cancel the letter of credit, but was at all times aware of its own inability to cancel the irrevocable letter of credit, without the

appellant's consent.

In his judgment, the learned judge, dismissed the suit with the costs having found that, despite the existence of the expiry period of 90 days, that the period did not commence, and consequently, there was no expiry of the letter of credit. On the issue of whether the appellant fulfilled the obligations under the

letter of credit, the learned judge found that the appellant did not perform its obligations to deliver the equipment. As to whether the appellant suffered any loss, the learned judge found that there was no evidence that the appellant had suffered any loss, contrary to its contention that it had lost the deposit paid to the suppliers for the manufacture of the equipment.

The appellant was aggrieved by the decision of the High Court and filed this appeal, wherein it specified several grounds of appeal which in the main, centered on the letter of credit. In summary, the contention was that the learned judge erred in finding that the 2nd respondent's letter dated 19th April 1999 did not amount to a cancellation of the letter of credit dated 22nd February 1999, and which letter of credit could not be cancelled, that the finding that the letter of credit was not utilised and remained valid was erroneous; that the learned judge erred in finding that the appellant did not fulfil its obligations under the letter of credit failed to appreciate that the contract was frustrated when the 2nd respondent cancelled the letter of credit, and could not proceed to import the equipment when the respondents had clearly repudiated the contract; that the learned judge did not appreciate the nature of a letter of credit, and the finding that the letter of credit dated 22nd February 1999 was a local letter of credit, that was incapable of importing the equipment was erroneous; that the learned judge erred in finding that the appellant had not suffered any loss; and finally that the learned judge erred in finding that the appellant having failed to file a reply to defence was deemed to have admitted the entire defence and evidence of the respondents.

When the parties appeared before us, **Mr. Mwangi** learned counsel for the appellant submitted that upon the presentation of the letters of credit, the 2nd respondent was obliged to comply with the terms and conditions. It was on the assurance under the letter of credit that the appellant procured the equipment for delivery. Counsel questioned whether, a letter of credit having been issued, it could be cancelled by the 2nd respondent. Counsel submitted that a letter of credit could not be cancelled without the consent of the seller and the paying bank. In counsel's view the cancellation of the letter of credit was unlawful, and the only instances where a letter of credit was dishonoured was either where documentation was not presented or where there was an element of fraud. Counsel complained that the learned judge took into account extraneous matters including whether the appellant was capable of importing the goods without a foreign bank's letter of credit. The learned judge also considered that despite being aware that the letter of credit was incapable of revocation or cancellation, the appellant did not proceed to complete the contract terms, but did not question the reasons behind the appellant's failure to perform. On the issue of the failure to file a reply to the defence, counsel submitted that Order 6 rule 10 of the Civil Procedure Rules only applies to cases where no defence is filed, there is a joinder of issue, which operates as a denial of the facts, and that the learned judge failed to take this into consideration. On the question of the quantum, the appellant had made advance payments for 7 million Liras, 4.5 million Liras and US Dollars 2,400, and the total amount requested is for Kshs. 1.3 million.

Mr. Moibi, learned counsel for the respondents opposed that appeal and submitted that the respondents did not cancel the letter of credit. According to counsel, the letter of 19th April 1999 merely sought information from the appellant, to which the appellant failed to respond. Counsel contended that the appellant had failed to open a foreign letter of credit yet the suppliers were foreign, and that a local letter of credit would only suffice where the contract sums were to be paid locally. Counsel continued that the advance payment allegedly paid by the appellant was not acknowledged by the suppliers, and questioned whether the payments were in respect of the machines or for other supplies. There was also no evidence to show that the goods were transported to the port of shipment. These amounts were special damages which had not been proved. No documentary evidence was produced to support the claims for profits. On the failure to reply to the defence, counsel submitted that there was an obligation on the part of the appellant to reply to the defence, and the failure to do so was to the appellant's detriment.

This being a first appeal, it is our duty to re-evaluate the evidence, assess it and reach our own conclusions bearing in mind that we have neither seen nor heard the witnesses and hence due allowance must be made for this – See **SELLE V. ASSOCIATED MOTOR BOAT COMPANY LTD. [1968] E.A. 123** and **WILLIAMSON DIAMONDS LTD. VS. BROWN [1970] E.A. 1.**

Having considered the pleadings, the evidence, the judgment and the respective parties' submissions, we take the view that the issues for determination are as follows:

- i) Was there a valid letter of credit in existence?
- ii) Was the letter of credit cancelled?
- iii) Were the terms and conditions specified under the letter of credit complied with, and was the appellant entitled to payment?
- iv) Was the appellant entitled to reimbursement?
- v) By failing to file a reply to defence, did the appellant admit the respondents' entire defence and evidence?

From the evidence it is clear that the suit evolved around an irrevocable letter of credit, and its subsequent alleged cancellation, and whether following the cancellation of the sale contract and the letter of credit, the appellant was entitled to damages for loss.

Before we proceed to consider the issues, we find a definition of a letter of credit necessary. **Black Law Dictionary** Ninth edition defines a “**letter of credit**” as,

An instrument under which the 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 payment complies with specified condition, and regardless of whether any underlying agreement between the customer and the beneficiary is satisfied.

With this in mind, we turn to the first issue, on the validity of the letter of credit in the instant case. It is apparent that, in order for the letter of credit to be valid, it required to be issued by a bank upon the request of the customer, in favour of a beneficiary.

From the evidence the 1st respondent requested for a letter of credit which the 2nd respondent's Issuing bank issued on 22nd February 1999 in favour of the appellant.

It was the 2nd respondent's argument, that the letter of credit that was opened by its Issuing bank was a local letter of credit payable locally to the appellant. In their view, the shipments involved payments overseas, and required a foreign letter of credit to be opened to facilitate payment to the overseas suppliers. This was not done, as the appellant found this requirement to be irrelevant, and consequently, the local letter of credit was inoperable.

Clearly, in order for a valid letter of credit to be opened, all that was required was for an issuing bank to issue the letter of credit on the instructions of its customer, in favour of the seller, or beneficiary, upon terms already agreed between the parties. There is no doubt that the 2nd respondent's Issuing bank opened a confirmed and irrevocable documentary credit no 88/99/001 on 22nd February 1999 in favour of the appellant. Accordingly, we find that a valid letter of credit properly existed between the parties.

As a consequence, the failure by the appellant to open a back -to -back letter of credit or a foreign letter of credit did not in any way affect the validity of the letter of credit for reasons that the transaction was inoperable. Provided that it was opened by an Issuing bank, and specified the terms and conditions of shipment, and the particulars of payment to the beneficiary, it was considered to be a valid and

binding document.

The next issue is whether the letter of credit was cancelled by the 2nd respondent's letter of 19th April 2014.

The appellant contended that the letter dated 19th April 1999 cancelled the letter of credit, and as a result, it was unable to proceed with the importation of the equipment. The 2nd respondent maintained that the impugned letter did not amount to a cancellation, but was a proposal from its Issuing bank to cancel the letter of credit.

As to whether a letter of credit can be cancelled by the issuing bank is provided for under **Article 9 (d) (i) of the ICC Uniform Customs and Practice for Documentary Credits**, which provides,

“an irrevocable credit can neither be amended nor cancelled without the agreement of the issuing bank, the confirming bank if any and, the beneficiary.”

To determine whether the 1st respondent's letter was tantamount to a cancellation of the letter of credit, we find it necessary to reproduce verbatim the 2nd respondent's letter.

“The Manager 19.4.99

Ital Imports Ltd

P.O. Box 66538

Nairobi

Dear Sir

RE: LOCAL LETTER OF CREDIT NO 88/99/001 USD 39,457 B/O MR
MOHAMED SALIM KARANJA T/A MOSAL CLEANING ENTERPRISE

Further to our letter dated 14.4.99 we advise that we have received instructions from the opening bank- Meru Branch under instruction form their client T/A Mosal Cleaning Enterprise to cancel the above letter of credit.

Please contact the openers if you have not done so and let us have your confirmation to this effect.

Yours faithfully

S.N. MBURU

BRANCH MANAGER”

When we consider the contents of the impugned letter as framed, it is clear to us that the letter was an advisory from the 2nd respondent to the appellant informing it that its Issuing bank had been instructed by the 1st respondent to cancel the letter of credit, but requested the appellant to contact the 1st respondent regarding the proposed cancellation. In response, the appellant advised the 2nd respondent that the letter of credit was not capable of being cancelled by the issuing bank or by the 1st respondent, without its consent.

It is our view, that the communication in and of itself did not amount to a cancellation, as the 2nd respondent's issuing bank was incapable of cancelling the letter of credit, without the appellant's consent. Instead, the appellant was requested to contact the 1st respondent regarding the proposed cancellation, and to advise the 2nd respondent whether or not the parties were agreeable to a cancellation of the letter of credit. There is correspondence to show that at all times the appellant

was opposed to a cancellation, and consistently maintained that the letter of credit was not capable of cancellation by the respondents. In the circumstances, we find that the letter of credit was not cancelled by the 2nd respondent, but rather, it remained open until the terms and conditions were duly complied with.

This leads us into the next issue on whether the terms and conditions of the letter of credit were complied with.

In the case of Har Bottle (Merchantile) Ltd & Another vs National Westminster Bank & Others 1977 2 All ER 720

The whole commercial purpose for which the system of confirmed irrevocable documentary credits has been developed in international trade was to give the seller of goods an assured right to be paid before he parted with control of the goods without risk of the payment being refused, reduced or deferred because of a dispute with the buyer. It followed the contractual duty owed by an issuing or confirming bank to the buyer to honour the credit notified by him on presentation of apparently confirming documents by the seller was matched by a corresponding contractual liability on the part of the bank to the seller to pay him the amount of credit on presentation of the document". (emphasis ours)

From the sale contract and the letter of credit, the appellant agreed to supply the 1st respondent with the equipment. The letter of credit specified that the equipment would be shipped from Genoa, Italy to IUD Embakasi, Kenya accompanied by,

“ a) the signed invoices in triplicate;

b) full set of clean “on board” Ocean bills of lading made out to order and endorsed in blanked marked “freight” copy of bill of lading not negotiable and notify”;

c) certificate of origin- ITALY;

d) certificate to the effect that the goods conform to proforma invoices dated 3rd December 1998;

e) certificate of issuance of clean report of findings by Bureau Veritas;

f) packing list original covering for Realstar Dry Cleaning Machine RS 237-US\$ 28215 and Pressing Machine Ghidini GB- Matic 87 U3AP-US\$ 11260.”

The letter of credit also provided that reimbursement would be paid,

“...at sight claim reimbursement from K.C.B Meru for value of documents that conform to L/C terms.”

At the last paragraph it is stated that the letter of credit was subject to the terms and conditions of **the ICC Uniform Customs and Practice for Documentary Credits. Article 9** states.

“An irrevocable letter of credit constitutes a definite undertaking of the issuing bank, provided that the stipulated documents are presented to the nominated bank of the issuing bank and that the terms and conditions are complied with;

i) If the credit provides for sight payments- to pay at sight.

ii) ...”

Under the Special Conditions of the letter of credit, it was clearly provided that,

“1. Only 95% of the payment amounting to US Dollars (37,501.25) will be affected (sic) on production of documents a-b-c-d-e-f as on page one of the L/C”.

It is evident that these were obligations that required to be performed by the appellant prior to receipt of payment.

Following receipt of the impugned letter, the appellant, despite refuting the purported cancellation of the letter of credit, sought to obtain assurance from the 1st respondent, that the letter of credit had not been cancelled. As this was not forthcoming the shipment was stopped, and the equipment returned to Genoa.

From this evidence, it is clear that no equipment was shipped to ICD, Embakasi, Nairobi, as required by the letter of credit. There is also no evidence to show that the appellant presented a full set to shipping documents to the 2nd respondent's Issuing bank as specified in the letter of credit, in exchange for the reimbursement of the amounts being the value of the equipment.

We would agree with the learned judge, that, since the appellant did not fulfil the terms and conditions set out in the letter of credit, it was not entitled to payment from the 2nd respondent's Issuing bank. We find it curious that, despite being fully cognizant of the infallibility of the irrevocable letter of credit, the appellant did not deem it necessary to comply with the stipulated terms and conditions, and seek to present a complete set of shipping documentation to the 2nd respondent in return for the payment under the letter of credit.

The principle governing letters of credit is that, payment by the issuing bank is made on the basis of presentation of documentation that conform to the terms and conditions of the letter of credit. Without presentation of the requisite documentation, an issuing or paying bank has no authority upon which to make payment to a third party.

In the circumstances, we find that notwithstanding the letter of credit remained open, since the appellant did not present any documentation to the 2nd respondent's Issuing bank, it was not entitled to payment in respect of the letter of credit.

The next issue is the appellant's claim for compensation on account of the part performance of the sale contract, that being the payment of the deposit of US\$4,300 and US\$ 2,400 to the suppliers, transport costs and profit. The appellant's complaint is that the contract was frustrated by the cancellation of the sale contract and the letter of credit by the respondents, and therefore it was entitled to a reimbursement for the amounts paid as deposit.

The terms of the sale contract and the proforma invoices provided that the payment would be through a letter of credit to be opened by the 2nd respondent's Issuing bank, and that "reimbursement" would be on the basis of,

“...presentation to the issuing bank of a Full set of “Clean on Board Bills of Lading.”

As to whether the appellant was entitled to a refund of the amounts paid is entirely dependent on the terms of the agreement. The sale contract required the appellant to import the equipment, whereupon, it would be paid through a letter of credit, upon presentation of the shipping documentation to the 2nd

respondent's Issuing bank. Consequently, though the 1st respondent cancelled the sale contract, the letter of credit remained open, and was a guarantee and an assurance of payment under the letter of credit, upon presentation of the shipping documents. Again, as the appellant did not import the equipment, and deliver the shipping documents to the 2nd appellant, it followed that, the appellant was not entitled to reimbursement of the deposit alleged to have been paid to the suppliers or the ancillary costs. Accordingly, we find that the appellant was not entitled to compensation for part performance of the

contract.

Regarding the final issue where the learned judge found that by failing to file a response to defence the appellant admitted the respondents' pleadings and evidence, we consider that the facts pleaded by the Plaintiff are already particularized, and are deemed to be a denial as there is a joinder of those issues by virtue of rule 10 (1) of the Civil Procedure Rules, which joinder operates as a denial of the material allegations of fact alleged in the pleadings. The High Court therefore erred in deeming the appellant as having admitted the allegations of negligence in the defence against him. **See Denmus Oigoro Oonge vs Njuca Consolidated Limited [2012] eKLR.**

For the above stated reasons, we find no reason to interfere with the decision of the court below, and dismiss the appeal with costs to the respondent herein.

Dated and Delivered at Nairobi this 3rd day of OCTOBER, 2014.

S. GATEMBU KAIRU

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JUDGE OF APPEAL

K. M'INOTI

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JUDGE OF APPEAL

A. K. MURGOR

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JUDGE OF APPEAL

I certify that this is a true copy of the original.

DEPUTY REGISTRAR