IN THE COURT OF APPEAL

AT NAIROBI

CIVIL APPEAL NO. 328 OF 2002

KENINDIA ASSURANCE COMPANY LIMITED …….. APPELLANT

AND

FIRST NATIONAL FINANCE BANK LIMITED ……. RESPONDENT

(Appeal from the Ruling of the High Court of Kenya at Nairobi (Mwera J.) delivered at Nairobi on 5th November 2002

in

H.C.C.C.NO. 874 OF 2002)

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JUDGMENT OF THE COURT

This is an appeal against the judgment of Mwera J. delivered on 5th November, 2002, in **Nairobi High Court Civil Case No. 874 of 2002,** pursuant to the provisions of **Order 35 rules 1** and **2** of the Civil Procedure Rules.

In an application for summary judgment under the foregoing provisions, the duty is on a defendant to show he should have leave to defend the suit. His duty is limited to showing on a prima facie basis, the existence of at least one triable issue or that he has an arguable case. On the other hand if a plaintiff is able to show that a defence raised by the defendant in an action falling within the purview of the aforesaid provisions, is shadowy or a sham, he will be entitled to summary judgment (**Continental Butchery Ltd v. Samson Musila Nthiwa Civil Appeal No. 35 of 1977**. (CA).

In the above case, Madan J.A, enunciated the principles thus:

"With a view to eliminate delays in the administration of justice which would keep litigants out of their just dues or enjoyment of their property the Court is empowered in an appropriate suit to enter judgment for the claim of the Plaintiff under the summary procedure provided by O.35 subject to there being no triable issue which would entitle a defendant to leave to defend. If a bona fide triable issue is raised the defendant must be given unconditional leave to defend but not so in a case in which the Court feels justified in thinking that the defences raised are a sham."

Cases which fall under **O.35,** above are of two types, the first one being where the plaint makes a liquidated demand. The second category is where the claim is for the recovery of land.

In the appeal before us the plaint made a liquidated demand of Kshs.24,208,710/10 being the amount allegedly due to the plaintiff under a performance bond the defendant had agreed to furnish to the plaintiff in respect of financial facilities extended to a third party, ***Universal Apparels Ltd.***

The plaintiff was ***First National Finance Bank Limited***, the respondent in this appeal. The defendant, which is the appellant herein, was ***Kenindia Assurance Company Limited*** described in the plaint as an insurance company carrying on business in Nairobi.

It was averred in the plaint that under the terms of the aforesaid performance bond the appellant bound itself to pay to the respondent on demand a sum of Kshs.25,000,000/= in the event Universal Apparels (EPZ) Ltd (*hereinafter referred to as the third party*), failed to fulfill its obligations to the respondent regarding certain letters of credit.

It was the respondent's case that the third party defaulted. The respondent was thereby forced to make a formal demand to the appellant to meet its obligations under the performance bond, which it failed to do and thus provoked the filing of the suit from which this appeal arose.

The appellant in its written statement of defence admitted having executed the performance bond but denied it was on account of financial facilities generally. It was its case that the execution of the bond was specifically in relation to the exportation of garments and textile products. It was further its case that its liability would only arise once the respondent as plaintiff, had exhausted all avenues of recovery directly from the third party, which the respondent had not done as at the date of the suit and consequently, no liability attached to it.

On the basis of the above pleadings and a reply to defence whose details we need not rehash, the respondent took out a motion on notice, under **O.35,** above, for summary judgment. The affidavit in support thereof was sworn by one Carroll N. Mathenge, who described herself in the affidavit as the legal officer of First National Finance Bank Limited, the respondent herein. She deposed in that affidavit that she had been authorized by the Board of Directors of that company to swear the affidavit on its behalf. In paragraph 2 of the affidavit she deposed that she was acquainted with the facts and issues of this case and was therefore competent to swear the affidavit. She then went on to set out the basis for the respondent's claim.

In paragraph 7 of that affidavit Carroll deponed that the respondent brought a suit against the third party, along with two others for the recovery of US ? 342, 415/95 together with compound interest at 12 % per annum. Judgment was given in its favour, and efforts made to recover the decretal sum were fruitless. Consequently the company made a written demand by its letter dated 28th June 1997.

In reply, Ish Kumar, the Deputy Manager of the appellant company, on the main, raised three issues. First, whether the performance bond was valid as at the date of demand. Two, whether the respondent had indeed exhausted all avenues in seeking to recover money owed to it by the third party before making the demand. Third, if the performance bond was valid, whether it was a conditional one or otherwise.

Mwera J. heard the motion and delivered his ruling on 5th November 2002. He found as fact that in the event of default by Universal Apparels (EPZ) Ltd, to discharge its liability the appellant as the defendant needed to be notified and that it was notified before 27th August 1997, the last date of the life of the performance bond. It was his view that the condition for liability to crystalise did not include filing a suit and failing to recover through it. In his view the plaintiff had demonstrated there was default on the part of the principal debtor and a valid demand had been made to the appellant which had not been satisfied. He then entered judgment for the respondent and provoked this appeal.

Ten grounds of appeal were filed. However, Mr. Gautama for the appellant argued those grounds together. He submitted that there were several triable issues raised. The appellant's obligation was to show the existence of at least one triable issue. He attacked the propriety of the application for summary judgment. In his view it was supported by a defective affidavit, as the same was not sworn by an official of the bank. He submitted that the deponent could not possibly be said to have personal knowledge of the

matters she deposed to. In that regard he cited the English Case of **LAGOS V. GRUNWALDT [1910] 1 KB 41** in which it was held that the affidavit in the matter had been sworn by a person other than the plaintiff who could swear positively to the facts. The affidavit had been sworn on the basis of information and belief only and therefore the court lacked jurisdiction to make an order for payment upon it.

The second part of Mr. Gautama's submission concerned the performance bond. In his view it was not a general one but was conditional and contingent upon terms and conditions of import or export of certain textiles. In his view letters of credit had to be issued, and as those letters were not part of the evidence before Mwera J. its terms were unknown and no judgment could properly be entered without its terms being known.

The third issue Mr. Gautama submitted on concerned the general conduct of the respondent. In his view the plaint asserts that default occurred in 1997. He wondered why it took 5 years before the plaintiff could act.

The last point learned counsel submitted on was on interest. In his view no provision was made in the performance bond for interest. Consequently, he submitted that interest was improperly awarded.

In answer, Mr. Ochieng Oduol for the Respondent/Plaintiff, started by lamenting that matters which were not canvassed before the trial court were improperly being raised, among them, the validity of the affidavit in support of the application. He cited the case of **KCB V. OSEBE [1982] KLR 296** in support of his submission. He pointed out that the appellant, in effect raised only three issues, in the court below. First that liability could only attach after all avenues had been exhausted. Two, validity of the performance bond. Third, that the claim was premature.

Citing the case of **MAGUNGA GENERAL STORES V. PEPCO DISTRIBUTORS [1987] 2 KAR 89**, Mr. Oduol submitted that the principles therein stated formed the basis of Mwera J.'s ruling and he, therefore, saw no proper basis for faulting him. Learned counsel then went on to submit that there was nothing objectionable about the way the application was drawn. The affidavit had been sworn by a proper person, a legal officer, who was not only seised of the facts, but was an officer of the respondent bank. In his view, **LAGOS V. GRUNWALDT** should be confined to its own peculiar facts as it is distinguishable from this matter on facts. We have considered the rival submissions on this issue and we cannot but agree with Mr. Oduol that Carroll was an officer of the company and in her position she was expected to have personal knowledge of the matters she deponed to.

As regards the performance bond, Mr. Oduol submitted that the trial Judge went through it and came to the conclusion that there had been default on the part of the principal debtor and that there were no other pre conditions before demand was made for payment. He further submitted that the bond merely guaranteed performance, and that all the bank needed to do was to make a demand and show that the principal debtor had defaulted in payment. Such default, he said, was **prima facie** evidence of liability on the part of the guarantor. In that regard Mr. Oduol cited the English case of **EDWARD OWEN ENGINEERING LTD v. BANK INTERNATIONAL LTD [1978] ALL ER 976**.

On the question of interest learned counsel submitted that it is payable at the discretion of the court more so if there is no good reason for default in paying the money demanded.

Regarding the letters of credit, Mr. Oduol submitted that only the principal debtor could properly raise any issue touching on letters of credit. The principal debtor, he said, has not raised any complaint on it and that it should not therefore lie in the appellant's mouth to raise it.

Those are, in summary the respective submissions of counsel. The relevant part of the performance bond respecting which determination of this appeal hinges on reads as follows:

"… We KENINDIA ASSURANCE COMPANY LIMITED P.O. BOX 44372, NAIROBI – KENYA hereby guarantee as for our debt, in the event that Messrs UNIVERSAL APPAREL (EPZ) LTD

should fail to fulfil their obligations according to the letters of credit as proved to us, to pay to FIRST NATIONAL FINANCE BANK LTD an amount not exceeding in the aggregate of Kshs. 25,000,000/= (say Kenya Shillings twenty five million only). The liability under this guarantee and indemnity shall attach the guarantor only after the lender has exhausted all avenues of recovery directly from the principal.

This guarantee shall remain valid up to and inclusive of 27TH AUGUST, 1997. After this date our guarantee shall become null and void."

In the summary judgment application the learned trial Judge was satisfied that the appellant executed the guarantee, it had been notified in time about default on the part of Universal Apparels [EPZ] Ltd, and that a demand had been made before the expiry date of the guarantee. The issue which dominated submissions by counsel in the superior court was whether the respondent had exhausted "***all avenues of recovery directly from the principal"*** and also whether as at the date the demand was made the guarantee was valid. It is in evidence that the respondent advised the appellant of the default by the principal debtor by a letter dated 28th June 1997. The letter of demand is dated 18th August 1997 and was received by the appellant on the same day. The expiry date of the guarantee was 27th August 1997. It is our view that as at the date the demand was made the guarantee had not expired and was therefore still valid. But it was contended on behalf of the appellant that the respondent had not by then proved to the appellant that there was failure by Universal Apparels ***" according to the Letters of Credit"*** to fulfil their obligations. The respondent relied on the letter notifying the appellant of such default as the proof needed. Mr. Gautama for the appellant appears to us to suggest that the terms of the Letters of Credit needed to be known before liability could attach to the appellant. Mwera J. relied on the practice as expounded by B.C. Mitra in his works. ***LAW OF BANK GUARANTEES***; that the statement of the beneficiary ***"shall be taken at its face value unless …"*** there is evidence that the beneficiary's stand is motivated by fraud, misrepresentation or deliberate suppression of material facts.

The appellant's position appears to us to be this; that evidence was necessary to establish default and that evidence was lacking here. Like the trial Judge we are of the view that construction of the performance bond is central to the determination of this matter. The bond had a limited life. The respondent must have recognized this and in our view that is why it gave notice of default to the appellant and followed it, about a month and half later, with a letter of demand.

The recovery processes which were open to the respondent were not stated in the bond, but in its notice to the appellant it set out its options, namely, ***"appointment of a receiver and related legal steps."*** The respondent did not appoint a receiver. It brought action against the principal debtor. Mwera J. ruled that the agreement between the parties did not envisage a civil suit as one of the avenues of recovery as the process takes long. The suit was filed after the expiry of the life of the performance bond. By fixing the period of validity, the parties did not, in our view, envisage that a demand would only be validly made after the conclusion of the suit. Such a construction will lead to an absurd conclusion and we, like the trial Judge reject such a construction. The parties could not possibly have intended that after failing to recover through a civil action it would then make a demand of payment. Time would not have permitted - **AG V. WICKMAN MACHINE TOOL SALES LTD [1973] 2 ALL 39** at P.45. In that case Lord Reid observed:

" The more unreasonable the result the more unlikely it is that the parties can have intended it and if they do intend it the more necessary it is that they shall make that intention abundantly clear."

Our view of the matter is that upon giving notice of default, the respondent had discharged its obligations under the guarantee. The burden then shifted to the appellant to rebut the rebuttable presumption raised by the notice that liability had attached unless payment is made before a formal demand is made. Notice is to enable the guarantor to approach the principal debtor to ascertain the truth and to urge it to pay. The position would have been different had no fixed period been fixed within which liability would attach. The respondent would then have been placed in the unenviable position of exhausting even the avenue of litigation and appointment of a receiver. But as the matter stands, the performance bond had a life of only twelve months. It was executed on 28th August 1997. It cannot have been contemplated that the

respondent would first sue or appoint a receiver, and when those failed then make a formal demand. It would be faced with the answer that the demand has been made too late. For these reasons, we adopt the words of Lord Denning M.R. in the case of **EDWARD OWEN ENGINEERING LTD V. BARCLAYS BANK INTERNATIONAL LTD (1978) 1 ALL ER. 976**, in which he rendered himself as follows:

"All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit. 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 clear fraud of which the bank has notice."

Those words accord with those by BC Mitra, in **LAW OF BANK GUARANTEES**, quoted by Mwera J in his ruling. B.C. Mitra penned as follows:

"As to the fulfillment of the conditions incorporated in the guarantee the statement of the beneficiary shall be taken at its face value unless the contractor can establish that the beneficiary's stand is motivated by fraud, misrepresentation, deliberate suppression of material facts or the like of which would give rise to special equities in favour of the contractor – In absence of such elements the bank guarantee has to be honoured by the bank and the beneficiary cannot be restrained from enforcement."

Mwera J. was troubled by a condition in the bond that all avenues towards recovery from the principal must first be exhausted before liability could attach. We do not know who drafted the performance bond. It is in the nature of a covenant by the appellant to pay upon the happening of a particular event. It is a form of security guaranteeing payment by a third party. In such cases the most important factor to consider before liability can attach is whether there has been default. Once default is established and that there has been a formal demand the other conditions are of a secondary nature and may not be used to defeat the security.

In **CARGIL INTERNATIONAL SA AND ANOTHER V. BANGLADESH SUGAR** and **FOOD INDUSTRIES CORP. [1966] ALL E.R. 563** Morrison J in dealing with the commercial purpose of performance bonds cited the case of **STATE TRADING CORP. OF INDIA LTD V. ED OF MAN (SUGAR) LTD.(1981)** Times 22nd July, in which Denning M.R. made the following important pronouncement:

"I may say that performance bonds fulfil a most useful role in international trade. If the seller defaults in making delivery, the buyer can operate the bond. He does not have to go to far away countries for damages, or go through a long arbitration. He can get damages at once which are due to him for breach of contract. The bond is given so that, on notice of default being given, the buyer can have his money in hand to meet his claim for damages for the seller's no-performance of contract… The courts must see that these performance bonds are honoured."

Morrison J. also added:

"I think, the courts always recognize that the bonds affected the 'tempo' of the parties' obligations but not their substantive rights."

In our case the appellant's obligation was to pay upon demand. The obligation was established when it was served with a notice of default and upon a demand of payment being made. Liability to pay in the circumstances is not and cannot be an issue. There is no question outstanding to go to trial or which will require the examination of witnesses. The issues which Mr. Gautama said should not be tried on affidavits are peripheral and do not affect the obligation to pay. If anything they are concerned with the question as to when payment would be effected and not whether the appellant is liable.

On the question of interest it was within the respondent's right to demand it provided the overall liability did not exceed what was covenanted. Besides it was a matter in the discretion of the court.

Having come to the foregoing conclusions we are of the view that no ***prima facie*** triable issues have been disclosed to make us allow this appeal. Whatever issues which have been pointed out in no way affect the appellant's liability to pay. Accordingly we have no alternative but to dismiss the appeal with costs.

Dated and delivered at Nairobi this 31st day of October 2008

P.K. TUNOI

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JUDGE OF APPEAL

S.E.O. BOSIRE

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JUDGE OF APPEAL

D.K.S. AGANYANYA

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JUDGE OF APPEAL

I certify that this is a

true copy of the judgment.

DEPUTY REGISTRAR