

INTERTEC CONTRACTING A/S
v.
CEYLINCO SEYLAN DEVELOPMENT LTD AND ANOTHER

COURT OF APPEAL
UDALAGAMA, J. AND
NANAYAKKARA, J.
CALA NO. 396/2000
DC COLOMBO NO. 5544/Spl
SEPTEMBER 21, 2001

Performance Bond – Liability of the Bank to honour a demand – Is the Performance Bond conditional to a finding of the Arbitrator? – Or is the Bond payable on demand?

The plaintiff-petitioner entered into a contract to carry out certain work for the 1st defendant-respondent, the plaintiff-petitioner also furnished a "Performance Bond" from the 2nd defendant-respondent Bank, by the said Performance Bond, the Bank undertook to bind themselves to the 1st defendant-respondent in a certain sum should the contractor fail in the due and punctual performance of the conditions set out in the contract. As there was a dispute, the 1st defendant-respondent claimed from the Bank the value of the Performance Bond.

The interim relief prayed for by the plaintiff-petitioner was refused by the District Court.

Held:

- (1) The Performance Bond is not conditional, it is an unconditional one payable on demand.
- (2) The arbitration would be relevant only to determine the failure (if there was one) in the performance of the main contract. The Bond was not conditional to a finding of the Arbitrator.

Per Udalagama, J.

"I would hold that the Performance Bond is in fact an accessory and a separate obligation to the main contract and one capable of being independently

acted upon providing for payment on demand, the Bank could not violate its guarantee as per the Bond."

APPLICATION for Leave to Appeal from the Order of the District Court of Colombo.

Cases referred to :

1. *Edward Owen Engineering (Pvt) Ltd. v. Barclays Bank International Ltd.*
– 1978 – 1 QB 159.
2. *United International Merchants Investments Ltd. v. Royal Bank of Canada*
– 1982 – 2 All ER 720.
3. *Indica Traders v. Seoul Lanka Construction* – 1994 3 Sri LR 387.

S. L. Gunasekare with *Nihal Fernando* for the petitioner.

K. Kanag-Iswaran, PC with *Anil Tittawella* and *A. Rodrigo* for the respondent.

Cur. adv. vult.

November 15, 2001

UDALAGAMA, J.

The plaintiff-petitioner entered into a contract to carry out certain work morefully described in the documents marked P2 (a) and P2 (1) and filed of record in the court below, for the 1st defendant-respondent. The contract also contains an arbitration clause.

The plaintiff-petitioner also furnished to the 1st defendant-respondent a performance bond valued in Rs. 16,200,000/- from the 2nd defendant-respondent, the People's Bank. By the said performance bond the People's Bank undertook to bind themselves to the employer (1st defendant-respondent) in a sum not exceeding Rs. 16,200,000/- should the contractor fail in the due and punctual performance of the conditions set out in the contract referred to above. It appears that a dispute

arose between the plaintiff-petitioner and the 1st defendant-respondent in respect of the contract and the 1st defendant-respondent claimed from the 2nd defendant-respondent bank the value of the performance bond.

The above facts are conceded.

It is apparent that by letter dated 19. 12. 2000 the Attorney-at-Law for the plaintiff-petitioner notified the 2nd defendant-respondent bank to refrain from making any payment on the performance bond referred to above.

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In fact, the plaintiff filed action against the defendant-respondent seeking a declaration that the 1st defendant is not entitled to demand and/or receive payment on the aforesaid performance bond and for a declaration that the 2nd defendant-respondent is not entitled to make payment to the 1st defendant-respondent on the said performance bond and also moved for interim relief restraining the 1st defendant-respondent from demanding and/or receiving any payment on the performance bond and further interim relief restraining the 2nd defendant from making any payment on the performance bond.

By order dated 30. 12. 2000 the Additional District Judge dismissed the application for interim relief and the plaintiff-petitioner seeks leave to appeal from the said order.

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The dispute appears to have arisen on the contradictory stances taken up by the two parties as to whether the performance bond referred to above should or should not be complied with or acted upon until at the arbitration referred to above it is concluded that the contractor has defaulted. It is the contention of the plaintiff-petitioner that until and unless determined by the arbitrator that the plaintiff had

failed in the due and punctual performance of the contract referred to above that the 2nd defendant-respondent is restrained from making any payment to the 1st defendant-respondent. *Vide* submissions of the learned Counsel for the 1st defendant-respondent, his contention is that the performance bond referred to above is ancillary to the main contract and the obligation created by the said bond is separate and distinct and that same is exclusively between the 1st defendant-respondent and the 2nd defendant-respondent bank. Perusing the performance bond (marked X2) I am inclined to the view that 2nd defendant-respondent bank by the performance bond referred to above guaranteed payment in respect of the contract between the plaintiff and the 1st defendant. In fact, the relevant paragraph in the performance bond, *inter alia*, reads as follows :

"The bank in consideration of such agreement as aforesaid hereby guarantee, undertake, bind and oblige themselves to the employer, that if the contractor fail in the due and punctual performance and fulfilment of the contract referred to then in that case to make payment on demand at Colombo to the employer of a sum not exceeding Rs. 16,200,000/-." As described by Halsbury *Laws of England*, 4th edn. : "A guarantee is an assessor contract by which the promisor undertakes to be answerable to the promisee for debt default or miscarriage of another person whose primary liability to the promisee must exist or be contemplated".

From the wording referred to above I am unable to agree with the learned Counsel for the plaintiff-petitioner that the said bond is conditional. On the contrary I would agree with the learned District Judge and hold that same is, in fact, an unconditional one payable on demand.

The learned Additional District Judge appears to have relied on the following judgments to arrive at a finding on the nature of a performance bond :

- (1) *Edward Owen Engineering (Pvt) Ltd. v. Barclay's Bank International Ltd.*⁽¹⁾ 70
- (2) *United International Merchants Investments Ltd. v. Royal Bank of Canada.*⁽²⁾

These authorities deal with the obligations arising out of a contract whereby banks are required to pay on guaranteed bonds they executed. The learned Additional District Judge also relied on *Indica Traders v. Seoul Lanka Construction*⁽³⁾ which dealt with section 54 of the Judicature Act in relation to ingredients necessary for the issue of an interim injunction and I am inclined to the view that he came to a correct finding as to the strength of the petitioner's case. 80

It is observed that the learned Additional District Judge has also come to definite finding that the performance bond is, in fact, unconditional and payment due accordingly on demand even though the dispute between the plaintiff-petitioner and the 1st defendant-respondent is subjected to arbitration. The learned District Judge had also come to a finding for that reason that he is precluded from injuncting the 2nd defendant-bank from paying the sum mentioned in the bond until the confirmation of a violation of the terms of the main contract between the plaintiff and the 1st defendant is ascertained.

I am inclined to hold that the words "to make payment on demand" 90 are crucial words when interpreting the construction of the terms of the bond itself. These words could not refer to a situation as submitted by the learned Counsel for the plaintiff-petitioner, that payment on the performance bond is subject to a finding by the arbitrator".

I would hold that arbitration would be relevant only to determine the failure (if there was one) in the performance of the main contract. I would unequivocally reject the contention of the petitioner that the performance bond was conditional to a finding of the arbitrator.

As stated earlier, I would on the contrary hold that the same was, in fact, a bond payable on demand. This fact is apparent from the 100 bond itself.

Perusing an authority cited by the learned Counsel for the 1st defendant-respondent, namely, *Edward Owen Engineering Ltd. v. Barclay's Bank International Ltd.* referred to above which authority was also relied on by the learned District Judge, I would with approval concur with Lord Denning when he observed therein that :

“A bank which gives performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relation between the supplier and the customer nor with the question whether the supplier had performed his contractual 110 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 condition. The only exception is when there is a clear fraud of which the bank has notice.”

In the instant case there is no allegation of fraud.

In all the circumstances aforesaid I would hold that the performance bond (X2) is, in fact, an assessor and a separate obligation to the main contract and one capable of being independently acted upon providing for payment on demand. The words “If the contractor fails 120 in the due and punctual performance and fulfilment of the contract

referred to" in my view do not make a performance bond conditional but, in fact, considered with the words, "make payment on demand" inserted therein that same is, in fact, unconditional. The bank could not violate its guarantee as per the bond.

For the reasons stated above I am inclined to interfere with the finding of the learned District Judge and the plaintiff-petitioner's appeal is dismissed with costs fixed at Rs. 10,500/-.

The stay order issued by this Court dated 19. 12. 2000 is set aside.

NANAYAKKARA, J. – I agree.

Application dismissed.