

IN THE HIGH COURT FOR ZAMBIA

2016/HPC/0208

AT THE COMMERCIAL REGISTRY

HOLDEN AT LUSAKA

BETWEEN:

CAVMONT BANK LIMITED

APPLICANT

AND



SPANCRETE ZAMBIA LIMITED

1ST RESPONDENT

DAVIES CHOLA KATAYA

2ND RESPONDENT

ANDISENI AILOSI PHIRI

3RD RESPONDENT

Before the Honourable Lady Justice Irene Zeko Mbewe

*For the Applicant : Mr. M. M. Mwananshiku of Messrs M M
Advocates*

For the 1st Respondent : N/A

For the 2nd Respondent : N/A

For the 3rd Respondent : N/A

JUDGMENT

Cases Referred To:

1. *Edward Owen Engineering Limited v Barclays Bank International Limited* [1978] 1 All E R
2. *Harbottle (R.D) Mercantile Limited v National Westminster Bank* [1978] 1 Q.B 146
3. *Discount Records Limited v Barclays Bank Limited* [1975] 1 W.L.R 315
4. *Howe Richardson* [1978] 2 Lloyds L.R 165
5. *Nwosu v Zenith Bank PLC* [2015] 9 NWLR 314
6. *Investors Compensation Schemes Limited v West Bromwich Building Society* [1998] 1 All E R 98
7. *Esal Company Limited v Oriental Credit and Wells Fargo Bank* [1985] Lloyds L.R Vol 2 546
8. *IE Contractors Limited v Lloyd Bank Plc and Rafiden Bank* [1990] 2 Lloyds Reports 496

Legislation Referred To:

1. *High Court Rules, Cap 27 of the Laws of Zambia*

Other Works:

1. *Mark Hapgood Q.C in Paget's Law of Banking, 12th Edition Butterworths at paragraph 34.2*
2. *Learned Authors of Halsbury's Laws of England Volume 9 (1) 4th Edition paragraph 992,*
3. *Geraldine Andrews Q.C and Richard Millett Q.C "law of Guarantees" 6th Edition, Sweet and Maxwell 2011*

By way of Originating Summons dated 9th May, 2016, the Applicant made a claim for the following reliefs:

1. *Payment of all sums of monies plus interest thereon due to the Applicant from the Respondents and such costs as would be payable by the Respondents if this were the only relief granted;*
2. *Alternatively, delivery by the Respondents to the Applicant of possession of the mortgaged properties or the relief of foreclosure and further an Order for the power of sale by the Applicant of the properties*
3. *Further or other relief*
4. *Costs of this action*

The application was supported by an affidavit deposed by Martha Lungu Sichone the Recoveries and Securities Manager in the Applicant Bank. It is averred that in January 2015, the 1st Respondent applied for an Advance Bank Guarantee in the sum of K7,787,436 in favour of ZESCO Limited (**Exhibit "MS1"**). That in April 2015, the Applicant issued an advance payment guarantee in the sum of K7,787,436 in favour of ZESCO Limited on behalf of the 1st Respondent (**"Exhibit MS-2"**). That a third party mortgage was created over Stand No 1044/CL/4 Lusaka belonging to the 2nd Respondent (**Exhibit "MS-4"**). That the 1st Respondent provided further security in the form of a third party mortgage executed by the 3rd Respondent relating to S/D 71 of S/D A of Lot 437/M Kitwe

(Exhibit "MS-5"). That the 1st Respondent provided additional security in the form of cash cover in the sum of K5,800,000. It is averred that in October 2015, the Applicant received a letter from ZESCO Limited indicating that the 1st Respondent was in breach of its obligation and demanded payment in line with the Bank Guarantee ("**Exhibit MS-7**"). It is averred that the Applicant honoured the advance payment guarantee and paid ZESCO Limited the full amount, and after paying the K5,800,000 provided by the 1st Respondent, an outstanding balance of K2,057,705.43 remains which the Respondents despite several reminders have failed to pay. The application was opposed by way of affidavit deposed by Davies Chola Kataya the Managing Director in the 1st Respondent Company and the 2nd Respondent herein. It is deposed that by a facility letter dated 11th March 2015, the 1st Respondent was granted an advance payment guarantee by the Applicant in the sum of K7,787,436.00 to enable the 1st Respondent carry out its obligations under a contract with ZESCO Limited Contract No ZESCO/003/214 for the supply of 1000 kilometers of ABC Cable to ZESCO Limited (**Exhibit "DCK-1"**). That the said facility was secured by a third party mortgage over Stand No 1044/CL/4 Lusaka to secure K1,130,000 which was duly registered at Lands and Deeds Registry on 27th April 2015. It is averred that the ABC Cable was being imported from Zhengzhou Jin Hang High Tech Co Limited in China. According to the 2nd Respondent, the advance payment guarantee was made to ZESCO Limited by the Applicant and according to its terms and conditions, the Applicant was

obligated to pay the said guarantee to ZESCO Limited upon receipt of a written demand declaring that the 1st Respondent as a supplier was in breach of its obligations under the contract because the Supplier used the advance payment for purposes other than towards delivery of the goods. It is averred that the advance payment in the sum of K7,787,436.00 was made to the 1st Respondent and transferred into the 1st Respondent's account held with the Applicant under Account Number 800000285915 Makumbi Branch, Lusaka. That the Applicant acting on the 1st Respondent's instructions transferred the sum of US\$168,600.00 to Jinshui Cable and deposited the sum of K5,800,000.00 into a fixed deposit account it held with the Applicant. It is averred that the 1st Respondent did not divert funds from the advance payment as all payments were made through its account with the Applicant, and were held to the credit of the Applicant. According to the 1st Respondent, it purchased 250 kilometres of ABC cabling and a pre-shipment inspection was required to have been carried out by ZESCO Limited on 15th February 2015 at Jinshui Cable's premises in Henan Province, China. That on 12th May 2015, ZESCO Limited carried out the pre-shipment inspection and as a consequence of the delayed pre-shipment exercise, ZESCO Limited incurred losses in terms of the forfeited deposit and storage charges of US\$404,000.00. That on 22nd October 2015 ZESCO Limited demanded a refund of the advance payment guarantee (**Exhibit "DCK-3"**). According to the deponent, ZESCO Limited did not specify that the 1st Respondent had breached its obligation and

therefore the conditions of the advance payment guarantee were not honoured by ZESCO Limited. It is averred that the Applicant negligently paid out the advance payment guarantee by calling on the sum of K5,800,000 standing to the 1st Respondent's credit in its fixed deposit account with the Applicant and withdrawing/overdrawing the 1st Respondent's current account with the Applicant amounting to K1,987,436.00. It is averred that the Applicant has claimed interest on the total amount paid out under the advance payment guarantee without providing a statement of how the same was arrived at. According to the deponent, that the 1st and 2nd Respondent's are not indebted to the Applicant in respect to the amount claimed and that the Applicant is indebted to the 1st and 2nd Respondent inclusive of interest and costs as the said amount is not due and payable, and that the Applicant negligently paid out on the advance payment guarantee. The Applicant filed an affidavit in reply on 25th November 2016 in which it reiterated that the 1st Respondent had issues with ZESCO Limited which were of no concern to the Applicant. That the K5,800,000 was held by the Applicant as cash collateral as stated in Clause 5.1 of the letter dated 11th March 2015 (**Exhibit "DCK-1"**) in the affidavit in opposition and was not intended to be utilised by the 1st Respondent. That in its letter dated 22nd October, 2015 (**Exhibit "DCK-3"**) ZESCO Limited had indicated that the 1st Respondent had failed to supply the 120mm ABC cables and accessories to ZESCO Limited thus being in breach of its obligations under the contract. It was averred that it was not the

duty of the Applicant to investigate and verify the 1st Respondent's misapplication of funds when it failed to supply the cables. Further that the Applicant was obliged to pay out the advance payment guarantee.

It is common cause that there was an agreement for the Applicant to issue an advance payment in favour of ZESCO Limited which was secured by the advance payment guarantee issued by the Applicant. The parties agreed that the Applicant was to refund ZESCO Limited with the full amount of the advance payment upon receipt of a written notification that the supplier (1st Respondent) was in breach of its obligation on the premise that the advanced payment was used for purposes other than delivery of the goods. It is also not in dispute that the 1st Respondent as security for the advance payment guarantee provided a third party mortgage in respect to Stand No.1044/CL/4 and an additional security of K5,800,000 with the Applicant. Further that ZESCO Limited wrote a letter of demand to the Applicant alleging that the 1st Respondent being the supplier under the agreement was in breach of its obligations, upon which the Applicant proceeded to refund ZESCO Limited with the sum of K7,747,347 being the amount advanced to the 1st Respondent by the Applicant Bank. It is not in dispute that the guarantee was subject to the Uniform Rules for Demand Guarantees, ICC Publication No 458.

At the hearing, the Applicant submitted that it was no longer pursuing its claim relating to the third party mortgage on S/D 71 of S/D A of Lot 437M, Kitwe. Therefore, in respect to the structured loan facility, I shall not make any pronouncement on the issue.

I proceeded to determine the matter in the absence of the Respondents as there was an affidavit of service showing proof of service of the notice of hearing, and therefore the Respondents were aware of the hearing and there was no explanation as to their non attendance.

I have considered the affidavit evidence of both parties and skeleton arguments filed herein including Counsel for the Applicant's oral submissions.

The issue for determination is whether the Applicant is entitled to the relief sought and secondly whether the Applicant's payment to ZESCO Limited of K7,787,436 is in compliance with the terms of the advance payment guarantee.

In answering the above questions, the starting point is to define the term "advance payment guarantee", and the Applicant's obligations therein. According to the learned authors, **Geraldine Andrews and Richard Millett** in the book "**Laws of Guarantees**", **6th Edition, Sweet and Maxwell**,

"a contract of guarantee is considered to be a secondary obligation because the surety's liability is contingent upon

establishing the principal's breach of an obligation owed to the beneficiary under an underlying contract."

According to the **Learned Authors Mark Hapgood Q.C in Paget's Law of Banking, 12th Edition Butterworths** at paragraph 34.2, it states that:

"The principle which underlines demand guarantees is that each contract is autonomous. In particular, the obligation of the guarantor are not affected by disputes under underlying contract between the beneficiary and the principal. If the beneficiary makes an honest demand, it matters not whether as between himself and the principal must reimburse the guarantor (or counter-guarantor), and any disputes between the principal and the beneficiary, including any claim by the principal that the drawing was a breach of the contract between them, must be resolved in separate proceedings to which the bank will be a party..."

From the definition of an advance payment guarantee, the Respondent signed what is termed a "demand guarantee". The Applicant Bank assumed the financial payment obligations as security for the fulfilment, in this case, of the Respondent's contractual obligations in the underlying contract arising in a separate contract made between ZESCO Limited and the 1st Respondent and referenced in the advance payment guarantee as Contract No ZESCO/003/214. The rationale behind a demand

guarantee is that it is designed as a security instrument to enable the beneficiary quickly gets its money without resorting to prolonged litigation. This rationale will become apparent in later paragraphs.

There is a plethora of English cases on demand guarantees which are persuasive in nature. The English leading case in the field of what is referred to generically as performance bonds which for all intents and purposes includes demand guarantees is **Edward Owen Engineering Limited v Barclays Bank International Limited (1)** in which Lord Denning M.R laid the foundation for virtually all performance bond law. The case is called the *locus classicus* of performance bond law, in that it established the strict application of the fraud rule to performance bond cases.

The facts of the case are that **Edward Owen** involved a contract between the Agricultural Development Council of Libya and an English concern Edward Owen Engineering Limited, for the construction of a number of large greenhouses in Libya. The parties agreed that Libyan law would govern the contract and that any disputes between the parties would be taken up in a Libyan Court. As a precondition to the making of any contract, the Libyan party demanded a performance guarantee from Edward Owen in the amount of ten per cent of the final contract price, which was to remain valid up until the final delivery date. Edward Owen instructed its English bankers Barclays to arrange for a performance bond in the requisite amount. Barclays then asked the

Libyan Bank to issue the guarantee in favour of the Libyan party. Later Barclays confirmed to the Libyan Bank that the guarantee was *"payable on demand without proof or conditions"* Barclays obtained an indemnity agreement from Edward Owen guaranteeing that Owen would pay the amount of the bond in the event it was called on by the Libyans. Under the terms of the contract, the Libyans were to arrange for a confirmed letter of credit in favour of Edward Owen for the payment of the contract price. The Libyans issued a letter of credit but it was not the confirmed letter of credit required by the contract. After several months of trying to get the Libyans to amend the letter of credit, Edward Owen wrote to the Libyans stating that since the letter of credit was not operative, it meant that the guarantee had no effect. Relying on the guarantee agreement the Libyan bank demanded payment from Barclays. Upon hearing the demand by the Libyan Bank, Edward Owen obtained an injunction against Barclays Bank restraining Barclays from paying the Libyan bank the amount of the bond. Barclays succeeded in its application to have the injunction lifted. Edward Owen appealed asking for restoration of the injunction. Lord Denning M.R called the performance bond a new creature and went on to state that:

"the bank ought not to pay under the credit if it knows that the documents are forged or that the request for payment is made fraudulently in circumstances where there is no right to payment. A bank which gives a performance guarantee must

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

Similarly, in the case of **Harbottle (R.D) Mercantile Limited v National West Minister Bank (2)** Kerr J alluded at page 155 to the practice that courts will not interfere with the machinery of irrevocable obligations assumed by banks and that except for fraud, the courts will leave merchants to resolve their underlying disputes by litigation or arbitration as available to them. The Courts are not concerned with difficulties to enforce such claims as these are risks that the supplier take. This principle was further affirmed by Justice Mergarry in the case of **Discount Records Limited v Barclays Bank Limited (3)** where he stated that he:

"would be slow to interfere with banker's irrevocable credits, and not in the least in the sphere of international banking unless a sufficiently grave cause is shown; for interventions by the court that are too ready or too frequent might gravely impair the reliance, which, quite properly, is placed on such credits."

Similarly, in **Howe Richardson (4)** Lord Justice Roskill stated as follows:

"Whether the obligation arises under a letter of credit or under a guarantee, the obligation of the bank is to perform that which it is required to perform by that particular contract, and that obligation does not in the ordinary way depend on the correct resolution of a dispute as to the sufficiency of performance by the seller to the buyer or the buyer to the seller as the case may be under the sale and purchase contract; the bank here is simply concerned to see whether the event has happened upon which its obligation to pay has arisen."

Instructive and persuasive is the Nigerian case of **Nwosu v Zenith Bank Plc (5)** where it was held that:

"A banker's guarantee shall effect payment on demand by the beneficiary giving a written statement that the principal has failed to perform his obligations. Such written statement will be the sole condition for the guarantor to pay under the guarantee. The guarantor will not take additional steps to determine any facts or documents relating to the underlying contract or the very appropriateness of the claim."

Based on the above principles, the Applicant was triggered upon its receipt from ZESCO Limited of the written demand without having

to subject ZESCO Limited being the beneficiary, to await a judicial resolution of a dispute as to who is at fault. Since the Applicant made an undertaking to refund ZESCO Limited upon receipt of the first demand declaring that the supplier was in breach of its obligations, the Applicant was bound by such undertaking. I am therefore satisfied that the demand was valid and find the Respondent's arguments that the Applicant negligently paid ZESCO Limited untenable.

The next issue is to construct and construe the true nature of the advance payment guarantee, which states as follows:

" At the request of the Supplier, we Cavmont Bank Limited, represented by Mike Sikazwe and Martha Lungu Sichone in their respective capacity as Chief Credit Officer and Manager-Recoveries and Rehabilitation with our Head Office in Lusaka, Piziya Office Park, Cavmont House, P O Box 38474, Thabo Mbeki Road, hereby irrevocably undertake to pay you any sum or sums not exceeding in total an amount of ZMW7,787,436 (Seven Million Seven Hundred and Eighty Seven Hundred and Eighty Seven Thousand Four Hundred and Thirty Six Only) upon receipt by us of your first demand in writing declaring that the Supplier is in breach of its obligations under the contract because the Supplier used the advance payment for purposes other than toward delivery of the Goods." (Emphasis the Court's).

When construing the meaning of contractual terms, I am required to ascertain the intention of parties on an objective basis and in its factual and contractual context having regard to its common purpose. I place reliance on the case of **Investors Compensation Scheme Ltd v. West Bromwich Building Society (6)**, where Lord Hoffmann stated that:

“Courts must look for the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.”

Instructive is the case of **IE Contractors Limited v Lloyd Bank Plc and Rafiden Bank (7)** where the Court emphasised that the question is one of contractual interpretation and that the degree of compliance required by a performance bond may be strict, or not so strict depending on its wording.

The Applicant's obligation to pay ZESCO Limited on demand under the advance payment guarantee is stated in the following terms:

" upon receipt by us of your first demand in writing declaring that the Supplier is in breach of its obligations under the contract because the Supplier used the advance payment for purposes other than toward delivery of the Goods.

The demand from ZESCO Limited to the Applicant dated 15th October, 2016 is stated in the following terms:

"You may wish to know that the supplier has to-date failed to supply the 120mm² ABC cables and accessories to ZESCO Limited, thus being in breach of its obligations"

The question then is, did the demand from ZESCO Limited comply with the terms of the advance payment guarantee and the real intentions of the parties? The 1st Respondent argued that ZESCO Limited's demand did not specify that the 1st Respondent had breached its obligations under the Contract by using the advance payment *"for purposes other than towards the delivery of goods"* as specifically worded in the advance payment guarantee. It was the 1st Respondent's argument that instead the demand stated that *"You may wish to know that the supplier has to-date failed to supply the 120mm² ABC cables and accessories to ZESCO Limited, thus being in breach of its obligations"*

Does the use of the above wording invalidate the demand contained in a letter of 15th October, 2016? I find that the latter part of the demand stating *"...thus being in breach of its obligations"* gives meaning and effect to the qualifying words in the advance payment guarantee *".. in breach of its obligations under the Contract....."*. I opine that the demand from ZESCO Limited not only asserted breach of the contract, but the demand notice went further and made it clear that the breach arose from a non supply of the

120mm² ABC cables by the 1st Respondent encompassing the qualifying words of "*breach of its obligations under the Contract*".

The 1st Respondent argued that the Respondents are not indebted to the Applicant in respect to the claimed sum and that in fact it is the Applicant who are indebted to the Respondents for the sum negligently paid out on the advance payment guarantee inclusive of interest and costs. From my earlier finding in the preceding paragraphs that the Applicant rightly paid ZESCO Limited in terms of the advance payment guarantee, I find that the 1st Respondent is indebted to the Applicant in the claimed amount of K2,057,705.43. **(Exhibit "DCK-8")**.

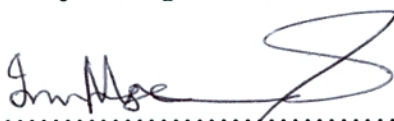
The 1st Respondent argued that it is in the dark as to how interest on the claimed amount of K2,057,705.43 was arrived at. In respect to the accrued interest, upon perusal of the evidence, the Applicant has provided an explanation as to how the claimed amount was arrived at **(Exhibit "DCK-8")**. However, I find no supporting evidence showing how the accrued interest was arrived at in the claimed amount. In line with banking practice, the Applicant has a duty to furnish the 1st Respondent with bank statements showing the activities on its account including accrued interest. Equally, I find that the 1st Respondent as a borrower has a corresponding duty to request for bank statements, and prudence dictates so.

The net result is that Judgment is entered in favour of the Applicant against the 1st Respondent. It is hereby Ordered as follows -

1. That the Applicant avails the bank statement to the 1st Respondent showing the interest charged on the claimed amount of K2,058,000. This is to be done within 14 days of this Judgment. Upon receipt of the bank statement, the 1st Respondent shall settle the claimed amount of K2,057,705.43 plus accrued interest calculated at the short term deposit rate from date of the originating summons to date of Judgment and thereafter at the commercial lending rate until full payment. The claimed amount plus accrued interest is to be paid within fifty-five (55) days of receipt of the bank statement thereof. In default, the Applicant shall foreclose and take possession of the 2nd Respondent mortgaged property being Stand No 1044/CL/4 Lusaka and exercise the power of sale.
2. Costs to the Applicant to be taxed in default of agreement.

Leave to appeal granted.

Delivered in Lusaka this 25th day of April, 2017


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HON IRENE ZEKO MBEWE
HIGH COURT JUDGE