

THE REPUBLIC OF UGANDA
IN THE HIGH COURT OF UGANDA SITTING AT KAMPALA
(COMMERCIAL DIVISION)

MISCELLANEOUS APPLICATION No. 0764 OF 2022

(Arising from Civil Suit No. 0805 of 2022)

DFCU BANK LIMITED APPLICANT

VERSUS

**ABUBAKER TECHNICAL SERVICES & GENERAL SUPPLIES LTD
RESPONDENT**

Before: Hon Justice Stephen Mubiru.

RULING

a) Background:

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The respondent entered into two subcontracts with M/s Shimizu-Konoike Joint Venture, being; contract Number SKJV/COT/057 during the month of April, 2021 for provision of asphalt works and another subcontract dated 10th December, 2020 for provision of package 2 works under contract number SKJV/COT/039. In compliance with the requirements of the second
20 subcontract, the responded procured from the applicant, an Advance payment Guarantee No. A8G012022030953 and Performance Guarantee No. P8G0120220103001 in favour of M/s Shimizu-Konoike Joint Venture.

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By way of an addendum dated 8th December 2021, the respondent's scope of work under contract Number SKJV/COT/057 was reduced and the Advance payment Guarantee too was reduced to shs. 1,616,487,059/= while the performance Guarantees too was reduced to shs. 1,352,604,262.61 The scope of works reduced under the addendum was awarded to M/s Muga Technical Services Limited on Gaba Road works and the respondent's Advance Payment Guarantee and Performance Guarantee continued to cover the works awarded to M/s Muga
30 Technical Services Limited. Furthermore, during the month of March, 2022 M/s Shimizu-Konoike Joint Venture reduced the applicant's scope of works under subcontract number SKJV/COT/039 and the works were awarded to M/s M & N Limited.

On the 27th August, 2022 M/s Shimizu-Konoike Joint Venture issued a notice of default and termination under sub clause 15.2 in relation to the subcontract agreements SKJV/COT/039, package 2 works and SKJV/COT/057, Asphalt works and issued notice to rectify alleged defaults
5 by 3rd September, 2022. On the 1st September 2022, M/s Shimizu-Konoike Joint Venture made a call to the guarantees requiring the respondent to pay the sums claimed on the basis of breach of the subcontract and failure to repay the Advance payment Guarantee. The respondent secured an interim Administrative Order restraining the applicant from making the payment for a period of three days, or until final determination of the substantive application. On 15th September, 2022
10 the Court revoked the interim Administrative Order, whereupon the beneficiary made another demand on the Performance Guarantee and Advance Payment Guarantee on 16th September, 2022. The applicant honoured that demand on 21st September, 2022.

The respondent then sued both the applicant and M/s Shimizu-Konoike Joint Venture jointly,
15 seeking declaratory orders, an order directing the applicant to refund the sums paid under the Advance payment Guarantee No. A8G012022030953 and Performance Guarantee No. P8G0120220103001 in relation to subcontract agreements of the Kampala Flyover Construction and Road Upgrade project, subcontract for Package 2 works, general damages, interest and costs.

20 In its written statement of defence, the applicant indicated that it would raise a preliminary objection to the effect there is no cause of action against it because it was obligated to comply with the demand from M/s Shimizu-Konoike Joint Venture, more especially since it was not required to inquire into the performance of the contracts for which it provided the Guarantees, and the fact that there was no longer an injunction in place restraining the payment.

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b) The application:

This application by Notice of motion is made under the provisions of section 98 of *The Civil Procedure Act*, Order 6 rules 29 and 30; and Order 52 rules 1 and 3 of *The Civil Procedure Rules*.
30 The applicant seeks an order striking out Civil Suit No. 805 of 2022 for failure to disclose a cause of action against the applicant. It is the applicant's case that the respondent obtained

irrevocable Performance and Advance Payment Guarantees from the applicant in compliance with its security obligations under the subcontracts entered into with Shimizu-Konoikc Joint Venture. On 1st and 12th September, 2022 the beneficiary called on the Performance Guarantee and Advance Payment Guarantee in the sums of shs. 813,085,542/= The applicant declined to
5 make payment on the demand in compliance with an interim Administrative Order restraining it from making the payment for three days or until final determination of the substantive application. On 15th September, 2022 the Court revoked the interim Administrative Order, whereupon the beneficiary made another demand on the Performance Guarantee and Advance Payment Guarantee on 16th September, 2022.

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On 21st September, 2022 the applicant complied with the beneficiary's demand. The applicant cannot be faulted since it was duty bound to honour the beneficiary's call of 16th September 2022 on the Performance and Advance Payment Guarantees and had no duty of inquiring into the performance of the underlying subcontracts between the respondent and the beneficiary.

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c) The Affidavit in reply:

By the respondents' affidavit in reply, it is contended that the Advance Payment Guarantee No. ABG012022030953 dated 7th March, 2022 was conditional in nature and that the applicant had to
20 comply with the conditions set out under the guarantee deed. It was payable upon presentation of a demand supported by the beneficiary's statement, whether in the demand itself or in a separate signed document accompanying or identifying the demand stating either that the Sub contractor;
- has used the advance payment for purposes other than costs of mobilisation in respect of the Works; or has failed to repay the advance payment in accordance with the Subcontract
25 conditions specifying the amount which the Applicant has failed to pay. It was a term of the guarantee that the maximum amount of the guarantee would be progressively reduced by the amount of the advance payment repaid by the Sub-contractor as specified in copies of interim statement payment certificates which would be presented to the applicant. On the 21st September, 2022 the applicant complied with a demand that did comply with the terms of the Guarantee
30 deed as no copies of interim statement payment certificates were presented as required under the terms of the Advance Payment Guarantee.

On the other hand, performance Guarantee No. P8G0120220103001 dated 3rd January, 2022 was payable on demand in types of proportions of currencies in which the Subcontract price is payable upon receipt by the applicant of the Beneficiary's complying demand supported by the beneficiary's statement, whether in the demand itself or in a separate signed document accompanying or identifying the demand stating that the Subcontractor was in breach of its obligation(s) under the Subcontract without the beneficiary needing to prove or to show grounds for its demand or he sums specified therein. The applicant complied with demands which were in breach of the terms of the performance guarantee. The applicant's liability under the guarantees was not discharged upon compliance with the demands that were in breach of the terms and conditions of the guarantees. Variation of the Subcontracts by the beneficiary discharged the applicant from liability and the applicant was under no obligation to pay the amounts demanded under the guarantees.

15 d) The submissions of counsel for the applicant;

Counsel for the applicant M/s S & L Advocates (formerly Sebalu & Lule Advocates) submitted that both guarantees were "on demand guarantees"; "irrevocable and do not require proof of breach" The advance guarantees read; "irrevocable stating that...." They are payable on demand. The URDG obligated the applicant to pay. The notification was on 19th yet the cashing was on 16th. A mere assertion was not enough for notice of fraud. The advance payment was 1.4 billion yet the applicant encashed was shs. 813,085,542/= which was less than the amount guaranteed and this was because the applicant took into account the amounts that had been made and this was in compliance with the conditions.

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e) The submissions of counsel for the respondent;

Counsel for the respondent M/s M/s Jason & Co. Advocates, opposed the application. They submitted that the advance payment guarantee at page 2 refers to progressive reduction requiring presentation of payment certificates. The call was non-compliant. The performance guarantee is a demand guarantee. There was a variation of the sub-contract which absolved the applicant from

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liability. Under section 74 of *The contracts Act*, a variation of the contract between the principle debtor and creditor, hence the beneficiary in this case, without the consent of the guarantor, the guarantor is discharged from liability. There was notice of fraud, and the particulars of fraud are in para 11 and 12 of the plaint. They were parties to the process of the interim orders. They
5 cashed more money than the beneficiary was entitled to. The respondent submitted the certificates to court as part of the application for the interim injunction.

f) The decision:

10 A preliminary objection consists of a point of law which has been pleaded, or which arises by clear implication out of the pleadings, and which if argued as a preliminary point may dispose of the suit (see *Mukisa Biscuit Manufacturing Co. Ltd v. West End Distributors Ltd [1969] EA 696*). It raises a pure point of law which is usually on the assumption that all the facts pleaded by the other side are correct. It is thus based on a commonly accepted set of facts as pleaded by both
15 parties. It cannot be raised if any fact has to be ascertained or if what is sought is the exercise of judicial discretion. Preliminary objections relate to points of law, raised at the outset of a case by the defence without going into the merits of the case. In any preliminary objection therefore, there is no room for ascertainment of facts through affidavit or oral evidence. I have found that all objections raised by the defendants in the instant case are based on the assumption that all the
20 relevant facts pleaded by the plaintiff are correct, and do not require ascertainment through affidavit or oral evidence.

A cause of action was defined as a bundle of facts which if taken together with the law applicable to them give the plaintiff a right to a relief against the defendant (see *Attorney
25 General v. Major General Tinyefuza, Constitutional Petition No.1 of 1997*). It is alternatively defined as every fact which is material to be proved to enable the plaintiff succeed or every fact which if denied, the plaintiff must prove in order to obtain judgment (see *Cooke v. Gull, LR 8E.P 116* and *Read v. Brown 22 QBD 31*). The pleadings must disclose that; the plaintiff enjoyed a right known to the law, the right has been violated, and the defendant is liable (see *Auto Garage
30 and others v. Motokov (No.3) [1971] E.A 514*). Whether or not a plaint discloses a cause of action must be determined upon perusal of the plaint alone together with anything attached so as

to form part of it (see *Kebirungi v. Road Trainers Ltd and two others [2008] HCB 72*). Order 7 rule 11 (a) of *The Civil Procedure Rules*, requires rejection of a plaint where it does not disclose a cause of action.

5 Identifying the cause of action requires consideration of two factors; – the legal theory and remedy. The legal theory is defined from the standpoint of the rights of the plaintiff and duties of defendant with the breach of duty that resulted in loss and damage. To constitute a proper cause of action, the plaintiff must plead all the material elements, which are; a primary right possessed by the plaintiff, and a corresponding primary duty devolving upon the defendant; a delict or
10 wrong done by the defendant which consisted in a breach of such primary right and duty; a remedial right in favour of the plaintiff, and a remedial duty resting on the defendant springing from this delict, and finally the remedy or relief itself. Every cause of action, however complicated or however simple, must contain these essential elements.

15 In the instant case, the respondent’s claim arises within the context of rights and duties springing from advance payment and performance bonds. Such guarantees have a tripartite structure comprising of the bank, the beneficiary and the principal. The principal and the beneficiary first enter into contract between themselves imposing certain obligations upon the principal, which is known as the underlying contract. The second contract is made between the bank and the
20 beneficiary to indemnify the beneficiary with a sum of money if the principal fails to perform his obligations, which the bank will later collect from the principal. This second contract is the bank guarantee in its most basic form.

A performance guarantee is a bond taken out by the contractor, usually with a bank or insurance
25 company (in return for payment of a premium), for the benefit of and at the request of the employer, in a stipulated maximum sum of liability and enforceable by the employer in the event of the contractor’s default, repudiation or insolvency. The purpose of the performance guarantee in the construction industry is to perform the role of an effective safeguard against non-performance, inadequate performance or delayed performance and its production provides a
30 security as readily available to be realised, when the prescribed event occurs.

There are two types of performance guarantees: Conditional guarantees or default bonds, whereby the surety accepts “joint and several” responsibility for the performance of the contractor’s obligations under the contract; and Unconditional guarantees or on-demand bonds, which is a covenant by the surety (usually a bank) to indemnify the employer following contractor’s default, subject to stated terms.

On-demand performance guarantees constitute primary independent obligations placed on a guarantor to make payment of a guaranteed amount. The obligations are independent from the main contract and are usually triggered by a written demand being made on the guarantor. When a performance guarantee is unconditional, and intended to be cash equivalent, subject to the exceptions of fraud, unconscionability and express terms to the contrary, it can be called on by the beneficiary upon written demand to the issuing institution, without regard to the underlying construction contract. It is characterised by the absence of any conditions required to make a call on the guarantee other than the making of the call itself. This is what is known as the “autonomy principle. A bank is not concerned in the least with the relations between the contractor and the employer nor with the question whether the contractor has performed his contractual obligation or not, nor with the question whether the contractor is in default or not, the only exception being where there is clear evidence both of fraud and of the bank’s knowledge of that fraud (see *Edward Owen Engineering Ltd v. Barclays Bank International Ltd* [1978] 1 QB 159)

With unconditional performance guarantees, the contractor is not a party to the arrangement. The guarantor will become liable merely when demand is made upon it by the beneficiary with no necessity for the beneficiary to prove any default by the principal in performance of the underlying construction contract. The maxim “pay first and argue later” best describes one of the key principles underlying demand guarantees (see *Ward Petroleum Corp. v. Federal Deposit Inc. Corp* (1990) 903 F. 2d 1299). The beneficiary need only have a bona fide claim of a breach of contract; upon the beneficiary asserting the basis of the claim contending that there has been a breach of contract. As between the bank and the employer beneficially such a bond is tantamount to cash in the hand of the employer.

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A call on conditional performance guarantees is conditioned upon proven facts establishing a breach. In conditional performance guarantees, the beneficiary must comply with conditions precedent for calling the guarantee. This has the effect of making the call on the guarantee dependant on proving both the contractual liability of the principal as well as loss suffered by the
5 employer as a consequence of the principal's breach. In on-demand performance guarantees, on the other hand, the only condition precedent for calling the guarantee is a written notice to the guarantor.

For the avoidance of doubt, Article 5 (a) of *The Uniform Rules of Demand Guarantee (URDG)*;
10 ICC Publication No. 758, expressly provides that the obligations of a guarantor are independent of any issues in the underlying contract. It states as follows;

A guarantee is by its nature independent of the underlying relationship and the application, and the guarantor is in no way concerned with or bound by such
15 relationship. A reference in the guarantee to the underlying relationship for the purpose of identifying it does not change the independent nature of the guarantee. The undertaking of a guarantor to pay under the guarantee is not subject to claims or defences arising from any relationship other than a relationship between the guarantor and the beneficiary

20 Article 12 of the URDG limits the liability of the guarantor to only the terms contained in the agreement, hence further alienating and protecting the guarantor bank from liabilities emanating from other agreements entered into by the other parties to the contract of which it may or may not even be aware. Under the URDG, demand guarantees are clearly completely independent of
25 any underlying relationship between the applicant and the beneficiary, and subject to only the terms contained in it, thereby limiting the liabilities and rights of the guarantor bank to only matters it voluntarily commits itself to.

Unconditional and irrevocable performance guarantees impose an obligation on the guarantor
30 that is absolute or unconditional, which becomes fixed upon the principal's default. When a performance guarantee is characterised as unconditional and irrevocable, clear words will be required to support a construction which inhibits a beneficiary from calling on it where a breach is alleged in good faith, i.e. non-fraudulently. Just as and the guarantor who issues an

unconditional and irrevocable performance guarantee is not entitled to require that the creditor first proceed or exhaust remedies against the principal debtor, save for cases of fraud or unconscionable conduct, the principal debtor cannot fetter the beneficiary's capacity to call until after a binding determination has been made in respect of whether there had been a breach of
5 contract.

The intended purpose of an unconditional and irrevocable performance guarantee is twofold: (i) to secure the contractor's performance of the contract / provide security against the contractor becoming insolvent; and (ii) to give the employer access to funds it claims notwithstanding the
10 fact that a dispute with the contractor is afoot, i.e. security and risk allocation as to "who shall be out of pocket pending resolution of a dispute." In the latter case, it serves as a risk allocation device as it is used to allocate the risk between the parties as to who will be out of pocket during a dispute arising under the contract. Therefore to allow an injunction, as an interim measure of protection, in order to restrain a call on a guarantee that is intended to act as a risk allocation
15 device would defeat the purpose of that security: i.e. that the employer will have access to funds during a dispute between the parties. The courts will be slow to disrupt the risk allocation that the parties have agreed on.

The performance bond secures the beneficiary from the default of the counterpart. In its standard
20 form, it is the feature of an "on-demand" guarantee to allow the beneficiary to have an almost immediate remedy against the defaults of the principal, because: its payment can be requested to the guarantor without having to prove the actual default of the principal; and its payment can be obtained notwithstanding any objection based on the underlying contract which the applicant itself or the guarantor may raise. A performance bond is arguably beneficial for the employer as
25 it provides a security of usually 10–20 per cent of the contract value, which in theory is cashable on demand regardless of the existence of a dispute. However, this does not mean, that the performance bond can be called in any case and at the sole discretion of the beneficiary. There are circumstances entitling the guarantor to reject the payment for issues that are strictly related to the performance bond (in cases of the calling which is in breach of formal requirements as
30 stated in the performance bond), for fraud known to the guarantor, illegality and unconscionability.

During the calling process the guarantor has certain obligations to comply with. In particular, the guarantor has the obligation not to pay (without any need for instructions from the applicant) if the calling is manifestly unlawful, fraudulent or unconscionable; the obligation to promptly
5 inform the principal about the calling; and obligation to verify if the calling is abusive. The call is unlawful if the contract has been duly and timely fulfilled. The call is abusive or fraudulent when, the conditions for calling the bond, as indicated in the text of the performance bond, have not met; or the contract has been correctly fulfilled. Fraud is defined as the unlawful and intentional making of a misrepresentation that causes actual prejudice or is potentially prejudicial
10 to another.

Unconscionability contains elements of abuse, unfairness and dishonesty. It imports notions of unfairness and bad faith and is unlikely to be established if there is a genuine dispute between the parties. Unconscionability caters for situations where the conduct of the beneficiary is
15 sufficiently reprehensible to justify an interdict in circumstances where the facts do not amount to fraud. It may manifest itself by; - (i) calls for excessive sums; (ii) calls based on contractual breaches that the beneficiary of the call itself is responsible for; (iii) calls tainted by unclean hands, e.g., supported by inflated estimates of damages or mounted on the back of selective and incomplete disclosures; (iv) calls made for ulterior motives; (v) tactical calls aimed at putting
20 contractors under financial pressure to compromise or as a tool to obtain strategic leverage against the other party; and (vi) calls based on a position which is inconsistent with the stance that the beneficiary took prior to calling on the performance bond. This is not an exhaustive list of circumstances where unconscionability arises. The list is not and will probably never be closed.

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The guarantor will have to reject any call but only if and to the extent that the guarantor has been put in the condition of being able to verify that the underlying contract has been correctly fulfilled. In other words, the guarantor does not have any obligations to make its own searches to verify whether the underlying contract has been fulfilled, but once it has been informed (by the
30 principal) that the call is unlawful, then the guarantor must ascertain, in its opinion, whether the call is unlawful. A principal faulting a guarantor for honouring a call must establish a strong

prima facie case of unlawfulness, fraud or unconscionability, which is a high threshold. A *prima facie* vital piece of evidence in and of itself does not make a strong overall *prima facie* case.

Therefore, in the event that the guarantor does not comply with its obligations towards the principal, it would be imperative to start the necessary court proceedings to prevent the guarantor from debiting onto the principal's account, the amounts paid to the beneficiary (in breach of the obligations provided by the mandate contract). In order to sustain such action, the principal is required to plead facts which; (i) identify the nature of the guarantee; (ii) the obligations owed by the guarantor to the principal under the terms of the guarantee; and (iii) the nature of breach of those obligations, i.e. that the call was honoured in spite of a strong *prima facie* case of manifest unlawfulness, fraud or unconscionability; and (iv) the nature or injury suffered as a consequence. Of course, the facts constituting the cause of action should be stated with certainty and precision, and in their natural order, so as to disclose the four elements essential to this cause of action.

By paragraphs 5 (r) and (s); and 6 – 12 of the plaint, the respondent contends that the call on both Guarantees was non-compliant, the call on the Performance Guarantee was fraudulent since the respondent had undertaken over 70% of the works, and that payments had been made on the Advance Payment Guarantee by way of deductions from invoices before remittance of payments. The applicant further contends that due to variations introduced into the subcontracts without the consent of the applicant, the applicant's obligation to honour calls on the bonds was extinguished. The applicant is faulted for processing and encashment of the Guarantees when it was no longer bound by the terms of the guarantees, with notice that its obligations thereunder had been extinguished upon the variation of the subcontracts without its consent. Nowhere in these averments is it pleaded that the applicant had actual notice of a strong *prima facie* case of those circumstances at the time of honouring the call.

A cause of action entails pleading essential facts constituting the right and its infringement which entitle a person to sue the wrong doer or defaulter or any one liable for it. It does not comprise every piece of evidence which is necessary to prove each fact, but every fact which is necessary to be proved. The cause of action, as it appears in the plaint when properly pleaded, will therefore always be the facts from which the plaintiff's primary right and the defendant's

corresponding primary duty have arisen, together with the facts which constitute the defendant's delict or act of wrong. In the instant case, the liability of the applicant as guarantor to the respondent as principal lies in honouring a call that is manifestly unlawful, fraudulent or unconscionable, not otherwise. It is critical to plead facts asserting that the guarantor had actual
5 notice of a strong *prima facie* case of those circumstances at the time of payment. The plaint does not contain averments to the effect that the call was manifestly unlawful, fraudulent or unconscionable, and that the applicant had actual notice of a strong *prima facie* case of those circumstances.

10 Not only is a cause of action an important part of a civil suit but is in essence the reason that the suit exists in the first place. If a plaint does not contain averments of facts sufficient to support every element of a claim, the court, upon motion by the opposing party, may strike out the plaint for failure to state a claim for which relief can be granted. According to Order 6 rule 30 (1) of *The Civil Procedure Rules*, the court may, upon application, order any pleading to be struck out
15 on the ground that it discloses no reasonable cause of action. Where there are bare conclusions, but no supporting factual basis for the claim, the plaint will be found not disclose a reasonable cause of action and will be struck out (see *Kelly Lake Cree Nation v. Canada*, [1998] 2 F.C. 270 (T.D.))

20 Moreover, it is clear in the instant case that payment was made on 21st September, 2022 after the respondent's unsuccessful attempt to injunct the payment on account of alleged fraudulent and illegal call of the Advance Payment Guarantee and Performance Guarantee, and that the two instruments had ceased to be legally binding upon the applicant after the terms of the subcontract were varied, was dismissed on 15th September, 2022 under Miscellaneous Cause No. 0069 of
25 2022. I therefore find that the plaint does not contain some of the essential averments required to establish a cause of action in a suit by a principal against a guarantor for alleged wrongful payment upon a call made on an advance payment and demand performance guarantee.

For all the foregoing reasons, I find that the plaint does not disclose a reasonable cause of action
30 as against the applicant and it is accordingly struck out as against the applicant (2nd defendant). The costs to the application and the suit are awarded to the applicant.

Delivered electronically this 1st day of September, 2023
Mubiru.....

.....**Stephen**

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Stephen Mubiru
Judge,
1st September, 2023.