

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

MISCELLANEOUS APPLICATION No. 1397 OF 2022

(Arising from Civil Suit No. 0858 of 2022)

UGANDA ELECTRICITY TRANSMISSION COMPANY LIMITED APPLICANT

VERSUS

1. CITIBANK UGANDA LIMITED }

10 2. ELECTROMAXX UGANDA LIMITED } RESPONDENTS

3. MAXOL UGANDA LIMITED }

Before: Hon Justice Stephen Mubiru.

RULING

a. Background.

15 The 2nd respondent M/s Electromaxx (U) Limited is licensed as an independent thermal power generating company and bulk supplier of electricity. On or around 20th April 2018 the applicant and the 2nd respondent executed a Power Purchase Agreement by which the applicant undertook to purchase 50 MW of electricity generated from the 2nd respondent's thermal power generation complex at Tororo, for a period of six years, twenty-four hours per day. The said Power Purchase Agreement was subsequently amended by agreements dated 10th April 2019 and 4th September, 2019 respectively. Under the terms and conditions of the agreement, the applicant was required to provide a performance guarantee to the 2nd respondent. On 19th October 2021, a performance guarantee Ref. No. 5680600348 was issued by the 1st respondent M/s Citibank Uganda Limited in
20 favour of 2nd respondent in the sum of US \$ 1,802,089 payable on written demand by the 2nd respondent, declaring the applicant to be in default under the Power Purchase Agreement.

On basis of a memorandum of understanding between the 2nd and 3rd respondents, the 1st respondent on or about 28th December 2021 issued to the 3rd respondent M/s Maxol Uganda Limited, a performance guarantee Ref. No. 5680600348 for payment of a sum of US \$ 1,094,479
30 arising from defaults in payments under the Power Purchase Agreement. The guarantee had an expiry date of 19th October 2022. By a letter dated 3rd October 2022 the 3rd respondent called on the said guarantee "on account of default by UECTL to effect payment as agreed in the Power

Purchase Agreement between UETCL and Electromaxx Uganda Limited novated in favour of Maxol (U) Ltd ...” The 3rd respondent contends that the 1st respondent is obliged to honour that call since the guarantee is independent of the underlying Power Purchase Agreement.

5 It is the applicant’s case on the other hand that since the execution of its Power Purchase Agreement with the 2nd respondent it has fulfilled all its payment obligations and has no outstanding sums. It was therefore surprised when on or around 5th October 2022, it received information that the 1st respondent had received a call on a performance guarantee dated 28th December, 2021. The applicant contends that it hitherto was not aware of any novation of the
10 Power Purchase Agreement nor the existence of the performance guarantee dated 28th December, 2021. It never received any notice of the novation of the performance guarantee from any of the respondents. The applicant denies having instructed the 1st respondent to issue the performance guarantee dated 28th December 2021 in favour of M/s Maxol Uganda Limited and the claimed novation on basis of which it was issued.

15 The applicant contends further that he 3rd respondent fraudulently and falsely misrepresented in its call on the Performance Guarantee to the 1st respondent that the applicant defaulted in effecting payment under the Power Purchase Agreement well-knowing that the applicant did not in fact default on payments under the said agreement. The 3rd respondent fraudulently and falsely
20 misrepresented that invoices Ref. Nos. AGO/ APR/0422-02; AGO/MAY/0522; AGO/JULY/0722 and AGO/JUNE/0622 were the basis of default by the applicant well-knowing that the said invoices were not addressed to nor payable by the applicant and were not for supply of power but were for purchase by the 2nd respondent of automotive gas oil and as such could not have been issued under the Power Purchase Agreement.

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b. The application.

This application by Chamber Summons is made under the provisions of section 98 of *The Civil Procedure Act* and Order 44 rule 1 and 9 of *The Civil Procedure Rules*. The applicant seeks a
30 temporary injunction order restraining the 1st respondent from effecting payments of any sums to the 3rd respondent M/s Maxol Uganda Limited, its agents, employees or anyone deriving authority

from them or the encashment of the performance Guarantee Ref. No. 5680600348 dated 28th December, 2021 pursuant to the demand for US \$ 1,094,479 pending the hearing and final determination of H.C. Civil Suit No. 858 of 2022. It is the applicant's case that it filed that suit against the respondents challenging payment of any sums under the said Performance Guarantee.

5 It is a case which *prima facie* has a likelihood of success. The applicant is likely to suffer irreparable damage in the execution of its statutory duties that cannot be compensated by damages if this application is not granted and the Performance Guarantee is cashed by the 2nd respondent. On the balance of convenience the applicant stands to suffer more inconvenience greater than any of the respondents if the application is not granted.

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The applicant contends that it has a *prima facie* case with a likelihood of success considering that the demand letter from the 3rd respondent makes reference to four invoices which the applicant has allegedly defaulted to pay, but none of the said invoices were due from or payable by the applicant. The said invoices are all addressed to the 2nd respondent as payer and the applicant cannot default
15 on the payment of invoices that are not addressed to it as payer and which it is not obligated to pay. The applicant contends further that the 2nd respondent fraudulently obtained the Performance Guarantee dated 28th December, 2021 from the 1st respondent in so far as it obligated the 1st respondent to transfer in its entirety upon the same terms and conditions the Performance Guarantee number 5680600348 of 19th October 2021 issued previously to the 2nd respondent on
20 the basis of the Power Purchase Agreement, the 3rd respondent on the false basis that the 3rd respondent had acquired the 2nd respondent's rights under the Power Purchase Agreement whereas not. Therefore the 3rd respondent's call on the Performance Guarantee dated 28th December 2021 is tainted by fraud on the face of it in so far as the 3rd respondent fraudulently procured and accepted the issuance of the Performance Guarantee dated 28th December, 2021 on the false basis that there
25 was a novation of the Power Purchase Agreement in its favour well-knowing that this was false.

c. The affidavits in reply;

In the 2nd respondent's affidavit in reply, it is averred that the 2nd respondent having on or about
30 20th April 2018 executed a Power Purchase Agreement with the applicant and obtained from the applicant a performance guarantee in the 2nd respondent's favour Ref. 5680600348 issued by the

1st respondent on 19th October 2021, the 2nd respondent subsequently, the second respondent on 1st July, 2020 entered into a fuel supply agreement with the 3rd respondent to secure fuel supply for the power generation. On the 16th December 2021 the 2nd respondent entered into a memorandum of understanding with the 3rd respondent to assign / transfer the above-mentioned Performance Guarantee to the latter in order to secure payment of fuel supplied to the former.

Instead of assigning / transferring the said performance guarantee to the 3rd respondent, the 1st respondent re-issued the same performance guarantee 28th December 2021 to the 3rd respondent for the payment of the sum of US \$ 1,094,479 but on the basis of a non-existent Power Purchase Agreement purportedly between the applicant and the 3rd respondent. It is not true that there was any novation of the Power Purchase Agreement entered between the applicant and the second 2nd respondent as is being alleged. The 3rd respondent nevertheless made a call on the performance guarantee for the payment of US \$ 1,094,479 on account of default by the applicant to effect payments as agreed in the Power Purchase Agreement between the applicant and the 2nd respondent allegedly novated in favour of the 3rd respondent. There is no payment due to the 3rd respondent. Instead it is the 3rd respondent who owes the 2nd respondent US \$ 1,096,920 in liquidated damages for short supplies of fuel. The 2nd respondent denies having falsely misrepresenting that the 3rd respondent had acquired its rights and obligations.

The performance guarantee dated 28th December, 2021 was issued illegally and irregularly without the knowledge of the 2nd respondent. The 3rd respondent is not a party to the Power Purchase Agreement and it cannot therefore make a demand on the basis of an agreement to which it is not a party. The 3rd respondent has in effect made a call on the basis of a non-existent Power Purchase Agreement purportedly between the applicant and the 3rd respondent. The 3rd respondent's enforcement of the Performance Guarantee will interfere and greatly affect the 2nd respondent's operations in the supply of electricity to the notional grid which shall cause great injury and inconvenience majorly to the consumers.

In the 3rd respondent's affidavit in reply, it is averred that the second guarantee was issued at the instance of the 2nd respondent, as a modification of the first guarantee. The Second guarantee was issued by the 1st respondent at the instance of the applicant. The 2nd respondent is aware of the

second guarantee and all the events leading to the issuance of the guarantee to the 3rd respondent. The 1st respondent is obliged to honour its obligations under the second guarantee to the extent that the demand for payment complies with the terms and conditions in the second guarantee and be drawn in accordance with and in respect to the obligations secured by the guarantee.

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d. Submissions of counsel for the applicant.

M/s K & K Advocates on behalf of the applicant submitted that the entire process from procurement, issuance and finally the call on the performance guarantee was tainted with illegality and fraud on the part of the 2nd and 3rd respondents. It is a well-established principle that a call on a performance guarantee may be halted in the event of fraud by the beneficiary and knowledge of the fraud has been brought to the Bank's attention or unconscionability of the call on the guarantee. The Performance Guarantee dated 28th December, 2021 Ref No 5680600348 was issued to the benefit of the 3rd respondent upon a fraudulent and false claim that there was a novation of the Power Purchase Agreement in its favour whereas not, and that that the 3rd respondent had acquired the rights of the 2nd respondent under the underlying relationship whereas not. The 3rd respondent made a fraudulent and dishonest claim in a letter dated 3rd October, 2022 that the applicant UETCL was in default of obligations to effect payment as agreed under a Power Purchase Agreement between it and the 2nd respondent Electromaxx Uganda Limited novated in its favour whereas not. The 3rd respondent made the call knowing fully that UETCL was not in breach of its Power Purchase Agreement.

The 2nd and 3rd respondents made a false and fraudulent claim that there was a novation of the Power Purchase Agreement whereas not. These misrepresentations were made to enable the 3rd respondent benefit from the Performance Guarantee and this amounts to outright fraud. UETCL has never signed or consented to any novation of the Power Purchase Agreement and at present still purchases power from Electromaxx, not Maxol. There is no Power Purchase Agreement between the applicant and Maxol as to give rise to an indebtedness and no novation of the Power Purchase Agreement between Electromaxx and UETCL to Maxol has occurred. A novation requires consent of all the parties to the old contract as well as the new party introduced to take on the obligations of a previous party.

Since novation involves a new contract, it is essential that the consent of all parties to be obtained. In this necessity for consent lies the essential difference between novation and assignment. The applicant has never consented to a novation or transfer of the Power Purchase Agreement from the 2nd respondent to the 3rd respondent or any other such similar action by whatever name called and
5 it is apparent that the applicant has not entered into any tripartite agreement with the 2nd and 3rd respondents to effect a novation as required under the law. The applicant cannot be deemed to be indebted for money not payable by it under a separate contract between the 2nd and 3rd respondents to which it is not privy and under which it bears no obligations.

10 The 3rd respondent accepted a guarantee issued on a false basis and for a different purpose, that is, supply of automotive gas oil to the 2nd respondent and thereafter sought for enforcement of the same without so much as bringing the alleged default in payments supposedly attributable to the applicant, the principal in the guarantee relationship, to its attention. There is a strong *prima facie* case that the Performance Guarantee, dated 28th December, 2021 under which the 3rd respondent
15 seeks payment, is tainted with fraud on the face of it and that the Performance Guarantee was fraudulently, illegally and irregularly issued in the circumstances. The call on the Performance Guarantee by the 3rd respondent was also tainted with fraud.

Encashment of the performance guarantee shall cause the applicant irreparable damage in the
20 commercial reputation, standing and creditworthiness and shall cause a restraint to its ability to provide service delivery to the general public leading to damages that cannot be quantified. The balance of convenience in the present application lies largely in favour of the applicant. Failure to grant the application would be detrimental to the day to day operations of the applicant which involve providing electricity transmission services to the public at large. In this instance, the
25 applicant's cash flows would be severely affected and as well as programs that it plans to implement in favour of the public. It is necessary in cases in which a party is a public authority performing duties to the public that one must look at the balance of convenience more widely and take into account the interests of the public in general to whom these duties are owed. Failure to grant the application could lead to loss of public funds under questionable circumstances and
30 would render the main suit nugatory most especially as neither of the respondents have pleaded

that they are in a position to compensate the applicant for any losses or damages that would result if the main suit is decided in its favour.

e. Submissions of counsel for the 1st respondent.

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M/s AF Mpanga Advocates, on behalf of the 1st respondent submitted that the second guarantee was issued to secure the payment obligations of the applicant under the Power Purchase Agreement between the applicant and the 2nd respondent, as the vendor and purchaser respectively, dated 20th April 2018. The second guarantee was issued to replace an earlier Performance Guarantee No. 10 5680600348 dated 19th October, 2021 in the sum of US \$ 1,802, 089.00. The first guarantee was issued to secure the 1st respondent regarding the payment obligations of the applicant, under the Contract, for the power / energy that was to be supplied by and purchased from the 2nd respondent by the applicant under the Contract. The payment obligations of the applicant in the Contract and secured by the second guarantee were specifically in respect to the payment for energy sold to the 15 applicant by the 2nd respondent, and not any other obligation. The need to issue the second guarantee arose following the letter of the 2nd respondent dated of 16th December, 2021, to the 1st respondent which contained a position / representation to the effect that there had been a novation of the Contract. In that letter the 2nd respondent informed the 1st respondent that there had been a transfer of the first guarantee, in its entirety upon the same terms and conditions as the original 20 first guarantee, to the 3rd respondent and that 3rd respondent had therefore taken over and assumed the obligations of the 2nd respondent under the Contract.

It has now come to the attention and actual knowledge of the 1st respondent, which is the Bank that issued the second guarantee, and before honouring the demand issued by the 3rd respondent in 25 respect to the second guarantee, that; - (i) there has never been a novation of the Contract; (ii) all invoices for the supply and purchase of energy under the Contract, which the 2nd respondent issued to the applicant were settled by the applicant so that there is no money that is due owing to the 2nd respondent from the applicant or, that the applicant is not indebted to the 2nd respondent in the manner claimed in the demand or at all; (iii) the invoices which were / are listed in the demand that 30 was served on the 1st respondent by the 3rd respondent, were issued to the 2nd respondent only, and never issued to the applicant at all; (iv) the invoices referred to in (iii) above were for the supply

of AGO fuel, by the 3rd respondent to the 2nd respondent, and were not for energy supplied by the 3rd respondent to the applicant; (v) the 3rd respondent which is not a party to the Contract is the beneficiary or the intended beneficiary of / under the demand wherein it seeks to be paid and therefore take benefit of the sum of US \$ 1,094,479.45; (vi) the 3rd respondent, which is the beneficiary of the demand is aware that it is not a party to the Contract, and / or has not supplied any energy or power to the applicant under the Contract; and (vii) there does not exist any novation of the Contract or a novated Contract, between the applicant, the 2nd respondent and the 3rd respondent.

In both the main suit and the application, the matter in issue is in regard to the position presented by the 2nd respondent and the 3rd respondent, in the notice and the demand respectively, that the Contract was novated or that there exists a novated Contract, so that the 3rd respondent has a basis to demand for payment under the second guarantee. In such case, the fraud would be in the underlying transaction i.e. the Contract or the novation thereof, and in the demand presented, to the extent that the demand makes an express reference to the existence of a novation of the Contract. Honouring any presentation of documents, whether a Letter of Credit, Performance Guarantee or Demand Guarantee, may be refused where there is clear and established fraud on the part of the beneficiary. For the fraud exception to apply or be effective as a basis for non - payment, the fraud must be brought to the attention and knowledge of the bank before it pays. This means that the bank must become aware and therefore know about the existence of the fraud before the bank effects payment under the Letter of Credit or the guarantee.

An injunction will be granted where it can be clearly shown that the call on a bond was made in bad faith or that there has been a lack of good faith i.e. where it can clearly be shown that the beneficiary who made a call on the bond was aware that they were not entitled to make the call. When presenting the demand, dated 3rd October, 2022, the 3rd respondent was aware that there was never / had never been a novation of the contract, as contained in the demand. In presenting the demand for payment, the 3rd respondent was aware that it had never issued the four invoices to the applicant. The 3rd respondent was therefore aware that it never issued the invoices to the applicant, and that the applicant could not, and was therefore not in default for non-payment of the amounts in the invoices. In presenting the invoices in the demand, the 3rd respondent was aware that the

invoices, which it authored, were for the supply to the 2nd respondent of AGO fuel, and not energy / power under the Contract.

f. Submissions of counsel for the 2nd respondent

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M/s Muwema & Co. Advocates and Solicitors, on behalf of the 2nd respondent submitted that the 2nd respondent opposes this application only to the extent of fraud and misrepresentation being attributed to it by the applicant. Otherwise the application satisfies the conditions for the grant of a temporary injunction order. The purpose of a temporary injunction is to preserve the status quo until the main suit is disposed of. The performance guarantee that the 3rd respondent seeks to enforce was fraudulently issued by the 1st respondent as it is not the one that was issued to the 2nd respondent by the applicant. There are serious questions to be investigated and tried and indeed the suit is not frivolous or vexatious. The 2nd respondent never novated nor agreed to novate the Power Purchase Agreement in favour of the 3rd respondent. Indeed the 2nd respondent only assigned its payment rights under the Power Purchase Agreement pursuant to Clause 17.3 which permits the grant of a security interest in favour of a company fuel supplier or any lender. The assignment of the payment rights was limited to only the performance guarantee dated 18th October and not the one dated 28th December, 2021.

20 For a novation to take effect, there should be in existence a tripartite agreement between the three parties which in this case there is none. Therefore in the absence of such an agreement, it would be absurd to claim a novation. The 2nd respondent has never consented to any novation of the Power Purchase Agreement it has with the applicant and none of its obligations have ever been given to the 3rd respondent. The 1st respondent issued the performance guarantee dated 28th December, 2021 to the 3rd respondent without the knowledge and / or consent of the 2nd respondent. The applicant is likely to be seriously prejudiced if the order sought for is not granted.

g. Submissions of counsel for the 3rd respondent

30 M/s Byenkya, Kihika & Co. Advocates, on behalf of the 3rd respondent submitted that a Performance guarantee is a contract between two parties; the 1st respondent and the 3rd respondent.

The applicant is not party to the guarantee and neither is the 2nd respondent. None of the two parties to the performance guarantee has challenged its validity, repudiated it or claimed any breach of its terms. Therefore the challenge presented to the court is purely a third party challenge. The basic principle of contract law is that a person who is not privy to a contract has no *locus standi*. The performance guarantee does not give the applicant any rights to sue upon it. The applicant seeks to interfere with rather than enforce the said contract. *The Contracts Act, 2010* does not provide any locus to third parties to interfere with other people's contracts. The applicant is not seeking to enforce any benefit granted to it under the guarantee.

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 relationship. The undertaking of the 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. All allegations about the terms of the power purchase agreement and whether or not it was "novated" are completely irrelevant. Those are matters between the applicant and the 2nd respondent. All supposedly fraudulent acts are attributable only to the 2nd respondent. The mere fact of accepting a guarantee and making a demand on that guarantee after performing obligations under a fuel supply contract cannot amount to fraud. It has not been suggested that fuel was not supplied by the 3rd respondent to the 2nd respondent. It has also not been shown that payments were made in respect of that fuel supply to the 3rd respondent. Having performed its own obligations under that particular contract, it cannot be fraudulent to make a call on the performance guarantee.

Averments by the applicant and the 2nd respondent expose completely their self-serving claims. They demonstrate that their case is a complete sham, a conspiracy to take benefit of the 3rd respondent's fuel supply and defeat its attempt to obtain payment by framing a case based on fabrication and lies. When one reviews the affidavits of the applicant and 2nd respondent they appear more of conspirators than adversaries. The 2nd respondent is apparently anxious to admit to fraud and wrongdoing.

The obligation of the 1st respondent to pay the demand has crystallized upon receipt of the demand. Under the terms of the performance guarantee they undertook to pay "...upon receipt of your first

demand declaring Uganda Electricity Transmission Company in default under the contract and without cavil or argument....” The life of the performance guarantee has now expired. The 3rd respondent cannot make any other demand on the performance guarantee after the 19th October 2022. This demonstrates the true strategy and scheme of the applicant and 2nd respondent. Any order that disables the 3rd respondent from taking benefit of its demand would be as good as passing final judgment in favour of the applicant and the 2nd respondent yet the general principle is that where grant of a temporary injunction would decide the whole suit, the grant should not usually be made. Any injunction issued now by this honourable court would be tantamount to rewriting or amending the terms of the guarantee contract. It would facilitate breach rather than performance. It would defeat the entire purpose for which irrevocable performance guarantees are intended. It would set a bad national and international precedent and isolate Uganda, portraying it as an unreliable country in which to accept a performance guarantee. It would consequently weaken and possibly destroy the role of irrevocable performance guarantees in supporting the business ecosystem in Uganda.

The applicant has not demonstrated any likelihood of suffering irreparable damage that cannot be compensated by an award of damages. The payment in question is not required from the applicant. It is required from the 1st respondent. The 1st respondent has confirmed that it is obliged to honour its obligations under the guarantee. Therefore no money will be lost to the applicant. If it turns out that there was wrongdoing on the part of the 1st respondent leading to wrongful payment and the 1st respondent seeks indemnification from the applicant, the latter shall have its normal remedies against the 1st respondent in terms of their underlying relationship as envisaged by Article 5 of ICC Publication 758. The subject matter of the suit is money which can always be compensated for by an appropriate award of damages. When one’s obligations are settled in a timely manner by a guarantor it enhances rather than damages reputation. It is attempts like the present one to defeat a guarantee that are more damaging to reputation.

The balance of convenience does not favour the applicant. The applicant is not required to perform any obligation under the performance guarantee. The applicant will not be required to pay out any money. So it loses nothing in the short run and it can always fall back on its defences against the 1st respondent. On the other hand the 3rd respondent will be greatly inconvenienced by a temporary

injunction order because: (i) it supplied fuel worth over a million United States dollars to the 2nd respondent for the benefit of the applicant's business and it is being kept out of its money. It is not earning any interest from that money; (ii) because it has been denied payment its business is being adversely affected. It is not going to be able to seek compensation from anyone for loss of prospects if the court orders a stop to the payment.

h. Submissions in rejoinder by counsel for the applicant;

A contract of guarantee is a contract to perform a promise or to discharge the liability of a third party in case of default of that third party, which may be oral or written. There are three parties, namely, the surety, the principal debtor and creditor. The person who gives the guarantee is called the "surety," the person in respect of whose default the guarantee is called the "principal debtor" and the person to whom the guarantee is given is called the "creditor." A performance security bond is a three-party agreement between the principal, the obligee, and the surety in which the surety agrees to uphold, for the benefit of the obligee, the contractual obligations of the principal if the principal fails to do so. If the principal fulfils its contractual obligations, the surety's obligation is void. However, if the principal defaults on the underlying contract, the obligee can make a claim against the surety under the surety bond. The "fraud" rule to function as an exception to the privity rule. The law applies the maxim "*ex turpi causa non oritur action*," or "fraud unravels all." In the current suit the applicant pleaded fraud as against the 3rd respondent in its acquisition of the Performance Guarantee dated 28th December, 2021 and in its subsequent actions while calling on the same. There therefore exist an exception to any privity rule that may be argued by the 3rd respondent.

For the Performance Guarantee dated 28th December, 2021 to be valid there must have been a primary liability to a promise by the applicant to the 3rd respondent, which simply does not exist. There is no Power Purchase Agreement novated in favour of the 3rd respondent from which liability of the applicant to the 3rd respondent would arise. Article 33 (e) of the ICC Uniform Rules for Demand Guarantees requires a statement to be provided to the bank that an underlying contract has been transferred before a transfer of a guarantee occurs. The 3rd respondent claim is laid under a fuel supply contract, to which the applicant is not a party and under which the applicant has not

issued any performance guarantee, unlike as under its Power Purchase Agreement. The Power Purchase Agreement between the applicant and 2nd respondent did not impose any obligation upon the 2nd respondent to supply fuel to the applicant and the applicant was not a party to neither was the 2nd respondent's fuel contract with the 3rd respondent which is distinct from the Power Purchase Agreement. There is therefore no basis upon which any claim by the 3rd respondent in respect to a performance guarantee issued under a Power Purchase Agreement could be made as regards the supply of fuel in a Fuel Supply Contract.

The 3rd respondent by its own evidence admitted having participated in the review of the Performance Guarantee dated 23rd December, 2021 leading to a change in its wording and issuance of the Performance Guarantee dated 28th December, 2021, which also contained fraudulent representations that the Power Purchase Agreement had been novated in the 3rd respondent's favour. The applicant's remedy would ordinarily be as against the 3rd respondent who has made the fraudulent call on a guarantee despite no amounts being due to her from the applicant, but this would be almost impossible where there is no underlying contractual relationship under which to recover. Article 20 (a) of the ICC Uniform Rules for Demand Guarantees provides that as long as a demand has been made, the examination of the demand by the Bank will not be affected by the expiry of the guarantee as long as the demand was made prior to the expiry date. The Bank has not yet paid out the amounts under the Performance Guarantee. That is the status quo to be maintained.

i. The decision.

It has been established by the law and the decided cases that, the main purpose for issuance of a temporary injunction order is the preservation of the suit property and the maintenance of the *status quo* between the parties pending the disposal of the main suit. The conditions for the grant of an interlocutory injunction are now, well settled. First, an applicant must show a *prima facie* case with a probability of success. Secondly, an interlocutory injunction will not normally be granted unless the applicant might otherwise suffer irreparable injury, which would not adequately be compensated by an award of damages. Thirdly, if the court is in doubt, it will decide an application on the balance of convenience (see *E.A. Industries v. Trufoods*, [1972] E.A. 420 *American Cyanamid Co v. Ethicon Limited* [1975] AC 396; *Geilla v. Cassman Brown Co. Ltd* [1973] E.A.

358 and *GAPCO Uganda Limited v. Kaweesa and another* H.C. Misc Application No. 259 of 2013). The conditions that have to be fulfilled before court exercises its discretion to grant an interlocutory injunction have been well laid out as the following:-

1. The Applicant has shown a *prima facie* case with a probability of success.
- 5 2. The likelihood of the applicants suffering irreparable damage which would not be adequately compensated by award of damages.
3. Where in doubt in respect of the above 2 considerations, then the application will be decided on a balance of convenience (see *Fellowes and Son v. Fisher* [1976] 1 QB 122).

The applicant seeks to restrain payment under a guarantee. The independence of the demand
10 guarantee from the underlying contract has the effect that, in principle, the guarantor must pay a demand presented in compliance with the terms of the guarantee, irrespective of whether or not the Principal has, in fact, committed a breach of the underlying contract with the Beneficiary. Therefore Courts will very rarely order a bank not to pay a beneficiary who has made an apparently complying demand. However, in order to preserve the autonomy between the banks' obligations,
15 on the one hand, and the rights and obligations of the parties to the underlying contract on the other, the law applies a separate, more stringent, test in the case of injections sought against the payment of demand guarantees. The exceptions are; (i) fraud affecting the documents presented by the beneficiary (for example if they have been forged). Fraud is not limited to dishonesty or fraudulent intent, but extends to an absence of objective good faith, as where no reasonable person
20 would have considered the demand to be justified e.g. if the beneficiary had no honest belief in the validity of its demand; (ii) illegality in the demand guarantee contract or underlying contract; (iii) the infringement of international obligations and express contractual derogation from the principle of autonomy; and (iv) the total failure of the basis of the contract, i.e. the reason for its existence.

25 In the instant application, the applicant relies on the fraud exception. To prove that a demand under a performance guarantee is fraudulent, the applicant for an injunction must show that the beneficiary knows that the demand is fraudulent, or that the circumstances around the demand are such that the only reasonable inference is that the demand is fraudulent.

The International Chamber of Commerce defines a demand guarantee in article 2 of its 2010 Uniform Rules for Demand Guarantees (URDG) 758, as “any signed undertaking, however named or described, providing for payment on presentation of a complying demand.” In contradistinction, a letter of credit is a strong payment instrument. A documentary credit is in essence a banker’s assurance of payment against presentment of specified documents. Over the years both instruments have secured a strong presence in international commerce. To this end, English courts have aptly described these instruments as the “lifeblood of commerce” (see *RD Harbottle (Mercantile) Ltd v. National Westminster Bank Ltd* [1977] 2 All ER 862 at 870b; *Edward Owen Engineering Ltd v Barclays Bank International Ltd* [1978] 1 All ER 976 at 983; and *Intraco Ltd v Notis Shipping Corporation (the Bhoja Trader)* [1981] 2 Lloyd’s Rep 256 at 257. This is only natural as both demand guarantees and letters of credit satisfy their purpose by ensuring that the commercial transaction, particularly in terms of payment with regard to letters of credit, is secure. Given their similarity in function and the legal principles that demand guarantees and letters of credit share, cases dealing with the one instrument are regularly referred to in cases relating to the other.

A guarantee is essentially a promise by a third party to ensure that an obligor meets its liabilities to another. Performance Guarantees enjoy widespread use in the services industry, particularly in construction / engineering projects and international sale of goods contracts, where they are typically used to secure the interests of the supplier for the performance of the consumer’s obligation to pay, especially when no previous dealings have taken place between them. It is now common practice for many suppliers in the public and major private sectors in strong bargaining positions, to demand that buyers provide demand guarantees as security to ensure that the terms of their contract are adhered to. They are versatile instruments that are essential to risk management in credit transactions. There are two main types of guarantee: suretyship guarantees and demand guarantees.

With a suretyship guarantee, equity will intervene to protect a guarantor in some circumstances (for example, if the underlying contractual obligations which it has guaranteed have been increased without the guarantor’s consent). A surety’s obligations are also secondary: the beneficiary of the guarantee must first establish the main obligor’s liability and default. When they are used in that context, they often require one or more of the following documents: a written statement indicating

breach by the applicant; a judgment or arbitral award confirming the breach of contract; a written notice demanding payment of the specified amount; and/or a certificate by an expert or surveyor attesting to a certain fact (the amount paid or outstanding, the quality or the quantity of the product, and so on). Suretyship guarantees tend to be drafted with wording that makes the guarantor

5 "primary obligor" and liable to "pay on first demand" (i.e. gives the guarantor a primary obligation to perform the primary debtor's obligations once the debtor defaults).

A demand guarantee may be defined as an undertaking given for payment of a fixed or maximum sum of money on presentation to the party giving the undertaking of a demand for payment (nearly

10 always required to be in writing) and such other documents (if any) as may be specified in the guarantee within the period and in conformance with the other conditions of the guarantee. Most demand guarantees are payable on "first written demand" or "simple demand" without any additional documents. Normally, demand guarantees are not subject to the equitable defences that are available in the case of suretyship guarantees. In *Edward Owen Engineering Ltd v. Barclays*

15 *Bank International Ltd and another* [1978] 1 QB 159; [1978] 1 Lloyd's Rep 166; and [1978] 1 All ER 976 Lord Denning MR held that performance guarantees were virtually promissory notes payable on demand. He also stated that;

All this leads to the conclusion that the performance guarantee stands on a similar

20 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

25 stipulated, without proof or conditions. The only exception is when there is clear fraud of which the bank has notice.

Similarly in *R D Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd.*, [1978] 1 QB 146; [1978] 2 All E.R. 862 at 870, Judge Kerr states:

It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international commerce. Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly

in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration as available to them or stipulated in the contracts....Otherwise, trust in international commerce could be irreparably damaged.

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Some of the key characteristics of demand guarantees are that they contain an undertaking to pay on demand, an absence of clauses excluding or limiting the equitable defences normally available to a guarantor, the guarantor is a primary obligor and not merely acting as the surety, payment is triggered by a demand and the obligation to pay is stated to be immediate, and the obligation to pay was unaffected by any dispute in the underlying contract. Demand guarantees are more onerous for guarantors as they have far less room for argument about whether payment is due and generally no access to the equitable defences. As such, demand guarantees are intended to prevent or penalise bad faith, poor performance and non-performance for whatever reason. They also provide the beneficiary with a ready source of funds that can be used to help meet the costs of remedying the principal's failure to perform in terms of the underlying contract.

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A demand guarantee is not quite as good as cash or a letter of credit, but it is a lot closer to cash than a suretyship guarantee is, and there is far less scope for litigation about whether payment is due from the guarantor. With a demand guarantee payment is only conditional on the beneficiary serving a demand in the required form (although this can be made conditional on an event happening). Perhaps the most significant feature of demand guarantees, however, is that they afford vital safeguards against abusive calls by the parties to commercial transactions.

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Demand guarantees, being a substitute for cash, are created to provide the beneficiary with a speedy monetary remedy against the principal to the underlying contract, and to that end they are primary in form and documentary in character. This means that the demand guarantee is an abstract payment undertaking, which is expressed to be payable solely on presentation of a written demand and / or any other specified documents conforming to the terms of the undertaking, and is independent of the underlying contract. In view of this, any demand within the maximum amount stipulated in the demand guarantee must, in principle, be paid by the guarantor, irrespective of whether the underlying contract has, in fact, been breached and irrespective of the loss actually suffered by the beneficiary. This is in contrast to the suretyship guarantee that is an undertaking to

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be answerable for another's debt or default, and is triggered only by proof of actual default and is not independent of the underlying contract, and which is limited to the amount of loss suffered from the default within the maximum amount stipulated in the guarantee. In this regard, demand guarantees differ from surety guarantees or bonds, in which the security lender (i.e., surety) is only involved if the principal party defaults in the performance of an obligation.

The operative words of the performance guarantee Ref. No. 5680600348 for payment of a sum of US \$ 1,094,479 issued by the 1st respondent on 28th December, 2021 in favour of the 3rd respondent state that;

Now therefore we hereby affirm that we are guarantors and irrevocably responsible to you on behalf of Uganda Electricity Transmission Company Limited up to a total of US \$ 1,802,089.00 (United States [dollars] one million eight hundred two thousand eighty nine only) and we undertake to pay you upon receipt of your first written demand declaring Uganda Electricity Transmission Company Limited to be in default under the contract and without cavil or argument any sums within the limits of US \$ 1,802,089.00 (United States [dollars] one million eight hundred two thousand eighty nine only) as aforesaid without your needing to prove or to show grounds reasons for our demand for the sum specified therein and that the amount does not exceed the outstanding sum at the time.

This clearly is a demand performance guarantee under which, subject to the fraud exception, the 1st respondent bank's obligations are autonomous from the underlying contract between the 3rd respondent beneficiary and the 2nd respondent as principal; which means that, in principle, the 1st respondent bank must pay if proper complying documents are presented, even if the 3rd respondent beneficiary and the 2nd respondent as principal have not stipulated that there is a default under the original underlying contract. In order to obtain a temporary injunction, the applicant will be required to establish that: (i) there is a serious question to be tried as to whether the 3rd respondent has a right to call on the guarantee; (ii) that if the application is not granted, the applicant stands to suffer irreparable damage; and (iii) the balance of convenience favours leaving the guarantee intact until the dispute is resolved. This will often be the case where the applicant can demonstrate that the payment of damages in lieu of an injunction would be an inadequate remedy.

While it might appear that these requirements could be readily satisfied where there is a bona fide dispute, particularly where the applicant stands to suffer significant reputational damage if a call were to be made, in the context of demand performance guarantees, courts will typically refuse an injunction unless there are special circumstances that suggest they should do otherwise. The rationale behind this is that, by agreeing that the applicant will provide the demand performance guarantee on the terms set out in the contract, the parties have also agreed to allocate the financial risk of any dispute to the applicant until it is finally resolved.

There are however at least three instances where courts will deviate from this position: (i) where there is compelling evidence of fraud on the part of the beneficiary; (ii) where there is compelling evidence of unconscionable conduct on the part of the beneficiary; or (iii) to ensure the beneficiary adheres to any contractual promise not to call on the performance guarantee (i.e. a negative stipulation). Unless the above circumstances are present, a court is likely to refuse an injunction for the reasons set out above.

i. Whether the applicant has *locus standi* to make this application.

Counsel for the 3rd respondent though contends that for lack of privity, the applicant does not even have the *locus standi* for making the application in reliance on the fraud exception. In essence, privity means that only the parties to a contract, those “privy” to it, have enforceable rights and obligations under that contract. A contract cannot (as a general rule) confer rights or impose obligations arising under it on any person except the parties to it (see *Dunlop Pneumatic Tyre Company v. Selfridge & Co* [1915] AC 847). A third party does not have enforceable rights or obligations under the contract. The privity rule though is subject to a large number of common law and statutory exceptions, including; contracts involving trusts, collateral contracts, restrictive agreements, insurance companies, agent-principal contracts, and cases involving negligence. For example the third party rights exception in section 65 of *The Contracts Act, 7 of 2010* was applied in *Guangdong Hao He Engineering & Construction Company (U) Ltd v. Britam Insurance Co (U) Ltd and another*, H.C. Misc. Cause No. 37 of 2020. The traditional analysis of privity though begins with the position that third party beneficiaries cannot enforce a contract because they were

not parties to the exchange, and then finding exceptions to that rule in which the third party is permitted to do so on either common sense or equitable grounds.

5 Generally, there is a minimum of three parties involved in the provision of a performance demand guarantee; (1) the principal, (2) the guarantor and (3) the beneficiary. However, the transaction involves three contracts; the underlying contract between the principal and the beneficiary, the contract established by the performance demand guarantee issued by the principal's bank to the beneficiary, and the counter-indemnity contract (or reimbursement contract) between the principal and his bank. Each contract is completely separate from the other. Each contract does not concern
10 any participant who is not a party to that particular contract.

The guarantor's undertaking (commitment) to the beneficiary arises once it issues the demand guarantee, and its obligation to pay is conditioned only on presentation of a demand and other specified documents in compliance with the terms and within the duration of the guarantee. The
15 guarantor is not a party to the underlying contract and is not concerned with its performance or non-performance. The principal is also not concerned with the contract between the guarantor and the beneficiary. Similarly, the beneficiary has no interest in the contract between the guarantor and the principal. The beneficiary's right to payment depends solely on his acting in accordance with the terms of the demand guarantee.

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However, a performance guarantee is collateral to the underlying contract. A collateral contract is one that accompanies the main contract between two parties. It is one involving either of them and a third party. It is usually a single term contract, made in consideration of the party for whose benefit the contract operates agreeing to enter into the principal or main contract. With a bipartite
25 collateral contract, both parties who enter the main contract also enter the collateral contract. A tripartite collateral contract includes a promissory statement by a third party who is not involved in the original contract. A performance guarantee is a type of tripartite collateral contract in which the bank guarantees the fulfilment of an obligation by its customer, i.e. the guarantee applicant, and assumes the obligation to pay if the guarantee applicant does not fulfil its contractual
30 obligations to the guarantee beneficiary.

In the case of a tripartite collateral contract, wherein the consideration for the collateral contract is the entering into of the main contract, terms of the collateral contract may be enforced by a third party (see *Shanklin Pier Ltd v. Detel Products Ltd* [1951] 2 KB 854). In doing so, the third party establishes a direct contractual relationship between it and the beneficiary which is an extension of its obligations to its immediate contract party. Where there is a collateral contract between one of the parties to a main contract and a third party arising from the terms of the main contract, any of the parties to the main contract has the right to sue the third party to enforce terms of the collateral contract and vice versa. This is one of the common law exceptions to the doctrine of privity of contract. Accordingly a principal may sue for the enforcement of rights created under the guarantee, despite not being a party thereto, on basis of the collateral contract exception to the doctrine of privity.

In the instant case, on basis of the nature of the 3rd respondent's claim, the applicant furnished consideration to the 3rd respondent by causing the 1st respondent to issue performance guarantee Ref. No. 5680600348 dated 19th October 2021, which performance guarantee the 3rd respondent claims to have acquired by novation, upon issuance of performance guarantee Ref. No. 5680600348 dated 28th December 2021 in its favour. The right to call on and use a performance guarantee is dictated by the terms of the underlying contract and any applicable legislative requirements. When a third party has entered into a main contract as the applicant did, it can thus file a suit to enforce the collateral contract in spite of not being a party to it.

When faced with a call on a demand performance guarantee, it is common for a contractor to either pay the sum demanded by the beneficiary to avoid a call or apply to the court for an injunction to restrain that call. This is typically done in order to safeguard the contractor's reputation in the market and cash flow in particular. A case of unfair calling arises if the beneficiary draws the demand guarantee and demands payment, although the beneficiary knows or can easily ascertain that the risk covered by the guarantee has not materialised. Therefore, as soon as a contractor learns of the danger that an unfair or fraudulent calling of the guarantee might be made by the beneficiary, the contractor must promptly take emergency measures to prevent it from being paid. Should the contractor hear that the beneficiary intends to make an unjustified call on the demand guarantee, an interlocutory injunction may be sought, either against the guarantor preventing payment, and /

or against the beneficiary, preventing the beneficiary from making a demand on the guarantor. The objection is accordingly overruled.

ii. Whether the applicant has a *prima facie* case against the respondents.

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First, a preliminary assessment must be made of the merits of the suit that has been filed against the respondents, to ensure that there is a “serious question to be tried.” One of the criteria to be applied when considering whether or not to grant a temporary injunction is disclosure by the applicant’s pleadings, of a “serious triable issue,” with a possibility of success, not necessarily one that has a probability of success (see *American Cyanamid v. Ethicon* [1975] AC 396; [1975] ALL ER 504; *Godfrey Sekitoleko and four others v. Seezi Peter Mutabazi and two others*, [2001–2005] HCB 80 and *Nsubuga and another v. Mutawe* [1974] E.A 487). There is no need to be satisfied that a permanent injunction is probable at trial; the court only needs be satisfied that the claim is not frivolous or vexatious; in other words, that there is a serious question to be tried. A serious question is thus any question that is not frivolous or vexatious. As long as the claim is not frivolous or vexatious, the requirement of a *prima facie* case is met. The Court must be satisfied that there is a serious question to be tried as to whether the respondent has a right to call on the guarantee (see *G&S Engineering Services v. MACH Energy Australia Pty Ltd* [2019] NSWSC 407).

The court no doubt must be satisfied that the claim is not frivolous or vexatious; in other words, that there is a serious question to be tried, and that there is at least a reasonable chance that the applicant will succeed at trial. The applicant needs to show only a reasonable likelihood of success on the merits. The applicant’s burden on this part of the test is relatively low, and in most cases an applicant will be able to show that there is a serious question to be tried. The applicant is required to provide reasonably available evidence to satisfy the court with a sufficient degree of certainty that the applicant is the rights-holder and that his or her rights are being infringed, or that such infringement is imminent. The applicant must show a strong probability that the feared conduct and resulting damage will occur.

The undisputed facts in this case appear to be that; - the contract underlying issuance of performance guarantee Ref. No. 5680600348 dated 19th October 2021, is a Power Purchase

agreement between the applicant and the 2nd respondent executed on 20th April 2018. On the other hand, the contract underlying issuance of performance guarantee Ref. No. 5680600348 dated 28th December, 2021 is a fuel supply agreement executed between the 2nd and 3rd respondents on 1st July, 2020. Whereas the guarantee dated 19th October 2021 was intended to secure the 1st respondent regarding the payment obligations of the applicant under the power purchase agreement, the guarantee dated 28th December, 2021 was intended to secure the 3rd respondent regarding the 2nd respondent's payment obligations for automotive gas oil (AGO) under the fuel supply agreement. It so happens that the guarantee dated 28th December, 2021 does not reference the fuel supply agreement it was intended to secure, but instead references a non-existent power purchase agreement executed between the applicant and the 3rd respondent. It is no wonder therefore than when calling on the guarantee by its letter dated 3rd October, 2022, the 3rd respondent wrote as follows;

On account of default by UETCL to effect payment as agreed in the Power Purchase Agreement, between UETCL and Electromaxx Uganda Limited (novated in favour of Maxol (U) Limited) we seek to enforce the guarantee and request for payment of the sums stated below.

Attached to that call, are four invoices for the supply of automotive gas oil (AGO) by the 3rd respondent to the 2nd respondent, dated; - 29th June, 2022 in the sum of US \$ 141,292.15; 30th July, 2022 in the sum of US \$ 407,287.38; 29th August, 2022 in the sum of US \$ 347,266.13; and 29th September, 2022 in the sum of US \$ 198,633.49. The total claim is for US \$ 1,094,479.45.

On basis of those facts, the controversy between the parties seems to rotate around the following questions, among others; whether or not there was an effective and binding novation of the performance guarantee dated 19th October 2021 to yield that dated 28th December, 2021; whether or not the performance guarantee dated 28th December, 2021 is valid and enforceable; and whether or not the 3rd respondent's call on the performance guarantee dated 28th December, 2021 is fraudulent. I find these to be serious questions to be tried. They, and other that the parties may subsequently raise at the trial, are the basis upon which the court will determine whether the 3rd respondent has a right to call on the guarantee. To obtain an interlocutory injunction an applicant must show only that its claim is not frivolous or vexatious, that is to say, it has a serious issue to be tried. The applicant has satisfied this requirement.

- iii. Whether the applicant will have an adequate remedy at law or will be irreparably harmed if the injunction does not issue.

Second, the applicant must show that it will suffer irreparable harm if the court refused to grant the injunction and the respondents were allowed to continue in their course of conduct. “Irreparable” in this context refers not to the size of the harm that would be suffered, but its nature. If the harm could not be quantified by payment of money, or if the harm is not readily calculated or estimated, this part of the test will usually be satisfied. In some cases, the availability of damages often precludes such a finding.

Irreparable damage has been defined by *Black’s Law Dictionary*, 9th Edition page 447 to mean; “damages that cannot be easily ascertained because there is no fixed pecuniary standard of measurement.” It has also been defined as “loss that cannot be compensated for with money” (see *City Council of Kampala v. Donozio Musisi Sekyaya C.A. Civil Application No. 3 of 2000*). The purpose of granting a temporary injunction is for preservation of the parties, legal rights pending litigation. The court doesn’t determine the legal rights to the property but merely preserves it in its current condition until the legal title or ownership can be established or declared. If failure to grant the injunction might compromise the applicants’ ability to assert their claimed rights, for example when intervening adverse claims by third parties are created, there is a very high likelihood of occasioning a loss that cannot be compensated for with money.

The Court may grant a temporary injunction if it is apparent that the respondent is about to embark on a course of action that would infringe an applicant’s rights. The court will particularly be inclined to grant the injunction where there appears to be a *prima facie* breach of property rights, or where the potential harm that could flow should a court order not be granted is difficult or impossible to calculate and quantify at a later stage in the suit, or where the damages when awarded may be irrecoverable (see *Itek Corp. v. First Nat. Bank of Boston*, 566 F. Supp. 1210 (D. Mass. 1983)). The fact that damages may be reasonably calculable will provide an applicant with little consolation in the event those damages ultimately prove uncollectable.

As an injunction is an equitable and discretionary remedy, it is a general rule that an injunction will not be granted where damages are an adequate remedy. Before an injunction is ordered, it must be established that an award of damages is not an adequate remedy. That type of claim can be made in exceptional cases involving breach of contract, akin to a breach of fiduciary duty, where the normal remedies are inadequate and where deterrence of others is an important factor. An injunction ought not to be granted where the respondent would be restored to the financial position it would have been in had the injunction not been granted.

In order to establish that damages are not adequate, the innocent party will generally have to evidence either that a) the subject matter of the contract is rare or unique or b) damages would be financially ineffective. Damages may be found to be an inadequate remedy in the following circumstances, among others: (a) the damage is impossible to repair; (b) the damage is not easily susceptible to be measured in economic terms; (c) the harm caused is not a financial one; (d) monetary damages are unlikely to be recovered; (e) an award of damages is inappropriate in light of the importance of the interest in issue; and (f) the harm has not yet occurred or the wrong is continuing. If there is an adequate alternative remedy, the claimant should pursue such remedy.

Examples of rare or unique subject matters might be the sale of an interest in land (as no two pieces of land are the same) or a one-off antique vase. In both scenarios, damages may not be an adequate remedy because no market substitute exists, and the innocent party would therefore be unable to secure equivalent performance (no matter what the price). Examples of circumstances where damages may be financially ineffective might be where the defaulting party is insolvent and unable to pay; if damages would be difficult to quantify (e.g. a contract to indemnify); if an order for the payment of damages would be difficult to enforce (e.g. because any enforcement would need to be in a foreign country); or if an express term of the contract restricts or limits the damages recoverable for that particular breach.

The calling up of a demand guarantee, especially if it is an unfair or fraudulent calling, often has the following severe consequences for the principal: irreparable damage to his commercial reputation; cash liquidity problems; and the risk that the cash will be misappropriated by the beneficiary and no longer recoverable. Courts have recognised on a number of occasions that calls

upon performance guarantees may cause significant damage to a contractor's reputation and financial standing that is not readily curable by an award of damages (see for example *Barclay Mowlem Construction Ltd v. Simon Engineering (Aust) Pty Ltd* (1991) 23 NSWLR 451 at 461 – 462; *Reed Construction Services Pty Ltd v. Kheng Seng (Australia) Pty Ltd* (1999) 15 BCL 158 at 167; *Lucas Stuart Pty Ltd v. Hemmes Hermitage Pty Ltd* [2010] NSWCA 283 at [45]; *Austrak Pty Ltd v. John Holland Pty Ltd* [2006] QSC 103 and *Structural Systems (Constructions) v. Hansen Yuncken Pty Ltd* [2010] FCA 1358.).

Calling of a guarantee tends to erode the confidence banks have in the contractor's systems and project management. It tarnishes the business image of a contractor, especially where such contractor has built its business on meeting its contractual obligations, meaning completing its obligations without the need for security ever being called upon. Irreparable damage will be done to its reputation as: (a) its clients may question its ability to meet its contractual obligations; (b) its prospects of future successful tenders will be diminished; and competitors will take advantage to the contractor's detriment.

The fees payable in respect of the face value of each bank guarantee and the amount of the facility which the bank is prepared to advance to the contractor is directly referable to how the bank assesses the contingent risk that the bank guarantee will be called upon. As a result of a call on a guarantee, the bank will be likely to assess the contractor's contingent liability risk as being higher. If the bank were to assess that the contingent liability of the contractor in relation to bank guarantees is higher than in previous years as a result of the respondent calling the guarantee, then those fees may increase and the limit of the facility may decrease for the contractor specifically. Furthermore, in the world of commerce, a contractor's reputation is paramount. A contractor's "security" history (in the sense of whether any of its bank guarantees have ever been cashed) is an important part of that contractor's reputation, and is taken into account by prospective clients of the contractor when considering "Expressions of Interest" or tenders. If loss is suffered, for example, through failure to obtain tenders, the assessment of damages would be a difficult and unsatisfactory process.

The calling up of a bank guarantee is a serious matter, with the potential to irreparably damage the contractor's reputation as a competent service provider, which might be taken advantage of in future projects by the contractor's competitors. It is in that context that Hunter J in *Abigroup Contractors Pty Ltd v. Peninsula Balmain Pty Ltd* 2003] HCA Trans 688 opined:

The question of commercial reputation and the effect of a demand on a large contractor, with a record to date which has been evidenced in that context, should not be underestimated and there is a strong legitimate entitlement on the part of such a contractor to protect that reputation to the hilt.

Similarly Rolfe J in *Barclay Mowlem v. Simon Engineering (Australia) Pty Ltd* (1991) 23. NSWLR 451 stated;

Once the evidence [of damage to reputation] is admitted....it demonstrates how inadequate a remedy in damages would be. The matter, so far as the plaintiff is concerned, which is detrimentally affected upon a performance bond being called up, is the perceived ability of the plaintiff to properly perform its obligations under a contract. If the plaintiff's ability in this regard is called in question, even improperly, it is not difficult to infer that there will be damage to its reputation in the industry in which it operates. Nor is it difficult to infer that its competitors would be quick to utilise such information in competing with the plaintiff. Finally, particularly as matters presently stand in the commercial world, questions may be raised as to the financial viability of the plaintiff ... This would be underlined if ... there has not previously been any call upon a performance bond. In other words people may be tempted to ask whether the plaintiff's business was "going downhill."

In the instant case though, the applicant enjoys a near *de facto* monopoly, or participants in the applicant's line of business are extremely few in number and, presumably, well aware of each other's affairs, to the extent that it is unlikely that serious businessmen would question its capacity to do business or jump to the speculations described by Rolfe J, simply because a bank guarantee has been called on. In the same vein, its reputation is most unlikely to be seriously damaged by knowledge that one of its banker's undertakings had been called on. This though does not imply that actors in the applicant's line of business may never suffer irreparable reputational damage by calls on guarantees. For example in *PRA Electrical Pty Ltd v. Perseverance Exploration Pty Ltd and another* [2007] VSC 74; 20 VR 487; [2007] VSCA 310, Court accepted that the applicant

might suffer damage to its reputation which could not be adequately recompensed by an award of damages should it turn out that the respondent wrongly demanded payment.

That notwithstanding, irreparable damage may be occasioned to the commercial reputation of the principal by an abusive enforcement of a first demand guarantee. For that reason a temporary injunction may be issued in order to prevent the abusive and imminent enforcement of a first demand guarantee, pending a decision of the main suit. The injunction will be granted in case of a *prima facie* or manifest abuse or fraud by the beneficiary, or in case of collusion of the latter with the principal. In such cases the fraud or the abuse merges with the bad faith of the beneficiary who seeks to enforce his/her guarantee while he/she/it is fully aware that the enforcement requirements are not met. While the Courts acknowledge that the beneficiary of a first demand guarantee has the right to enforce such guarantee without having to worry immediately of what the principal owes or does not owe, the beneficiary may not, on the other hand, knowingly exercise his/her/its right to enforce the guarantor's commitment with a view to receiving funds that are not due to him/her/it. As such, a request for enforcement of a guarantee must be held manifestly abusive wherever there is a *prima facie* awareness of the lack of right by the beneficiary and the knowledge of such abuse by the guarantor, are both established.

Our legal system must of necessity entail mechanisms to prevent the wrongful, fraudulent and/or otherwise unconscionable calling of bank guarantees, even on-demand bank guarantees, without compromising the independence or autonomy principle, the documents principle and the strict compliance principle underpinning their utility in commerce. The court will thus now proceed to determine whether the applicant has made out a case of an unfair or fraudulent calling of the guarantee, by considering the following sub-issues; (a) whether the applicant has made out a *prima facie* case of fraud in the documents rather than the underlying transaction; (b) whether the 3rd respondent could not honestly have believed in the validity of its demand under the guarantee; (c) whether the 1st respondent knew of the fraud at the time the 3rd respondent sought payment under the guarantee.

- a) Whether the applicant has made out a *prima facie* case of fraud in the documents presented, rather than the underlying transaction.

Three core principles underpin the International Chamber of Commerce (ICC) Uniform Rules for Demand Guarantees (URDG 758): the independence or autonomy principle, the documents principle and the strict compliance principle. By virtue of those principles, demand guarantees, standby letters of credit, and commercial letters of credit are all treated as autonomous contracts whose operation will not be interfered with by courts on grounds irrelevant to the guarantee or credit itself. Guarantors are concerned with documents, rather than with goods, services or performance of the underlying contract (see *Leonardo S.p.A v. Doha Bank Assurance Company LLC* [2019] QIC (F) 6; [2020] QIC (A) 1). Under the autonomy principle, an issuing bank must make payment under a demand guarantee on receipt of compliant documents irrespective of any dispute which may have occurred in respect of the underlying transaction.

The independence or autonomy principle, insulates the bond or guarantee from the terms in the underlying contract. This is important because the autonomous nature of the bond or guarantee means that conditions giving rise to the obligation to pay are found exclusively in the bond or guarantee. This independence principle is embodied in Article 5 (a) of the URDG 758. As discussed in by the Privy Council in *Alternative Power Solution Ltd v. Central Electricity Board* [2014] UKPC 3, there is a bias or presumption in favour of the construction which holds a performance bond to be conditioned upon documents rather than facts, but the presumption is rebuttable (see *IE Contractors v. Lloyd's Bank* [1990] 2 Lloyd's Rep. 496). However, the appropriateness of the distinction between letters of credit and demand guarantees had been doubted in a more recent English Commercial Court judgment with suggests that the intention of the URDG is that the principle of strict compliance should apply both to letters of credit incorporating UCP 600 and demand guarantees incorporating URDG (see *Teare J in Sea-Cargo Skips v. State Bank of India* [2013] EWHC 177 (Comm)).

Demand guarantee undertakings rest on two legal principles: the principle of documentary or strict compliance, and the independence principle. The first legal principle essentially means that the guarantor is obliged to pay if the documents submitted with the demand for payment comply with

the terms of the demand guarantee. The second legal principle is that the guarantor's obligations against the beneficiary are determined in the instrument itself, and are independent, or abstract, of the underlying contract between the applicant for, and the beneficiary of, the guarantee, as well as the contract of mandate between the applicant and guarantor.

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The essential characteristic of a demand guarantee is that it is independent of the underlying transaction between the applicant and the beneficiary that prompted the issuance of the guarantee. Further, a demand guarantee is also independent of the instruction relationship pursuant to the applicant having requested the guarantor to issue the guarantee in favour of the beneficiary. The conditions giving rise to the obligation to pay are found exclusively in the demand guarantee and the terms of the underlying contract are of no relevance (*see Edward Owen Engineering Ltd v. Barclays Bank International Ltd* [1978] 1 All ER 976, [1978] 1 QB 159, [1977] 3 WLR 764, [1978] 1 Lloyd's Rep 166). A direct consequence brought about by the independence principle is the "pay first, argue later" rule; the beneficiary of a demand guarantee can expect payment under the guarantee as soon as it is able to tender the documents stipulated in the demand guarantee, irrespective of any dispute arising from any of the contracts other than the demand guarantee itself.

There are of course exceptions to the strict general rule that the court will not intervene to prevent a guarantor from making payment under a demand bond or guarantee following a compliant presentation of documents; the fraud exception that is more or less universally acknowledged, and illegality exception applied in some jurisdictions. In the United States of America (see *Intraworld Industries, Inc. v. Girard Trust Bank*, 336 A.2d 316 (Pa. S.C. 1975); *Sztejn v. J. Henry Schroder Banking Corp.* - 177 Misc. 719, 31 N.Y.S.2d 631 (Sup. Ct. 1941); *Asbury Park & Ocean Grove Bank v. National City Bank of New York* 35 N.Y.S.2d 985 (N.Y. Sup. Ct. 1942) and *New York Life Insurance Co. v. Hartford National Bank & Trust Co.*, 378 A.2d 562 (Conn. S.C. 1977) at p. 567), and South Africa (see *Joint Venture between Aveng (Africa) (Pty) Ltd and Strabag International GmbH v. South African National Roads Agency Soc Ltd and Another* [2020] ZASCA 146), illegality in the underlying contract is also an exception. When the issuer of a demand guarantee knows that a document, although correct in form, is, in point of fact, false or illegal, he cannot be called upon to recognise such a document as complying with the terms of the demand guarantee. Where the documents or the underlying transaction are tainted with intentional fraud, the guarantee

need not be honoured by the bank, even though the documents conform on their face and the court may grant injunctive relief restraining such honour (see *NMC Enterprises v. Columbia Broadcasting System, Inc* 14 U.C.C. REP. SERV. 1427 (N.Y. Sup. Ct. 1974)).

5 In Australia, a contractor may restrict the beneficiary from making a call on a performance guarantee if the contractor can show that the call would be a breach of a term in the underlying contract. It is not necessary to allege any fraud on the part of the beneficiary (see *Uber Builders and Developers Pty Ltd v. MIFA Pty Ltd* [2020] VSC 596, where Nichols J re-affirmed that “where the contract does impose an obligation on the right to access the security, the party seeking to
10 restrain recourse must establish the existence of a serious question to be tried as to whether the beneficiary has in fact met the contractual requirements”).

In all the above mentioned jurisdictions, where the beneficiary’s fraud had been called to a bank’s attention, before the documents have been presented for payment, the principle of the
15 independence of the bank’s obligation under the demand guarantee should not be extended to protect an unscrupulous beneficiary. The courts aver that when the issuer of a guarantee knows that a document, although correct in form, is false or illegal, it cannot be called upon to recognise such a document as complying with the terms of the guarantee. A bank should be vitally interested in assuring itself that there is some exchange of value represented by the documents.

20 The Courts in England do not consider illegality in the underlying contract to be a valid exception to the autonomy principle of demand guarantees. They however attempted to acknowledge as the second exception in addition to that of fraud, situations where a beneficiary seeks payment in circumstances where the underlying contract clearly and expressly prevents it from doing so. The
25 Courts’ view in principle, was that if the underlying contract (in relation to which the bond has been provided by way of security) clearly and expressly prevents the beneficiary from making a demand under the bond, it can be restrained by the court.

For example in *Simon Carves Ltd v. Ensus UK Ltd* [2011] EWHC 657 (TCC), [2011] BLR 340,
30 135 Con LR 96, the underlying construction contract contained a provision stating that the performance bond shall become null and void, and returned to the contractor, immediately upon

the issue of an acceptance certificate by the employer. The employer issued an acceptance certificate prior to the expiry date of the bond and subsequently purported to make a call on the bond. The court held that the bond remained valid between the employer and the issuing bank, but as between the employer and the contractor the bond was null and void. The court, however, did not grant an injunction preventing a call on the bond per se but instead granted an injunction preventing a breach of an express term of the underlying contract which regulated the ability of the employer to call on the bond. In its passing comments the court contemplated the existence of an alternate possible ground on which a contractor might resist a call on a bond straight breach of contract.

Similarly in *Doosan Babcock Ltd v. Comercializadora de Equipos y Materiales Mabe Limitada* [2013] EWHC 3010 (TCC) the underlying construction contract contained similar provisions to those in *Simon Carves* in that the contract stated the bond was to expire on the earlier issue of a taking-over certificate by the employer or a fixed expiry date. The employer did not actually issue the taking over certificate prior to making a call on the bond. The contractor, however, sought an injunction against the employers subsequent call on the basis that the employer ought to have issued a taking-over certificate but had not done so in breach of the underlying contract, and had it done so it would have no entitlement to call on the bond. The court granted an injunction preventing the call on the bond, relying on the common law principle that a party should not profit from its own breach of contract.

The decisions in *Simon Carves* and *Doosan*, however, indicate a departure from the traditional exceptions of fraud and illegality. Commentators have much-maligned the two decisions for their perceived broadening of the circumstances in which a court may enjoin a call on a bond beyond fraud and illegality. Nevertheless, these decisions suggest that the courts may look to provisions in an underlying contract, which regulate calls on a bond related to such contract, in a way that pierces the autonomy between the parties' obligations under the contract and the issuing banks obligation under the associated bond.

The distinction between *Alternative Power Solution*, on the one hand, and *Simon Carves* and *Doosan*, on the other seems not that the former concerns a letter of credit and the latter a

performance bond, but that the latter concerned a contract which contained provisions regulating the beneficiaries call on the bonds, whereas the former did not. Moreover the contractual provisions which the courts looked to in *Simon Carves* and *Doosan* were technical in nature, essentially preventing a call on the bond where the discharge of obligations under the contract meant the security afforded to the beneficiary through the bond had, or ought to have, effectively expired.

In *Alternative Power Solution Ltd v. Central Electricity Board & Anor (Mauritius) [2014] UKPC 31*, the Privy Council found that the Mauritian Central Electricity Board was not entitled to an interlocutory injunction to prevent payment under a letter of credit, notwithstanding its allegations of fraud and the fraud exemption. In that case, Alternative Power Solutions Ltd (“APS”) entered into an agreement (the “Agreement”) following a bid process to supply 660,000 compact fluorescent lamps (“CFLs”) to the Mauritanian Central Electricity Board (“CEB”). The means of payment was by letter of credit (“LOC”) which was issued by Standard Bank (“SB”) in favour of APS. Inspection at the place of manufacture was required under the Agreement but there was no requirement for certificates of inspection or similar documentation to be presented to SB under the LOC. APS and CEB failed to come to any arrangement relating to delivery and inspection of the CFLs. With the expiry date of the LOC approaching, the Chinese manufacturers shipped the CFLs. APS tried to claim payment under the LOC. Whilst SB considered the documentation discrepant, SB made it clear that it would be prepared to pay against compliant documents. CEB sought an injunction to prevent SB releasing the payment. CEB alleged that APS’s bid mentioned that the CFLs would be manufactured by Philips or under licence by Philips in China. It further alleged that APS was throughout in breach of the tender documents because it had not allowed CEB to inspect and verify the 660,000 CFLs at the place of manufacture in China. It was also alleged that at an initial hearing one of APS’s representatives had stated that the goods would not be shipped until the inspection took place, when the goods were, in fact, in transit. The court at first instance and the Mauritian Court of Appeal both ruled in favour of CEB as they felt that there was enough evidence to engage the fraud exemption.

On appeal to the Privy Council, it held that the test for the fraud exemption cannot be quite the same as at a trial and that the test at the interlocutory stage can properly be described as whether

it is seriously arguable that, on the material available, the only realistic inference is that the beneficiary could not honestly have believed in the validity of its demands on the letter of credit and that the bank was aware of that fact. The difficulty with CEB's allegations was that they were allegations of breach of contract and thus matters for arbitration and irrelevant to the liability of SB under the LOC. In so far as the judges in the lower court relied upon them they erred in principle. In all these circumstances, the Privy Council concluded that, whatever test is applied, neither the judge nor the Court of Appeal was entitled to reach the conclusion that the fraud exception was satisfied, in the case of either APS or SB.

In Singapore, the position of the courts is similar to the position of the courts in England. Calls on on-demand Bank Guarantees can be restrained, either on the account of "fraud" or "unconscionability," which are treated as two distinct and independent grounds of restraint (see *Bocotra Construction Pte Ltd v. Attorney General (No. 2)* [1995] 2 SLR 523; *GHL Pte Ltd v. Unitrack Building Construction Pte Ltd* [1999] 4 SLR 604; *Dauphin Offshore Engineering & Trading Pte Ltd v. HRH Sheikh Sultan bin Khalifa bin Zayed Al Nahyan* [2000] SGCA 4 and *Shanghai Electric Group Co Ltd v. PT Merak Energi Indonesia* [2010] SGHC 2). In Malaysia, "unconscionability" is recognised as a separate and independent ground to issue a restraining order, which stems from the "general underlying notion....of equity's traditional jurisdiction to grant relief against unconscientious conduct namely, that a person should not be permitted to use or insist upon his legal rights to take advantage of another's special vulnerability or misadventure for the unjust enrichment of himself..." (see *Sumatec Engineering & Construction Sdn Bhd v. Malaysian Refining Company Sdn Bhd* [2012] 3 CLJ 401).

The Courts in Singapore have defined "unconscionability" as "...unfairness, as distinct from dishonesty or fraud, or conduct of a kind so reprehensible or lacking in good faith that a court of conscience would either restrain the party or refuse to assist the party. Mere breaches of contract by the party in question ... would not by themselves be unconscionable" (see *Kiso (S) Pte Ltd v. Lum Chang Building Contractors Pte Ltd* [2013] SGHC 86). A contractor applying for an injunction on the basis of "unconscionability" has to establish a "strong *prima facie* case of unconscionability," in which case the parties' conduct leading up to a call on a bond and the presence of notice are all relevant considerations (see *Tactic Engineering Pte Ltd (in liq) v. Sato*

Kogyo (S) Pte Ltd [2017] SGHC 103). The Singapore courts have allowed the exception of unconscionability to cater for situations where the conduct of the beneficiary was sufficiently reprehensible to justify an interdict in circumstances where the facts do not amount to fraud.

5 The case law canvassed here demonstrates that the principle of independence continues to be a dominant theory in demand-guarantee practice. With varying outcomes, Courts in the different jurisdictions have considered whether the application of the fraud rule should be confined to cases of forged or fraudulent documents or extend to fraud in the underlying transaction. As a general proposition, injunctions will not be granted to prevent a party from calling upon a demand bank
10 guarantee, except in cases of fraud, unconscionability, or breach of a negative stipulation in the underlying contract. It is this court's considered view that provisions in an underlying contract, which regulate calls on a bond, should only be considered with circumspection where events or conduct are of such degree such as to prick the conscience of a reasonable and sensible man. Resort to the underlying contract requires a certain and compelling case to be established; cases where
15 the demand on the guarantee can be said to be "clearly untrue or false," or "utterly without justification," or where it is apparent there is "no right to payment." Cases in which proof is furnished of the absence of any colourable or plausible basis under the underlying contract for the beneficiary to call the guarantee.

20 While the notion of fraud may elude precise definition, it is a concept well known to the law, connoting some aspect of impropriety, dishonesty or deceit. Fraud is not mistake, error in interpreting a contract; fraud is something dishonest and morally wrong, resulting in mischief or unnecessary pain. Fraud is defined as the unlawful and intentional making of a misrepresentation that causes actual prejudice or is potentially prejudicial to another. The traditional approach of
25 English courts to the calling of Bank Guarantees is to limit injunctions to situations where there is clear evidence of "fraud," which under English law can only be proven if it is demonstrated that a false representation has been made (i) knowingly; or (ii) without belief in its truth; or (iii) recklessly without caring as to whether it be true or false (see *Derry v. Peek [1889] 14 App Cas 337*). Fraud in relation to the calling of Performance Bonds has been extensively discussed in cases
30 such as *Enka Insaat Ve Sanayi v. Banca Popolare Dell'Alto Adige [2009] EWHC 2410*, which further confirms the high threshold for proving fraud under English law.

In light of the foregoing comparative analysis, given that the purpose of the fraud rule is to stop dishonest beneficiaries from abusing the demand guarantee system, this court is inclined to state that the test for fraud is met, not by showing breach or other non-compliance with the terms of the underlying contract, but when strong or compelling evidence is led to show that the documents presented to the Bank are forgeries or contain any express material misrepresentations. As in any other case, where fraud is alleged, it will not be inferred lightly and mere error, misunderstanding, non-compliance with the terms of a guarantee or oversight does not translate into fraud and will not amount to fraud. It should rise to the level of egregious conduct; meaning conspicuously, glaringly, or staggeringly or flagrantly bad, of a nature that would vitiate the very foundation of the bank guarantee. A kind of outrageous conduct which shocks the conscience of the court, such as or where the guarantee is called upon with absolutely no basis in fact. Courts will not permit a guarantee to be used for a purpose for which it was never generated. The facts of the case should depict that fraud committed by the beneficiary is of such nature that it destroys the entire underlying transaction.

In the instant case, neither the 2nd nor the 3rd respondent have adduced evidence to show that there exists a power purchase agreement between the applicant and the 3rd respondent, whether by transfer or novation, nor evidence to show that the applicant has defaulted under such agreement, yet the 3rd respondent's call is premised on the applicant's failure to pay under that alleged agreement. Furthermore, whereas the guarantee sought to be enforced is intended to cover the risk of the applicant's failure to pay for power supplied by the 2nd respondent under the Power Purchase Agreement, the invoices submitted as proof of the applicant's failure to pay relate to the supply of automotive gas oil (AGO). The applicant has therefore made out a strong *prima facie* case to the effect that the guarantee is called upon with absolutely no basis in fact.

Consequently in the guarantee itself as well as the call made on that guarantee, a false representation has been made as regards the existence of a power purchase agreement between the applicant and the 3rd respondent as well as a breach thereof. On basis of the evidence availed to court at this stage, the applicant has furnished proof of the absence of any colourable or plausible basis under the underlying Power Purchase Agreement, for the 3rd respondent to call the guarantee. Although the merits of the parties' respective cases and their relative strengths are not to be

considered at this stage, the court is of the view that a strong *prima facie* case of fraud has been established.

- b) Whether the 3rd respondent could not honestly have believed in the validity of its demand under the guarantee.

Other than in cases of illegality, a court may only step-in to enjoin a call on a guarantee in the case of fraud on the part of the beneficiary. An injunction will only be granted against a bank if there is a seriously arguable case that the person calling on it, did not honestly believe the validity of the cause (see *United Trading v. Allied Arab Bank [1981] 2 Lloyds 256, at para 257*). When determining this in interlocutory proceedings, the Courts apply a two-stage test: (a) that the beneficiary could not honestly have believed in the validity of its demand under the guarantee and (b) that the bank knew of the fraud at the time the beneficiary made the demand. It must be seriously arguable on the material available that the only realistic inference is that 3rd respondent could not honestly have believed in the validity of its demand under the guarantee.

The correct test is stated in *United Trading Corporation S.A. v. Allied Arab Bank Ltd [1985] 2 Lloyd's Rep 554*, namely; whether it is seriously arguable that, on the material available, the only realistic inference is that the beneficiary could not honestly have believed in the validity of its demands and that the bank was aware of that fact. To successfully rely on fraud, a party has to go further and show that the beneficiary made the call in bad faith, knowing it to be incorrect. If a beneficiary makes a false representation without actual knowledge that it is false, but with no honest belief in its truth, this too could constitute a fraud in terms of the fraud exception. This is because fraud connotes the absence of an honest belief in either the entitlement to claim under the guarantee or in the amount claimed.

An injunction will be granted where, for the purpose of drawing on the guarantee, the beneficiary fraudulently presents to the bank documents that contain, expressly or by implication, material representations of fact that to his knowledge are untrue (see *United City Merchants (Investments) Ltd. v. Royal Bank of Canada, [1983] 1 A.C. 168 at 183*). A material fraudulent misrepresentation occurs where the beneficiary makes a false statement or representation, knowing the representation

to be false, or without belief in its truth; or recklessly, careless whether it be true or false. The word “material” means “material to the bank’s duty to pay, so that if the document stated the truth the bank would be obliged to reject the document.

- 5 Demanding payment in the knowledge of the absence of material entitlement, constitutes fraud. There must be no honest belief in the validity of a demand for the fraud exception to apply (see *Uzinterimpex JSC v. Standard Bank plc* [2007] 2 Lloyd’s Rep 187 para 107; *Intraco Ltd v. Notis Shipping Corporation (The Bhoja Trader)* [1981] 2 Lloyd’s Rep 256 and *National Infrastructure Development Co Ltd v. Banco Santander SA* [2016] EWHC 2990 Comm para 11). The fraud must
- 10 be clearly illustrated, or it must be the only realistic inference that may be drawn from the available circumstantial evidence. Conduct whereby the beneficiary’s submission of the demand rests on statements of fact which, to its own positive knowledge, are incorrect or contain misrepresentations, may translate into fraud.
- 15 Although both the original guarantee and the “novated” guarantee make reference to a Power Purchase agreement, the available circumstantial evidence offers no explanation as to how the 3rd respondent could honestly believe that default by the 2nd respondent on its obligation to pay for automotive gas oil, would trigger the 1st respondent’s obligation to pay under a guarantee issued to ensure that the applicant pays for the consumption of power, generated by the 2nd respondent
- 20 under a Power Purchase Agreement. The evidence that was adduced to show that the 3rd respondent as beneficiary honestly believed it had a valid claim is most unsatisfactory, considering that it rejected the initial draft until the 1st respondent adopted the actual unfortunate phraseology. That the 3rd respondent claimed the applicant was in default is not in doubt, yet this was a false statement. The only party that could possibly be in default for non-payment for the automotive gas
- 25 oil was the 2nd respondent.

A demand is fraudulent if the applicant knowingly misrepresented the material facts when the demand was made. The circumstantial evidence irresistibly points to the fact that the 3rd respondent either was aware of the absence of the underlying Power Purchase agreement between itself and

30 the applicant alluded to in the guarantee, as well as the fact that the applicant had not defaulted under the Power Purchase Agreement, or else was reckless when in its call on the guarantee, it

made representations to the contrary. In either of those cases, the only realistic inference to be drawn in the circumstances is that the demand was fraudulently made. Since the 3rd respondent could not at the time honestly have believed in the validity of its demand under the guarantee.

- 5 c) Whether the 1st respondent knew of the fraud at the time the 3rd respondent sought payment under the guarantee.

It is necessary that at the time of the calling of the guarantee, the Bank should have notice of the fraud. Moreover, such fact of notice along with its evidence has to be averred in the application.

- 10 A bank should not pay where a fraud by the beneficiary of the guarantee has been sufficiently brought to its knowledge before payment or demonstrated to a court called on by the customer of the bank to issue an interlocutory injunction to restrain the bank from honouring the draft (see *Bank of Nova Scotia v. Angelica-Whitewear Ltd [1987] 1 SCR 59*).

- 15 In the instant case, the evidence supports a finding that the alleged fraud with respect to the material misrepresentations contained in both the guarantee and the call made upon it, were sufficiently established to the knowledge of the 1st respondent before payment, and also have been demonstrated to this court. In conclusion therefore, having perused the pleadings of all parties and considered their submissions at length, I find that the applicant has made out a strong *prima facie*
20 case of an unfair or fraudulent calling of the guarantee.

- iv. Balance of convenience (whether the threatened injury to the applicant outweighs the threatened harm the injunction might inflict on the respondents).

- 25 When the court is in doubt considering the outcome of its consideration of the first two factors, the third part of the test involves the court assessing which of the parties would suffer greater harm from the granting or refusal of the injunction pending trial. Unless the material available to the court at the hearing of the application for an interlocutory injunction fails to disclose that the applicant has any real prospect of succeeding in his or her claim at the trial, the court should go on
30 to consider whether the balance of convenience lies in favour of granting or refusing the interlocutory relief that is sought.

This part of the test is referred to as the “balance of convenience.” Balance of convenience means comparative mischief or inconvenience that may be caused to the either party in the event of refusal or grant of injunction. It is necessary to assess the harm to the applicant if there is no injunction, and the prejudice or harm to the respondent if an injunction is imposed. The courts examine a variety of factors, including the harm likely to be suffered by both parties from the granting or refusal of the injunction, and the current *status quo* as at the time of the injunction. The court should then take whichever course appears to carry the lower risk of injustice if it should turn out to have been “wrong.” It is thus necessary to weigh in the balance of convenience the public interest as well as the interest of the parties.

The Court has the duty to balance or weigh the scales of justice by ensuring that the suit is not rendered nugatory while at the same time ensuring that a respondent is not impeded from the pursuit of his or her contractual rights. No doubt it would be wrong to grant a temporary injunction order pending disposal of the suit where the suit is frivolous or where such order would inflict greater hardship than it would avoid. Save in the simplest cases, the decision to grant or to refuse an interlocutory injunction will cause to whichever party is unsuccessful on the application, some disadvantages which his or her ultimate success at the trial may show he or she ought to have been spared and the disadvantages may be such that the recovery of damages to which he or she would then be entitled would not be sufficient to compensate him or her fully for all of them.

The extent to which the disadvantages to each party would be incapable of being compensated in damages in the event of his or her succeeding at the trial is always a significant factor in assessing where the balance of convenience lies. The governing principle is that the court should first consider whether if the applicant were to succeed at the trial in establishing his or her right to a permanent injunction, he or she would be adequately compensated by an award of damages for the loss he or she would have sustained as a result of the respondent’s continuing to do what was sought to be enjoined between the time of the application and the time of the trial. If damages in the measure recoverable at common law would be adequate remedy and the respondent would be in a financial position to pay them, no interlocutory injunction should normally be granted, however strong the applicant’s claim appears to be at this stage.

If, on the other hand, damages would not provide an adequate remedy for the applicant in the event of his succeeding at the trial, the court should then consider whether, on the contrary hypothesis that the respondent were to succeed at the trial in establishing his right to do that which was sought to be enjoined, he would be adequately compensated by the applicant for the loss he or she would have sustained by being prevented from doing so between the time of the application and the time of the trial. If damages would be an adequate remedy and the applicant would be in a financial position to pay them, there would be no reason upon this ground to refuse an interlocutory injunction.

Even if a party is able to establish the fraud exception, it still faces an insuperable difficulty, in that it will have an adequate remedy against the bank in damages if it pays despite being on notice of fraud. By contrast, an injunction might cause greater damage to the bank than the party seeking the injunction could pay on their undertaking as to damages. In these circumstances, the balance of convenience will almost always be in favour of allowing the bank to pay. The balance of convenience will almost always militate against the grant of an injunction. The reasons for this disinclination become readily understandable when one contrasts the uncertainty in which a court finds itself with respect to the merits at the interlocutory stage, with the sometimes far-reaching albeit temporary practical consequences of an injunction, not only for the parties to the litigation but also for the public at large. However in this case, having found that the applicant has made out a strong *prima facie* case of an unfair or fraudulent calling of the guarantee, I find that the balance of convenience is in favour of the applicant.

In light of all the foregoing, the application is accordingly allowed. A temporary injunction hereby issues restraining the respondents, their agents, employees or persons claiming under them from cashing performance guarantee Ref. No. 5680600348 dated 28th December 2021 in the sum of US \$ 1,094,479, until the final disposal of High Court Civil Suit No. 0858 of 2022, or further orders of this Court. The costs of this application will abide the result of the suit.

Delivered electronically this 22nd day of December, 2022

.....Stephen Mubiru.....
Stephen Mubiru
Judge,
22nd December, 2022.