IN THE SUPREME COURT OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

In the matter of an Appeal against the Judgement of the High Court of the Western Province Holden in Colombo (exercising Civil/ Commercial jurisdiction)

Seylan Bank Limited
No. 69. Janadhipathi Mawatha,
Colombo 01.

SC/CHC/15/2012

HC (Civil) 239/2004/(1)

Plaintiff

Vs.

1. Samdo Macky Sportswear (Private) Limited,
   No. 241, Layard's Broadway,
   Colombo 14

2. Mohamed Uvais Mohamed Rushdi,
   No. 112, Horton Place,
   Colombo 07

Defendants

And Now Between

Mohamed Uvais Mohamed Rushdi,
No. 112, Horton Place,
Colombo 07.

2nd Defendant – Appellant

Vs.

Seylan Bank Limited
No. 69. Janadhipathi Mawatha,
Colombo 01.

Plaintiff - Respondent

Samdo Macky Sportswear (Private) Limited,
No. 241, Layard's Broadway,
Colombo 14.

1st Defendant – Respondent

Before: **Murdu N.B. Fernando, PC. CJ.,**
A.H.M.D. Nawaz, J. and
K.K. Wickremasinghe, J.

Counsel: Rasika Dissanayake for the 2nd Defendant-Appellant

Shanaka de Livera with Ms. Vihanga Dissanayake and Ms. Yashoda Silva for the Plaintiff-Respondent instructed by De Livera Associates.

Argued on: 03.10.2024

Decided on: 23.07.2025

Murdu N.B. Fernando, PC. CJ.,

This Appeal arises from the Judgement of the High Court of the Western Province Holden in Colombo (exercising Civil/ Commercial) jurisdiction ("the High Court") dated 04th March, 2011.

By the said judgement the High Court granted the relief prayed for by the Plaintiff-Respondent ("the Plaintiff" / "the Bank") who sued the Defendants but proceeded to trial only against the 2nd Defendant, MUM Rushdi ("the Defendant"/ "the Appellant"). The docket bears out the case was laid by against the 1st Defendant, Samdo Macky Sportswear (Private) Ltd., as a Winding Up Order had been made against such company.

The plaint dated 26th October 2004 bears out, that the Foreign Currency Unit of the Plaintiff - Bank has lent and/or advanced a Term Loan of USD 806,842.00 to the 1st Defendant Company and the 1st Defendant Company has undertaken to re-pay the Bank, on demand, the Loan together with interest, expenses and charges. However, the 1st Defendant Company failed to honour such undertaking.

Further, the plaint discloses that the 2nd Defendant promised in writing to pay the Bank on demand, the monies and to renounce all rights of sureties in law and jointly and severally be bound and liable together with the 1st Defendant Company *vide*, Guarantee Bond **P9**.

The only defense taken by the 2nd Defendant in the Answer was that there was no cause of action against him and that the Guarantee Bond has no connection whatsoever to this action.

The 2nd Defendant also pleaded, the monies referred to in the Guarantee Bond have been fully paid by the 1st Defendant Company and that the plaint was not in compliance with many provisions of the Civil Procedure Code.

At the trial, the evidence of a Senior Manager was led on behalf of the Bank who gave evidence in respect of the financial transactions between the Bank and the 1st Defendant Company, *inter-alia* the mandate **P3**, Statement of Accounts **P4** and the Loan Agreement **P5** which has been signed by the 2nd Defendant as the Managing Director of the 1st Defendant Company, and the Letter of Demand **P6**. The 2nd Defendant did not lead any evidence or mark any documents and the learned High Court Judge entered judgement in favour of the Bank.

Upon reading of the impugned judgement, it is apparent that the only objection taken at the trial by the Defendant was as to the proof of document **P7**, an affidavit said to have been tendered by the Chief Officer of the Foreign Currency Unit of the Bank referring to the total sum due from the 1st Defendant Company and the fact that the Bank lodged a claim for the said sum due from the debtor, 1st Defendant Company, with the Liquidator, in the Winding Up application.

The learned High Court Judge has considered the totality of the evidence, the failure of the Defendant to challenge the evidence led on behalf of the Bank and on a balance of probability, categorically held that the Bank has satisfactorily proved that a cause of action has arisen for the Bank, in respect of the Term Loan, outstanding as at 30-06-2004 in a sum of USD 781,842.00 against the 1st Defendant Company. The learned Judge also held that the said sum of money has not been reimbursed to the Bank by either the 1st or the 2nd Defendants.

Furthermore, the learned Judge held that the 2nd Defendant, is personally liable, upon the Guarantee Bond **P9,** for such sum, as the Guarantee Bond executed on 25-08-1999 is for a continuing guarantee.

The learned Judge in his judgement highlighted that the Guarantee Bond specifically includes a condition that the guarantee is not only relevant to monies

borrowed at the time of execution of the Guarantee Bond, but also includes money to be borrowed thereafter.

Moreover, the learned Judge held that the Defendant failed to show that the guarantee was terminated and based on the fact that the Defendant could not disprove the claim of the Bank and / or establish the relevant monies had been paid, came to the conclusion that the 2nd Defendant being the Surety, is liable for the payment of the monies claimed.

The Appeal Before the Supreme Court.

When this Appeal was initially heard before the Supreme Court on 25-09-2015, the parties agreed that the hearing would be limited to two questions of law.

Thereafter, when this Appeal was re-heard before this Bench, the said position was re-iterated and the parties agreed to hear and determine this Appeal on the following two questions of law;

(1) Whether the Plaintiff Bank is entitled to maintain the action against the 2nd Defendant in the Commercial High Court, after submitting its claim to the Liquidator appointed by the Commercial High Court in the Winding Up Application, D.C. Colombo 158/CO?

(2) Whether the Plaintiff Bank is entitled to claim the money referred in the plaint, based on the Guarantee Bond **P9** at the trial?

Winding-Up Application

The learned Counsel for the Appellant's principal contention before this Court in respect of the first questions of law was that since the Bank has gone before the Winding Up Court, that the Bank has ample opportunity to recover whatever is due to the Bank from the winding up application.

Further, it was contended, if the Bank had not proceeded with that application and/or it had deliberately neglected and/or abandoned such course of action, it must now be considered that the Bank has waived off its claim and therefore, the impugned judgment is erroneous and cannot stand.

Responding to the aforesaid submissions of the Appellant, the learned Counsel for the Bank contended, in view of the provisions of the Section 262(2) of the Companies Act No. 17 of 1982 (which was the relevant law at the time the winding up application of the 1st Defendant Company was lodged) when a Winding Up Order is made, the date of winding up reverts back to the date of filing of the petition for winding up. In this instance,

the petition for winding up of the 1st Defendant Company was dated 20.10.2004, six days prior to the date of the plaint and therefore at the time of filing of the plaint, the Bank was unaware of the petition of winding up of the 1st Defendant Company.

Further, it was contended that the Rules of winding-up published under the old Companies Ordinance (which are the Rules followed even at present) specifically denotes the timelines the public notifications are published and until then, the public are unaware that a winding up application had been filed and therefore contended, that the 1st Defendant Company was in existence when the plaint was filed. Further the learned Counsel for the Bank contended, no evidence has been led by the 2nd Defendant to contradict such position and when the time is right, steps will be taken to resurrect the case against the 1st Defendant Company and/or to proceed against the Liquidator if need be, and such course of action will have no effect on the claim against the 2nd Defendant, the Managing Director of the 1st Defendant Company, who signed the Guarantee Bond as a personal guarantee.

The learned Counsel for the Bank further submitted, that presently the matter in issue is the claim against the Guarantor and Clause 19 of the Guarantee Bond expressly states, that if monies secured by the Guarantee Bond are not recoverable from the principle debtor due to any reason, including the operation of the law, that the monies can be recovered from the Guarantor and such process can be proceeded against the Guarantor in the first instance, and therefore moved that the 1st question of law be answered in favour of the Bank.

I have considered the submissions of the learned Counsel for the Bank with regard to maintainability of this application, in the light of lodging an application before the Liquidator. I have also considered the provisions of the Companies Act then and now, Rules published under the old Companies Ordinance and I see merit in the submissions of the Bank, that the Plaintiff Bank is entitled to maintain this action, even if the Bank went before the winding up court. In the said circumstances, I answer the 1st question of law in the affirmative.

Can the Bank claim on the Guarantee Bond?

The learned Counsel for the Appellant relied upon the judgement of **Hatton National Bank Limited v Rumeco Industries Ltd SC/APP/99A/2009, S.C.M. 08.06.2011** where the Hatton National Bank relied on a continuing guarantee, which contention was not accepted by court and there by dismissed the case against such party. Drawing a parallel, the Counsel emphasised that the Appellant herein, is not the borrower, but only a third party. The Counsel also submitted that the Guarantee Bond has been executed prior to the loan agreement and therefore it has no nexus with the loan agreement signed between the Bank and the 1st Defendant Borrower, at a later point of time.

The Appellant further put forward the contention that the Respondent Bank cannot claim on the Guarantee Bond since in the instant case too, as in **Rumeco Case,** the cause of action was based on a facility granted in 2003 and the guarantee bond was executed in the year 1999.

Responding to same, the learned Counsel for the Bank argued, that the said **Rumeco case** can be distinguished from the Appeal before this Court.

Hence, I wish to advert to the facts of the **Rumeco case**.

In the said case, the Hatton National Bank granted a term loan to the 1st defendant Rumeco Ltd., in 1995. This term loan was secured by the 1st defendant company and the 2nd defendant, by two mortgage bonds executed in the year 1987 and 1993. Upon the company, failing to re-pay the loan, the bank sued the 1st, 2nd and the 3rd defendants. The 1st defendant and the 2nd defendant failed to present themselves before court and trial proceeded ex-parte against the said 1st and 2nd defendants and judgement was obtained.

However, the evidence presented by the bank against the 3rd defendant, was on a different basis, *viz,* re-scheduling of a loan originally given to the 1st defendant in 1992 and guaranteed by the 3rd defendant also in 1992. Upon non-payment of this loan the facility was re-scheduled in 1995. That is the facility that was secured by the 1st and 2nd defendants. Non honouring of the said facility was the cause of action pleaded by the bank against the 1st, 2nd and 3rd defendants. The reference to the 1992 facility was not pleaded in the plaint. The guarantee given by the 3rd defendants in 1992 and the re-scheduling of the facility was not a part of the pleadings. The trial judge dismissed the case against the 3rd defendant holding that the transaction sued was the term loan granted in 1995 and not the facility given in 1992 and therefore there was no guarantee given by the 3rd Respondent nor the guarantee given in 1992 can be considered a continuing guarantee. The trial Judges findings were upheld by the High Court referring also to the principle of novation of contract.

From the aforesaid, I see merit in the contention of the Counsel for the Respondent Bank, that **Rumeco case** can be distinguished from the facts of the Appeal before this Court. Furthermore, there is no dispute that a novation discharges the original obligation and the obligations accessory to it. In my view the facts of the instant Appeal do not fall within the realm of 'novation' and on such ground too, **Rumeco case** can be distinguished.

Legal submissions

In the case of **Union Bank of Colombo Ltd. v Emm Chem Pvt Ltd. SC/App/CHC 22/2011, 07.03.2019** the contention of the appellant was that the guarantee bonds cannot be enforced for future and antecedent debts. This Court referring to **Paget's Law of Banking** 12th Ed, and having considered the dicta in the aforesaid **Hatton National Bank**

Ltd v Rumeco case laid to rest the uncertainties relating to continuing guarantees and novation and observed that courts must consider the factual background known to the parties at or before the date of contract and ascertain the objective of the transaction, when interpreting the guarantee bond. Having referred to the facts of the said case, the court further observed that "it would be difficult to believe that, in the circumstances where there had been default and delay in paying the monies that were due, the plaintiff bank would have even considered making the re-structured banking facilities available without security of the existing bank guarantee. All these factors cumulatively indicate that there was only one continuing loan for which a guarantee bond was signed."

I have considered the aforesaid two judgments, **Hatton National Bank Ltd v Rumeco** and **Union Bank v Emm Chem Pvt Ltd.,** and am of the view that when examining a guarantee bond, it cannot be looked at in isolation. It has to be considered in the circumstances under which the guarantee bond was executed. What was it that was guaranteed? Who are the guarantors? What is their connection to the principal debtor? Is it a family relationship or persons who have beneficial interest in the company or with the principal debtor? How many facilities are being guaranteed, initial facility, new loans, re-scheduling of existing loans, or giving extra time for payment?

Thus, I see merit in the submissions of the learned Counsel for the Bank. Nevertheless, I wish to consider the legal regime pertaining to guarantees.

Paget on Law of Banking 15th Ed., page 547 with regard to commercial banks states as follows:

> "In particular, they preserve the guarantor's liability in the event of the bank giving time or any indulgence to the principal debtor."

In the instant case, admittedly the 1st Defendant Company obtained a number of facilities from the Seylan Bank for many years as the principal debtor. Packing credit and term loans were some of the facilities obtained by the 1st Defendant Company. In order to secure the said facilities, the Managing Director of the 1st Defendant Company *i.e.,* the 2nd Defendant in the year 1999, provided the Bank with an assurance by way of a Guarantee, that he will fulfill the obligations, in the event the principal debtor, the 1st Defendant Company fails to meet its commitments.

The plaint in this case indicates that in the year 2003, the 1st Defendant Company entered into a written agreement **P5** with the Bank as the borrower to obtain a facility in foreign currency. The 1st Defendant Company received the facility, but failed and neglected to honour the commitment to re-pay the facility obtained consequent to the **P5** written agreement.

In view of the failure of the 1st Defendant Company to re-pay and make good the sums borrowed, the bank demanded from the 1st and 2nd Defendants the said sum. The plaint specifically states, that by the Guarantee Bond **P9**, since the 2nd Defendant has renounced all rights of sureties in law, especially the right *Beneficium Ordinis,* and agreed to jointly and severally be bound and be liable for all monies due, the instant case was filed against the 2nd Defendant too, as both the 1st and 2nd Defendants had failed to honour their commitments.

I am of the view, that such course of action is permitted and is in accordance with the law governing financial instruments.

Whilst I do not wish to undertake a legal recourse on the difference between different financial instruments, I wish to refer to **Paget on Law of Banking** 15th Ed, at page 988 wherein the difference between guarantees and demand guarantees is considered.

It's as follows:

> "The essential difference between guarantee in the strict sense (i.e., a contract of suretyship) and a demand guarantee is that the liability of a surety is secondary, whereas the liability of the issuer of a demand guarantee is primary and triggered by demand. A surety's liability is co-extensive with that of the principal debtor and, if default by the principal debtor is disputed by the surety, it must be proved by the creditor. Neither proposition applies to a demand guarantee."
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> "**The principle which underlies demand guarantee is that each contract is autonomous**. It particular, the obligations of the guarantor are not affected by disputes under the underlying contract between the beneficiary and the principal. **If the beneficiary makes an honest demand, it matters not whether as between himself and the principal he is entitled to payment**."
>
> "The guarantor must honour the demand, the principal must reimburse the guarantor (or counter-guarantor) and any disputes between the principal and the beneficiary, including any claim by the principal that the drawing was a breach of contract between them, must be resolved in separate proceeding to which the bank will not be a party." (emphasis added)

Therefore, the English Law clearly lays down that a demand made on a Guarantee Bond which is commonly called demand guarantee is an autonomous contract. It's not a part of the underlying contract. Thus, there is no doubt that a cause of action, can be raised on the demand guarantee.

Ref: **Edward Owen Engineering Ltd v Barclays Bank International Ltd [1978] 1 Q.B.159; Standard Bank London Ltd v Canara Bank [2002] EWHC 1032 (Comm)**.

In order to sue or litigate on a guarantee, the most essential factor is that a demand should be made. That too, in the first instance. When a demand is made and it is not honoured only, a cause of action accrues for a creditor to sue the debtor and where necessary the guarantor.

Ref: **Sivasubramanium v Alagamuttu 53 NLR 150; Seylan Bank Limited v Intertrade Garments Private Limited (2005) 1 SLR 80; Merchant Bank of Sri Lanka v Budhadasa and another 2002 BALR 64** and **L.B. Finance Ltd. v Manchanayake (2000) 2 SLR 142.**

If I may apply the above principles to the present case, the Guarantee Bond **P9** (which was for USD One Million) in Clause 1 (vii) defines 'monies' to include monies which may now and which shall from time to time become due, and remain unpaid to the Bank and also any advances, overdraft or any transaction whatsoever. As per Clause 3, the guarantee is a continuing security. Clause 4 refers to a termination of guarantee.

In the instant case, while no evidence was led by the Appellant that the continuing guarantee has been cancelled and / or discharged as per Clause 4 of the Guarantee Bond the contention of the Bank before this Court was that the most important feature of the Guarantee Bond **P9,** was that the Appellant, being a Director and Managing Director of the 1st Defendant Company had guaranteed the re-payment of sums overdue, and interest thereon upon a cafeteria of facilities given by the Bank, to the 1st Defendant Company, subject however, to a limit *viz.,* USD One Million being the sum guaranteed.

Having examined the Clauses of the Guarantee Bond, I see merit in the contention of the Bank, that the Guarantee Bond **P9** is a continuing security and covers loans, facilities and all borrowings made by the 1st Defendant Company. It will not get discharged upon one such facility of the cafeteria of facilities and / or a loan being re-paid.

I also observe that the Appellant, who is the Guarantor, has failed to lead any evidence to establish that the guarantee lapsed prior to signing of the Loan Agreement **P5** and / or that the Guarantor, being the Managing Director of the 1st Defendant Company was completely unaware of the Loan Agreement executed in the year 2003. The Loan Agreement is the underlying contract upon which the Bank has sued the 1st Defendant Company. Though it would have been desirable to have referred to the Guarantee Bond

when the facility **P5** was granted in the year 2003, non- reference in my view, does not necessarily mean that the security or the guarantee is not applicable.

I reiterate that the principle that underlies a demand guarantee is that each contract is autonomous. Thus, when a demand is made on the guarantee and if the guarantor has failed to honour such demand, a cause of action arises. Even if a guarantor fails to acknowledge or fails to respond, a cause of action arises. These contentions are based on the principle that in business matters if a party receiving a letter disputes certain assertions contained in it, he must reply henceforth and failure to do so, amounts to an admission of the claim made therein.

Ref: **Saravanamuttu v R.A. De Mel 49 NLR 529; The Colombo Electric Tramways and Lighting Co. Ltd v Pereira 25 NLR 193** and **Seneviratne and another v Lanka Orix Leasing Company Ltd. (2006) 1 SLR 230**

Based upon the aforeatsted principles, the failure of the Appellant, in the present case, to respond to the Letter of Demand, in my view, heightens the liability of the Appellant, with regard to the sum claimed.

Coming back to the autonomous nature of a demand guarantee, which is the crux of this case, it is evident that the rationale for honouring of a guarantee is paramount. It is an irrevocable obligation assumed by the guarantor. The reason for these principles to be embedded in our law is because the demand guarantees are the lifeblood of international trade and commerce. Such obligations are regarded as collateral to the underlying rights and obligations, free from interference by courts. The courts will intervene, in these relationships only in the case of a clear fraud.

Ref: **R.D. Harbottle (Mercantile) Ltd v National Westminster Bank Ltd and others [1976] QB 146** and **Bolivinter Oil SA v Chase Manhattan Bank and others (1984) 1 All ER 351.**

The aforesaid jurisprudence has been accepted and embedded in our law. The judgements referred to below clearly recognises the propositions referred to above.

Ref: **Lagan International Limited v Janashakthi Insurance Company Limited SC/CHC/ Appeal 52/ 2007- S.C.M. 25-02-2025; Lanka Milk Foods (CWE) Limited v Seylan Bank Limited SC/CHC/ 16/2007, S.C.M. 19-03-2025**

Moreover, in the instant case in Clause 18 and 19 of the Guarantee Bond **P9** parties *i.e.,* the Bank and the Appellant, have agreed upon the Bank's right and liberty to proceed against the guarantor in the first instance, since the guarantor has enunciated all privileges which were encapsulated in the legal maxim *Beneficium Ordinis*. Such right of the Bank to proceed against a particular party first, is accepted by consent and is referred to as the 'absolute discretion of the Bank' in the said clauses.

From the aforesaid factors it is evident, that in the instant case, the Guarantee Bond **P9** is a continuing guarantee and is in force until it is terminated or discharged. This guarantee covers all facilities given to a debtor, whether it is given before or after granting of a facility or at the time of the execution of the facility. The guarantee will not lose its validity or extinguish its rights, because the underlying contract is re-adjusted or re-formulated or re-scheduled.

In the said circumstances, I answer the 2nd question of law, as to whether the Plaintiff Bank is entitled to claim the money referred to in the plaint based on the Guarantee Bond, also in the affirmative.

Conclusion

I have already answered the 1st question of law, pertaining to the maintainability of this case specifically, in view of the Bank referring the claim to the Liquidator in the Winding Up application, in the affirmative and now I have answered the 2nd question of law also in the affirmative.

Based on the aforesaid, and for reasons adumbrated in this judgement, I see no reason to interfere with the impugned judgement.

Thus, I uphold and affirm the judgement of the High Court exercising Civil and Commercial jurisdiction in Colombo dated 04th March, 2011.

Accordingly, the Appeal of the 2nd Defendant - Appellant is dismissed with costs fixed at Rs. 250,000.00.

Appeal is dismissed.

Chief Justice

A.H.M.D. Nawaz, J.
I agree

Judge of the Supreme Court

K.K. Wickremasinghe, J.
I agree

Judge of the Supreme Court