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

The Attorney General,
Attorney General's Department,
Colombo 12.
PLAINTIFF

C.A. L.A. Case No.50/2007

D.C. Colombo Case No.37551/MR

-Vs-

Sri Lanka Insurance Corporation Ltd.,
No.21, Vauxhall Street,
Colombo 02.
DEFENDANT

AND NOW BETWEEN

Sri Lanka Insurance Corporation Ltd.,
No.21, Vauxhall Street,
Colombo 02.
DEFENDANT-PETITIONER

-Vs-

The Attorney General,
Attorney General's Department,
Colombo 12.
PLAINTIFF-RESPONDENT

BEFORE	:	A.H.M.D. Nawaz, J.
COUNSEL	:	Sagara Kariyawasam instructed by D. Perera for the Defendant-Petitioner Vikum de Abrew, DSG with Nayomi Kahawita, SC for the Plaintiff-Respondent
Decided on	:	02.08.2019

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

Performance bonds, sometimes called bank guarantees, are typically issued by a financial institution at the request of a party to a contract. These bonds are often issued pursuant to an obligation contained in a construction contract. They take the form of a promise by the issuing institution that it will pay to the beneficiary named in the bond, an amount up to the limit set out in the bond *unconditionally* or *on specified conditions* and without reference to the terms of the contract between the parties.

Such a performance bond figures in the case and the bond was issued by the Insurance Corporation of Sri Lanka ("Sri Lanka Insurance Corporation" or "the Defendant-Petitioner" or "the Defendant-Petitioner Corporation" as it is hereinafter sometimes referred to) with a promise to pay the beneficiary *Project Director, Southern Province Rural Development Project* in the event of a default in the performance of a construction contract by the *Iddamalgoda* Commercial Company. So the underlying construction contract was between the *Project Director, Southern Province Rural Development Project* and the *Iddamalgoda* Commercial Company. The performance bond was issued to compensate the *Project Director, Southern Province Rural Development Project* in the event of a default in the performance of the contract by the *Iddamalgoda* Commercial Company. There was indeed a default alleged in the performance of the construction contract by the *Iddamalgoda* Commercial Company and the Honorable Attorney-General (the Plaintiff-Respondent) sued the Insurance Corporation of Sri Lanka (the issuer of the performance bond or the Defendant-Respondent) on behalf of the *Project Director, Southern Province Rural Development Project* (the beneficiary of the monies due under the performance bond). The performance bond as it styles itself in the document limits the liability of the issuer of the bond-Sri Lanka Insurance Corporation to a sum of Rs. 216, 457.05.

There had been two demands made on the bond prior to the institution of the suit in the District Court and the question that arose as a preliminary issue before the District Court of Colombo was whether the action was prescribed as the Defendant-Petitioner claimed that the action was filed 6 years after the demand had been made. The Defendant-Petitioner Sri Lanka Insurance Corporation traversed in its answer that it is section 6 of the Prescription Ordinance that would apply and as such the plaint was prescribed on the face of it.

It is this preliminary issue that was gone into under Section 146 of the Civil Procedure Code and the primary issue to be determined by this Court would then be which provision of the Prescription Ordinance would apply as the learned Deputy Solicitor General has now contended before this Court that it is Section 10 of the Prescription Ordinance that would apply in this instance. I would begin with the order made by the learned Additional District Judge of Colombo on the preliminary issue.

By the order dated 8^{th} February 2007, the learned Additional District Judge of Colombo held *inter alia* that:-

a) The applicable period of prescription was 6 years.

b) The Plaintiff had demanded payment on 16^{th} December 1996 and 06^{th} August 1997.

c) The Plaintiff filed action within 6 years of sending the demand.

Thus, the learned Additional District Judge held that the applicable period of prescription was 6 years but came to the conclusion that the plaint had been filed within 6 years of the demand, even though the 1^{st} demand marked **P3** had been made on 16^{th} December 1996 and there had been a lapse of more than 6 years since the 1^{st} demand before the action came to be filed. In fact it is quite clear upon a perusal of the plaint that the action had been filed

06 years, 08 months and 6 days after the 1st demand dated 16th December 1996. The plaint filed by the Attorney-General representing the *Project Director, Southern Province Rural Development Project*, is dated 28th August 2003.

Thus, as is evident from the order of the learned Additional District Judge, despite it being as plain as the pikestaff that the action had been filed 06 years, 08 months and 6 days after the 1st demand for payment, the learned Additional District Judge held that the action had been filed within 06 years of the demand. Thus his final conclusion does not follow the basis on which he decided the applicable law for prescription namely section 6 of the Prescription Ordinance.

I must say that the learned Additional District Judge had accepted the fact that the applicable period of prescription in respect of the performance bond was 6 years in terms of Section 6 of the Prescription Ordinance and if that was the legal position, it was argued by the learned Counsel for the Defendant- Petitioner (Sri Lanka Insurance Corporation) that the cause of action was clearly prescribed having regard to the fact that the action was filed 06 years, 08 months and 6 days after the 1st demand dated 16th December 1996.

Is the prescriptive period for the performance bond 10 years as the learned Deputy Solicitor General argued or is it 6 years as the learned counsel for the Sri Lanka Insurance Corporation (the issuer of the performance bond) contended?

Before I resolve this question, let me focus on the nature and ambit of the instrument in contention namely the performance bond as the title of the document calls itself.

Performance Bonds-Unconditional or Conditional

As Ellinger's Modern Banking Law authored by Peter Ellinger, Eva Lomnicka and Christopher Hare (5th Edition,) declares at p 904,

> "...*Sometimes the term guarantee is used within the banking industry even though it is not a guarantee in the sense of being predicated upon the default of another party. A common form of security is an unconditional 'performance guarantee'-more properly described as a performance bond-given by a bank in favour of a beneficiary to secure the obligations under a contract, often*

to be performed overseas. Examples include a bond given to an owner to secure the performance of the contractor pursuant to a building contract or given to a vendor of goods to secure payment of the purchase price by the buyer. The usual ***unconditional performance bond*** *makes it clear that the bank is liable to pay simply upon a demand being made by the beneficiary, as in a bond which states "the bank unconditionally undertakes and covenants to pay on demand any sum or sums which may from time to time be demanded".*

So the beneficiary in an unconditional performance guarantee or bond is entitled to demand the sums without proving any default by the other party to the underlying transaction and the bank must pay unless it knows the claim is fraudulent-see ***Edward Owen Engineering Ltd v Barclays Bank International Limited*** (1978) 1 QB 159; ***Turkiye Is Bankasi AS v Bank of China*** (1996) 2 Lloyd's Rep 611 and, on appeal, (1998) 1 Lloyd's Rep.250.

Two types of performance bonds

Thus one could see that a performance bond may be issued with or without conditions attached. When a performance bond is made payable without any conditions attached, a simple demand by a beneficiary is sufficient to bring on the obligation of the bank or financial institution issuing the bond to make the payment under the bond. When a valid call for payment is made by a beneficiary, a bank or financial institution like an insurance corporation which issues the bond comes under an immediate liability to make payment under the bond. There is no necessity to prove default on the part of the party to the underlying transaction. This is the essence of an unconditional performance guarantee or bond or an on-demand bank guarantee as it is called in its varied appellations.

A performance bond may also be issued with conditions attached. When conditions are attached to the payment of a performance bond, it becomes a conditional performance bond. Under a conditional performance bond or guarantee, proof of default is required which means that there will have to be an extensive investigation of the facts and possibly a lengthy trial before payment will be ordered. Whatever the description of the bond issuer's undertaking, the terminology used is not conclusive and whether a performance bond is payable on demand (an unconditional performance bond or an independent bank guarantee or an on-demand bank guarantee) or it is payable upon proof of default as a conditional bank guarantee it is an interpretation of the substance of the obligation undertaken rather than form. In ***American Home Assurance Company v Hong Lam Marine Pte Ltd*** (1999 3 SLR 682), the Singapore Court of Appeal stated:

> *"the term 'performance bond' or 'performance guarantee' is sometimes used to denote a genuine contract of guarantee and indemnity. To make matters even more confusing, a guarantee or indemnity may be given in circumstances in which one might expect to find a true performance bond. The nature of the particular contract, whether it happens to be a guarantee or an indemnity, or a performance bond and whether the normal incidents of a contract of that class have been modified, is ultimately a question of construction in each case, and is often very difficult to resolve..."*

For an English case for distinguishing between true demand and suretyship guarantees see ***Wuhan Guoyu Logistics Group Co Ltd v Emporiki Bank of Greece*** (Court of Appeal) (2013) EWCA Civ 1679.

So the question arises how this Court would characterize the performance bond in question before this court. The nomenclature used in the document itself namely "performance bond" is not determinative of the question whether it is an unconditional performance guarantee (or an on-demand bank guarantee), which requires the service of a demand on the issuer or it is just a conditional bank guarantee that requires the proof of default on the part of the contractor, *Iddamalgoda* Commercial Company.

In order to ascertain the true nature of the bond it is the substance of the performance bond that has to be looked at and moreover there are other indicia one has to bear in mind in the process of looking at the substance of the contract. In my view the real issue of a performance bond is one of commercial interpretation and it raises the question of examining the intent of the document.

The context in which the parties entered into the contract would also go to prove the intent of the parties and this can be gathered from the pleadings, accompanying documents and issues at the trial. So before looking at the substance of the performance bond, let me examine the pleadings, accompanying documents and issues in order to understand the commercial context in which the performance bond was issued.

An examination of the plaint filed by the Attorney-General on behalf of the beneficiary of the bond and the issues raised in the District Court nowhere show any assertion that the bond in question is a conditional bank guarantee so that the Plaintiff would lead evidence and prove default on the part of the building contractor i.e *Iddamlagoda* Commercial Company. The issues raised on behalf of the Plaintiff do not show that the Plaintiff was suing on a traditional bank guarantee i.e a conditional bank guarantee. In a conditional bank guarantee the liability of the guarantor is secondary. A guarantor is liable to pay the creditor only if the principal debtor is liable in the first instance and has defaulted on his obligations. The main obligation is comprehensively covenanted into the underlying contract marked as **P1** wherein the contractor -*Iddamalgoda* Commercial Company has promised to pay the employer the *Project Director, Southern Province Rural Development* Project by way of liquidated damages a sum of Rs 1082 for each and every day if the contractor fails to complete the work by the agreed date or extended date by the Employer.

In other words the plaint does not refer to any attempt to demand damages from the contractor who is the principal debtor. No letter of demand was ever sent to *Iddamalgoda* Commercial Company the contractor on the basis of primary liability-a requirement that has to be followed in the case of a conditional guarantee or traditional guarantee. Instead the Plaintiff acted as if the Sri Lanka Insurance Corporation was primarily liable for the breach of the contractor and accordingly demanded payment by calls made on 16.12.1996 and 06.08.1997. Even the demand made on 16.12.1996 sets out the breach committed by the contractor and demands payment of Rs 216457.03 **forthwith**.

If a beneficiary demands immediate payment from the issuer, the conduct is consistent with that of a person in possession of an unconditional or on-demand performance bond, because it is only under an unconditional performance bond that the payment obligation is triggered by a demand.

The above indicates that the Plaintiff came into court armed with an on-demand performance bond. The assurance of that instrument is that it is independent of the underlying obligation and requires no proof of default in the performance of the primary obligation namely the construction undertaken by the *Iddamalgoda* Commercial Company.

Upon a perusal of the answer filed by the issuer of the bond -Sri Lanka Insurance Corporation and the preliminary issues based on its defence of extinctive prescription, it is clear that Sri Lanka Insurance Corporation had issued an unconditional performance guarantee. The answer pleaded that the action was prescribed because it had been instituted after 6 years from the demand. This is a recognition by the issuer that its payment obligation is triggered by a demand. The answer does not aver that the damages claimed in the plaint have to be established as arising out of a breach of the underlying contract.

This recognition of an on-demand guarantee also emerges from the preliminary issues.

Implied recognition that the performance bond is payable on demand

Issue No 12 that was tried as a preliminary issue and the written submissions filed thereon impliedly recognize that the prescriptive period must be computed from the date of the demand. The preliminary issues No 11 and 12 which were raised by the Defendant-Petitioner Corporation (the issuer of the performance bond) went as follows:

11. *Does the plaint confirm to the imperative provisions of the Civil Procedure Code and in particular Sections 40, 44, 46 and 50?*

12. *Is the Plaintiff's action prescribed on the face of the plaint?*

As the written submission filed by the Defendant-Respondent Sri Lanka Insurance Corporation on Issue No 12 demonstrates, it had based its prescriptive plea on the 6 year period prescribed in Section 6 of the Prescription Ordinance and the period had been computed from the date of the 1st demand namely 16.12.1996. Implicit in this issue and its explanation in the written submission is the admission that the Sri Lanka Insurance Corporation had issued an on-demand performance bond or an unconditional performance bond.

Thus I would make the observation that it was the case of both parties in the District Court that the performance bond in question was payable on demand. The Plaintiff was attempting to enforce an immediate payment obligation without recourse to the underlying contract, whilst the Defendant was resisting the action on the basis that the action had become *passe* because the 6th year period had elapsed from the date of the 1st demand.

Even the Plaintiff-Respondent in their written submissions filed on 29th May 2009 admits that the prescriptive period has to be calculated from the date of the demand. The only inference I reach upon these facts which are quite apparent on the face of the pleadings, documents and issues is that both parties-the Plaintiff-Respondent and the Defendant-Petitioner intended demand to be a term of the performance bond though I hasten to point out that the performance bond does not contain the usual words-"payable on demand".

Implication of the term "On Demand" into the performance bond

Even if the words "on demand" are absent from the performance bond in question, one can imply terms into a commercial contract and in the decision of the Australian High Court in ***Byrne v Australian Airlines Ltd*** (1995) 185 CLR 410, it was laid down that when the question of implication of terms arises, the question is whether the implication of the particular terms is necessary for the reasonable or effective operation of the contract in the circumstances of the case; only where this can be seen to be true will the term be implied-for a similar approach towards implying "on demand calls" into the banker-customer relationship- see the English Court of Appeal decision of ***Joachimson v Swiss Bank Corporation*** (1921) 3 K.B. 110 where it was established that no cause of action arises against a bank in respect of money standing in current account until the customer demands payment by the bank. *Joachimson*'s case is to the effect that the parties can "intend to make the demand a term of the contract. Atkin L.J posed the question-"did the parties in fact intend to make the demand a term of the contract? ......in seeking to ascertain their intention the nature of the contract may be material."

So it boils down to this question. Did the parties intend the performance bond to predicate payment upon demand?

Upon a perusal of the pleadings, documents and issues raised in the case, I have held that they did so. The intention remains to be looked at from the substance of the bond too.

When I look at some clauses in the performance bond in question it becomes crystal clear that for the sake of commercial efficacy of their relationship the parties intended the performance bond to be payable upon demand.

Renunciation of benefits and privileges belonging to guarantors

The performance bond clearly shows that the surety (the Sri Lanka Insurance Corporation) has renounced the well-known privileges accorded to sureties, namely *beneficium ordinis divisionis et excussionis* (*sic*) by which a surety is entitled to claim that, as his liability is of an accessory character, it shall not be enforced against him until the creditor has unsuccessfully endeavored to obtain satisfaction from the principal debtor; the *beneficium divisionis* provides for the apportionment of liability among the co-sureties.

In the Roman-Dutch Law (as in English Law), there are several well-established privileges and defenses afforded to guarantors when sued by the creditor. A guarantor in Sri Lanka is entitled to the following defenses or privileges if he has not expressly renounced them.

1) *Beneficium ordinis seu excussionis*-the benefit of excussion

This benefit or privilege is known as benefit of excussion or discussion which is quite aptly described as "*beneficium ordinis seu excussionis*". This was introduced by Justinian, by a Novel- *see Roman Private Law founded on the Institutes of Gaius and Justinian* (1906) by Richard William Leage at page 285. The word "*ordinis*" in the term "*beneficium ordinis seu excussionis*" relates to the order in which the creditor may pursue his remedies, first against the principal debtor and thereafter against the surety. In other words, it is the right of the surety against the creditor to have him proceed first against the principal debtor with a view to obtaining payment from him, if necessary by execution upon his assets, before turning to the surety for payment of the debt or of so much of it as remains unpaid. In other words, the creditor is to excuss the assets of the debtor before turning to the surety is expressed in the word "*excussionis*" which sometimes appears as "*discussionis*"-*see* the incisive discussion by Ralph Slovenko "**Suretyship**" (1965) 39 Tulane Law Review 427 at 447: *also see* **Caney's the Law of Suretyship** (5th Edition 2002 by Christopher Forsyth & JT Pretorius) at 119.

If I may relate this privilege to the case at bar, the guarantor (Sri Lanka Insurance Company) is entitled to ask the creditor (*the Project Director, Southern Province Rural Development Project*) to first proceed against the principal debtor (*Iddamalgoda* Commercial Company in this case) and to claim the debt from the guarantor only if the creditor is unable to recover it from the principal debtor; *see*-***Gurusin Appu v. Carlina Hamine*** (1897) 2 N.L.R 307.

This benefit has been renounced by the Sri Lanka Insurance Corporation in this case.

2) ***Beneficium Divisionis*-the benefit of division**

As between the sureties themselves a rescript by Hadrian introduced the *beneficium divisionis*, which enabled one of several sureties when sued for the whole debt to demand that the claim should be divided between himself and the other solvent sureties. In other words this benefit requires the creditor to divide his claim among all the solvent sureties, so that each is liable for his share only.

It would appear that both these two benefits or privileges have been waived or abandoned by the surety Sri Lanka Insurance Corporation. Any renouncement of rights and privileges has to be intentional, unambiguous and clear. The Courts have held that the renunciation of a guarantor's rights must be express. The renunciation must be deliberate and with a full knowledge of the rights he is renouncing. A general renunciation is valid only if the guarantor himself is a lawyer or if he declares in writing that he had a full knowledge of the rights he is renouncing: see *Amerasinghe v Perera* (1934) 35 N.L.R 306.

If one peruses the performance bond in question, I find that the Insurance Corporation of Sri Lanka has renounced these two privileges as the following paragraph of the performance bond clearly shows.

> *"We the surety hereby renouncing the beneficium ordinis divisionis at excussionis the meaning, force and effect of renouncing which have been explained to us by our Proctor and with which we hereby declare that we are now fully acquainted and all other benefits, privileges and advantages to which sureties as such are by law entitled......" (sic).*

Since there are no co-sureties, one cannot understand as to how waiver of *beneficium divisionis* will have a role in this case but it is quite clear that the *beneficium ordinis* (or *excussionis* or *discussionis*) has been waived by the Sri Lanka Insurance Corporation. In other words the Sri Lanka Insurance Corporation binds itself as a co-principal debtor *in solidum*. In *solidum* would mean "in the whole", *i.e.*, the whole amount of the debt.

The effect of renunciation-Sri Lanka Insurance Corporation becomes a principal debtor-the performance bond becomes an indemnity.

Once these Roman-Dutch Law and English Law privileges are waived, the guarantor is virtually a principal debtor. He assumes primary liability and the guarantee becomes an indemnity. A suit against the indemnifier (Sri Lanka Insurance Corporation) alone is properly constituted, because the Sri Lanka Insurance Corporation has become the principal debtor.

The adoption of this approach leads almost ineluctably to the conclusion that once the performance bond is also an indemnity, the Plaintiff does not have to prove default with reference to the underlying contract but can proceed to sue the indemnifier (Sri Lanka Insurance Corporation) on the promise to compensate embodied in the performance bond.

The renunciation also reiterates the independence or autonomy of the payment obligation contained in the performance bond and so the above construction I arrive at points unerringly to the on-demand guarantee or indemnity that the performance bond in question is all about.

Having identified the nature of the assurance document in question let me now turn to quintessential question for resolution. It is payable on demand. The prescriptive period would run from the date of the demand. Is the period 10 years according to section 5 or 6 years according to section 6 of the Prescription Ordinance?

Synopsis of Ordinance

A. **Section 5** - No action shall be maintainable

- *a)* for the recovery of any sum due upon any hypothecation or mortgage of any property; *or*
- *b)* upon any bond conditioned for
  - *i.* the payment of money
  - *ii.* the performance of any agreement or trust or
  - *iii.* the payment of penalty

unless the same be commenced

- *a)* in the case of an instrument payable at or providing for the performance of its condition within a definite time, within ten years *of the expiration of such time* and
- *b)* in all other cases
  - *i.* within ten years *from the date of such instrument or mortgage or hypothecation*; *or*
  - *ii.* *of last payment of interest* thereon; *or*
  - *iii.* *of the breach of the condition.*

B. **Section 6** - No action shall be maintainable

- *i.* upon any deed for establishing a partnership; *or*
- *ii.* upon any promissory note or bill of exchange; *or*
- *iii.* *a)* upon any written promise, contract, bargain, or agreement, *or*
  b) other written security not falling within the description of instruments set forth in section 5

unless such action shall be brought

a) within six years *from the date of the breach* of such partnership deed or of such written promise, contract, bargain or agreement, or other written security, *or*

b) *from the date when such note or bill shall gave become due; or*

iv. *of the last payment of interest* thereon the performance of any agreement or trust or

v. the payment of penalty

The learned Deputy Solicitor General placed reliance on the words "upon any bond conditioned for the payment of money" in Section 5 of the Prescription Ordinance and characterized the performance bond as a species under section 5 and therefore his contention was that the prescriptive period was 10 years.

His argument was that the assurance document was an instrument conditioned to pay money. That raises the question of nature of the indemnity that the performance bond has become in the end.

In *Tissera vs. Tissera* (1896) 2 N.L.R. 238, Bonser C.J. discussing the meaning of "bond conditioned for the payment of money," found in section 6 (now section 5), said, "In English law bond means a deed poll, whereby the obligor binds himself to pay money or do some act....It seems to me that the attestation of an instrument by a notary may be regarded as a solemn act equivalent to the formality of the affixing of their seals by the parties to an English deed. So that in this Island a deed may be defined as a writing attested by a notary, and a bond as the acknowledgment of or promise to pay a debt in an instrument attested by a notary...."The expression conditioned for the payment of money" means, in my opinion, a bond debt in an instrument is given for the securing the payment of money."

For Bonser C.J the essentials of notarial attestation and the existence of a bond debt are ingredients of Section 5 of the Prescription Ordinance.

The performance bond under consideration is not one that is notarially attested nor it is an instrument that evidences debt. The fact that hypothecation or mortgage of any property is found in the section followed by a bond conditioned to pay money is a pointer to the interpretation placed by Bonser C.J because in mortgages and hypothecation that are mentioned first there is a debt bond because a mortgage is executed in order to secure the payment of a loan. Notarial attestation is mandated for a mortgage whilst it is not a legal requirement that a guarantee or an indemnity need be notarially attested. So on the strength of interpretation in *Tissera vs. Tissera* (supra), a performance bond or a guarantee or indemnity cannot fall within Section 5 as the substantial requirement of notarial attestation is a must for mortgages whilst it is not so for a performance bond or a guarantee or indemnity under the laws of Sri Lanka. It is noteworthy that whilst a guarantee has to be in writing, an indemnity does not even necessitate such a requirement.

On the lines of *Tissera v Tissera* (supra) in ***Suppramaniapillai v Kalikutty*** 11 N.L.R 71 at 72 the Supreme Court stated

> *As regards section 6 (now Section 5) of Ordinance No 22 of 1871, it seems to me to contemplate only such instruments as are usually embodied in the external formality and solemnity of a deed under English Law. In our system of legal procedure the nearest approach to a deed in point of solemnity is a notarially executed document. Bonser C.J in Tissera v Tissera said that in this island a deed might be defined as a writing attested by a notary, and a bond as an acknowledgment of or promise to pay a debt in an instrument attested by a notary.*
>
> *I think, therefore, that if a document purports to be stamped as an agreement executed notarially, and contains a condition for the payment of money on the non-fulfilment of its agreed terms, that it may well be deemed to be a bond within the meaning of section 6 (now section 5)........"*

Later in ***Suthukkumah v Vachchravagee*** 12 N.L.R 289, the Supreme Court held that an agreement was not a 'bond' within the meaning of section 5 of the Prescription Ordinance since it had not been notarially attested and that the lack of notarial attestation made the document a written agreement within the provisions of section 6 of the Prescription Ordinance.

It would thus appear that only a mortgage bond hypothecating property or a notarially attested document would fall within the provisions of section 5 of the Prescription Ordinance attracting a prescriptive period of 10 years.

But in ***Seman vs. Silva*** (1915) 18 N.L.R. 397, Ennis J. (with De Sampayo J. agreeing) expressed a different view and said, "In my opinion the lease under which rent is claimed is not a "bond conditioned for the payment of money and that it falls under section 7, and not section 6 of the Ordinance No. 22 of 1871".

This case holds that though a lease is notarially attested, it is not a bond conditioned upon payment of money.

It was held in this case that a notarial lease is a written contract or agreement within the meaning of section 7 (now section 6) of the Ordinance No. 22 of 1871, and the period of limitation in regard to an action for the recovery of rent due thereon is six years.
In the above case, De Sampayo J. said:

> *The word "bond" is used in Ordinance No. 22 of 1871 exactly in same sense as in the earlier enactments, and an instrument should be construed as a bond or not according to its substance and real characteristics, and not according to its form of execution.*

Sampayo J made a very pertinent observation.

> *"Whatever a bond may be, I am quite sure that a lease is not a bond. Its **main purpose** is not to secure the payment of money, but to vest the right of possession of a land for a certain period in the lessee. A lease also usually contains many subsidiary covenants, and simply because one of these covenants relates to the payment of rent, the instrument is not thereby constituted a bond. If the rent is paid wholly in advance there will be no such covenant in the lease at all, and in such a case there will be no shadow of reasons for calling it a bond. A lease belongs to the specific class of contracts which the civil law calls **locatio conductio**, and in no way partakes of the nature of a bond."*

It follows that a bond conditioned for the payment of money clearly means an instrument by which one person binds himself to another for the purpose of securing the payment of money. Whether the document is notarially attested or not, the main purpose or substance of the performance bond should be the payment of money. Then only it would qualify under the term "bond" under section 5 of the Prescription Ordinance.

Then the all important question arises-what is the substance of a performance bond? Is it to pay only money?

On the nature and scope of a performance bond, *Schmitthoff's Export Trade: The Law and Practice of International Trade* (11th Edition, 2007) states thus at p 620.

> "*.....It is usual for the contractor to provide a performance guarantee which is issued by a bank, insurance company or other third party. The guarantee is intended to safeguard the employer against the failure of the contractor to perform his obligations under the contract....*"

Though one of the subsidiary terms of a performance guarantee is to pay money, the main purpose or substantial object of the performance guarantee is to ensure the performance of the contractual obligation..i.e the construction undertaken in this instance.

So the performance bond in question is not a bond conditioned upon payment of money alone as stipulated in section 5 of the Prescription Ordinance. In fact the employer in a construction contract finds himself with two options. He can sue the contractor on the underlying contract or call in the guarantee. If he has called in the guarantee and the amount has exceeded the true loss, the provider of the bond is entitled to recover the overpayment-see ***Cargill International SA v Bangladesh Sugar & Food Industries Corporation*** (1996) 2 Lloyd's Rep 424.

All this leads to the conclusion that the performance guarantee/indemnity stands on a different footing from a mortgage bond or a bond conditioned upon payment of money and I hold that section 5 of the Prescription Ordinance is inapplicable to the computation of the limitation period of a demand guarantee or indemnity.

Section 6 of the Prescription Ordinance

No action shall be maintainable

iv. upon any deed for establishing a partnership; *or*

v. upon any promissory note or bill of exchange; *or*

vi. *a)* upon any written promise, contract, bargain, or agreement, *or* *b)* other written security not falling within the description of instruments set forth in section 5

unless such action shall be brought

c) within six years *from the date of the breach* of such partnership deed or of such written promise, contract, bargain or agreement, or other written security, *or*

d) *from the date when such note or bill shall gave become due; or*

vi. *of the last payment of interest* thereon the performance of any agreement or trust or

vii. the payment of penalty.

Some species of instruments that are mentioned in section 6 of the Prescription Ordinance share identical features. For instance the promissory note or bill of exchange referred to in section 6 is payable on demand unless a usance bill (a time bill) has been issued. In other words these instruments can be converted into ready cash and performance guarantees/indemnities partake of similar characteristics. They amount to ready cash. It is for this reason that Lord Denning MR described demand guarantees and on-demand performance bonds as '..........virtually promissory notes payable on demand'-See ***Edward Owen Engineering Ltd v Barclays International Limited*** (1978) QB 159 at 170; see also ***Cargill International SA v Bangladesh Sugar & Food Industries Corp*** (1996) 2 All ER 563 at 568, per Morison J (upheld by CA (1998) 1 W.L.R 461).

The performance bond would also fall within the general description 'any written promise, contract, bargain or agreement" or "other written security not falling within the description of instruments set forth in section 5."

The fact that guarantees are distinct and different from mortgages is brought out by the case of ***Hatton National Bank v Sellers Sports (Pvt) Ltd*** (2000) 3 Sri.LR 326 wherein the Supreme Court (per Sarath N. Silva C.J, Perera J and Weerasekera J) held:

".....as regards the guarantee of the 2nd to 5th defendants, the applicable section is section 6 of the Prescription Ordinance which relates to amounts due on a written promise or other written

security and the period of prescription is 6 years. That period should be computed not from the date of the default on the principal obligation, but from the date on which the payment upon the guarantee became due namely, 10 days after demand in writing was made, as stated in Clause 2 of the agreement. The demand for payment was made on 26.04.1996, and the breach took place upon the failure to make payment 10 days after the demand......."

The Supreme Court placed the mortgage bond-the other written security in the case within section 5 of the Prescription Ordinance. The Supreme Court stated thus:

"......The action was filed to enforce the obligation created by the mortgage bond. The applicable section would be Section 5 of the Prescription Ordinance which relates to instances where the action is for the recovery of any sum due upon any mortgage of property or upon any bond conditioned for the payment of money...."

Thus the on-demand performance bond in this case falls fair and square under section 6 of the Prescription Ordinance and the prescriptive period of 6 years would begin to run from the date of the 1st demand namely 16th December 1996. The plaint filed on 26th August 2003, long after the 6th year period had elapsed, was prescribed on the face of it and the plaint did not show any ground claiming exemption from the operation of prescription-see ***Boteju v Rajanathan*** (1986) 1 Colombo Appellate Reports 385 which stated that compliance with section 44 of the Civil Procedure Code is mandatory. In the circumstances since this is an action which is *ex facie* prescribed, the plaint should have been dismissed-see ***Soysa v Soysa*** 17 N.L.R 118.

But the learned Additional District Judge's finding that the Plaintiff-Respondent had filed this action within 6 years is erroneous and should be set aside.

Before I part with the judgment let me also advert to another argument that the learned Deputy Solicitor General has taken up in his written submissions though this was not raised in the course of oral submissions.

Rules of limitation have no application to State

Section 15 of the Prescription Ordinance is invoked to advance this argument. At the very outset I must say that this argument is inherently inconsistent with the argument that section 5 of the Prescription Ordinance applies to the performance bond in question. Let me *though* appraise the applicability of section 15.

Section 15 makes reference to prescription against the State thus:

> *"Nothing herein contained shall in any way affect the rights of the state, or shall be taken to apply to any proceedings in any action for divorce, or to any case in which special provision has been or may hereafter be made for regulating and determining the period within which actions may be commenced against any public officer or other person..."*

This is expressed in the Latin tag *Nullum tempus occurrit regi* or *Nullum tempus occurrit reipublicae-no time runs against the state.* According to Black's Law Dictionary (Tenth Edition, 2014), the purpose of the rule is to fully protect public rights and property from injury. Subsequently Nullum Tempus Act or the Crown Suit Act of 1769 (amended in 1862) was passed and it enacted that the rights of the Crown in regard to lands and rents should be barred after a lapse of 60 years. In terms of this Act, 60 years of adverse possession against the Crown was sufficient to pass title to an adverse possessor. This statute then altered the common law rule of *Nullum tempus aut locus occurrit regi* ("no time or place affects the Crown"), which was based on the idea that the Crown was too busy with governmental affairs to timely attend to its legal affairs. Nullum Tempus Act was repealed in 1939.

We are dealing with a case of extinctive prescription set up against the State similarly but in a case of a commercial contract which the agent of the State, *Project Director, Southern Province Rural Development Project* concluded with a contractor and the Sri Lanka Insurance Corporation issued an on-demand indemnity-another commercial undertaking to ensure the performance of the construction contract. When the Insurance Corporation issued the performance bond in favor of the state functionary, it was indeed a commercial transaction and the Project Director was acting as an agent of the state as if a private citizen would for his principal.

Christopher Gregory Weeramantry-the celebrated jurist and Vice President of the International Court of Justice in his well known tome *The Law of Contracts* (Vol-II S 914- page 868) sets out the position under the Roman Dutch law as follows:

> *"Under the Roman Dutch Law as well, the Crown would not be entitled to claim immunity from the rules relating to prescription. Under that system, although prescription did not as a general rule run against the Crown, it did run against the Crown where debts were due to it as though it were a private individual so that if the right the Crown was seeking to enforce was an ordinary right of property or an ordinary obligation, prescription could be pleaded against it- Wessels, s 2778.*
>
> *This principle did not thus apply in regard to a claim by the Crown relating to its "inalienable rights', this principle being thus limited only to rights capable of alienation."*

So prescription could be pleaded against the state if a debt is due to it out of an obligation flowing from an indemnity. This debt arising out of the performance bond is certainly transferable and shared by the state in its ventures. The proceeds of the performance bond do not necessarily go into the exchequer of the central government and though the Attorney General would recover it on behalf of the Project Director, it cannot be argued that it becomes an inalienable property of the state.

The observations of Wessels (supra at para 2777 and 2778) on this issue is complemented by Voet. A person cannot allege that he is exempted from paying a yearly tax because he has not paid this particular tax for thirty years, but when sued for an overdue tax, Voet holds that he can reply that the debt due by him to the Crown by virtue of the overdue tax is prescribed in the form in which the action is brought.

If a right which the Government seeks to enforce is not an inalienable right of the Crown, but an ordinary right of property or an obligation; then it is bound by a Prescription Act or statute of limitations.

One is at once reminded of *Attorney-General v Wilson and Another* (1997) 2 Sri LR 349 wherein Ameer Ismail J held that rights applicable to the state can be classified as alienable rights and inalienable rights and further went on to recapitulate the passages I have quoted above from Dr. Weeramantry. Ismail J's holding on damages by the State being prescribed in three years having regard to the obsolete South African Act No 18 of 1943 is not directly in issue in this case and this Court is only concerned whether the immunity contained in Section 15 of the Prescription Ordinance would avail the state when it has engaged in a commercial transaction as if it were a private citizen.

I am fortified by Wessels and the English jurisprudence to hold that section 15 cannot be invoked by the state in what would be called commercial contracts entered into by the state or its agents. International Law makes a distinction between *jure imperii* (public acts of the sovereign) and *jure gestionis* (private acts of the sovereign). If the purpose of the governmental act is to achieve an act of sovereignty, there is immunity. If the purpose of the transaction is non-sovereign, there is no immunity. Once again this test looks to the nature of the act-is it of a nature which is essentially a commercial transaction? -for an insightful discussion of the distinction between *jure imperii* and *jure gestionis* see the Supreme Court decision of ***British High Commission v Ricardo Wilhelm Michael Jansen*** (S.C. Appeal No. 99/2012, SC Minutes of 10/07/2014).

The case of ***Trendtex Trading Corporation v Bank of Nigeria*** (1977) QB 529 gave effect to the long emerging doctrine of restrictive immunity accorded to states and its organs. In ***Trendtex Trading Corporation***, Lord Denning M.R stated-

> *"If a government department goes into the market places of the world and buys boots or cement, as a commercial transaction that government department should be subject to all the rules of the market place. The seller is not concerned with the purpose to which the purchaser intends to put the goods."*

In ***Trendtex Trading Corporation*** the Court held that in deciding whether it was *jure imperii* or *jure gestionis*, it was enough if the transaction itself was of a commercial type- such as a contract for the supply of goods or services. In the *Trendtex* case the court was concerned primarily with the intrinsic nature of the arrangement entered into by the Central Bank. On finding that the transaction was essentially 'commercial', the Bank had not immunity, even if it could be regarded as performing functions and charged with the purposes of an organ of the state. The conclusion that Lord Denning reached in ***Trendtex*** was followed in the House of Lords in ***I Congreso del Partido*** (1983) AC 244. Likewise in *Central Bank of Yemen v Cardinal Finance Investments Corp* (2000) EWCA Civ 266, a promissory note was enforceable between the parties as a commercial transaction even though concluded by a state's central bank.

On the strength of these cases, one can observe that much water has flowed under the bridge as far as prescription against state is concerned and section 15 of the Prescription Ordinance cannot have the overbroad ambit as contended by the learned Deputy Solicitor General.

In the end as I said before, the prescriptive plea set up by the Defendant-Petitioner succeeds and I would accordingly set aside the order made by the learned Additional District Judge on 8th February 2007 and allow both the leave to appeal application and appeal. The action filed by the Plaintiff-Respondent is therefore dismissed *nunc pro tunc*.

JUDGE OF THE COURT OF APPEAL