IN THE SUPREME COURT OF PAKISTAN
(Appellate Jurisdiction)

PRESENT:
MR. JUSTICE UMAR ATA BANDIAL
MR. JUSTICE SYED MANSOOR ALI SHAH
MR. JUSTICE MUNIB AKHTAR

CIVIL PETITION NO.607 OF 2021
(On appeal from the judgment dated 12.11.2020 passed by the Islamabad High Court, Islamabad in R.F.A. No.196 of 2015.)

EFU General Insurance Limited ... Petitioner

vs

Zhongxing Telecom Pakistan (Private) Limited (ZTE) and others ... Respondents

For the Petitioner : Mr. Munawar-us-Salam, ASC

For Respondent No.1 : Mr. Mir Afzal Malik, ASC

Date of Hearing : 08.06.2021

ORDER

Munib Akhtar, J.: At the conclusion of the hearing, this matter was disposed of in terms of the following short order:

> "For reasons to be recorded later, this petition is converted into appeal and allowed and the suit filed by respondent No. 1 is dismissed."
>
> Those reasons are given below.

2. The respondent No. 1 (herein after the "contesting respondent") is a company engaged in the telecoms business. On or about 23.10.2007, it entered into a contract with the respondent No. 2 for the latter to erect civil works and telecom installations, on a turnkey basis, for a project owned by the former. The contract contemplated an advance payment to be made by the contesting respondent and required, as security, for the respondent No. 2 to

provide an advance payment guarantee. That guarantee was provided by the petitioner. The guarantee was issued on or about 08.11.2007 and its terms, as relevant for present purposes, provided as follows (emphasis supplied):

> "In consideration of your M/s. Zhongxing Telecom Pakistan (Pvt.) Limited (hereinafter referred to as "The Contractor") agreeing to make Advance Payment of Rs.19,286,257/- (Rupees Nineteen Million Two Hundred Eighty Six Thousand Three Hundred Fifty Seven only) to M/s. Techcorp Holding (Pvt.) Limited, a company incorporated in Pakistan with its registered office at 12-A, St. No.29, F-7/1, Islamabad (hereinafter referred to as the "Sub-Contractor") against the P.O. No.ZTE/CMPAK/GSM-Phase-1/PO/Tk SERVICES/ THL/001.
>
> We, M/s EFU General Insurance Limited, 23-Shahrah-e-Quaid-E-Azam, Lahore (an insurance company incorporated under Companies Ordinance 1984) hereby undertake to pay Rs.19,286,357/- (Rupees Nineteen Million Two Hundred Eighty Six Thousand Three Hundred Fifty Seven Only) to you immediately *on receipt of your first written demand starting that the Sub-Contractor has breached the above mentioned contract with you*."

3. The guarantee was initially valid up to 22.12.2007 and was thereafter extended from time to time, till 22.10.2008. On 06.10.2008, the contesting respondent wrote to the petitioner. The letter bore the subject heading "EXTENSION OF GUARANTEE" and provided as follows:

> "It is brought to your notice that below mentioned guarantee issued, by EFU General Insurance Ltd. on behalf of M/s Tech Corp Holding (Pvt.) Ltd. against PO # ZTE CMPAK/GSM Phase-1/PO/TK SERVICES/THL/001 is expiring as mentioned below. You are advised to extend the validity of this guarantee for further one quarter.

Guarantee No.	Amount	Issue Date	Expiry Date
71705228/11/2007	19,286,357/-	08-11-2007	22-10-2008

> In case the party for which guarantee has been issued do not agree for further extension of guarantee, this letter may be treated as notice for encashment of guarantee."

4. In the event, the guarantee was not extended. On or about 25.02.2010 the contesting respondent served what was termed to

be the final notice regarding encashment of the guarantee. In this the letter of 06.10.2008 was stated to have been a demand for encashment. Thereafter, a last and final notice was issued on 20.04.2010. The claim remaining unattended, the contesting respondent filed suit in the civil courts at Islamabad for recovery of the amount payable under the guarantee. The suit was resisted by the petitioner. After trial, the learned civil court was pleased, on 10.09.2015, to decree the suit as prayed. The petitioner appealed to the learned High Court which, vide the impugned judgment dated 12.11.2020, dismissed the same. Hence, this leave petition.

5. Before us, the principal ground urged by learned counsel for the petitioner was that the guarantee was in the nature of a demand guarantee and the law in relation to such instruments was well established. It was submitted that it was of the essence that a demand under any such guarantee comply with the terms of the same, and if it did not the issuer (here the petitioner) had no liability to the beneficiary (here the contesting respondent). Drawing attention to the terms of the guarantee and the letter of 06.10.2008 (i.e., the stated demand), learned counsel submitted that there complete non-compliance with what was required under the former. Therefore the petitioner had rightly refused payment and the learned courts below had erred materially in coming to the contrary conclusion. It was prayed accordingly. Learned counsel for the contesting respondent on the other hand submitted that the courts below had reached the correct conclusion both on the law and the facts, and prayed that the leave petition be dismissed.

6. After having heard learned counsel and considered the record, we were of the view that the petitioner ought to succeed in

terms of the short order already set out. It is clear that the guarantee in question was in the nature of a demand guarantee. The law relating to performance bonds and demand guarantees, and the conceptual framework regarding the same, especially as to the enforcement (or otherwise) of such instruments, in now well settled in common law jurisdictions. In our country one of the leading decisions is of this Court, reported as *Shipyard K. Damen International v Karachi Shipyard and Engineering Works Ltd.* PLD 2003 SC 191, 2003 CLD 1 ("*Karachi Shipyard*"). It is a leave refusing order of a learned three member Bench. Reference was made therein to a large number of authorities, including English and Indian cases, and many were considered in detail. The principles deducible were set out in para 7 (pp. 201-3), with which (subject to what is stated below) we are in agreement. For convenience, the relevant portions are given below (emphasis supplied; we may note that the case involved a reference to arbitration):

> "7. After having gone through the precedent[] law as mentioned hereinabove the judicial consensus seems to be as follows:--
>
> (i) *The performance of guarantee stands on the footing similar to an irrevocable letter of credit of Bank, which gives performance guarantee must honour that guarantee according to its terms*. It is not concerned in the least with the relations between 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 all demand if so stipulated without proof or conditions. Only exception is when there is a clear fraud of which Bank has notice.
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> (ii) There is an absolute obligation upon the banker to comply with the terms and conditions as enumerated in the guarantee and to pay the amount stipulated therein irrespective of any disputes there may be between buyer and seller as to whether goods are up to contract or not.
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> (iii) The bank guarantee should be enforced on its own terms and realization against the bank guarantee would not affect or prejudice the case of contractor, if ultimately the dispute

> is referred to arbitration for the reason, once the terms and conditions of the guarantee were fulfilled, the bank's liability under the guarantee was absolute and it was wholly independent of the dispute proposed to be raised.
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> (iv) *The contract of bank guarantee is an independent contract between the bank and the party concerned and is to be worked out independently of the dispute arising out of the work agreement between the parties concerned to such work agreement* and, therefore, the extent of the dispute and claims or counter-claims were matters extraneous to the consideration of the question of enforcement of the bank and were to be investigated by the arbitrator.
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> ...
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> (vi) The Bank guarantee is an autonomous contract and imposes an absolute obligation on the bank to fulfil the terms and the payment on the bank guarantee becomes due on the happening of a contingency on the occurrence of which the guarantee becomes enforceable.
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> ...
>
> (viii) In the absence of any special equities and the absence of any clear fraud, the bank must pay on demand, if so stipulated and whether the terms are such must be have to found out from the performance guarantee as such...."

7. It will be seen that demand guarantees are regarded as being in nature similar to letters of credit, and the guarantee constitutes an autonomous contract between the issuer and the beneficiary. Now, one aspect of the law relating to letters of credit is the rule of strict compliance. The documents presented by the beneficiary to the issuing (or, if such be the case, confirming) bank must comply strictly with the terms thereof. If so, the bank is (subject to exceptions and conditions not presently relevant) bound to pay. If not, the bank is bound to refuse payment. Now, the key document (indeed, in most instances the only document) in respect of a demand guarantee/performance bond is the demand itself. Does the rule of strict compliance apply in relation thereto? A leading treatise (*The Modern Contract of Guarantee* by O'Donovan and Phillips, 3rd English ed. (2016)) gives the following answer (para 13-021; internal citations omitted):

> "There has been some difference of opinion as to the standard of compliance required for a beneficiary to satisfy the conditions for a demand specified in the bond. It seems that a standard of literal compliance will often be applied; that is, whatever is done or provided by the beneficiary should exactly match the requirements of the bond. But this may be tempered to substantial compliance where the circumstances or construction of the bond so indicate. The generally stringent standard can be justified by the nature of the bond, namely, that the obligor does not enquire into the merits of any underlying dispute but merely pays in response to a conforming demand. Although it is often assumed that literal compliance favours the obligor, it may favour the beneficiary."

An interesting case, considered in the cited treatise, is *Franz Maas (UK) Ltd. v Habib Bank AG Zurich* [2001] Lloyd's Rep. Bank 14, [2001] CLC 89. The demand guarantee obligated the issuing bank to make payment to the beneficiary on the latter's first demand "in writing stating therein that the Principals have failed to pay you under their contractual obligation". The demand actually made by the beneficiary, dated 14.12.1998, stated that the principals had "failed to meet their contractual obligations to us". The question whether this complied with the requirements of the guarantee was answered in the negative. The Court held that the rule of strict compliance did not apply in the case, but concluded that on a true construction of the guarantee the difference in wording, though ostensibly very minor, made it non-compliant. It was held as follows:

> "62. The statement in the demand of 14 December 1998 does not in terms allege a 'failure to pay' but a 'failure to meet contractual obligations'. Without there being any question of resorting to the doctrine of strict compliance, it seems to me that a failure to 'meet a contractual obligation' is far from being the same as 'failure to pay under a contractual obligation'. In effect, the former concept is wide enough to cover any claim for damages for unliquidated or unascertained sums arising from any breach of the WTA [i.e., the principal agreement], which would seem to me to widen the scope of the guarantee far beyond that which the parties intended. In my view the natural scope of the guarantee is limited to the failure to pay the liquidated and ascertained sums falling due under the WTA from time to time."

This decision amply demonstrates the importance of how closely the demand actually made must track the requirements of the bond/guarantee in order to be compliant with the same.

8. In our view, the correct approach to be adopted in this jurisdiction is for the Court to initially proceed on the basis that strict compliance is required. If this test is not met it is then for the party claiming otherwise to show that the test of substantial compliance should be applied in the facts and circumstances of the case, while keeping in mind the actual text of the bond/guarantee. However, it should be kept in mind that the threshold required for the party to succeed on such a submission is a high one and is not to be lightly or easily accepted by the Court. There must be clear justification (which must be recorded in appropriate reasoning) for the Court to so hold, i.e., to uphold the claim notwithstanding that the rule of strict compliance has not been met.

9. When the facts of the present case are considered in light of the above, it is clear that the demand purportedly made by the contesting respondent fell far short of what was required. It is obviously not in strict compliance with the terms of the guarantee since that required a categorical statement in the demand that the respondent No. 2 had breached the contract. Such statement was entirely missing. Nothing was shown as would justify the application of the rule of substantial compliance, but even there the case of contesting respondent would have failed. This is for the reason that the purported demand did not remotely come near, let alone cross, the threshold required for such compliance. The letter was in substance nothing but a request for further extension in the validity period. The guarantee, as noted, had been extended many

times before and it seems that all that the contesting respondent was really looking for was another such period. The statement at the end ("this letter may be treated as notice for encashment of guarantee") was essentially an afterthought, designed to cover the contesting respondent's position if the extension was not granted. The purported demand was not in accordance with what the law required. Therefore, the petitioner had no obligation to pay and could not be held liable to the contesting respondent. The learned High Court, with respect, erred materially in coming to the contrary conclusion.

10. Before concluding, something must be said of the decision in *Karachi Shipyard*. It is now almost two decades old. In certain respects, the law relating to performance bonds and performance guarantees has moved on. It may therefore be that some of the observations made and points touched upon in the cited decision require a revisit or at least to be updated. For example, para 7 recognizes fraud as a well established ground for refusing to make (or the Court restraining) payment on a bond/guarantee. Clause (viii) makes passing reference to "special equities" as an additional ground that may also be so available. In one common law jurisdiction, Singapore, unconscionability is now a well established ground for the Court intervening to restrain payment (see O'Donovan and Phillips, *op. cit.*, para 13-049 and the cases gathered at f.n. 153). It may be that this is a ground which comes within the rubric of "special equities". However, whether it does or not and if so should be made subject to any conditions or modifications such as are appropriate for our jurisdiction, remains yet to be seen. This and other developments in the law are to be determined in future cases. While *Karachi Shipyard* is clearly an

important milestone in this area of the law, the High Courts should not consider themselves as limited only to what may be regarded as falling strictly within the four corners of the decision. In commercial and corporate matters in particular the development of the law must continue apace and it should be recognized that the real engines of change are the High Courts. While of course always keeping Article 189 of the Constitution in mind and adhering to the requirements thereof, the decisions of this Court should, in these areas of the law, be regarded as being akin (to borrow a famous phrase from elsewhere in the law) to "living tree[s]", "capable of growth and expansion within [their] natural limits".

11. For the foregoing reasons, this leave petition was converted into an appeal and allowed.

Judge

Judge

Judge

Islamabad, the
8th June, 2021
Naveed Ahmad/*
Approved for reporting