

SUPREME COURT OF NIGERIA
11TH FEBRUARY, 2000. SC. 174/95
**CORAM:- S. M. A. BELGORE, I. L. KUTIGI, A. I KATSINA-
ALU, A. O. EJIWUNMI, E. O. AYOOLA**

AFRICAN INSURANCE DEVELOPMENT APPELLANT
CORPORATION
AND
NIGERIAN LGN LIMITED RESPONDENT

ACTIONS - Relief claimed - Where based on satisfaction of several conditions - Satisfying only one condition is futile.

ARBITRATION - Guarantor - Who has guaranteed due performance by the contractor - Can be sued on a default by the principal debtor - And not on finding of liability against such debtor.

ARBITRATION - Scot v. Avery clause - The two forms therein - The Arbitration clause in this case - Can be said to fall within the first form only.

ARBITRATION - Stay of proceedings - Defendant who is not a party to the arbitration contract - But just a guarantor - Is not entitled to stay of proceedings.

INSURANCE - Bond - On demand bond - Not every performance bond is an on demand bond.

INSURANCE - Performance bond - Description thereof - Is based on the contents - And not the tag on the bond - Towards determining whether payment is to be made just on demand.

FACTS

The plaintiff/respondent entered into a contract with Fedision Nigeria Ltd. (the contractor) for the drilling of a water well. The contract contained an arbitration clause to the effect that any dispute shall be finally and exclusively settled by three arbitrators under the Nigeria Arbitration and Reconciliation Decree of 1988. The defendant/appellant pursuant to a performance bond bound itself to pay the sum of N538,122.00 to the plaintiff if the contractor fails to perform and observe all the terms of the contract. By a writ of summons, the plaintiff sued the defendant before the Lagos High Court on the bond on the ground that the contractor did not complete the contract within 91 days.

The defendant applied to the High Court for a stay of proceedings pending a reference to arbitration on the grounds that the subject matter of the action was governed by an arbitration clause. The trial Court granted the defendant's application. Plaintiff's appeal to the Court of Appeal was successful. Being dissatisfied, defendant has now appealed to the Supreme Court.

ISSUE OF DETERMINATION

Whether a person who is bound under a performance bond by which he undertook to pay to the employer damages in default of performance of a contract by the contractor, is entitled to a stay of proceedings in an action against him by the employer upon the default of performance by the contractor, on the strength of an arbitration clause in the agreement between the employer and the contractor, notwithstanding that on the face of that agreement he has not been named a party thereto.

HELD (Unanimously dismissing the appeal per lead judgment of **AYOOLA JSC**)

Performance bond - Description thereof

1. The description of a performance bond in Andrews & Millet, Law of Guarantees, 1st edn. page 403, as "essentially unconditional undertakings to pay a specified amount to a named beneficiary, usually on demand, and sometimes on the presentation of certain specified documents.", is misleading if it obscures the fact that it is not the tag put on the bond that

determines the obligation incurred thereby, but, rather, the contents of the bond. The proper approach when there is dispute as to whether the obligation incurred on a bond is to pay on demand or whether the obligation incurred is that of a suretyship is to revert to the contents of the bond. In the case of Trafalgar House Construction (Regions) Ltd v. General Surety and Guarantee Co Ltd [1995] 3 ALL ER 737 where the bond was substantially in similar form as the bond in this case, the House of Lords held that the bond amounted to a guarantee. (p. 477 F)

On demand bond

2. Similar considerations apply to the bond in this case. In an 'on demand bond' the creditor is entitled to be paid merely on making a demand for the amount of the bond. A performance bond may in its terms be an on demand bond but not every performance bond is an on demand bond. In this case the performance bond is not an 'on demand bond' but a guarantee. (p. 478 C)

Actions - Relief claimed

3. Where in the proceedings, the right claimed by a party to seek relief must be based on satisfaction of several conditions which must co-exist, it is futile to claim a right to such relief by establishing satisfaction of only one of such conditions. (p. 479 A)

Arbitration - Scot v. Avery clause

4. The two forms in which a Scott v. Avery clause may take are described in Mustil & Boyd, Commercial Arbitration (supra) thus at p. 161:

"(1) An express or implied term of the contract that no action shall be brought until an arbitration has been conducted and an award made

(2) A provision that the only obligation of the defendant shall be to pay such sum as the arbitrator shall award."

The arbitration clause in this case, earlier set out, is not in the latter of the two forms described above. However, it has been argued that as a matter of construction it must be held to be in the former of the

two forms. The phrase 'exclusively settled by arbitration, it is argued, raises an implied term that no action shall be brought until an arbitration has been conducted. To my mind, there is considerable force in that argument. The term of the arbitration clause that: "Any dispute.... shall be finally and exclusively settled by arbitration" rules out any other means of settling such disputes. (p. 480 E)

Guarantor - Who has guaranteed due performance

C 5. However, although, as between the employer and the contractor, any dispute to which the arbitration clause related must be settled by arbitration, the right of the employer to sue the guarantor who has guaranteed due performance of the contract is not affected. The principle is now well established that the right of action against a guarantor arises on a D default by the principal debtor and not on a finding of liability against such debtor. (p. 481 A)

Arbitration - Stay of proceedings

E 6. It follows from the principles of law stated above that, regardless of the agreement of the plaintiff and the contractor, embodied in the arbitration agreement, in terms that, as between them, any dispute concerning the principal contract shall be resolved exclusively by arbitration, the F right of action against the defendant is neither impaired nor delayed by such agreement. Nothing in the arbitration agreement between the plaintiff and the contractor can be interpreted as making the defendant a party to that agreement. The Court of Appeal was fully justified in the view they held that the defendant was not entitled to the order for stay of G proceedings it sought. Accordingly, this appeal should be and is hereby, dismissed. (p. 481 E)

NOTABLE POINT OF INTEREST

H **AYOOLA JSC**

1. Performance bond defined

Performance bonds are bonds made to secure the performance of a principal contract. Such bonds may be classified according to the obligation

undertaken by the obligee. In some cases it is, in reality, a conditional guarantee, while in others, it may be what is described as an 'on demand bond' or, as it is sometimes called a 'first demand bond'. If the performance bond is an 'on demand bond', as argued by the plaintiff, the defendant's liability would follow merely on a demand for payment made in good faith without a need to prove the validity of the claim. (p. 477 B)

REPRESENTATION

Ademola Akinrele SAN (with him Miss A. A. Adeyemi) for the Appellant.
O. Ajayi for the Respondent. C

CASES REFERRED TO

Trafalgar House Construction (Regions) Ltd v. General Surety and Guarantee Co Ltd [1995]3 ALL ER 737 D

Ikpeazu v African Continental Bank Ltd (1965) NMLR 374

Dunlop Pneumatic & Company Ltd v. Selfridge & Co. Ltd (1914-15) All ER Rep. 333.

E

STATUTE REFERRED TO

Nigeria Arbitration and Reconciliation Decree of 1988 S. 5 (1)

BOOK REFERRED TO

Commercial Arbitration - Mustil and Boyd 2nd Edition

F

LEAD JUDGMENT BY AYoola JSC

The main question on this appeal is whether a person who is bound under a performance bond by which he undertook to pay to the employer damages in default of performance of a contract by the contractor, is entitled to a stay of proceedings in an action against him by the employer upon the default of performance by the contractor, on the strength of an arbitration clause in the agreement between the employer and the contractor, notwithstanding that on the face of that agreement he has not been named a party thereto. G

Sometime in October, 1990, Nigeria NLG Limited, "the plaintiff" H

entered into a contract with one Fedision Nigeria Limited, "The contractor," for the drilling of a water well at Bonny Island, Rivers State. Clause 19.2 of the contract contained an arbitration clause in the following terms:

"Any dispute, whether in contract or at law, arising out of or in connection with the contract or the work performed thereunder shall be finally and exclusively settled by arbitration in Lagos, Nigeria, under the Nigeria Arbitration and Reconciliation Decree of 1988, by three arbitrators appointed in accordance with the Decree".

By a performance bond date 21st December, 1990, the contractor and African Development Insurance company, Limited, "the defendant," severally and jointly bound themselves to pay the plaintiff the sum of N538,122.00. The condition of the bond is in the following terms:

"NOW THE CONDITION of the above written Bond is such that if the Contractor shall duly perform and observe all the terms, provisions conditions and stipulations of the said contract on the Contractor's part to be performed and observed according to the true purport intent and meaning thereof or if on default by the Contractor the Surety shall satisfy and discharge the damages sustained by the Employer thereby up to the amount of the above written bond, then this obligation shall be null and void but otherwise shall be and remain in full force and effect. PROVIDED always and it is hereby declared that no alteration in terms of the said Contract made by agreement between the Employer and the Contractor Or in the extent or nature of the works to be constructed completed and maintained thereunder and no allowance of time by the Employer or the Engineer under the said Contract nor forbearance or forgiveness in or in respect of any matter or thing concerning the said Contract on the part of the Employer or the said Engineer shall in any way release the Surety from any liability under the above written bond."

By writ of summons dated 11th March, 1992, the plaintiff sued the defendant in the High Court of Lagos State on the Bond. By its Statement of Claim it averred inter alia, that the contractor " did not duly perform, execute or complete the said contract within 91 days, and as a result the contract was terminated on April 2, 1991." It also pleaded the terms of the bond, albeit in paraphrase. By a motion on Notice dated 8th

May, 1992, the defendant applied to the High court for a stay of the proceedings pending a reference to arbitration on the grounds that the subject matter of the action was governed by the arbitration clause.

Silva, J. before whom the matter came, granted the defendant's application. He was of the opinion that the performance bond arose in connection with the contract between the plaintiff and the contractor and that "without this contract, there would not have been a Performance bond or vice versa". Being of that view, he concluded that "although an arbitration clause is not included in the performance bond, I think it ought to be read into it since it was brought into being by the existence of the main contract between the plaintiff and Fedision Nigeria Limited."

On the plaintiff's appeal to the Court of Appeal, Uwaifo JCA, (as he then was) came to the conclusion:

(1) that since the contractor was not a party to the suit before him the learned Judge had no power to direct that the dispute should be referred to arbitration; (2) that "dispute" in the arbitration clause meant dispute between the plaintiff and the contractor and, (3) that the defendant not being a party to the contract between the plaintiff and the contractor, the defendant could not rely on the arbitration clause in a contract to which it was not a party.

In addition to these grounds Uwaifo, JCA, (as he then was) went on to proffer the opinion that even if the defendant could "possibly have a way of going to arbitration, it would have turned out to be a wholly undesirable waste of time. The final result would not be other than a dispute as to the effect of the performance bond; in other words the interpretation of the document."

Kalgo JCA (as he then was) and Pats-Acholonu, JCA agreed with these views. By a unanimous decision the Court of Appeal allowed the plaintiff's appeal and set aside the decision of the High Court.

This appeal by the defendant is from the decision of the Court of Appeal. Counsel on behalf of the defendant argued two issue as follows:

"(1) Whether the appellant is a party to the contract in consequence of which he can take the benefit of the arbitration clause contained therein. (2) Whether the arbitration clause is in the Scot v. Avery

The substance of the argument advanced by counsel on behalf of the defendant is that the present case falls within one of the exceptions to the principle of privity of contract, whereby a person not a party to a contract sue on it. It was argued that the factor, which constituted this case an exception, is that the defendant was in the position of guarantor whose liability is defendant on the default of another. As I understand defendant's argument, by reason of that fact the defendant would be regarded as a party to the even though it had not been named as a party to the contract. For this argument, reliance was placed on the opinion of the learned authors, Mustill and Boyd, in their book Commercial Arbitration, 2nd Edition, where the learned authors discussed, at pages 137-140, the question of arbitration and third parties. As rightly noted by the authors on p.137.

"Most arbitrations take place between persons who have from the onset been parties to the arbitration agreement, and to the substantive contract underlying that agreement. It occasionally happens, however, that the claim is made by or against someone who was not originally named as a party. In such circumstances, the question whether the claim can be and must be the subject of arbitration may give rise to considerable difficulty."

The situation, which may be relevant to the present case, is that in which the defendant has incurred liabilities which are secondary to the primary liabilities contained in the contract. In regard to such situation, learned counsel for the defendant, drawing largely from the opinion of Mustill and Boyd, submitted that the two conditions, one only of which needs be satisfied before a third party not named as a party in the primary contract can be considered a party entitled to take benefit of the arbitration clause, are: (1) that he has guaranteed the liability of the party to the primary contract and the terms of the guarantee must be expressed to be contingent upon the ascertainment of the liability under the primary contract; and, (2) that the arbitration clause must be in the Scott v. Avery form thus making an award against the principal debtor a condition precedent to proceeding against the guarantor. Learned counsel for the de-

fendant argued that the defendant's case fell within the two conditions.

For his part, learned counsel for the plaintiff argued that the bond is an on demand bond and that the arbitration clause is not in the Scott v. Avery form.

These contentions have been made to appear to be of determinative importance to the main issue on this appeal. Hence, some time will be spent in considering the nature of the performance bond in this case and the form of the arbitration clause.

Performance bonds are bonds made to secure the performance of a principal contract. Such bonds may be classified according to the obligation undertaken by the obligee. In some cases it is, in reality, a conditional guarantee, while in others, it may be what is described as an 'on demand bond' or, as it is sometimes called a 'first demand bond'. If the performance bond is an 'on demand bond', as argued by the plaintiff, the defendant's liability would follow merely on a demand for payment made in good faith without a need to prove the validity of the claim. Uwaifo, JCA, proceeded on the footing that the bond was a guarantee. The plaintiff has not asked in the proper way, by a respondent's notice or notice of cross-appeal, that that view should be rejected. However, the parties have addressed the question of the nature of the bond on this appeal. It is but proper that, in deference to their industry in this regard, some attention be paid to that aspect of the matter.

The description of a performance bond in Andrews & Millet, Law of Guarantees, 1st edn, page 403, as "essentially unconditional undertakings to pay a specified amount to a named beneficiary, usually on demand, and sometimes on the presentation of certain specified documents.", is misleading if it obscures the fact that it is not the tag put on the bond that determines the obligation incurred thereby, but, rather, the contents of the bond. The proper approach when there is dispute as to whether the obligation incurred on a bond is to pay on demand or whether the obligation incurred is that of a suretyship is to revert to the contents of the bond. In the case of Trafalgar House Construction (Regions) Ltd v. General Surety and Guarantee Co Ltd [1995]3 ALL ER 737 where

the bond was substantially in similar form as the bond in this case, the House of Lords held that the bond amounted to a guarantee. Lord Jauncey at p.741 said in that case.

B *"In the first place the bond itself contains indications that it was intended to be a guarantee. The appellants are described as 'The surety'. There is a provision to the effect that no alterations in the terms of the sub-contract should release the surety from liability. In the absence of such provision a surety will normally be released from his obligation by any subsequent material alteration to the contractual provisions agreed*
C *between the contractor and the sub-contractor."*

Similar considerations apply to the bond in this case. In an 'on demand bond' the creditor is entitled to be paid merely on making a demand for the amount of the bond. A performance bond may
D **in its terms be an on demand bond but not every performance bond is an on demand bond. In this case the performance bond is not an 'on demand bond' but a guarantee.**

E I now turn to the main question in this case, which is whether the defendant, who is neither a party to the arbitration agreement nor a derivative party, is entitled to a stay of proceedings in an action brought on the guarantee.

Section 5(1) of the Arbitration and Conciliation Decree, 1988 provides that

F *"If any party to an arbitration agreement commences any action in any court with respect to any matter which is the subject of an arbitration agreement, any party to the arbitration agreement, may at any time after appearance and before delivering any, pleadings or taking any other*
G *steps in the proceedings, apply to the court to stay proceedings."*

It is evident from the provisions of section 5(1), that the applicant for a stay of proceedings must be a 'party to the arbitration agreement' and that the subject matter of the action must be "with respect to
H any matter which is the subject of an arbitration agreement." Although the court of Appeal held that the defendant had not satisfied either of these conditions, which must co-exist, the defendant had concentrated on the former only and has not asked us to pronounce that the court

below was in error in regard to the latter. The result is that even if the defendant had been right in the contention that the defendant was a party to the arbitration agreement, the decision of the court below that it was not a proper applicant by reason of the subject of the arbitration agreement, would still have remained intact. **Where in the proceedings, the right claimed by a party to seek relief must be based on satisfaction of several conditions which must co-exist, it is futile to claim a right to such relief by establishing satisfaction of only one of such conditions.**

Although the defendant is neither a party to the arbitration agreement nor a derivative party, it was argued by counsel on its behalf that it became a party by reason of its liability as guarantor which was contingent on the default of the contractor. For this submission, heavy reliance was placed on the opinion expressed in *Mustill & Boyd, Commercial Arbitration*, 2nd edn, particularly at page 139, where the learned authors in considering arbitration and third parties adverted to the situation where, as in this case, the defendant not named as a party to the arbitration agreement "has incurred liabilities which are secondary to the primary liabilities contained in the contract." The learned authors expressed the opinion thus:

"..... where the guarantee and the arbitration clause are in the ordinary form, the liability of the guarantor arises simultaneously with that of the principal debtor; the creditor need not arbitrate against the principal debtor, but may proceed against the guarantor....."

"If on the other hand, the arbitration clause is in the Scott v. Avery form, the claimant must obtain an award against the principal, before proceeding against the guarantor, for the obtaining of an award against the principal is a condition precedent to the liability of the principal debtor, and the guarantor does not become liable until the principal debtor is liable."

In my opinion, nothing in these passages should lead to any proposition that a guarantor would become a party to the arbitration agreement so as to enable him to apply for a stay of proceedings in an action against him on the contract of guarantee. Factors, which may apply to

the right for a stay of proceedings, should not be confused with factors which pertain more to defence.

Where the arbitration clause is of that type of a Scott v. Avery form which ties the liability of the contractor to an award and makes it incumbent on the contractor to pay only such sum as the arbitrator shall award, the cause of action against the guarantor may not accrue until the liability of the contractor is found by an award. That may well be a defence in an action against the guarantor or a ground for terminating an action prematurely brought, in limine, but it is not a ground for seeking a stay of proceedings pursuant to section 5(1) of the Decree. In Halsbury's Laws of England 4th edn, Vol 2 at para 646 the law was put thus:

"A provision in an arbitration agreement, known as a 'Scott v. Avery clause', whereby the making of an arbitral award is expressed to be a condition precedent to any right in respect of any the matters agreed to be referred, does not oust the jurisdiction of the court, Such a clause constitutes a defence to any proceedings brought before the making of the award....."

The two forms in which a Scott v. Avery clause may take are described in Mustill & Boyd. Commercial Arbitration (supra) thus at p. 161:

"(1) An express or implied term of the contract that no action shall be brought until an arbitration has been conducted and an award made

(2) A provision that the only obligation of the defendant shall be to pay such sum as the arbitrator shall award."

The arbitration clause in this case, earlier set out, is not in the latter of the two forms described above. However, it has been argued that as a matter of construction it must be held to be in the former of the two forms. The phrase 'exclusively settled by arbitration, it is argued, raises an implied term that no action shall be brought until an arbitration has been conducted. To my mind, there is considerable force in that argument. The term of the arbitration clause that: "Any dispute.... shall be finally and exclusively settled by arbitration" rules out any other means of settling such

disputes.

However, although, as between the employer and the contractor, any dispute to which the arbitration clause related must be settled by arbitration, the right of the employer to sue the guarantor who has guaranteed due performance of the contract is not affected. The principle is now well established that the right of action against a guarantor arises on a default by the principal debtor and not on a finding of liability against such debtor. The law is well stated in Andrews & Millet, Law of Guarantees, 1st edn. at pages 162-163 thus:

"The fact that the obligations of the guarantor arise only when the principal has defaulted in his obligations to the creditor does not mean that the creditor has to demand payment from the principal or from the surety, or give notice to the surety, before the creditor can proceed against the surety. Nor does he have to commence proceedings against the principal, whether criminal or civil, unless there is an express term in the contract requiring him to do so."

It follows from the principles of law stated above that, regardless of the agreement of the plaintiff and the contractor, embodied in the arbitration agreement, in terms that, as between them, any dispute concerning the principal contract shall be resolved exclusively by arbitration, the right of action against the defendant is neither impaired nor delayed by such agreement. Nothing in the arbitration agreement between the plaintiff and the contractor can be interpreted as making the defendant a party to that agreement.

The Court of Appeal was fully justified in the view they held that the defendant was not entitled to the order for stay of proceedings it sought. Accordingly, this appeal should be and is hereby, dismissed with N10,000 costs to the respondent in this appeal which has, hitherto, been referred to as the plaintiff for convenience. It is directed that the action which was commenced in the High Court as long ago as 1992 and to which the defendant's application for stay of proceedings related now be given accelerated hearing.

BELGORE JSC

Privity of contract is still very much a part of our law of Contractual liability. A third party who was not privy to a contract cannot ordinarily be held responsible for the damages incurred by default of one of the parties. The performance bond in this case had no arbitration clause, neither did it allude to the main contract. This has created legal difficulty for the defendant who was not a party to the construction agreement. Court of Appeal was therefore right to have dismissed the appeal before it. I have no reason to hold otherwise and I am in full agreement with the judgment of my learned brother Ayoola J.S.C. that this appeal has no merit. I also dismiss it with N10,000.00 costs to the respondent.

D

KUTIGI JSC

I read in advance the judgment just rendered by my learned brother Ayoola J.S.C. I agree with his reasoning and conclusion that the appeal has no merit. It is accordingly dismissed with N10,000 costs to the Respondent in the appeal. The judgment of the Court of Appeal is affirmed.

F

KATSINA-ALU JSC

I have had the advantage of reading in draft the judgment just delivered by my learned brother Ayoola JSC in this appeal. I entirely agree that the appeal lacks merit and must be dismissed.

As a general rule only a person who is a party to a contract can sue on it; a fortiori, only such party can take the benefit of an arbitration clause contained therein - See Ikpeazu v African Continental Bank Ltd (1965) NMLR 374; Dunlop Pneumatic & Company Ltd v. Selfridge & Co. Ltd (1914-15) All ER Rep. 333.

The arbitration clause relied on by the appellant is contained in a contract to which he is not a party. The contract is between the plaintiff/respondent and Pedison. The appellant, it has been clearly established, is

not a party to the agreement and cannot therefore rely on the arbitration clause therein.

For this and the fuller reasons given by my learned brother Ayoola JSC, I also would dismiss this appeal with N10,000.00 costs to the respondent.

B

EJIWUNMI JSC

Being privileged to have read in advance the judgment just delivered by my learned brother Ayoola JSC, I will also dismiss the appeal for all the reasons given in the said judgment. Accordingly, this appeal is dismissed by me with N10,000.00 costs to the respondent.

C

D

E

F

G

H