

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**
% *Judgment Reserved on : February 09, 2017*
Judgment Delivered on : February 10, 2017

+ **FAO(OS) (COMM) 33/2017**

M/S ZILLON INFRAPROJECTS PVT.LTD.Appellant
Represented by: Mr.Rakesh Tikku, Sr.Advocate
instructed by Mr.Naveen Sharma
and Ms.Swati Bhushan Sharma,
Advocates

versus

ALSTOM SYSTEMS INDIA (P) LTD. & ORS. Respondents
Represented by: Mr.Amit Chadha, Sr.Advocate
instructed by Mr.Tejas
Karia,Mr.Akhil Anand,
Mr.Surjendu Sankar Das,
Mr.Siddhanth Kochar and
Ms.Avlokita Rajvi, Mr.Sahil
Mongia,Advocates for R-1.

FAO(OS) (COMM) 34/2017

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CORAM:

HON'BLE MR. JUSTICE PRADEEP NANDRAJOG

HON'BLE MR. JUSTICE YOGESH KHANNA

PRADEEP NANDRAJOG, J.

1. At the outset, it may be noted that against mobilization advance paid by the respondent to the appellant, four bank guarantees were issued at the instance of the appellant by the respondent No.3 bank. We are concerned in the two appeals with three out of the four bank guarantees which are in the sum of ₹90 lacs, ₹1.41 crores and ₹3.01 crores. The three bank guarantees are identically worded and are concededly unconditional, and suffice it to record that the learned Single Judge has reproduced the operative part of the second bank guarantee in sum of ₹1.41 crores in para 13 of the two impugned orders, both dated February 07, 2017, which are in challenge in the two appeals. We further note that after the impugned orders were passed the respondent No.3 bank has remitted the payments covered by the bank guarantees to the respondent No.1, being the beneficiary of the three bank guarantees.

2. Before deciding on the merits of the controversy which concerns denial of an interim measure prayed by the appellant in a petition filed under Section 9 of the Arbitration and Conciliation Act, 1996 (hereinafter referred to as the Act); prayer made therein to restrain respondent No.3 bank to remit money to respondent No.1 under the three bank guarantees has been declined : ad-interim stay granted against invocation of the guarantees has been vacated, a preliminary objection was raised by learned Senior Counsel for respondent No.1.

3. In the decisions reported as (1999) 2 SCC 479 Sunderam Financial Ltd. vs. NEPC India Ltd. and (2004) 3 SCC 155 Firm Ashok Trader &

Anr. vs. Gurumukh Dass Saluja & Ors. the Supreme Court emphasized that the very initiation of a proceeding under Section 9 of the Act implies that the petitioner accepts there being a final and binding arbitration agreement in existence and further that a dispute has arisen which is referable to the Arbitral Tribunal and that the petitioner has to satisfy that it intends to take the dispute to arbitration and while passing an order in the petition the Court must ensure that the party concerned is taking effective steps to commence with the arbitration.

4. Clause 29 of the Contract between the parties, under the caption APPLICABLE LAW – SETTLEMENT OF DISPUTES reads as under:-

“29.1 This Subcontract Agreement shall be governed by the laws of (India) with courts at (Delhi) having exclusive jurisdiction to adjudicate on all disputes/matters arising out of this Sub-Contract.

29.2 Reference to Mediation

29.2.1 In the event of any dispute or difference between the Contractor and the Subcontractor, whether arising during the execution or after the completion or abandonment of the Subcontract Works or after the determination of the employment of the Subcontractor under this Subcontract (whether by breach or in any other manner), in regard to any matter or thing of whatsoever nature arising out of this Subcontract or in connection therewith, then either Party shall give to the other notice in writing of such dispute or difference and such dispute or difference shall be and is hereby referred to mediation. A Party who receives a notice for mediation from the other party shall consent and participate in the mediation process and shall make all reasonable efforts to resolve the same through mediation in accordance with the mediation rules of the International chamber of Commerce – Alternate Dispute Resolution – ICC ADR.

29.2.2 Notwithstanding anything in this Subcontract, in the event of any dispute or difference arising out of or relating to this Subcontract, or the breach thereof, no party shall proceed to arbitration UNLESS the Parties have made reasonable efforts to resolve the same through mediation as provided in Clause 29.2.1 above.

29.3 Reference to Arbitration.

29.3.1 In the event that mediation is unsuccessful, the dispute or difference between the parties shall be finally settled in accordance with the Rules of Arbitration of the International Chamber of Commerce by three arbitrators appointed in accordance with said Rules. The place of arbitration shall be New Delhi and the language of the proceedings shall be in English.

29.3.2 The commencement of any arbitration proceedings shall in no way affect the continuous performance of the obligation of the Subcontractor under this Subcontract.”

5. It is not in dispute that the parties proceeded to make a reference to ICC ADR, seeking mediation at the first instance as contemplated by the dispute resolution clause in the contract. The appellant only deposited US\$ 2000 as ICC filing fee and did not deposit further sum of US\$ 11000 as per the Fee Schedule of ICC. The respondent deposited both sums. Repeated reminders sent to the appellant to deposit US\$ 11000 went unheeded to and not complied with by the appellant. The result is a letter dated January 20, 2017 written by ICC returning US\$ 11000 to the respondent and retaining the initial filing fee. The letter informs that the proceedings for settlement of the dispute under mediation is terminated.

6. Learned Senior Counsel for the respondent submitted that reason why the appellant did not deposit US\$ 11000 with ICC is an order passed on October 18, 2016 passed by the learned Single Judge directing measurements at site(s) to be carried out by the Project Engineer in

presence of representative of both parties followed by a meeting held between the representative of the appellant and the respondent to try and resolve the issue.

7. Learned Senior Counsel for the respondent did not dispute that an attempt, which has proved to be abortive, was made for an amicable resolution of the dispute, but it has failed. Under the circumstances, we are not inclined to hold against the appellant for the reason the conduct of the appellant is not such which evinces a desire not to have the dispute resolved as per the dispute resolution clause in the contract.

8. Relevant facts to be noted for deciding the two appeals on merits would that Dedicated Freight Corridor Corporation of India Ltd.(hereinafter referred to as DFCCIL) had entered into a contract on July 21, 2015 with the first respondent awarding works associated with the double track railway line for Bhaupur-Khurja Section. The works included preparation of drawings and design and civil works, apart from others. In turn, respondent No.1 entered into a sub-contract with the appellant on September 24, 2015 as per which, including the work of preparing drawing and designs, civil works had to be executed by the appellant at the contract (sub-contract) price of ₹118 crores. The sub-contract between the parties contemplated mobilization advance to be paid at two stages. 5% of the contract value being ₹5.91 crores after the appellant submitted bank guarantees. Further 5% of the contract value on submission of further bank guarantees but after the site was mobilized. Concededly, mobilization advance of the first tranche has been paid by the first respondent to the appellant and the dispute concerns recovery thereof under the bank guarantees. The appellant does not dispute that till date it has not raised any interim bill for any work done. Relevance of said admitted fact would be highlighted at the appropriate stage.

9. As per the sub-contract between the parties the appellant had to complete the sub-contracted works by June 08, 2017. Before the civil works could be executed, the design and drawings had to be submitted by the appellant and approved by DFCCIL. The appellant did not discharge said obligation under the contract resulting in the first respondent withdrawing the performance of design and drawings to be submitted by the appellant. The appellant accepted said novation of the contract.

10. As the adage goes : the proof of the pudding lies in its eating. We overlook the correspondence exchanged between the parties on the issue of whether the appellant mobilized the site and commenced execution of such civil works in respect whereof drawings and designs were approved for the reason we have before us a joint inspection report prepared pursuant to the order dated October 18, 2016 passed by the learned Single Judge directing measurements at site(s) to be carried out by the Project Engineer in presence of representative of both parties. The report shows that at various locations, no civil work has been executed. A site office, at the different locations by setting porta-cabins has been established. At some sites with furniture and at some site without furniture. At some sites, tools and tackles have been brought. At a few sites stone dust and Aggregate 20 mm has been kept. At one site 23.95 MT steel rods have been kept.

11. Annexure-II to the sub-contract between the parties vide clause 2.2 reads as under:-

“2.2 Terms of Payment (refer GC 14.3 & 14.4 of Main Contract)

Advance Payment:

(i) The Contractor shall pay on written request by the Sub-contractor as Mobilization advance up to 10 (Ten)

Percent of the contract price. The mobilization advance shall be released in two installment as under:-

- a) Up to (five) 5 percent: on submission of performance security and commencement on mobilization process, and*
 - b) Up to (Five) 5 percent: On submission of details utilization of initial mobilization advance of 5% to the satisfaction of contractor.*
 - c) The Advance payment will be released submission of unconditional Advance Bank Guarantee for the amount equivalent to the component of advance payment requested by Sub-contractor.*
 - d) Advance payment recovery: The advance shall be repaid through percentage deduction from subcontractor invoices. Deduction shall commence in the invoice in which the total of all certified payment (excluding the advance payment and deductions and repayments of retention) exceeds ten percent (10%) of the Subcontract amount. Deduction shall be made at amortization rate of one quarter (25%) of the amount of each payment certificate (excluding the advance payment and deduction and repayments of retention) until such time as the advance payment has been repaid.*
- (ii) The Subcontractor shall submit a Statement in 6 copies by the 25th of each month in accordance GC 14.3 of the Main Contract together with supporting documents which shall include the relevant report on progress in accordance with GC 4.21 of the Main Contract.*
- (iii) The main contract includes a Schedule of Payments and the Subcontract price will be paid in accordance with GC 14.4. The Price Schedules relevant to the Subcontract are:*
- Price Schedule 2.4 for Building Works and*
 - Price Schedule 2.1.7 for E&M Works.*

The installments quoted in the above mentioned schedules shall be the estimated subcontract values for the purposes of subparagraph (a) of GC 14.3 of the Main Contract.”

12. The clause in question only refers to clause 14.3 and 14.4 of the General Conditions of the Contract, which concededly are the FIDIC Conditions of Contract and not clause 14.2 thereof.

13. Before the learned Single Judge this gave birth to the controversy whether clause 14.2 of FIDIC Conditions of Contract, under the caption Advance Payment could be read into the contract, for the reason said condition clearly stipulates that the Advance Payment would be as an interest free loan for mobilization and design to be secured by a guarantee and this advance payment shall be repaid through percentage deductions from the running bills certified for payment as and when the work is executed. The learned Single Judge has reasoned, in para 24 of the impugned decisions as under:-

“24. It was contended on behalf of ZIPL that clause 14.2 of the General Conditions of the main contract was not applicable as it was not specifically referred to in Annexure 2 to the Sub-contract and therefore, the bank guarantees furnished for securing the advance for mobilization could not be recovered except by adjustment from interim payments. This contention is inconsiderable, first of all for the reason that the scheme of providing advance against securities as agreed in clause 14 of the main contract between Alstom and DFCCIL was incorporated in the Sub-contract; thus even though clause 14.2 is not specifically mentioned, the same would be implicit in the Sub-contract. More importantly, the entire purpose of release the advance against bank guarantees was to secure Alstom against non recovery of the said advance. Therefore to suggest that the bank guarantee cannot be invoked, even though the Sub-contract has been terminated and the question recovery of adjustment from

interim payments does not arise, would render the provision of the said security illusory.”

14. The relevance of the applicability of clause 14.2 of the FIDIC condition of contract would be, that if applicable, the advance payment made by respondent No.1 to the appellant would be treated as an interest free loan for mobilization and would be recoverable from the running bills as a percentage thereof as agreed by the parties. Meaning thereby, if no work whatsoever has commenced and no bill for interim payment is raised and the contract is rescinded, the recovery has to be immediate and if repayment secured under a bank guarantee, the bank guarantee would be immediately enforceable. If the bank guarantee is unconditional and payment payable by the issuing bank without any demur, the bank would have the honour the guarantee.

15. In our opinion it is irrelevant whether clause 14.2 of the FIDIC condition of the contract would be applicable for the reason clause 2.2 of Annexure-II to the contract, contents whereof have been noted above, vide para (i) thereof require respondent No.1 to pay to the appellant, as mobilization advance, up to 10% of the contract price which shall be released in two tranches. Vide sub-para (d) of para (i) this advance payment shall be repaid through percentage deductions from invoices raised by the appellant. The effect of clause 2.2 is the same as that of clause 14.2 of the FIDIC conditions of the contract.

16. Thus, the position would be that the appellant not having executed any work at site for which a bill could be raised, the contract being terminated, the respondent No.1 would be entitled to encash the bank guarantees offered for repayment of the mobilization advance inasmuch as the clause in question of the contract requires the advance payment to be repaid and the unconditional bank guarantee obliges the bank to pay

without demur.

17. Thus, on this count alone the bank guarantees are invocable. The conclusion in para 24 of the impugned order is affirmed by us, albeit on different reasons.

18. '*Fraud*', '*irretrievable injury*' and '*special equity*' are expressions found in a catena of judicial opinions penned by Learned and Hon'ble Judges and notwithstanding a plethora of case law on the subject, the debate goes on. Invocation of bank guarantees and payment thereunder can be interdicted by the Courts on said three grounds. In the instant case the appellant has not set up any ground of any irretrievable injury or a special equity and the plea is one of fraud. The fraud alleged is stated admission by the respondent No.1 that the appellant has mobilized the site. The argument was that the first tranche of the mobilization advance was to enable the appellant to mobilize the site.

19. The respondent No.1 disputes complete mobilization and relies upon the report of the Project Engineer which has not been challenged. The respondent No.1 also points out through a letter dated September 05, 2016 written by the appellant to it showing utilization of the mobilization advance by paying ₹2.39 crores to the bank as margin money and ₹66 lacs to the bank as commission for issuing the bank guarantees. The argument of the respondent is that out of ₹5.91 crores, ₹3.05 crores have admittedly been used for issuance of the various bank guarantees by providing margin money and commission to the issuing bank. The money has not been utilized for mobilization at site. With respect to the letters exchanged between the parties, case of the respondent is that the same shows a serious dispute as to who is responsible for non-commencement of the actual work at site and this issue cannot be gone into in proceedings under Section 9 of the Act.

20. Though opinions on bank guarantees span half a century, we plunge mid-stream and commence our discussion with the celebrated decision of the Supreme Court reported as 1987 (2) SCALE 1149 U.P.Co-op.Federation Ltd. Vs. Singh Consultants & Engrs. (P) Ltd. The decision has noted the prior landmark decisions on the subject and throws considerable light on what would be the ‘*fraud*’ ‘*special circumstances*’ or ‘*special equity*’ justifying issuance of an injunction to restrain the bank from paying under the guarantee issued by it, which decision has been constantly followed in latter decisions of the Supreme Court. We only highlight the aspect of the judgment and a few other on the issue of fraud for the reason the appellant has pleaded fraud in the invocation of the bank guarantees.

21. In U.P.Co-operative Federation case (supra), two guarantees, one a performance guarantee and the other by way of security for monies advanced were the subject matter before the Supreme Court in an action for injunction.

22. Holding that the language of the two guarantees made it crystal clear that the guarantees were unconditional, the Supreme Court proceeded to note prior decisions and culled out the exceptions whereunder a Court would be justified in issuing an injunction restraining invocation or payment under an unconditional guarantee.

23. The Supreme Court noted that the letter of credit has been developed over hundreds of years of international trade. It was most commonly used in conjunction with the sale of goods between geographically distant parties. That it was intended to facilitate the transfer of goods between distant and unfamiliar buyer and unknown customer. It was noted that it was difficult for a buyer to pay for goods prior to their delivery. The bank's letter of credit came into existence to

bridge the gap. In such transactions, the seller (beneficiary) receives payment from issuing bank when he presents a demand as per terms of the documents. The bank must pay if the documents are in order and the terms of credit are satisfied. The bank was not allowed to determine whether the seller had actually shipped the goods or whether the goods conformed to the requirements of the contract. Any dispute between the buyer and the seller must be settled between themselves.

24. The reason of the aforementioned opinion is obvious. The letter of credit is a contract. The bank promises to pay the '*beneficiary*' – traditionally a seller of goods – on demand if the beneficiary presents whatever documents may be required by the letter. They are normally the only two parties involved in the contract. The bank which issues a letter of credit acts as a principal, not as agent for its customer, and engages its own credit. The letter of credit thus evidences an irrevocable obligation to honour the draft presented by the beneficiary upon compliance with the terms of the credit. The Supreme Court noted that whether it is a traditional letter of credit or a new device like performance bond or performance guarantee, the obligation of the guarantor (usually a bank) is the same.

25. One exception to the rule of absolute independence of a bank guarantee was thereafter noted. It was traced to the opinion of Shientag J. in a case in U.S.A. reported as *Sztejn Vs. J.Henry Schroder Banking Corpn.* 31 NYS 2d 631.

26. The year was 1941. Injunctions against payments under letters of credit were not issued by courts. Mr.Sztejn had wanted to buy quality bristles from Indian and struck a deal for a quantity with an Indian seller. Payment was secured to the seller by means of a letter of credit which provided that upon receipt of appropriate documents the bank would pay

for the shipment. Somehow Mr.Sztejn discovered that the shipment made was crates of worthless rubbish. He went to the bank with a request not to pay and received a response that being a letter of credit it was an independent undertaking of the bank and hence it must pay. Mr.Sztejn went to Court. He sought an injunction against the issuing bank to restrain it from paying under the letter of credit. He made, prima facie, good his allegations that as against the contracted goods i.e. bristles, worthless material and was shipped. Noting a fraud in the transaction the Court issued an injunction against payment.

27. The Supreme Court noted that the exception of fraud created by Shientag J. had been subsequently accepted by Courts in England in the decisions reported as (i) (1958) 2 QBD 127 Hamzen Milas & Sons. v. British Imex Industries Ltd., (ii) (1977) 2 All E. 862 R.D. Harbottle Mercantile) Ltd. & Anr. v. National West Minister Bank Ltd., (iii) (1978) 1 All E.R. 976 Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.; and (iv) (1982) 2 All E.R.720 UCM (Investment) v. Royal Bank of India. The last case is of the House of Lords where Lord Diplock in his speech said (at p.725):

“The whole commercial purpose for which the system of confirmed irrevocable documentary credits has been developed in international trade is to give to the seller an assured right to be paid before he parts with control of the goods and that does not permit of the any dispute with the buyer as to the performance of the contract of sale being used as a ground of non-payment or reduction or deferment of payment.

To this general statement of principles as to the contractual obligations of the confirming bank to the seller, there is one established exception: that is, where the seller, for the purpose of drawing on the credit, fraudulently presents to the confirming bank documents that contain, expressly or by implication, material representations of fact that to his

knowledge are untrue. Although there does not appear among the English authorities any case in which this exception has been applied, it is well established in the American cases, of which the leading or 'landmark' case is Sztejn Vs. Henry Schroder Banking Corpn. This judgment of the New York Court of Appeals was referred to with approval by the English Court of Appeal Edward Owen Engineering Ltd. V. Barolays Bank International Ltd. though this was actually a case about a performance bond under which a bank assumes obligations to a buyer analogous to those assumed by a confirming bank to the seller under a documentary credit. The exception for fraud on the part of the beneficiary seeking to avail himself to the credit is a clear application to the maxim ex trupi cause non oriture or if plain English is to be preferred, 'fraud unravels all', the courts will not allow their process to be used by a dishonest person to carry out a fraud."

28. We may note that the exception of fraud has been codified in Sections 5-114 of the Uniform Commercial Code.

29. With respect to the question : Can an injunction be issued upon a plea that the beneficiary is in breach of the contract? Law on the subject was thereafter noted by the Supreme Court with reference to a decision of the Court of Appeal in England reported as (1985) 2 Q.B.D. 127 Hamzon Melas & Sons Vs. British Imex Industries Ltd., wherein it was held the principle was that commercial trading must go on the solemn guarantee either by the letter of credit or by bank guarantee or irrespective of any dispute between the contracting parties whether or not the goods were upon contract.

30. With reference to the decision of the House of Lords in UCM (Investment)'s case (supra) viz-a-viz a plea of fraud in invoking the guarantee and the opposite party being in breach of its obligations under the contract, the Supreme Court summarised the legal position as under:-

"The whole commercial purpose for which the system of confirmed irrevocable documentary credits had been developed

in international trade was to give the seller of goods an assured right to be paid before he parted with control of the goods without risk of the payment being refused, reduced or deferred because of a dispute with the buyer. It followed that the contractual duty owed by an issuing or confirming bank to the buyer to honour the credit notified by him on presentation of apparently confirming documents by the seller was matched by a corresponding contractual liability on the part of the bank to the bank to the seller to pay him the amount of the credit on presentation of the documents. The bank's duty to the seller was only vitiated if there was fraud on the part of the seller."

31. Tested on the unveil of legal principles culled out hereinabove, we agree with the contention advanced by learned counsel for the respondent No.1 that highly disputed questions of fact, fastening liability as to who was responsible for the delay cannot be gone into by this Court. The fraud pleaded by the appellant is that notwithstanding respondent No.1 being in default, it has invoked the bank guarantees; and this would be fraud. The plea of fraud contemplated by law is fraud of an egregious nature i.e. outstandingly bad and shocking.

32. We therefore dismiss the appeals but without any order as to costs.

(PRADEEP NANDRAJOG)
JUDGE

(YOGESH KHANNA)
JUDGE

FEBRUARY 10, 2017

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