

(2013) 04 MAD CK 0026

In the Madras High Court

Case No : O.A. No's. 610 and 611 of 2011 and Application No's. 3370, 3371, 3624 and 3625 of 2011

BEFESA AGUA and Another

APPELLANT

Vs

IVRCL Infrastructure and Projects Ltd. and Others

RESPONDENT

Date of Decision : 02-04-2013

Acts Referred:

Arbitration and Conciliation Act, 1996 — Section 6, 6(2), 7, 7(5), 9

Citation : (2014) 1 BC 547 : (2013) 3 CTC 414

Hon'ble Judges : R.S. Ramanathan, J

Bench : Single Bench

Advocate : R. Krishnamoorthy, for Vineet Subramani, for the Appellant; T.K. Seshadri, for R. Murari, for the Respondent

Final Decision : Dismissed

Judgement

R.S. Ramanathan, J.—The First Applicant is a Spanish Company operating in the infrastructure sector and operates in India through its

subsidiary, the Second Applicant, which is a Joint Venture Company. The Second Applicant is a wholly owned subsidiary of the First Applicant

and is a Company incorporated in India and is a contractor to the Second Respondent. The Third Applicant is a Partnership firm of the First

Applicant and it is also a contractor to the Second Respondent. The First Respondent is a Joint Venture partner of the Applicants and is also a

shareholder in the Second Respondent. The Second Respondent is the Joint Venture Company of the First Applicant and the First Respondent

and the Third Respondent issued Bank Guarantees in favour of the Second Respondent at the request of the First Applicant. The brief facts of the

case are as follows:

(a) In November 2004, the Chennai Metropolitan Water Supply and Sewerage Board ("CMWSSB") invited proposals from contractors wishing

to participate in the tender for a project to design, construct, operate and maintain a Desalination Plant to be built at Minjur, Chennai on a design,

build, own, operate and transfer basis. The First Applicant along with the First Respondent responded to the invitation. The First Applicant

provided detailed plans for the construction of the Desalination Plant and the sourcing and installation of desalination equipment on the basis of the

prevailing market conditions at that time, on the basis of which the consortium prepared and submitted its proposal.

(b) The consortium was chosen by CMWSSB to undertake the project. The First Applicant and the First Respondent incorporated the Second

Respondent as a special purpose vehicle to undertake the project, with Applicant owing approximate 25% of the Company and First Respondent

owning approximately the remaining 75% of the shareholding. The Second Respondent is governed by the terms of the Shareholders Agreement

(the "SHA") dated 31st August 2005 between the shareholders, i.e., First Applicant and the First Respondent.

(c) Pursuant to the above stated award of contract and forming of the joint venture between the First Respondent and the First Applicant, the

Company (Second Respondent) entered into an Agreement with CMWSSB, titled the Bulk Water Purchase Agreement (the "BWPA") on 13th

September 2005, under which it agreed to design and construct the Desalination Plant and then to operate the plant for a period of 25 years.

(d) In order to implement the BWPA, the Second Respondent then entered into sub-contracts for the execution of the project on 5 January 2007,

some 15 months after the date on which the BWPA was executed by the Second Respondent with CMWSSB. The three sub-contracts (together

referred as to the "Project Contracts") were:

(i) a contract for the Engineering, Construction and Commissioning of the Desalination Plant of Sea Water in Minjur (India) (the "ECC Contract"),

which was entered into between the Second Respondent and the Second Applicant.

(ii) a contract for the Supply of Equipment for the Desalination Plant of Sea Water in Minjur (India) (the "Supply Contract"), which was entered into

between the Second Respondent and the Third Applicant; and

(iii) the Master Agreement for the Design, Supply, Erect and Commissioning of a 100,000 m³/day Desalination Plant at Minjur, Chennai, India

(the "Master Agreement") which was entered into between the Second Respondent on the one part and the Second and the Third Applicants on

the other part. The purpose of this Agreement was to coordinate the activities under each of the above 2 Agreements.

(e) Thereafter, the Applicants and the First and Second Respondents entered in an MoU dated 16th October 2009 (the "MoU") to amend the

scope of work under the Project Contracts enumerated above. It was expressly stipulated in the MoU that all "marine works" would be excluded

from the scope of work under the Project Contracts and further that the Applicants would not be liable for any defects arising in relation to the

marine works.

(f) The Applicants completed the construction of the Plant and the Performance Achievement Test was conducted by the Independent Consultant

(appointed by CMWSSB) on 29th June 2010. Having successfully passed the test, the Performance Achievement Test Certificate was issued

under letter dated 9th July 2010 expressly certifying that the Plant had surpassed all the tests and is capable of operation in accordance with all

Technical Requirements and Performance Standards, and further expressly certifying that the Plant's tested capacity is greater than 100% of the

intended capacity. Neither the First Respondent nor the Second Respondent at any time have disputed the date or issuance of the Performance

Achievement Test Certificate. As such the Plant was built and operational at higher than required standards. As such as of July 2010 the Plant was

in exceptional condition and no complaints were raised by the Second Respondent or any other party.

(g) Based on the above certificate of performance, CMWSSB, and in turn the Second Respondent, issued the Certificate of Commencement of

Operations and fixed the commercial operations dated 25th July 2010 (the "COD").

(h) Under the Project Contracts, the Applicants were obliged to submit Bank Guarantees in favour of the Second Respondent against any latent

defects in the construction and/or supply of equipment. The Applicants requested

the Third Respondent to issue such Bank Guarantees in favour of the Second Respondent. These Bank Guarantees are referred to in the Project Contracts as "Defects Liability Bonds."

(i) Under the Project Contracts the Defects Liability Bonds are required to be valid for a period of 1 year from COD, i.e. until 25th July 2011.

However, any claim raised under these Defects Liability Bonds must relate to a defect identified and notified in writing by the Second Respondent

to the Applicants within a period 12 months from the completion of the Performance Achievement Tests, i.e., on or before 29th June 2011.

Therefore, the Project Contracts and the Defects Liability Bonds envisaged a period of time between the expiry of the Notification period and the period to rectify such defects.

(j) The relevant clauses of the Project Contracts are briefly described below:

(i) Clause 14.2 stipulates, the Applicants shall submit the Defects Liability Bond with a validity of 12 months from required COD.

(ii) Clause 16.1 defines the Defects Liability Period as "Twelve (12) months from the Test Achievement Certificate". The contractor shall be

exempted under Clause 16.3 from its obligations, if the defect/damage arose due to normal wear and tear, corrosion or erosion not caused due to

Applicants' negligence, and/or if any repairs are carried out by a third party.

(iii) Clause 16.2 stipulates that the Second Respondent must issue a notice identifying the alleged defects during the Defects Liability Period and the

Applicants must be allowed a reasonable period of time to rectify such defects.

(iv) Under Clause 18 liquidated damages are payable only if the Tested Capacity of the plant is less than 95%. In the present instance, this would

not arise since the Independent Consultant has issued Performance Test Achievement Certificate certifying that the plant is operating at more than

100% of capacity.

(k) The clauses set out above are from the ECC contract. The terms and conditions of the Supply Contract are in pari materia with those of the

ECC contract and hence, they are not repeated herein. The relevant Clauses in the Supply contracts are 15.2, 17 & 19.

(l) Pursuant to the above obligations, the Applicants caused the Third Respondent to issue 2 separate Bank Guarantees, i.e., the Defects Liability

Bonds dated 14th August 2010, one under the ECC Contract and another under Supply Contract in favour of the Second Respondent to secure against non-fulfillment of the obligations under the Project Contracts as amended by the MoU.

(m) The value of the Defects Liability Bond issued under the ECC Contract (hereafter referred to as the "BII Bond") is Euro 10,79,302.41 (Euros Ten Lakhs Seventy Nine Thousand Three Hundred Two and Cents Forty One) which is approximately equal to Rs. 6,87,07,248.26 [Rupees Six Crores Eighty Seven Lakhs Seven Thousand Two Hundred Forty Eight and Paise Twenty Six only] and the value of the Defects Liability Bond issued under the Supply Contract is Euro 23,17,385.17 (Euros Twenty Three Lakhs Seventeen Thousand Three Hundred Eighty Five and Cents Seventeen Only) which is approximately equal to Rs. 14,75,22,285.42 (Rupees Fourteen Crores Seventy Five Lakhs Twenty Two Thousand Two Hundred Eighty Five and Paise Forty Two only). Therefore, the combined value is Rs. 21,62,29,533.68 (Rupees Twenty One Crores Sixty Two Lakhs Twenty Nine Thousand Five Hundred Thirty Three and Paise Sixty Eight Only).

(n) According to the Applicants, the Defects Liability Bonds are not unconditional and/or irrevocable Bank Guarantees. Per contra, the payment under the Defects Liability Bonds is conditional upon (i) alleged defects being identified are within the scope of work as amended by the MoU; (ii) such defects must arise during the Defects Liability Period, i.e., on or before 29th June 2011; (iii) the alleged defects must be detailed in writing; (iv) even after such detailed written demand, the payment is liable to be made only if the Applicants fail to fulfill their obligations under the relevant Project Contract within a reasonable period; and (v) the said written demand must be valid and duly executed. Each of these conditions must be fulfilled if any payment is to be made under the said Defects Liability Bonds.

(o) It is submitted that the Defects Liability Period commenced on 29th June 2010, i.e., the date of completion of successful testing. Any alleged defects ought to have been identified by the Second Respondent and notified to Applicants between 29th June 2010 & 29th June 2011. However this was not done. No communications in this respect was received until 2nd July 2011-which was after the expiry of the Defects Liability Period.

Suddenly, on 2nd July 2011, after a gap of over 11 months from the commissioning of the Plant, the Applicants received an email with attachment containing a notice, dated 25th June 2011. It is submitted that no e-mail can take 8 days to be delivered and as such the Second Respondent knowing fully well that the Defects Liability period had expired has sought to pre-date the attachment containing the notice.

(p) In this Notice received on 2nd July 2011 (the ""2nd July Notice"") certain alleged defects were sought to be identified by the Second Respondent. The Applicants replied to the same pointing out that the alleged defects were outside the contractual scope of work, and hence no liability would arise. However, in keeping with their role as joint venture partner-albeit without prejudice to their contractual rights-the Applicants indicated their willingness to assist in the remedial measures.

(q) The Second Respondent also sought compensation for the alleged defects in its letter dated 11th July 2011 (the ""11th July Notice"") for an amount of Rs. 1,51,08,000/- [Rupees One Crore Fifty One Lakh Eight Thousand Only]. This notice is clearly outside the Defects Liability Period, and hence the Applicants are not bound to honour the claimed amount. It may further be seen that the alleged actual damages is quantified by the Second Respondent as being only about 1.5 Crores, but it seeks to claim the entire value of the Bank Guarantees worth about 21 Crores. The Applicants pointed in their reply that the various alleged defects contributing to this claimed amount are the responsibility of the Second Respondent itself for not adhering to the prescribed technical specifications, and hence disclaimed liability. However, in the interests of good relations the Applicants have agreed to take efforts to discuss the same and attempt to resolve the issue.

(r) After the Applicants have replied to the above two Notices, disclaiming any contractual liability therefor, the Second Respondent has suddenly issued Demand Notice to the Third Respondent in respect of the BII Bond alleging defects including the marine works and other matters outside the scope of work. The Second Respondent has further claimed ""consequential losses and such other defects as may be noticed during the balance defect liability period.

(s) The Second Respondent has also issued a Demand Notice to the Third

Respondent in respect of the UTE Bond alleging various defects that were not at any point in time notified to the Applicants as required under the Project Contracts. The Second Respondent has further claimed consequential losses and such other defects as may be noticed during the balance Defect Liability Period.

Therefore, the Applicants filed the above Original Applications O.A. Nos. 610 & 611 of 2011 u/s 9 of the Arbitration and Conciliation Act 1996

and Applications for interim relief restraining the Third Respondent from remitting any money pursuant to the Demand Notice, dated 21st July

2011 with reference to Bank Guarantee No. 5550225508, dated 14.8.2010 issued by the Third Respondent on behalf of the Second Respondent

for an amount of ₹ 10,79,302.41 and for interim injunction restraining the Third Respondent from remitting any monies pursuant to the Demand

Notice, dated 21st July 2011 with reference to Bank Guarantee No. 5550225510, dated 14th August 2010 issued by the Third Respondent on

behalf of BEFESA Infrastructure India Pvt. Ltd., for an amount of ₹ 10,79302.41 and the Applicants also prayed for stay of the Demand

Notices, dated 21.07.2011.

2. The Respondent 1 & 2 filed a common counter questioning the maintainability of the Applications under the Arbitration and Conciliation Act,

1996 and also the right of the Applicants to pray for interim injunction restraining the Respondents from invoking the Bank Guarantee, which is

unconditional and irrevocable.

3. It is stated that the Applications filed u/s 9 of the Act are not maintainable and the Bank Guarantees are distinct and separate Agreements

entered into between the Applicants and the Respondents 1 & 2 and the Bank Guarantees issued by the Third Respondent do not contain any

Arbitration Clause and therefore, an Application u/s 9 of the Arbitration and Conciliation Act, 1996, for interim reliefs pending Arbitration

proceedings cannot be filed for the purpose of determining a dispute arising under such Bank Guarantee. Further, the Third Respondent Bank was

not a party to the Memorandum of Understanding [MoU] and therefore, the Third Respondent was not a party to the Arbitration Agreement

contained therein and hence, the Applications filed u/s 9 of the Arbitration and Conciliation Act, 1996 are not maintainable.

4. It is further stated that the Bank Guarantees are separate, independent and distinct contracts in themselves and therefore, they cannot be read into the contracts, which have been entered into between the Applicants and the Respondents 1 & 2. The Bank Guarantee has nothing to do with the dispute that may arise between the Applicants and the Second Respondent and therefore, the Applicants cannot seek to raise any dispute in respect of the contract, they entered into with the Respondents 1 & 2 and on that basis, they cannot restrain the Second Respondent from enforcing the Bank Guarantees.

5. It is further stated that the Bank Guarantees provided by the Third Respondent are unconditional and irrevocable in nature and therefore, the Second Respondent cannot be restrained from invoking the Bank Guarantees.

6. It is further stated that once a Bank Guarantee is given, the Bank must honour the same and make payment according to the tenor of the guarantee without any proof or condition and exceptions to the above rule and when there was an egregious fraud of which the Bank has notice or irretrievable damage would cause to the parties, if the Bank Guarantees were allowed to be invoked.

7. It is further stated that no fraud has been alleged in the Petition and as a matter of fact, no fraud has been practiced by the Respondents 1 & 2.

It is further stated that the Applications are also not maintainable, as the Third Respondent is not a party to the Memorandum of Understanding [MoU], under which the Applicants are presently claiming the reliefs.

8. It is further stated that the Applicants have not made any positive statement to the effect that either they have entered into an amicable negotiations with the Second Respondent or they even intend to initiate an Arbitration proceeding against the Second Respondent and therefore, the Applicants have not even met with the basis requirements of Section 9 of the Arbitration and Conciliation Act, 1996.

9. The Respondents 1 & 2 denied that the Performance Achievement Test has no significance to the invocation of the Bank Guarantees as alleged by the Applicants. It is also denied that the plant was in exceptional condition or that no Complaints were raised by the Respondents or any other party. They also denied the allegation that they delayed the performance of their obligations and the work that ought to have been completed by

August 2008 was extended from time to time until October 2009 and therefore, the required COD was achieved only by 25th July 2010 and such allegations are all irrelevant to the invocation of Bank Guarantees.

10. It is further stated that:

(a) The Applicants, have deliberately omitted to include that Clause 14.2 of the ECC Contract, which provides the Defects Liability Bond has a

validity of 12 months "from Required COD" i.e. from 25.7.2010 onwards. This has also been included in the Bank Guarantee.

(b) Clause 16.1 provides that the Defects Liability Period will be of Twelve (12) months from the Test Achievement Certificate. Clause 1.52 of the

ECC Contract defines COD as meaning "the date from which the Facility passes the Performance Test and the Test Achievement Certificate

issued by the Independent Consultant". Further the reference to Clause 16.3 is of no consequence since none of the conditions as referred in

Clause 16.3 have arisen in this case.

(c) Clause 16.2 merely requires that the Contractor is required to remedy the errors, defects or any other failure of the Works at the Contractor's

own cost during the defects liability period and that this defect ought to be rectified within a reasonable period of notice from Respondent No. 2.

However, there is no formal requirement of issuance of notice "within" the Defects Liability Period and this is a deliberate misconstruction by the

Applicants of the term of the Agreement.

(d) The further statement that LD would not arise is also an incorrect statement and is in any event irrelevant to the invocation and enforcements of

the Bank Guarantees which have been furnished to Respondent No. 2 by Respondent No. 3. The Applicant had pointed out that the Facility was

not performing to its intended capacity time and again and that the shortfall was due to the defects in the Works of the Applicants. Respondent No.

2 had received a daily chart from CMWSSB that the Facility was "short" in fulfilling its capacity. It has further been indicated by the O & M

Operator that the shortfall was due to defects in the equipment. Further, the reference to the capacity at the time of the Performance Test

Achievement Certificate is irrelevant since the Defects Liability Period commenced from the Required COD date of 25.7.2010 onwards and it is

the performance from this period onwards that should be calculated.

11. It is further stated that the Applicants are attempting to deliberately mislead this Hon'ble Court in claiming that the completion of the

Performance Achievement Tests on 29.6.2010 is the date to be considered for the commencement of defects liability period. In fact, the terms

used in the Defects Liability Clause is "12 months from the Test Achievement Certificate". Therefore, even on the strength of the contention of the

Applicants own statement, the Test Achievement Certificate was issued only on 9.7.2010 and therefore, the sly statement regarding 29.6.2010 is

incorrect. The Applicants in the Applications have deliberately misconstrued the Agreements and concealed pertinent documents, which by itself

are grounds sufficient for vacating the ex-parte order that has been obtained with unclean hands by these Respondents. Therefore, it is stated that

Defects Liability Bond was provided by the Third Respondent at the request of the Applicants for the period commencing from 25.7.2010 and the

allegation that a notice has to be issued to the Respondents during the Defects Liability Period is also not correct. It is stated that the only

requirement to invoke the Bank Guarantee is to make a written demand detailing the defects by the Second Respondent and the detailing of the

defects need not have been made before 29.6.2011 and that is a deliberate misrepresentation of the Applicants.

12. According to the Respondents, Commercial Operation Date means, the date from which the facility passes the Performance Test and the Test

Achievement Certificate issued by the Independent consultant. The Commercial Operation Date, as per the document filed by the Applicant was

25.7.2010 and the date of conduct of the Performance Achievement Test has no relevance as to when the Defect Liability Period commences.

The Third Respondent Bank does not stand as a judge in deciding whether there is a failure to fulfill its obligations on the part of these Respondents

nor does the Bank Guarantees provide for any provision for the Applicants to respond to the detailing of the breaches. The Bank Guarantees are

worded in such a manner so as to make it unconditional and also that the Third Respondent will not enter into the merits of any such controversy.

As the procedural requirements were complied with, there was no scope for interference into the Second Respondent invocation of the Bank

Guarantees. They also denied that the compensation for the defects was only for a sum of Rs. 1,51,08,000/- as stated in the Application. In the

letter, dated 11.7.2011, it was only stated that the Applicants were also responsible for the rectification costs as incurred by the Operations and

Maintenance operator in addition to the defects to be rectified under the Applicants Defects Liability. They also denied the allegation that email,

2nd July 2001 was falsely dated on 25.6.2011 and no Notice was issued before the expiry of the Defects Liability Period.

13. It is stated that the Notice, dated 25.6.2011 was sent by hand delivery on the same day and it was made before the expiry of the period. It is

further stated that the Applicants have not substantiated any allegation or fraud and the Applicants have not established that fraud is of such

egregious in nature and the Bank has notice of the same. On the other hand, fraud was practiced by the Applicants in approaching the Court.

14. It is also denied that the Applicants ought to have been required to rectify the defects by giving reasonable time and according the

Respondents, the long series of correspondence would establish that the defects have been intimated to the Applicants and they failed to rectify the

defects. It is also stated that the guarantees are separate and distinct and the terms of the guarantee are to be considered for invoking them and

they cannot be controlled by the other contracts entered into between the parties and as per the Deed of Guarantee given by the Third

Respondent, on making a demand in writing by the Second Respondent notify the defects, the Bank Guarantee can be invoked and the Third

Respondent is bound to honour the Bank Guarantee and therefore, the relief prayed for by the Applicants cannot be entertained and the

Applications are to be dismissed.

15. It is submitted by the learned Senior Counsel Mr. R. Krishnamoorthy and supplemented by Mr. Vineet Subramani, learned Counsel appearing

for the Applicants that the First Applicant entered into a shareholders agreement with the First Respondent for establishing a Joint Venture

Company, the Second Respondent, to execute the Seawater Desalination contract awarded by Chennai Metropolitan Water Supply and

Sewerage Board [CMWSSB] and the First Applicant and the Respondents 1 & 2 were signatories to the shareholders agreement and are bound

by its terms.

16. He further submitted that the Second Respondent entered into ECC contract

with the Second Applicant for the construction of Desalination

Plant and the Second Respondent also entered into Supply Contract with the Third Applicant for the equipment supply for the Desalination Plant.

The Bank Guarantees known as "Defects Liability Bonds" were issued by the Third Respondent at the instance of the Second Applicant under the terms of ECC Contract and Supply Contract as stated above.

17. He further submitted that a Memorandum of Understanding [MoU] was also entered into by all parties to amend the ECC contract and Supply

Contract to specifically exclude "Marine works/Sea works" from the scope of work and also from the scope of Defects Liability Bonds.

18. It is further submitted that the Performance Achievement Test was completed on 29.6.2010 and therefore, the Defects Liability Bond was

valid for a period of 12 months from 29.6.2010, the date on which the Performance Achievement Test was completed and it was also agreed that

the Second Respondent should notify all defects, if any before the expiry of the Defects Liability Bond, namely on or before 29.6.2011. The

Commencement of Operations Date (COD) was on 25.7.2010 and as per the Defects Liability Bond, the bonds are valid for a period of 12

months from COD, namely till 25.7.2011.

19. It is further submitted that the Second Respondent called upon the Applicants to rectify the defects only on 2.7.2011, which was after the

expiry of the Defects Liability Period and the Second Respondent also issued a notice claiming compensation for defects under the ECC and

Supply Contract on 11.7.2011, which was also after the expiry of the period prescribed under the Defects Liability Bond and therefore, the notice

was also not a valid notice. Though, the Second and Third Applicants sent reply to the Second Respondent pointing out the legal infirmities in the

reply, dated 20.7.2011, the Second Respondent sent a demand notice to the Third Respondent invoking the Defects Liability Bond on 21.7.201

and therefore, the Applications were filed.

20. It is further submitted that the Memorandum of Understanding [MoU] entered into between the parties contained an Arbitration Clause and the

Bank Guarantees were issued only as per the Memorandum of Understanding and it is also made clear in the Defects Liability Bonds that they

were executed as per the obligation under the ECC contract as amended by the

Memorandum of Understanding [MoU] relating to Desalination

Plant and therefore, having regard to the Arbitration Clause in the MoU and also in the ECC, the Applications filed u/s 9 of the Arbitration and

Conciliation Act, 1996 are maintainable.

21. Mr. R. Krishnamoorthy, the learned Senior Counsel appearing for the Applicants further submitted that the Defects Liability Bonds executed

under the ECC Contract and Supply Contract are not unconditional and irrevocable and a reading of various clauses of the Bonds would also

make it clear that the bonds are conditional.

22. It is further submitted that it is clearly mentioned in the bond that the same was executed in compliance with the obligations under ECC

Contract as amended by the Memorandum of Understanding [MoU]. Therefore, the relevant provision of EC Contract must be read into the Bank

Guarantees and the conditions thereunder must be fulfilled for invocation of Bank Guarantees. He further submitted that in the bond, it has been

stated that at the first written demand of the Second Respondent receiving on or before 25th July 2011 including detailing of the alleged breach by

the contractor of ECC contract, the Third Respondent shall pay to the Second Respondent, the sum mentioned in the bond, if the contractor failed

to perform in accordance with its obligation during the defects liability bond under the ECC contract. The learned Senior Counsel, therefore,

submitted that the above wording in the Defects Liability Bonds makes it clear that the bonds are conditional and the bonds can be invoked: (i)

When a written demand is made on or before 25th July 2011 detailing the alleged breach by the contractor of ECC contract; and (it) If the

contractor failed to perform in accordance with its obligations during the Defects Liability Period under the ECC contract. He, therefore, submitted

that unless two conditions are satisfied, the Bank Guarantees cannot be invoked and therefore, the Bank Guarantees are conditional.

23. He further submitted that as per Clause 16.2 of ECC contract, the Second Applicant shall remedy the defects pointed out by the Second

Respondent within a reasonable time from the notice issued by the Second Respondent during the Defects Liability Period and in this case, the

Second Respondent did not issue the Notice identifying the defects within the period of 12 months from 29.06.2010, the date of conducting

Performance Achievement Test.

24. The learned Senior Counsel further submitted that the email sent by the Second Respondent pointing out the defects was sent only on 2nd July

2011, after the expiry of the period prescribed under the Defects Liability Bond, though, it was dated 25.6.2011. According to the learned Senior

Counsel, the e-mail sent on 25.6.2011 would not take a week to reach the Applicants and that e-mail, dated 25.6.2011 was received only on

2.7.2011 and therefore, the Notice was anti-dated to make it appear that it was sent within the expiry of the period and therefore, the Notice was

not issued within the time, which is one of the pre-requisite for invoking the guarantee and as the Notice was not issued before the expiry of the

period, one of the conditions was invoking in the Bank Guarantee was not fulfilled and therefore, the Bank Guarantee cannot be invoked.

25. He further submitted that as per Clause 16.2 of the ECC Contract and Clause 7.2 of the Supply Contract, the Second Applicant is expected

to rectify the defects within a reasonable period from the date of receipt of notice and the notice was issued after the expiry period of the Defects

Liability Bond and without giving reasonable time to the Second Applicant, the Second Respondent invoked the Bank Guarantee on 21.7.2011.

He, therefore, submitted that the Second Respondent has not fulfilled the two conditions as per the Defects Liability Bond for invoking the Bank

Guarantee and therefore, the Bank Guarantee cannot be invoked by the Second Respondent.

26. The learned Senior Counsel further submitted that though the Respondents claimed that the defects Notice, dated 25.6.2011 was delivered by

hand, the same could not have been delivered on 25.6.2011 as claimed by the Respondents 1 & 2. It is seen from the copy of the letter, dated

25.6.2011, the defects to be rectified are given in table enclosed therewith and it is seen from the enclosure that the enclosure was, dated

11.7.2011. Therefore, when the enclosure was dated 11.7.2011, the defects Notice containing the enclosure could not have been given on

25.6.2011 by hand as alleged by the Second Respondent and therefore, it is proved by the typed set of papers filed by the Respondents that the

defect notice was served only after the expiry of the period mentioned in the defects liability bond.

27. It is further submitted that as per the Memorandum of Understanding, entire "Marine works" were excluded and therefore, they were also

excluded from the scope of Bank Guarantee. He further submitted that the demand notices exceed the terms of the Bank Guarantee and therefore,

they are not valid. According to the learned Senior Counsel, the Bank Guarantee extends only to the same extent, as the obligation under the ECC

Contract and Supply Contract and therefore, the consequential losses included in the Demand Notice cannot be brought within the scope of Bank

Guarantee and therefore, the Demand Notices were also not valid. The learned Senior Counsel, therefore, submitted that having regard to the

terms in the ECC contract and Supply contract and also in the Memorandum of Understanding [MoU] executed by between the parties and

having regard to the terms of Defects Liability Bonds, the bonds are conditional and the Second Respondent failed to notify the defects within the

period stipulated under the MoU, ECC contract and Supply contract and did not give reasonable time for compliance and hence, the invocation of

the Bank Guarantee is not legal.

28. He further submitted that the Applicants have also invoked the Arbitration Clause as per the ECC contract and Supply contract, amended by

MoU and having regard to the condition for the invocation of Bank Guarantee and when questions were raised by the Applicants that the defects

were not notified within the stipulated period and there was violation of Clause 16.4 of ECC Contract and the Second Applicant is not liable to

rectify the defects, as the third parties were permitted to rectify some defects and also with regard to the inclusion of consequential losses in the

demand notice, which are also outside the purview of ECC contract and Supply contract, the dispute can be resolved only through Arbitration and

till such time, the Bank Guarantee should not be invoked and therefore, the Applications filed u/s 9 of the Arbitration and Conciliation Act, 1996 is

valid and if injunctions were not granted, that would cause serious prejudice and hardship to the Applicants and therefore, the Applications are to

be allowed.

29. The learned Senior Counsel appearing for the Applicants would also submit that the demand notices issued by the Second Respondent are

also not valid, as there was no Board Meeting convened authorising the

invocation of Bank Guarantees. It is submitted that Article 4.1 of the Shareholders Agreement stipulates that the Board shall exercise all of the powers pertaining to the Company and the Board is required to consist of at least three directors nominated by the First Respondent and two Directors nominated by the Applicants. As per Article 6.2 of Shareholders Agreement, the minimum quorum shall comprise of at least one nominee Director appointed by each party. As per Article 6.3(xxix), the act of majority of the Directors present at a meeting at which quorum is present shall be form the Board of Directors and for prosecution or settlement of any claim exceeding Rs. 25,00,000/-, Board Resolution is necessary. Admittedly, no Board Meeting was convened and the First Applicant's representative did not give consent for issuance of demand notice by the Second Respondent invoking Bank Guarantee and therefore, the issuance of demand notice is not legally valid, as it is against the Shareholders Agreement.

30. Mr. T.K. Seshadri, the learned Senior Counsel appearing for the Respondents 1 & 2 submitted that the law is very clear that when the guarantee is an unconditional and irrevocable, the Court shall not grant injunction from invoking the Bank Guarantee, unless the parties seeking injunction is able to prove the fraud to the knowledge of the Bank or irretrievable injury that may be caused to the Applicants by reason of the invocation the Bank Guarantee. The learned Senior Counsel, therefore, submitted that in the absence of these two ingredients stated above, no injunction shall be granted from invoking the Bank Guarantee and also relied upon the judgment reported in Dwarikesh Sugar Industries Ltd. Vs.

Prem Heavy Engineering Works (P) Ltd., and another, .

31. The learned Senior Counsel further submitted that the filing of the Applications u/s 9 of the Arbitration and Conciliation Act, 1996 itself is not maintainable. All the parties to the Arbitration Agreement are not parties to the present Applications and Third Respondent is not a party to the agreement and admittedly, the Bank Guarantee does not contain an Arbitration Clause. The Bank is not a party to the Arbitration Agreement in the MoU and the Bank Guarantee is a separate, distinct and independent agreement and therefore, the Applicants cannot file an Application u/s 9 of the Arbitration and Conciliation Act, to prevent the invocation of the Bank Guarantee. He, therefore, submitted that filing of the Applications u/s 9

of the Arbitration and Conciliation Act are not maintainable.

32. He further submitted that to invoke Section 9 of the Arbitration and Conciliation Act, one of the pre-condition is that the relief sought for must

be pursuant to an Arbitration Clause, which is valid and existing between the parties and there must be a manifest intend to refer disputes to

Arbitration. In the Affidavit, it is not stated that the Applicants are taking steps to refer the matter to Arbitration or have filed an Application before

Arbitration. The Bank Guarantees issued by the Third Respondent are unconditional and irrevocable and therefore, the Applicants cannot prevent

the invocation of such Bank Guarantee without establishing an egregious fraud played by the Respondents 1 & 2 and that fraud was also known to

the Bank. In the absence of any fraud or irretrievable injury caused to the Applicants, they cannot prevent the invocation of Bank Guarantees and

relied upon the judgment of the Hon'ble Supreme Court reported in United Commercial Bank Vs. Bank of India and Others, .

33. Further, as per the Bank Guarantee, the Respondents were only required to notify the Applicants of the defects arising during the Defects

Liability Period, which had been done by the Respondents 1 & 2 before the expiry of the period. It is also false to contend that the defects pointed

out by the Respondents 1 & 2 are not breaches. Therefore, the learned Senior Counsel submitted that having regard to the clauses in the Bank

Guarantee that the same is unconditional or irrevocable, the same can be invoked by the Second Respondent by making a demand and there is no

need to make a demand pursuant to the Bank Guarantee within the period prescribed under the Memorandum of Understanding and it is enough

that the Bank Guarantee is invoked before the expiry of the period mentioned in the Bank Guarantee and admittedly, the Bank Guarantees were

invoked before the expiry period and hence, the Second Respondent cannot be injected from invoking the Bank Guarantees and the Demand

Notices cannot be stayed.

34. He further submitted that mere reference of the Memorandum of Understanding and ECC Contract in the Bank Guarantee does not mean that

the Bank Guarantee is a conditional one and there is no requirement to give Notice under Clause 16.2 of ECC Agreement during the Defects

Liability Period and it is sufficient, if any failure or defect arises during the

Defects Liability Period and even though, the notice was given after the expiry of the Defects Liability Period, if those defects occurred during the period of defects liability, the Applicants are required to rectify those defects.

35. It is further submitted that invocation of Bank Guarantee does not come within the requirement of Article 6.3 of the Shareholders Agreement and the Shareholders Agreement is not a subject matter of the present proceedings and resorting to Arbitration was also not stated in the Articles of Association. The learned Senior Counsel, therefore, submitted that the present Application is filed by invoking Section 9 of the Arbitration and Conciliation Act, 1996 is not maintainable and the Bank Guarantees are unconditional and irrevocable and by making a demand by the Second Respondent calling upon the Third Respondent to pay the amount, the Bank Guarantees can be invoked and the Third Respondent is bound to pay the amount to the Second Respondent, in the absence of any pleadings and fraud known to the knowledge of the Bank or irretrievable injury that would be caused to the Applicants by that. Therefore, these Applications are liable to be dismissed.

36. The learned Senior Counsel appearing for the Applicants relied upon the judgment reported in the United Commercial Bank Vs. Bank of India and Others, Hindustan Construction Co. Ltd. Vs. State of Bihar and Others, Mahatma Gandhi Sahakra Sakkare Karkhane Vs. National Heavy Engg. Coop. Ltd. and Another, in support of his contention that the Bank Guarantees were conditional and therefore, the Second Respondent cannot be permitted to invoke the Bank Guarantee without fulfilling the conditions. He also relied upon the judgment reported in the Hindustan Steel Works Construction Ltd. Vs. Tarapore and Co. and another, ; Arul Murugan Traders Vs. Rashtriya Chemicals and Fertilisers Ltd., Bombay and Another, in support of his contention that injunction can be granted relating to Bank Guarantees. He also relied upon the judgment reported in the Arvind Constructions Co. Pvt. Ltd. Vs. Kalinga Mining Corporation and Others, Adhunik Steels Ltd. Vs. Orissa Manganese and Minerals Pvt. Ltd., , and contended that u/s 9 of the Arbitration and Conciliation Act, the Court has got power to grant interim injunction for protection of the subject matter of the Arbitration Agreement.

37. The learned Senior Counsel appearing for the Respondents 1 & 2 relied upon the judgment reported in the Impex Trading GmbH Vs. Anunay

Fab. Ltd. and Others, in the Hindusthan Paper Corporation Limited Vs. Keneilhouse Angami, in support of his contention that the Bank Guarantee

is a separate and distinct agreement and when the Bank is not a party to the Agreement with Arbitration Clause, the Bank is not bound by the

Arbitration Clause in the other Agreement. He also relied upon the following judgments:

1. In the Tarapore and Co. Vs. V/O Tractoroexport and Another,

2. In the United Commercial Bank Vs. Bank of India and Others,

3. In the Vinay Engineering Vs. Neyyeh Ligonite Corporation Limited and Another, in support of his contention that when the Bank Guarantees

are unconditional and irrevocable, the beneficiary cannot be prevented from invoking the guarantees even on the ground of fraud or irretrievable

injury. He further relied upon the judgment reported in the matter of Dwarikesh Sugar Industries Ltd. Vs. Prem Heavy Engineering Works (P)

Ltd., and another, wherein the Hon''ble Supreme Court dealt with the question of what would constitute as fraud. He also relied upon the judgment

reported in the matter of Svenska Handelsbanken Vs. M/s. Indian Charge Chrome and others, wherein the Hon''ble Supreme Court considered

the term "irretrievable injury" and submitted that in this case, there is no allegation of fraud or irretrievable injury and no case of fraud or

irretrievable injury has been made out and more so, in the case of fraud, it has been held in various judgments that the Bank must be aware of the

fraud alleged to have been committed by the beneficiary and there is no allegation or proof to substantiate these aspects and therefore, the

injunction cannot be granted.

38. From the submissions of the learned Senior Counsels appearing for the parties, the following points arise for consideration in these

Applications:

1. Whether the Applicants are entitled to file the Applications by invoking Section 9 of the Arbitration and Conciliation Act, 1996, when the Bank

Guarantees do not have any Arbitration Clause.

2. Whether the Bank Guarantees are unconditional and irrevocable as contended by the Respondents or conditional as contended by the

Applicants.

3. Whether the Applicants have made out a case for injunction if the Bank Guarantees were held to be unconditional; and

4. Whether they have proved fraud on the part of the Second Respondent and whether they have proved that irretrievable injury would be caused

in the event of invocation of the Bank Guarantee by the Second Respondent.

39. To appreciate the contention of the learned Senior Counsels appearing for both the parties and to arrive at a conclusion on the points for

determination as stated above, we will have to look into the provisions of Bank Guarantees to find out as to whether as per the Bank Guarantees,

an Application can be filed u/s 9 of the Arbitration and Conciliation Act, 1996. If so, whether the Bank Guarantees are unconditional or

irrevocable and if the Bank Guarantees are conditional, whether interim injunction can be granted.

40. According to me, if the answer to the first point for consideration is in favour of the Respondents, there is no need to go into the other points

for consideration. Therefore, let me take the first point for consideration "Whether the Applicants are entitled to file the Applications by invoking

Section 9 of the Arbitration and Conciliation Act, 1996, when the Bank Guarantees do not have any Arbitration Clause."

41. As stated supra, the Applications in O.A. Nos. 610 & 611 of 2013 were filed u/s 9 of the Arbitration and Conciliation Act, 1996 and it is the

contention of the learned Senior Counsel appearing for the Applicants that the Deed of Guarantees were executed pursuant to the ECC Contract

between the Second Respondent and the Second Applicant, dated 5.1.2007 and Supply Contract of the same date executed between the Second

Respondent and the Third Applicant. Therefore, it was contended by the learned Senior Counsel appearing for the Applicants that in the ECC

Contract, Supply Contract and the Memorandum of Understanding, there is an Arbitration Clause and the Bank Guarantees were executed

pursuant to Clause 14.2 of the ECC Contract and Clause 15.2 of the Supply Contract and the Bank Guarantees also clearly spell out that the

guarantees were executed in accordance with the provision of bonds required by the ECC Contract and Supply Contract as amended by MOU

and therefore, the aforesaid three contracts were referred to in the Bank

Guarantees and therefore, the Arbitration Clause mentioned in those contracts shall have to be incorporated by reason of reference into the Bank Guarantees and therefore, the Applications are maintainable u/s 9 of the Arbitration and Conciliation Act, 1996.

42. On the other hand, the learned Senior Counsel appearing for the Respondents 1 & 2 submitted that though, there was a reference to the ECC Contract, Supply Contract and Memorandum of Understanding in the Bank Guarantees, the clause relating to Arbitration in those contracts cannot be incorporated into the Bank Guarantees, unless there is a specific reference to Arbitration Clause in the Bank Guarantees and a reading of the Bank Guarantees would make it clear that pursuant to the obligations as per the ECC Contract, Supply Contract, the Bank Guarantees were executed and therefore, the clause relating to obligation alone can be considered, while invoking the Bank Guarantees and the clause relating to Arbitration cannot be incorporated. The learned Senior Counsel, therefore, submitted that when the Bank Guarantee do not contain clause relating to Arbitration, the Applications filed u/s 9 of the Arbitration and Conciliation Act, 1996 are not maintainable.

43. The Bank Guarantees, which are sought to be invoked by the Second Respondent are similar and therefore, to appreciate the contention of the parties, the Bank Guarantee, which is called as "Defects Liability Bond" executed pursuant to ECC Contract is extracted herein for better appreciation:

In the event of a first claim against the contractor and division of the debt, the bank known as Citibank, NA India branches, a National Banking Association duly constituted and in existence in accordance with the laws of the United States of America now in force, having its Principal Office in India at Citigroup Centre, C-16 Bandra-Kurla Complex, Bandra (East), Mumbai-400 051 and, for the purposes of this guarantee, acting through its branch, namely Citibank NA. Chennai branch presently situated at ground floor, No. 163 Anna Salai, Chennai-600 002. (hereinafter referred to as ""Citibank NA. Chennai"" or ""Bank"" which term shall mean and include, unless to repugnant to the context or meaning thereof, its successors and permitted assigns), hereby unconditionally and irrevocably guarantee the payment on receipt of written demand received at our

counters on or before 25th July 2011 to M/s. Chennai Water Desalination Ltd. (CWDL) of the sum of Euro 1,079,302,41 (Euro one million

seventy-nine thousand three hundred two and forty one cents) in accordance with the provisions of bonds required by the etc. contract for the

engineering construction and commissioning entered into between BEFESA Infrastructure India Private Limited or subsidiaries and CWDL for the

Desalination Plant at Minjur, Chennai for 100 mld production as stipulated in any or all the contracts this defects liability bond is requested by

BEFESA Agua S.A. to guarantee BEFESA Infrastructure India Private Limited's compliance with its obligations under the EC contract, as

amended by the Memorandum of Understanding relating to the construction of a Desalination Plant at Minjur, Chennai, India, between BEFESA

Agua S.A. BEFESA Infrastructure India (P) Limited, UTE Construction Desalination, Chennai, Chennai Water Desalination Limited and IVRCL

Infrastructures and Projects Limited and dated 16th October 2009 (the ""MoU"" to remove the sea works (as defined in the MoU) from the scope

of the EC Contract, and/or as amended by any subsequent agreement, during the defects liability period.

At the first written demand of M/s. Chennai Water Desalination Ltd. (CWDL) received at our counters on or before 25th July 2011 including

detailing of the alleged breach by the contractor of the EC Contract, the Bank known as Citibank N.A. Chennai branch shall pay to M/s. Chennai

Water Desalination Ltd., the aforesaid sum, if the Contractor failed to perform in accordance with its obligations during the defects liability period

under the EC Contract, as amended, ignoring such requests or allegations opposing the same as it may receive from any party or from a third

party, including ourselves, and refraining from entering into the merits of any dispute contended, as the Bank shall remain aloof from any

discrepancy which might arise.

This guarantee shall be valid and binding on us despite any change or addition to or other modification of the terms of the EC Contract (as

amended by the MoU) or of the scope of the works to be performed thereunder which may be made between BEFESA Infrastructure Private

Limited and CWDL and we hereby waive notice of any such change, addition or modification. However our liability under this guarantee shall not

exceed Euro 1,079,302.41 (Euro one million seventy nine thousand three hundred two and forty one cents) or extend its tenor beyond 25th July

2011. This guarantee will have a maximum period of validity ending on the date (subject to mutually agreed extensions if any) 25th July 2011 and

any claim arising thereof must be dealt with within that period of time. Please note that you may, if you so require, independently seek confirmation

with Citibank, N.A. Ground Floor, No. 163 Anna Salai, Chennai-600 002, that this guarantee has been duly and validly issued.

Notwithstanding anything to the contrary contained therein, the liability of Citibank, N.A. under this guarantee is restricted to a maximum total

amount of Euro 1,079,302.41 (Euro one million seventy nine thousand three hundred two and forty one cents) our guarantee shall remain in force

until 25th July 2011.

Our liability pursuant to this guarantee is conditional upon the receipt of a valid and duly executed written claim, in original, by City bank, N.A.

Chennai Branch Ground Floor, No. 163 Anna Salai, Chennai-600 002, delivered by hand, Courier or Registered Post, prior to close of banking

business hours on 25th July 2011, failing which all rights under this guarantee shall be forfeited and Citibank, N.A. shall stand absolutely and

unequivocally discharged of all of its obligations hereunder this guarantee shall be governed by and construed in accordance with the laws of India

and competent Courts in the city of Chennai shall have exclusive jurisdiction.

Kindly return the original of this guarantee to Citibank, N.A. Chennai Branch at Ground Floor, No. 163 Anna Salai, Chennai-600 002, upon the

earlier of (a) its discharge by payment of claims aggregating to Euro 1,079,302.41 (Euro one million seventy-nine thousand three hundred two and

forty-one cents), (b) fulfillment of the purpose for which this guarantee was issued, or (c) 25th July 2011.

All claims made under this guarantee will be made payment at Citibank, N.A. Chennai Branch, Ground Floor No. 163, Anna Salai, Chennai 600

002.

44. As stated by the learned Senior Counsel appearing for the Applicants, the Defects Liability Bond was executed in accordance with the

provision contained in the ECC contract and it is also made clear that the Defects Liability Bond was executed at the instance of the First

Applicant by the Second Applicant in compliance with his obligation as per ECC contract as amended by the MoU relating to a contract of

Desalination Plant at Minjur, Chennai.

45. Further, as per Clause 14.2, the Second Applicant, who is the Contractor shall deliver to the Company, namely the Second Respondent, a

Performance Guarantee" of all obligations and responsibilities, which may derive from the execution of the contract, which shall be issued by a

Bank, which is acceptable for the Second Respondent. Similarly, under Clause 15.2, the Performance Guarantee has to be executed in connection

with the obligations and responsibilities, which may derive from the execution of the Supply Contract. Therefore, having regard to the execution of

these Bank Guarantees as per Clause 14.2 of the ECC contract and Clause 15.2 of the Supply Contract, the question is whether the Arbitration

Clause in those contracts can be incorporated into the Bank Guarantees.

46. To answer this question, we will have to appreciate and understand the meaning of Section 7(5) of the Arbitration and Conciliation Act, 1996

which reads as follows:

7. Arbitration Agreement.--(1) In this Part, "Arbitration Agreement" means an agreement by the parties to submit to Arbitration all or certain

disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.

....

(5) The reference in a contract to a document containing an Arbitration Clause constitutes an Arbitration Agreement if the contract is in writing and

the reference is such as to make that Arbitration Clause part of the contract.

47. The Hon"ble Supreme Court in the judgment reported in the matter of M.R. Engineers and Contractors Pvt. Ltd. Vs. Som Datt Builders Ltd.,

discussed the scope of Section 7(5) of the Act as follows:

Having regard to Section 7(5) of the Act, even though the contract between the parties does not contain a provision for Arbitration, an Arbitration

Clause contained in an independent document will be imported and engrafted in the contract between the parties, by reference to such independent

document in the contract, if the reference is such as to make the Arbitration Clause in such document, a part of the contract. The wording of

Section 7(5) of the Act makes it clear that a mere reference to a document would not have the effect of making an Arbitration Clause from that document, a part of the contract. The reference to the document in the contract should be such that shows the intention to incorporate the Arbitration Clause contained in the document, into the contract. If the legislative intent was to import an Arbitration Clause from another document, merely on reference to such document in the contract, sub-section (5) would not contain the significant later part which reads: ""and the reference is such as to make that Arbitration Clause part of the contract"", but would have stopped with the first part which reads: ""7.(5) The reference in a contract to a document containing an Arbitration Clause constitutes an Arbitration Agreement if the contract is in writing."" Section 7(5) therefore requires a conscious acceptance of the Arbitration Clause from another document, by the parties, as a part of their contract, before such Arbitration Clause could be read as a part of the contract between the parties. But the Act does not contain any indication or guidelines as to the conditions to be fulfilled before a reference to a document in a contract can be construed as a reference incorporating an Arbitration Clause contained in such document into the contract. In the absence of such statutory guidelines, the normal Rules of Construction of Contracts will have to be followed.

8. There is a difference between reference to another document in a contract and incorporation of another document in a contract, by reference. In the first case, the parties intend to adopt only specific portions or part of the referred document for the purposes of the contract. In the second case, the parties intend to incorporate the referred document in entirety, into the contract. Therefore when there is a reference to a document in a contract, the court has to consider whether the reference to the document is with the intention of incorporating the contents of that document in entirety into the contract, or with the intention of adopting or borrowing specific portions of the said document for Application to the contract. We will give a few instances of incorporation and mere reference to explain the position (illustrative and not exhaustive).

9. If a contract refers to a document and provides that the said document shall form part and parcel of the contract, or that all terms and conditions

of the said document shall be read or treated as a part of the contract, or that the contract will be governed by the provisions of the said document,

or that the terms and conditions of the said document shall be incorporated into the contract, the terms and conditions of the document in entirety

will get bodily lifted and incorporated into the contract. When there is such incorporation of the terms and conditions of a document, every term of

such document (except to the extent it is inconsistent with any specific provision in the contract) will apply to the contract. If the document so

incorporated contains a provision for settlement of disputes by Arbitration, the said Arbitration Clause also will apply to the contract.

10. On the other hand, where there is only a reference to a document in a contract in a particular context, the document will not get incorporated in

entirety into the contract. For example, if a contract provides that the specifications of the supplies will be as provided in an earlier contract or

another purchase order, then it will be necessary to look to that document only for the limited purpose of ascertainment of specifications of the

goods to be supplied. The referred document cannot be looked into for any other purpose, say price or payment of price. Similarly, if a contract

between X & Y provides that the terms of payment to Y will be as in the contract between X & Z, then only the terms of payment from the

contract between X & Z, will be read as part of the contract between X & Y. The other terms, say relating to quantity or delivery cannot be

looked into.

11. Sub-section (5) of Section 7 merely reiterates these well-settled Principles of Construction of Contracts. It makes it clear that where there is a

reference to a document in a contract, and the reference shows that the document was not intended to be incorporated in entirety, then the

reference will not make the Arbitration Clause in the document, a part of the contract, unless there is a special reference to the Arbitration Clause

so as to make it applicable.

12. The following passages from Russell on Arbitration throw considerable light on the position while dealing with Section 6(2) of the (English)

Arbitration Act, 1996 corresponding to Section 7(5) of the Indian Act. (See pp. 52-55, 23rd Edn.):

Reference to another document.--The terms of a contract may have to be

ascertained by reference to more than one document. Ascertaining which documents constitute the contractual documents and in what, if any, order of priority they should be read is a problem encountered in many commercial transactions, particularly those involving shipping and construction. This issue has to be determined by applying the usual Principles of Construction and attempting to infer the parties' intentions by means of an objective assessment of the evidence. This may make questions of incorporation irrelevant, if for example it is clear that the contractual documents in question are entirely separate and no intention to incorporate the terms of one in the other can be established. However, the contractual document defining and imposing the performance obligations may be found to incorporate another document which contains an Arbitration Agreement. If there is a dispute about the performance obligations, that dispute may need to be decided according to the Arbitration provisions of that other document. This very commonly occurs when the principal contractual document refers to standard form terms containing an Arbitration Agreement. However, the standard form wording may not be apt for the contract in which the parties seek to incorporate it, or the reference may be to another contract between parties at least one of whom is different. In these circumstances it may be possible to argue that the purported incorporation of the Arbitration Agreement is ineffective. The draftsmen of the Arbitration Act, 1996 were asked to provide specific guidance on the issue, but they preferred to leave it to the Court to decide whether there had been a valid incorporation by reference.

Subject to drawing a distinction between incorporation of an Arbitration Agreement contained in a document setting out standard form terms and one contained in some other contract between different parties, judicial thinking seems to have favoured the approach of Sir John Megaw in *Aughton*, namely, that general words of incorporation are not sufficient. Rather, particular reference to the Arbitration Clause needs to be made to comply with Section 6 of the Arbitration Act, 1996, unless special circumstances exist.

After referring to the view of Sir John Megaw in *Aughton Ltd. v. M.F. Kent Services Ltd.*, 1991 (57) Bom LR 1, that specific words were necessary to incorporate an Arbitration Clause and that the reference in a sub-

contract to another contract's terms and conditions would not

suffice to incorporate the Arbitration Clause into the sub-contract, followed in *Barrett & Son (Brickwork) Ltd. v. Henry Boot Management Ltd.*,

1995 CILL 1026, *Trygg Hansa Insurance Co. Ltd. v. Equitas Ltd.* 1998(2) *Lloyds*" Rep. 439 and *Anonyous Greek Co. of General Insurances*

(*The "Ethniki"*) v. *AIG Europe (UK)*, 2002 (2) All ER 566 and *Sea Trade Maritime Corpn. v. Hellenic Mutual War Risks Assn. (Bermuda) Ltd.*

(*The "Aathena"*) No. 2, 2006 EWHC 2530, Russell concludes:

The current position therefore seems to be that if the Arbitration Agreement is incorporated from a standard form a general reference to those

terms is sufficient, but at least in the case of reference to a non-standard form contract in the context of construction and reinsurance contracts and

bills of lading a specific reference to the Arbitration Agreement is necessary.

48. Thereafter, the scope and intend of Section 7(5) of the Arbitration and Conciliation Act, was summarized by the Hon'ble Supreme Court as

follows:

(i) An Arbitration Clause in another document, would get incorporated into a contract by reference, if the following conditions are fulfilled: (i) the

contract should contain a clear reference to the documents containing Arbitration Clause, (ii) the reference to the other document should clearly

indicate an intention to incorporate the Arbitration Clause into the contract, (iii) the Arbitration Clause should be appropriate, that is capable of

Application in respect of disputes under the contract and should not be repugnant to any term of the contract.

(ii) When the parties enter into a contract, making a general reference to another contract, such general reference would not have the effect of

incorporating the Arbitration Clause from the referred document into the contract between the parties. The Arbitration Clause from another

contract can be incorporated into the contract (where such reference is made), only by a specific reference to Arbitration Clause.

(iii) Where a contract between the parties provides that the execution or performance of that contract shall be in terms of another contract (which

contains the terms and conditions relating to performance and a provision for settlement of disputes by Arbitration), then, the terms of the referred

contract in regard to execution/performance alone will apply, and not the

Arbitration Agreement in the referred contract, unless there is special reference to the Arbitration Clause also.

(iv) Where the contract provides that the standard form of terms and conditions of an independent trade or professional institution (as for example the Standard Terms and Conditions of a Trade Association or Architects Association) will bind them or apply to the contract, such standard form of terms and conditions including any provision for Arbitration in such Standard Terms and Conditions, shall be deemed to be incorporated by reference. Sometimes the contract may also say that the parties are familiar with those terms and conditions or that the parties have read and understood the said terms and conditions.

(v) Where the contract between the parties stipulates that the conditions of contract of one of the parties to the contract shall form a part of their contract (as for example the general conditions of contract of the Government where the Government is a party), the Arbitration Clause forming part of such general conditions of contract will apply to the contract between the parties.

Therefore, we will have to see, whether the Arbitration Clause mentioned in the ECC contract and supply contract and Memorandum of

Understanding can be incorporated into the Bank Guarantee, in the light of the law laid down by the Hon''ble Supreme Court as stated above. In

my opinion, having regard to the law laid down by the Hon''ble Supreme court explaining the scope of Section 7(5) of Arbitration and Conciliation

Act, 1996 in these cases the Arbitration Clause cannot be incorporated in the Bank Guarantees.

49. According to me, a mere reference to ECC Contract or Supply Contract or the execution of the Bank Guarantees, pursuant to the requirement

as per the ECC Contract and Supply Contract will not make the Arbitration Clause to be read into Bank Guarantees. According to me, the Bank

Guarantees, which are subject matter of the interpretation in these cases fall under the Category 3 of Paragraph 13 as stated above. Therefore,

unless a special reference to Arbitration Clause is mentioned in the Bank Guarantee, the same cannot be read into the Bank Guarantee and when

there is no Arbitration Clause in the Bank Guarantee, the Application u/s 9 of the Arbitration and Conciliation Act, 1996 is not maintainable.

50. Further, it has been held by the Hon''ble Supreme Court, in all the cases, referred to above, that Bank Guarantees are separate and distinct

agreement and the terms of the Bank Guarantee alone should be considered and therefore, in the light of the principles laid down by the Hon''ble

Supreme Court in the judgment reported in M.R. Engineers and Contractors Pvt. Ltd. Vs. Som Datt Builders Ltd., in my opinion, the Arbitration

Clause cannot be read into Bank Guarantee, and when the Arbitration Clause cannot be read into Bank Guarantee and when the Bank Guarantees

do not contain an Arbitration Clause, the Applications filed u/s 9 of the Arbitration and Conciliation Act, are not maintainable. When I hold that the

Applications are not maintainable, there is no need to decide the other issues, whether the Bank Guarantees are unconditional or irrevocable or

conditional.

51. Hence, the Applications are not maintainable u/s 9 of the Arbitration and Conciliation Act, 1996 and accordingly, the same are dismissed.

Consequently, connected applications are closed. No costs.

52. After pronouncing the order in the Applications, Mr. Vineet Subramani, the learned Counsel for the Applicants submitted that the Applicants

had the benefit of injunction till date and by reason of the order passed by in these Applications, the Respondents may invoke the Bank Guarantees

and requested the Third Respondent Bank to pay the amount as per the Bank Guarantees and in that event, they would be put to serious loss and

hardship. He further submitted that the Applicants would take steps to file the Appeal immediately on receipt of the copy of the order passed in the

above Applications and till such time, the order of this Court be stayed. Considering the fact that the Applicants had the benefit of injunction

throughout and the Applications O.A. Nos. 610 & 611 of 2011 were dismissed on the ground that the Applications filed u/s 9 of the Arbitration

and Conciliation Act, 1996 are not maintainable and it may take some time to transmit the order from Madurai Bench to Principal Bench at

Chennai, I am inclined to stay the order till 15.4.2013.