
(1997) 02 DEL CK 0093

In the Delhi High Court

Case No : First Appeal No. 311 of 1996

Walchandnagar Industries Ltd.

APPELLANT

Vs

Cement Corporation of India

RESPONDENT

Date of Decision : 25-02-1997

Acts Referred:

Citation : (1997) 2 AD 929 : (1997) 2 BC 1 : (1997) 89 CompCas 519 : (1997) 66 DLT 547

Hon'ble Judges : M. Jagannadha Rao, C.J.; Manmohan Sarin, J

Bench : Division Bench

Advocate : Arun Jaitley, Arun Bhardwaj, R.K. Jain and Ashok Bhalla, for the Appellant;

Judgement

M. Jagannadha Rao, C.J.

(1) This is an appeal by the plaintiff in Suit No. 2195/92 against the order dated 7.8.1996 in is No. 8932/92 vacating the interim injunction dated 15.6.92. The is was for temporary injunction restraining the respondent from invoking two Bank guarantees No. G. 76/1337 and G. 78/448 dated 6.12.82 and 9.4.84 respectively. The suit was one Filed by the appellant u/s 20 of the Indian Arbitration Act, 1940.

(2) The 1st respondent namely, the Cement Corporation of India invited tenders regarding supply, supervision of erection and commissioning of two numbers of Cement Mills at Tandur, State of Andhra Pradesh. On 9.11.82, a Letter of Intent was issued in favor of the appellant in respect of two cement plants. Though a formal contract was to be executed between parties ,none was executed as appellant failed to give technical details which were to be incorporated in the contract. Clause 2.0.0 of the Letter of Intent contemplated the appellant supplying material and supervising the erection of the plant by the 1st respondent. According to the appellant, both the Mills went into operation in May, 1986 and were running satisfactorily, but the 1st respondent unjustly invoked the Bank guarantees on 8.4.92 and reminded the Bank on 21.4.92 and 26.5.92

stating that appellant had failed to fulfill its contractual obligations. The present suit u/s 20 of the Arbitration Act has been filed in 1992 and temporary injunction was granted on 15.6.92 restraining the 1st respondent from encashing the Bank guarantees. Under the impugned order dated 7.8.96, injunction was vacated.

(3) The learned Single Judge held that the Letter of Intent no doubt stipulated that the first performance test was to be offered by the 1st respondent for a period of 4 days at 20 hours continuous operation per day for the whole section and the "final performance test" was required to be completed within 4 months of the first performance test, which in its turn was to start immediately after full load commissioning of the cement grinding section. The work was to be completed by the appellant within 30 months of the effective date of the contract. The learned Judge noticed that the case of the appellant was that with the supply of machinery and parts by the appellant, 1st respondent erected the two Mills, both Mills went into operation in May, 1986 and since then, they were running satisfactorily. As per the law on the subject, the Bank guarantees could be invoked unless there was fraud of such magnitude as would vitiate the underlying contract and there was likelihood of irretrievable injury to the person concerned. (Hindustan Steel Workers Construction Ltd. Vs. G.S. Atwal and Co. (Engineers) Pvt. Ltd., ; Larsen and Toubro Limited Vs. Maharashtra State Electricity Board and others, . After referring to the terms of the Bank guarantee, learned Judge observed that: "the Bank had conditionally and irrevocable agreed" to pay on demand, the amount specified in the Bank guarantee that the 1st defendant shall be the "sole Judge" to decide whether the appellant had committed breach and also as to the extent of loss or damages. The learned Single Judge Therefore vacated the injunction.

(4) There was no interim order in this appeal, but the understanding was that, inasmuch as this appeal was being disposed of at the stage of admission, the 1st respondent would not encash the Bank guarantees till we pass final orders in this FAO.

(5) Learned counsel for the appellant Sri Arun Jaitley contended that though the law in regard to Bank guarantees did not generally permit grant of temporary injunctions against encashment of Bank guarantees, there were a few exceptions to this rule, and that the case on hand fell within the exceptions. On the other hand, the learned counsel for the 1st respondent Sri R.K. Jain contended that the case did not fall within the exceptions.

(6) On facts, learned counsel for the appellant also contended that Mill No. 1 was commissioned in the 1st quarter of 1986 and Mill No. 2 in April/May, 1986. As per clause 2.6.0, performance tests were to be conducted. Appellant asked respondent to conduct performance test for Mill No. 1. A meeting took place on 24.4.87. The minutes show that 1st respondent was not in a position to have Mill No. 1 tested and stated that till full "power supply" was restored, the test could not be performed. The minutes also accept that the Mill No. 1 was running satisfactorily at 90% grinding load. It is pointed out that another meeting took

place on 22.6.87 and the minutes thereof show the inability of the 1st respondent to offer the first mill for performance tests because of acute shortage of power due to which clinker production came to a standstill. The appellant wrote a letter on 23.6.87, after visit to the site, that the mill was performing well and further requesting the 1st respondent to give a formal letter of acceptance for Cement Mill No. 1 and it was also stated that the appellant was keen for the conduct of a performance test for Mill No. 2, which was also erected. It is contended that 1st respondent did not initially provide for a performance test for Mill No. 1 which was commissioned in May, 1986. Ultimately, trial performance of Mill No. 1 was conducted on 10.9.87 and was completed on 11.9.87. Certain defects were pointed out by 1st respondent by letter dated 6.1.88 but according to appellant, they were rectified. It is stated that the details as to the rectification are contained in the letters dated 7.4.88 and 27.7.88 and minutes dated 19.8.89. So far as Mill No. 2 is concerned, it is the contention of the appellant that by letter dated 7.4.88, the appellant asked the 1st respondent to intimate a suitable date for conducting performance test. As there was no response, appellant wrote a letter dated 21.11.88 to the 1st respondent by which the arbitration clause was invoked. Appellant again requested on 16.12.88 by letter seeking arbitration. Appellant wrote on 11.4.89, 26.5.89, 9.6.89 and telex on 19.6.89 requesting 1st respondent to conduct trial test for Mill No. 2. It is stated that from September, 1989 to 1992 respondent did not raise any objection regarding the performance of Mill No. 2. It is contended that, in spite of the above facts, the 1st respondent illegally invoked the Bank guarantee on 8.4.82.

(7) The learned counsel for the respondent contended that right from the date of commencement of the project dated 9.11.82, the appellant was continuously defaulting in carrying out its obligations and innumerable letters were written to the appellant. The appellant had kept the two Bank guarantees alive by extending the same. The 1st respondent is the sole Judge to decide about the breach of conditions by the appellant and full details as to breach are set out in the written statement and reply to the IA.

(8) Bank guarantee dated 6.12.82 covers performance in regard to Mill Nos. 1 and 2. Bank guarantee dated 9.4.84 covers Mill No. 2 only. (There was a separate Bank guarantee dated 2.5.85 covering Mill No. 1 and has been released on 8.2.90, not because Mill No. 1 was functioning fully well but because there was partial performance of Mill No. 1 and respondent I released that guarantee. It is contended for respondent on sympathetic grounds as rectification was "promised" (para 14 of written statement).

(9) Before referring to the points set out below, we may make it clear that our decision with regard to the interlocutory orders as to the encashment of Bank guarantee will be subject to any final decision to be taken in arbitration proceedings by the Arbitrator.

(10) The points that arise for consideration are: (1) Is there material on record in support of respondent's contention that the appellant did not comply with the

terms of the Letters of Intent in regard to supply of material/machinery and supervision of the erection of the Mills by the respondent) and also in regard to removing the defects pointed out in respect of to Mill I and Mill 2 ? (2) Do the terms of the Bank guarantee, properly construed, permit invocation of Bank guarantees if the 1st respondent had come to the conclusion as to breach by the appellant, even though (a) the final test was not conducted for Mill 1 and (b) neither preliminary nor final tests were conducted for Mill 2? (3) Whether the guarantees were not enforceable because of fraud and also whether there would be great hardship in case the Bank guarantees are invoked? Point 1

(11) We shall consider and analyze the material available on record.

(12) The appellant was to supply equipment, respondent was to erect the Mills after civil works are completed by the 1st respondent. After erection of the Mills by the 1st respondent the latter was to offer the Mills for preliminary tests as to production of cement and if the tests yielded satisfactory results, the appellant was to be released from the bank guarantees. The supply of material by the appellant was to be completed within 21 months from the crucial dated and though these dated expired on 24.3.83, the appellant was not able to rectify the defects, pointed out by the 1st respondent. The correspondence between 1982 to 1987 is enormous and reveals that - let alone 21 months, even after several years, the appellant was not able to comply with the requests in the letters of respondents. These details are set out extensively in the written statement and in the reply affidavit filed in the IA.

(13) Ultimately, in 1987 in regard to Mill No. 1, the respondent I wrote to appellant on 22.7.87 and on 5.8.87 referring to the defects. Thereafter a preliminary test was conducted on 10.9.87 and 11.9.87. The test revealed several defects as pointed out in the Minutes of the meeting dated 14.9.87 (p. 388 of the paper book). As per the letters of 1st respondent dated 12.11.87 and 9.12.87 and 6.1.88 the defects were not rectified by the appellant. On the other hand, according to appellant, they were allegedly rectified as stated in the appellant's letters dated 7.4.88 (p. 186) and 27.7.88. But letter dated 18.5.89 of the respondent (p. 396 of paper book) shows that, it is the case of the respondent that several defects in Mill No. 1 still remained to be removed. The correspondence reveals that delay in conducting the preliminary test (which was ultimately conducted) and delay in conducting Final test for Mill No. 1 was not because of power cuts but also because, several defects were not rectified, vide letter dated 18.5.89 and other letters referred to in the written statement. Therefore, in regard to Mill No. 1 there is no material to repel the contention of appellant that final test was not conducted because of want of power supply alone.

(14) In regard to Mill No. 2, letter dated 11.6.87 (p. 383) was written by the respondent I to the appellant. Then appellant asked on 23.6.87 for a test trial but on 6.1.88, respondent wrote to appellant (p. 392) that Mill No. 2 need not be offered for preliminary test because defects in Mill No. 2 are the same as those in

Mill No. 1. Though no preliminary test was conducted for Mill No. 2, defects in Mill No. 2 were referred to in Minutes dated 27.7.89 inasmuch as the 2nd Mill was also erected with equipment similar to the equipment supplied by appellant for the 1st Mill. These facts are clearly set out in the written statement and in the reply to the IA.

(15) Therefore, when once the 1st respondent has revealed, with reference to documents, the basis on which the 1st respondent had come to the conclusion that the appellant had not supplied or rectified machinery and parts which would have enabled the two Mills to run satisfactorily, the appellant cannot challenge the said decision of the 1st respondent in the present proceedings before us though these reasons can be challenged before the arbitrator. In fact, the guarantees point out that the 1st respondent is the sole Judge in this behalf.

(16) The reasons set out by the 1st respondent in the written statement and in the reply to the Ia for invoking the Bank guarantee can be summarised as follows: (1) instead of 21 months, the appellant indeed got 10 years to supply/rectify defects. (2) the plaintiff failed to post a supervisor to oversee erection. (3) plaintiff failed to send any engineer to supervise. This was complained of on 22.1.85 and 18.2.85. (4) the suit contract themselves could not be executed as the technical information to be incorporated in the contracts were not supplied by the plaintiff despite letter and reminder dated 29.7.86. (5) plaintiffs supply of material to the 1st respondent for erection was delayed by 62 weeks, supervision of erection was delayed by 52 weeks, and commissioning was delayed by 50 weeks (Annexure A to written statement). (6) plaintiff failed in rectifying the defects in Mill No. 1 as noticed on preliminary test on 10.9.87, 11.9.87 and as recommended on 14.9.87 (p. 388). (7) Mills which ought to have been commissioned by May, 1985, were commissioned only in 1986. (8) Mill No. 1, at 1st performance, only worked out 30% load in December, 1981 and was tested at full load in June, 1987. In terms of the contract, this full load test could not be considered a first performance test at all as all the equipment was not tested simultaneously. Till date, the Auto load samples and Erection pneumatic valves were never been tested, worked or put to test. (9) The preliminary test for Mill 1 was conducted in September 1987 though all equipment was not in working order. These failures were recorded on 14.9.87. (10) The crux of the dispute so far as commissioning of both Mills were concerned, was that the known failures as revealed in performance test of September 1987 in Mill No. 1 were to be rectified in Both Mills because the equipment supplied for both Mills was similar i.e. replacement of parts etc. (11) it is not enough for the Mills to work, they must work at capacity and produce goods of a stipulated quality. Mill No. 1 was not even test run by defendant at a minimal 30% load till December, 1986 and not test run at the full load till June, 1987. Even up to 14th September, 1987, defects remained uncertified .

(17) As the 1st respondent is the sole Judge to decide about the breach of contract by the appellant and once the above reasons for invoking the two Bank

guarantees have been revealed, it is futile for the appellant to contend in the present proceedings before us that the terms of the Letters of Intent have not been breached. It will be open to attack these reasons when the matter goes before the arbitrator. Point I is decided against the appellant and we hold that there is no material on record to support the respondent's contention as enumerated. Point 2

(18) Learned counsel for the appellant then contended that in view of the language employed in the Bank guarantee, it is necessary that for both Mills, the preliminary as well as the final tests must be conducted and only then can the respondent invoke the Bank guarantees. Otherwise there was no scope for invocation of the Bank guarantees. It is argued that there is no final test performance conducted for Mill 1 and neither preliminary nor final performance tests were conducted for Mill No. 2, and hence the condition precedent for invoking the Bank guarantees has not even occurred.

(19) To appreciate this contention, which is based on the language of the Bank guarantee, it is necessary to set out the terms of the guarantee. There are three parts in the Bank guarantee. The first two parts are contained in the following paragraph:

"In terms of the above said contract, the Purchaser has agreed to make 5% payment of each consignment against dispatch documents through a bank, provided the Supplier furnishes a Bank guarantee to the Purchaser for % on the value of the Contract towards satisfactory performance guarantee tests stipulated in the Contract. The Bank hereby guarantees to the Purchaser that the Supplier shall satisfactorily fulfill the performance guarantee tests and replace (repair or rectify free of cost any equipment or part thereof supplied by them if it is found to be defective and not fulfilling the guaranteed output/performance of individual equipment and/or Department, due to faulty design, material or workmanship. The Bank guarantees to the Purchaser that if the Supplier fails to carry out the above mentioned obligations within a reasonable time from the date of receipt of notice therefore, the bank undertakes to indemnify and keep the Purchaser indemnified and pay on first demand, without demur and delay to the extent of Rs. 32,39,000 (Rupees Thirty two lakhs thirty nine thousand only) against any loss, damage or expenses incurred for removing the defects in the work by the Purchaser including the supply of the material, required for the removal of defects, or by reason of any breach of any of the terms and conditions of the said Contract on the part of the Supplier."

(20) The first part of the above para says that the Bank guarantees to the respondent:

(21) The first part of the above para says that the Bank guarantees to the respondent:

"That the supplier shall satisfactorily fulfill the performance guarantee tests and replace or repair or rectify free of cost any equipment or part thereof supplied by

them if it is found to be defective and not fulfilling the guarantor output/performance or individual equipment and/or department, due to faulty design, material or workmanship".

(22) The second part says that "if the supplier fails to carry out the above obligations, within a reasonable time from the date of receipt of notice therefore, the Bank undertakes to indemnify... and pay on first demand, without demur or delay... against any loss, damages or expenses incurred in removing defects in the work by the purchaser".

"Including the supply of material required for removal of defects, or by reason of any breach of any of the terms and conditions of the said contract on the part of the supplier".

(23) There is a third part of the guarantee which says that the 1st respondent is the sole judge as to whether appellant has breached the terms of the bank guarantee. This Clause reads:

"The Bank further agrees that the purchaser shall be the sole Judge to decide whether the supplier have committed any breach or breaches of any of the terms and conditions of the said contract and the extent of loss, damage, cost, charges and expenses suffered or incurred or would be suffered or incurred by the purchaser on account thereof...."

(24) Learned counsel for the appellant, Sri Arun Jaitley relied upon *Larsen & Toubro vs. Maharashtra State Electricity Board* 1995 (6) SCC 168 (at 172). In that case it was held on facts that if trial runs were generally satisfactory then the condition precedent for invoking the Bank guarantee did not arise. Learned counsel then referred us to the relevant clauses in the present cases which deal with the preliminary and final tests to be conducted by the 1st respondent. The term regarding preliminary test is contained in clause 2.6.0. It reads

"Performance test duration: The performance test duration will be for a period of 4 days @ of 20 hours continuous operation/per day for the whole section.

(25) The term regarding the final performance test is contained in clause 2.7.0. It reads:

"Final performance test should be completed within four months of first performance test which in turn will start immediately after full load commissioning of the cement grinding section".

(26) The contention for the appellant is based on the first part of the guarantee. It is argued basing on first part of the guarantee that there was no final test for Mill 1 and no test at all for Mill 2 and hence the condition precedent for invoking the Bank guarantee has not occurred.

(27) On the other hand, the learned counsel for the 1st respondent has argued that the second part governs the first part and that the words "by reason of any breach of any of the terms and conditions of the said contract on the part of the

supplier" overrides Part 1. It is also alternatively contended that in any event, (independent of part two) part three of the guarantee referred to above will govern Part one inasmuch as under Part three, the 1st respondent is the sole Judge to decide whether the appellant has committed any breach of the terms and conditions of the said contract.

(28) We shall assume that the first part of the guarantee should, as contended by the appellant, be first complied with by the 1st respondent before invoking the bank guarantee and that the second part does not override the first part. But, in our view, the third part of the guarantee governs the First part also. If that be so, the 1st respondent is the sole judge of the breach. So far as Mill I is concerned, long after the due dates stated in the contract, the appellant removed some defects and the preliminary test for Mill I was conducted on 19.9.87 and 11.9.87. The defects noticed are contained in the minutes dated 14.9.87 (p. 388) and we also have subsequent letters of the 1st respondent to the appellant dated 12.11.87 (p. 390), 9.12.87 (p. 391) and 6.1.88 (p. 392). Though it was contended that appellant rectified the defects as shown in letter dated 7.4.88, 27.7.88 and as per minutes dated 19.8.89, we do not have those letters in the paper book. In any event, whether the appellant had removed the defects or not, in spite of the minutes dated 14.9.87 and letters of 1st respondent dated 12.11.87, 9.12.87 and 6.1.88, the sole Judge thereof as per part three of the guarantee, is the 1st respondent. We have referred to these letters in detail under Point 1. The 1st respondent issued notice to the Bank on 8.4.82 and 21.4.92 invoking the Bank guarantee. The letter dated 21.4.92 of the 1st respondent to the Bank says:

"The party M/s Walchandnagar Industries Ltd. have not fulfilled all contractual obligations".

(29) As per part three of the guarantee, the 1st respondent is sole Judge in that behalf. The reasons for invoking the Bank guarantee are, as already stated, set out in great detail in the written statement and in the reply to the IA. We have analysed the same under Point 1 and have pointed out that the existence of material on record to support the contention that absence of adequate power supply was not the only reason for not conducting the final test for Mill 1 or for not conducting the preliminary and final tests for Mill 2. The correspondence and minutes reveal that the 1st respondent opined (see Point 1) that so far as Mill No. 1 was concerned, the final test could not be conducted as the defects revealed in the preliminary test were not rectified. So far as Mill 2 was concerned, it was the view of the 1st respondent as revealed in the correspondence and minutes, that similar defects existed in Mill NO. 2 as it was erected with like material used for Mill NO. 1 and Therefore conducting a preliminary test would be empty formality. That would indicate that the appellant has initially not complied with the terms of the Letters of Intent relating to supply and supervision so as to enable or require the 1st respondent to conduct a final test for Mill I and a preliminary test for Mill No. 2. These decision as to

non-compliance of terms of the Letters. of Intent are taken by the 1st respondent as the "sole Judge", as per the terms of the Bank guarantee and cannot be questioned in the proceedings before us though they can be questioned by the appellant in the arbitration proceedings.

(30) It is, Therefore, clear that part three of the Bank guarantee governs part one, and Therefore the invocation of the Bank guarantee cannot be faulted. Point 2 is decided accordingly. Points

(31) Learned counsel for the appellant cited several authorities to say that fraud or grave/irretrievable hardship are exceptions to the principle of not granting injunctions against invocation of Bank guarantees and that the present case comes within the two exceptions. On this point, there is no material to prove fraud in regard to the main contract or at the time of acceptance of Letters of Intent. Again mere encashment of Bank guarantee cannot be treated as causing irretrievable injury - at any rate on the facts of this case. The fact that 1st respondent is before the Bifr is also not, in our opinion, relevant. Point 3 is decided against the appellant.

(32) It is once again made clear that our prima facie findings on Points 1 to 3 are given for purposes of the IAs relating to Bank guarantee and will be subject to the decision of the Arbitrator in the arbitration proceedings.

(33) Appeal is dismissed.