ORDER SHEET
IN THE HIGH COURT OF SINDH AT KARACHI

Suit No.1222 of 2013

Forte Pakistan (Pvt.) Limited
Versus
Pakistan Petroleum Limited & another

Date	Order with signature of Judge

1. For hearing of CMA 10357/2013
2. For hearing of CMA 10999/2013

Date of hearing: 27.09.2016 and 08.11.2016

Mr. Basil Nabi Malik for plaintiff.
Mr. Khalid Mahmood Siddiqui for defendant No.1.

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Muhammad Shafi Siddiqui, J.- The counsels have substantially argued the two applications bearing CMA No.10357 and 10999 both of 2013. CMA No.10357 of 2013 is filed by the plaintiff under order XXXIX Rule 1 and 2 CPC seeking to restrain the defendants from encashing performance guarantee No.62 of 2007 dated 21.12.2010 whereas CMA No.10999 of 2013 is filed by defendant No.1 under order XXXIX rule 4 CPC for variation/setting aside of ad-interim orders dated 28.09.2013 passed by this Court on the above application. The core issue involved is encashment of subject performance guarantee.

2. In brief the facts are that the plaintiff, being a private limited company, participated in tender of defendant No.1 for supply, installation, commissioning and testing of an industrial grade diesel engine driven generators of 1250 KVA. It is claimed by the plaintiff's counsel that there are two important clauses in the tender documents, which relate to liquidated damages and execution of performance guarantee. The performance guarantee is filed along with plaint. The

plaintiff was awarded the contract being lowest and two purchase orders were issued in favour of plaintiff by defendant No.1. The first purchase order dated 13.12.2010 is in relation to local supplies for installation of generator, which also reiterated the need of execution of performance guarantee in favour of defendant No.1. The second purchase order dated 06.12.2010 is in relation to purchase of the equipment from abroad containing the need to execute performance guarantee in favour of defendant No.1 as well as the liquidated damages.

3. It is contended by plaintiff's counsel that in pursuance of such contract subject guarantee was submitted along with tender documents. It is however claimed that defendant No.1 unlawfully sought additional warranties on 29.12.2011 from plaintiff for certain spare parts of the generators. It is urged that these generators and parts were already under warranty under the local purchase order and foreign purchase order. It is claimed that such request was declined by the plaintiff, which resulted in encashment of advance payment guarantee No.62/2008 dated 24.12.2010. Defendant No.1 also held the payment in relation to work completed.

4. Learned counsel submitted that plaintiff agitated in relation to both the issues i.e. withholding of payment in relation to work completed and the encashment of advance payment guarantee. Plaintiff was then coerced to undertake new warranties and obligations of defendant No.1 and on execution of such undertakings, the payments were released on 20.03.2013. While releasing such payments the defendant No.1 also claimed to have deducted late delivery charges in terms of the contract. Such encashment of advance payment guarantee is also subject matter of Suit No.30 of 2013. The plaintiff submitted a performance bond to defendant No.1 by way of pay order/bank draft of 23.09.2013. It was subsequently learnt by them (plaintiff) that

defendant No.1 had already made a malafide demand of partial encashment of subject bank guarantee. The said partial demand was then converted into a full encashment of the performance guarantee despite the fact that no violation of the terms were shown or had taken place hence plaintiff filed this suit.

5. It is submitted by the learned counsel for the plaintiff that no grounds whatsoever are available for encashment of the performance guarantee. The only defence taken by the defendants is that plaintiff has denied to have performed his full obligations under the contract. It is claimed that in view of correspondence the denial of such performance is based on late delivery of supplies and the claim of additional obligations contained in documents dated 09.10.2012 by virtue of a bank guarantee for the amount of Rs.953,000/- as opposed to Rs.41,856/-.

6. Defendant No.1 on the other hand conceded to the facts in relation to the tender being awarded to the plaintiff and the execution of advance payment guarantee and performance guarantee. He however laid emphasis that the plaintiff had itself renewed the performance guarantee on 16.12.2011 and 19.12.2012, whereby the guarantee was to expired on 04.10.2013. The defendants' counsel further urged that vide email dated 29.12.2011 plaintiff had agreed to provide additional warranty of five years and agreed that PPL shall retain performance guarantee of plaintiff for five years, which was confirmed by the plaintiff while signing the printout of the email dated 09.10.2012 hence it was urged that the plaintiff did not provide additional warranty/ guarantee till expiry of earlier guarantee on 04.10.2013 and even thereafter. Such pay order/bank draft of Rs.41,856/- was provided malafidely based on wrong calculation and assumption. It is claimed that defendant No.1 initially called for a partial encashment of Rs.1.8 Million,

which was acknowledged by defendant No.2, whereafter request for encashment of full amount of guarantee was acknowledged by defendant No.2. However, by misleading and by misrepresentation interim orders were obtained by the plaintiff.

7. I have heard the learned counsel for the parties and perused the material available on record.

8. The contract in question contains specific terms in relation to any default of the plaintiff including but not limited to late delivery of the goods. It is also an admitted fact that on account of late deliveries of certain goods, in pursuance of such clauses relating to late deliveries the defendant No.1 had already deducted liquidated damages from the subject bills/invoice. Hence, once such late delivery charges have been recovered/deducted, the encashment of subject guarantee in relation to same issue is a debatable issue. It amounts to collecting liquidated damages twice over the same alleged default and can be termed as vexing the plaintiff twice which is also hit by Section 74 of the Contract Act. Therefore, any attempt to collect further amount on the basis of same default would tantamount to be in violation of Section 74 of the Contract Act which prima facie prohibits compensation/penalty in excess of any amount stipulated in the contract itself.

9. In the case of Province of West Pakistan v. Mistri Patel & Company reported in PLD 1969 SC 80, the Hon'ble Supreme Court while dealing case pertaining to section 74 of the Contract Act has held as under:-

> *"……The award of compensation by the Court under section 74 of the Contract Act will depend upon its finding as to what in the facts and circumstances of the case is reasonable compensation subject to the limit of the amount mentioned in the contract. 1t is true that the aggrieved party is entitled to recover compensation from the party who is guilty of breach of the contract whether or not actual damage or loss is proved to have been caused thereby.*

In the present case we are, therefore, to see whether the Province of West Pakistan can claim the whole or any part of the amount which the firm was to deposit by way of earnest money. It will be wrong to argue that since the firm had agreed to deposit a sum as earnest money and in lieu thereof furnished Bank Guarantee for the said amount the Government would be entitled to claim the whole of this amount simply because there was a breach of the contract by the firm. Such a contention does not even receive support from the cases where the view taken was that the forfeiture clause of a deposit in a contract does not come within the purview of section 74 of the Contract Act. In these cases also forfeiture was held to be justified if the amounts were found to be reasonable.

In the present case we have already seen that the plaintiff instead of suffering any loss for the failure of the firm made a profit of Rs. 10,500. The question that arises, therefore, is whether in spite of the above fact the claim of the plaintiff in whole or in part can be justified. We are of the view that the plaintiff is not entitled to any part of its claim whether the term of the contract regarding forfeiture comes within the purview of section 74 of the Contract Act or not. We have, therefore, found no reason to interfere with the decisions of the Courts below."

10. In the case of Zeenat Brother (Pvt.) Limited v. Aiwan-e-Iqbal Authority reported in PLD 1996 Karachi 183, this Court has observed as under:-

"….Resume of the above case-law will indicate that in our country, there exists an additional reason to stay enforcement of a bank guarantee, that is, the case of "injustice" but in exceptional cases. Besides, the two conditions of fraud and injustice, there is third ground available to a plaintiff or contractor to resist enforcement, particularly in the case of performance bond which is in the nature of penalty in view of section 74 of the Contract Act. This question came up for consideration before a learned Single Judge of this Court Mr. Zafar Hussain Mirza, J. (as his Lordship then was) in the case of Messrs Jamia Industries Limited v. Messrs Pakistan Refinery Limited PLD 1976 Karachi 644 wherein a bank guarantee was furnished by the plaintiff for Rs.5,00,000 encashable in case of any default in the due performance of all or any of the obligations under a contract executed between the plaintiff and the defendant. The learned Judge while referring to the dictum laid down in the case of Province of West Pakistan v. Messrs Mistri Pitel & Co. and another PLD 1969 SC 80 held that even if a breach was committed by the plaintiffs, the defendants could not, ipso facto, appropriate the whole amount. With this view, the learned

> *Judge granted interim injunction and restrained the encashment of the performance bond.*
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> *11. In vide of the law laid down by this Court in the case of M/s. Jamia' Industries and Pakistan Engineering Consultant, I am of the considered view that the defendants are not entitled to encash the performance guarantee dated 12-7-1986….”*

11. In the case Ayaz Builders v. Board of Trustees of the Karachi Port Trust reported in 2008 CLC 726, learned Single Judge has held that:-

> *“….In the case of encashment of Performance Bank Guarantees the consensus of the superior Courts are that in exceptional cases, where refusal to grant interim injunction, will perpetuate fraud, which should be apparent from the material available on record, the Court may grant interim injunction. Other reason for stay of bank guarantee in exceptional cases is "injustice". Admittedly, the defendant No.1 has not paid the bills of the plaintiff amounting to Rs.28 million. The encashment of Performance Bond at this stage without payment of pending bills will amount to double jeopardy and the defendant No.1 cannot be allowed to cause injustice to the plaintiff by encashing, the Performance Bank Guarantee for the entire amount without adjusting the pending bills. The defendant No.1 can claim encashment of bank guarantee after adjusting the pending bills.”*

12. Insofar as second contention, which relates to complying with the terms and conditions of new obligations of the documents dated 09.10.2012 and performance guarantee dated 21.12.2010 is concerned, it only covers the obligation as contained in the purchase order dated 08.12.2010 and 13.12.2010 and any other subsequent amendment, novation, additional obligation, that may arise in relation to the project shall not be covered by the terms thereof. The ultimate paragraph of this performance guarantee is in support of above observation. Such recourse is deducible out of section 128 of the Contract Act, which allows the guarantee obligation to be limited by way of contract.

13. Considering it to be an unconditional guarantee whether is encashable on breach of additional, separate and independent obligation the case of FAL Oil Company Ltd. v. Pakistan State Oil Company Ltd.

reported in PLD 2014 Karachi 427 may be relevant where learned Single Judge while considering such facts and circumstances held that the bank did not guarantee such additional obligation to arbitrate under arbitration agreement.

14. On such principle in the case of Triodos Bank NV v. Ashley Charles Dobbes reported in [2005] EWCA CW 630 (Court of Appeals) the English and Wales Court of Appeals observed that:-

> *"34. It is important to keep in mind that the underlying obligation of the guarantor under the 1996 guarantee – clause 2.1 – is in respect of monies and liabilities due, owing or incurred by the Company "under or pursuant to" the 1996 loan agreements. It is important to keep in mind, also, that the guarantor is not to be taken to have agreed that his liability under the guarantee would be increased or made more onerous by a subsequent agreement made between the lender and the borrower (to which he is not party) unless there are clear words in the guarantee which show that he did agree to be bound to a more onerous obligation in the future imposed without further reference to him."*

15. In the instant case the liquidated damages are yet to be ascertained or determined and hence encashment of performance guarantee is required to be restrained.

16. In the case Pak Consulting & Engineering (Pvt.) Ltd. v. Pakistan Steel Mills reported in 2002 SCMR 1781 Hon'ble Supreme Court has held as under:-

> *"7. Undoubtedly, at present prevailing view concerning encashment of the Bank-Guarantee in terms of section 126 of the Contract Act is that a Bank-Guarantee is an independent contract between the Bank and the party in whose favour guarantee has been furnished, therefore, encashment of irrevocable Bank Guarantee cannot be declined by the bank on the pretext that the original parties to the main contract are litigating with each other; as it has been held in the case of M/s. National Construction Co. Ltd. (ibid).*
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> *8. But in our tentative view, departure can be taken from the above rule, if it has been shown from the contents of the Bank Guarantee that there is a built-in condition to the effect that its encashment depends upon the violation*

of the conditions of the tender and the violation/breach cannot be determined without conducting inquiry and if the party in whose favour Bank-Guarantee has been furnished to judge as to whether the tenderer has failed to fulfill the conditions of the tender instead of exercising such conferred authority itself had approached to the Court of law by instituting legal proceedings for the recovery of damages etc. as-it had happened in instant case .because for such purpose respondent No. l had filed a Suit No.1040 of 2001, then till final decision of the said suit, Bank Guarantee cannot be encashed."

17. Similarly in the case of Crescent Steel & Allied Products Limited v. Sui Northern Gas Pipeline Limited reported in 2013 CLD 1110 it has been held that:

"19. In the present case, the Performance Guarantee, equivalent to the amount of the liquidated damages claimed by defendant No.1, was submitted by the plaintiff as a tentative measure. I have already held that the question as to whether defendant No.1 is entitled to the liquidated damages or not, is a dispute, and after such conclusion, the dispute has been referred to the Arbitrators and the Umpire in terms of the arbitration agreement. It is yet to be decided as to whether the conditions required for the encashment of the Performance Guarantee have been fulfilled or not. This dispute shall be decided by the Arbitrators and the Umpire. This view taken by me is supported by all the three aforementioned cases cited by the learned counsel for the plaintiff, and especially by the law laid down by the Hon'ble Supreme Court in the recent case of Standard Construction Company (Pvt.) Ltd. (supra). In my humble opinion, it would be unjust if defendant No.1 is allowed to encash the Performance Guarantee before the conclusion of the arbitration proceedings. Even otherwise, defendant No.1 shall have to prove in the arbitration proceedings the losses suffered by it in order to become entitled to the liquidated damages."

18. In the case of M/s Jam1a Industries Ltd v. M/s Pakistan Refinery Ltd. reported in PLD 1976 Karachi 644 this Court has observed as under:-

"17. ….. but I am .clearly of the view that even if a breach was committed by the plaintiffs the defendants could not, Ipso facto, appropriate the whole amount, in the light of the principle of law postulated by their Lordships of the Supreme Court in, :The Province of West Pakistan v. Mistree Patel & Co.

18. The defendants do not deny that the disputes relating to the bank guarantee are part of the contract.

Indeed, they could not have contended so in view of the clear language of the arbitration agreement. It would, accordingly, appear that a substantial dispute with regard to the question whether the defendants are entitled to claim and appropriate the entire guarantee amount or only a part thereof has arisen which is covered by the arbitration agreement and can only be referred to the forum chosen by the parties."

19. In the case of Government of Pakistan v. Adamjee Insurance Company reported in 2001 MLD 1444 this Court held as under:-

"15. Entitlement to claim a certain amount as damages or loss suffered consequent to a breach of contract either agreed for a particular sum through a contract or for the loss suffered as a breach of contract was considered by the Supreme Court in several cases. Recently this Court has also considered forfeitures of advance payment as agreed in a contract for the loss suffered; in the case of Transocan Asia Ltd. v. Rice Export Corporation of Pakistan (1999 MLD 1600 at 1603) in the following manner:--

> *".....It was also argued that mere mentioning of any penalty in an agreement will not authorise a party for forfeiture of earnest money. Reliance was placed on section 74 of the Contract Act and on the case of Province of West Pakistan v. Messrs Mistry Patel & Co. and another (PLD 1969 SC 80). Mr. Javed Farooqi, as against this has cited cases of Syed Sibte Raza and another v. Habib Bank (PLD 1971 SC 743) and Messrs Aslam Saeed & Co. v. Messrs Trading Corporation of Pakistan Ltd. (PLD 1985 SC 69). In the case of Mistri Patel & Co. (supra), a suit was filed before this Court claiming for the recovery of Rs.72,405.30 being the earnest money which was dismissed mainly on the ground that plaintiff was not entitled to sue for the recovery of some promised amount of earnest money. The letters patent appeal filed against the order of a learned Single Judge was dismissed with costs. Id that case, no cash amount was deposited as earnest money but an unconditional Bank Guarantee was furnished with the Government of Sindh with the stipulation that on the failure of the firm to fulfil its obligation, the agreed earnest amount will be paid by the bank. It was held by the Hon'ble Supreme Court, while interpreting section 74 of the Contract Act that it deals only with the right to receive a reasonable compensation from the party who has broken a contract and not the right to forfeit what has already been received by the aggrieved party..... "*

The claim for the amount as agreed in the Performance Bonds is dependent on the terms and conditions of the contract between the employer and the contractor.

16. The plaintiff has claimed that as a result of the acts of the O.B.L. in deserting the construction project and as a result of rewarding of the contract to the other contractor, the plaintiffs have suffered loss about 80 to 90 lacs rupees; however, during cross-examination, their witness was not able to disclose as to whom the contract of the project in question was awarded to after the O.B.L. abandoned the same. No copy of contract entered between the plaintiff and subsequent contractor was placed on record. It was not C shown as top how much amount was agreed between the plaintiff and the subsequent contractor. At the same time no substantial documents were placed on record to show that the project in question was successfully completed by the subsequent contractor which resulted in payment of excess amount over and above the agreed contract money with O.B.L. Therefore, in my considered view the plaintiffs are not entitled for the whole amount as accepted by this defendant in the total of all the four Performance Bonds which comes to Rs.20,89,786,40. In the aforesaid circumstances, the plaintiff is not entitled for the whole amount of the aforesaid four Performance Bonds."

20. In the ibid judgment in the case of Fal Oil Company Ltd v. Pakistan State Oil Company Ltd. reported in PLD 2014 Karachi 427, learned Single Judge of this Court has dealt with the performance bond as a contract and held that:-

"A performance bond is of course a contract, and it is well settled that the intention of the parties to a contract must be objectively determined. Lord Hoffmann's speech in Investors Compensation Scheme v. West Bromwich Building Society [1998] 1 All ER 98 is regarded as a seminal decision on the interpretation of contracts. His Lordship identified a number of principles, of which the following are relevant for present purposes (at pp. 114-5) (emphasis supplied):

"The principles may be summarized as follows:

(1) Interpretation is the ascertainment of the meaning which the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract.

(2) The background was famously referred to by Lord Wilberforce as the "matrix of fact," but this phrase is, if anything, an understated description of what the

background may include. Subject to the requirement that it should have been reasonably available to the parties and to the exception to be mentioned next, it includes absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man.

(3) ……

(4) The meaning which a document (or any other utterance) would convey to a reasonable man is not the same thing as the meaning of its words. The meaning of words is a matter of dictionaries and grammars; the meaning of the document is what the parties using those words against the relevant background would reasonably have been understood to mean....

(5) ……..

In Static Control Components (Europe) Ltd v. Egan [2004] 2 Lloyd's Rep 429, [2004] EWCA Civ 392, the Court of Appeal held that these principles applied also to the construction of contracts of guarantee (at [13]). It is in the foregoing terms that I propose to consider the questions posed in this paragraph."

21. Having gone through the above authorities and law, the fact remains that the liquidated damages have already been deducted from the invoices and what part of performance is lacking is yet to be established, hence prima facie the encashment of performance guarantee is not warranted and the defendant, as such, is hereby restrained. The application bearing CMA 10357/2013 as such is allowed to the above effect.

22. In view of the above, the application bearing CMA No.10999 of 2013 has become infructuous, which is accordingly dismissed.

Dated: 07.02.2017 **Judge**