ORDER SHEET
IN THE HIGH COURT OF SINDH AT KARACHI
JM No. 57 of 2013 &
Suit 1139/2011

Date	Order with signature of Judge

For hearing of main application and
CMA 13569/2013 in JM 57/2013
And
CMA 9408/2011 in Suit 1139/2011

Dates of hearing: 27.01 and 28.02.2014

Dr. Muhammad Farogh Naseem,
Advocate for the petitioner in JM 57/2013 &
for the plaintiff in Suit 1139/2011.
Mr. Mayhar Mustafa Kazi,
Advocate for the respondent No. 1 in JM 57/2013
& the defendant No. 1 in Suit 1139/2011.

Munib Akhtar, J.: By means of JM 57/2013 ("the JM"), the petitioner ("FAL"), a company incorporated under the laws of the UAE, seeks enforcement, under sections 3 and 6 of the Recognition and Enforcement (Arbitration Agreements and Foreign Arbitral Awards) Act, 2011 ("Act"), of an award made in London. The award was made on 03.10.2013 by a sole arbitrator ("Award") in arbitration proceedings between FAL and the respondent No. 1 ("PSO"), and enforcement is sought against the latter. By means of CMA 13569/2013, FAL seeks to restrain encashment of two performance bonds that were issued at Karachi in favor of PSO by the respondent No. 2, a banking company ("Bank"). Earlier, and before the making of the award, FAL had instituted Suit 1139/2011 ("the Suit") seeking declaratory and injunctive relief against PSO and the Bank in respect of the performance bonds. Interim injunctive relief was sought by CMA 9408/2011 filed in the Suit. On that application, interim relief was granted by order dated 19.09.2011. The foregoing proceedings came about in the following circumstances.

2. It appears that sometime in April, 2011 PSO issued tenders inviting offers for the procurement of low sulphur fuel oil ("LSFO") and high sulphur fuel oil ("HSFO"). FAL bid for both tenders and was awarded two contracts on or about 13.05.2011. The two contracts were (other than obvious differences such as quantities, etc.) the same in all material respects. Three clauses are relevant for present purposes. Firstly, the contracts were governed by English law. Secondly, FAL was required to provide a performance bond

in respect of each contract from a first class scheduled bank operating in Pakistan. The format for such bond was annexed to the contract. FAL met this obligation by providing performance bonds issued by the Bank in the sums of USD 7,771,600 and USD 1,305,600 for the HSFO and LSFO contracts respectively. The format of the performance bonds provided, and the bonds therefore stated, that they were governed by the laws of Pakistan. Thirdly, each contract contained an arbitration agreement embedded as a clause therein. The arbitration agreements were in identical terms and provided as follows:

> "The Parties shall endeavor to settle all disputes amicably arising out of the Contract. Those disputes which cannot be so settled, shall be submitted to arbitration. Any controversy or claim arising out of or relating to the Contract or the breach thereof shall be settled by arbitration in accordance with the Rules of the London Court of International Arbitration. Both the Parties shall mutually appoint one arbitrator and the decision of such arbitrator in such arbitration proceedings shall be final and binding on the Parties."
>
> It was provided that the venue of any arbitration would be London.

3. It appears that certain disputes arose between the parties with regard to the supply of both HSFO and LSFO. It is not necessary to give the details of the disputes. It suffices to note that ultimately PSO gave notice of termination of both the contracts on account of breaches allegedly committed by FAL, and sought encashment of the performance bonds. This led to the filing of the Suit on or about 19.09.2011 and the making of the interim order therein, on the same day, on CMA 9408/2011. The defendants (i.e., PSO and the Bank) were restrained from encashment of the performance bonds.

4. FAL, while denying breach of the contracts on its part, claimed that PSO was in repudiatory breach of the same by reason of the termination notices. It accepted such breach and invoked the arbitration agreements, claiming damages for the loss suffered. Proceedings commenced under the auspices of the London Court of International Arbitration (LCIA), and PSO in turn counterclaimed. The arbitrator stated the dispute in the following terms (FAL being the claimant and PSO the respondent):

> "8. The Claimant claims damages for the Respondent's failure to perform each of the HSFO Contract and the LSFO Contract. The Respondent, in its turn, counterclaims for the loss it claims it suffered as a consequence of the Claimant's failure to supply any of the HSFO or the LSFO for which it had contracted. In addition, it seeks declaratory relief that proceedings commenced by the Claimant in Pakistan to restrain the encashment of two performance bonds were in breach of the arbitration agreements between the parties and claims

damages for the loss suffered by it in consequence of these proceedings (although at present it is not able to quantify these)."

The arbitrator made his Award on 03.10.2013. As to FAL's claim, he concluded as follows:

> "84. As I have found that it was the Claimant and not the Respondent who was in breach of the terms of the HSFO Contract and the LSFO Contract, obviously the Claimant has no entitlement to damages."

As to PSO's counterclaim, the arbitrator concluded that the claim could not be entertained and refused to grant it (see paras 85-91 of the Award). The matter of "other relief" was then taken up. The arbitrator noted in para 94 that: "The Claimant accepts that I have the power to determine whether or not the proceedings brought by it in Pakistan constitute a breach of the arbitration agreements contained in each of the HSFO Contract and the LSFO Contract". Those proceedings were of course the Suit. FAL denied that it was in breach of the arbitration agreements and sought to argue, in part, that the Suit had been brought, and the interim injunctive relief sought, as a "conservatory measure". The arbitrator concluded as follows:

> "99. I do not accept that the Pakistan proceedings are merely conservatory. ... [In] Pakistan the Claimant seeks to advance the same arguments that it has advanced in this arbitration in order not merely to preserve the performance bond[s], but also to seek to establish that it has no liability to the Respondent. It is a substantive claim and one which the Claimant has given no indication of abandoning now that this arbitration has taken place. Accordingly, it is appropriate that it be ordered (insofar as they concern the Respondent) to discontinue them."

5. On the foregoing basis, the arbitrator made the following award:

> "108. Accordingly, I determine and declare that:
>
> (1) I have the jurisdiction to determine all matters within this reference and to grant the relief sought.
>
> (2) The Claimant is bound to refer all disputes under the HSFO Contract and the LSFO Contract, including those relating to the performance bonds issued under each of the same, to arbitration under the LCIA Rules.
>
> (3) The proceedings commenced by the Claimant in Pakistan, being Suit 1139 of 2011 in the Sindh High Court against the Respondent constitute a breach of the arbitration agreements contained in the HSFO Contract and the LSFO Contract.
>
> (4) The Claimant is to bear the costs of the arbitration to the date of this award, as determined by the LCIA Court.
>
> 109. Further, I award the Respondent:

(1) The sum of £19,610.50 in respect of the Respondent's other reasonable legal costs."

It was noted (in para 107) that PSO was not in a position to quantify the loss suffered by it as a result of FAL's breach of the arbitration agreements by bringing suit in Pakistan. It was observed that the parties had agreed that the arbitration proceedings be "left open for quantifying this loss (as well as to deal with any other matters that might arise in connection with the Pakistan proceedings)". The arbitrator held as follows: "Accordingly, and to this extent alone, this is not a final award".

6. Learned counsel for FAL referred to the facts substantially as above and drew attention to section 3 of the Act. Learned counsel submitted that the *non obstante* clause gave exclusive jurisdiction to the High Court. Learned counsel submitted that there was no clear finding recorded in the Award as to whether the performance bonds could be encashed. It was emphasized that the bonds could not be encashed for any loss suffered by PSO on account of breach of the contracts since the arbitrator had rejected the counterclaim. FAL was ready to pay the amount awarded by the arbitrator for the loss suffered by PSO for breach of the arbitration agreements (£19,610.50) and the bonds could not therefore be encashed for this amount. In effect, the case put forward by learned counsel was this: the Award should be enforced in terms of section 6 of the Act, and on account of what had been concluded by the arbitrator, the performance bonds could not be encashed by PSO, either for any claim on the main contracts or on account of a claim for breach of the arbitration agreements. Thus, either (or both) of the miscellaneous applications (CMA 13569/2013 in the JM and CMA 9408/2011 in the Suit) ought to be allowed. FAL stood ready to make immediate payment of £19,610.50 by way of deposit with the Nazir of the Court. Learned counsel relied on certain case law in support of his submissions.

7. Learned counsel for PSO did not object to the Award being enforced under section 6. However, he submitted that PSO was entitled to encash the performance bonds. Learned counsel specifically stated during the course of submissions that such encashment would be limited only, in the first instance, to the £19,610.50 referred to above, and secondly, to any amount that PSO might be able to quantify before the arbitrator by way of loss suffered as noted in para 107 of the Award (see para 5 herein above). In other words, the claim on the performance bonds would be limited only to the claim on account of FAL's breach of the arbitration agreements by filing the Suit in this Court. One question that arose during the submissions was whether the performance bonds, on their true and proper construction (which was, as always, ultimately

a matter for the Court to decide as a question of law) guaranteed only the obligations on the main contracts or also the obligation to arbitrate under the arbitration agreements embedded therein. This question, which quickly occupied center stage, naturally required consideration of the language of the bonds. It suffices to refer to only one of the bonds. The bond issued in relation to the HSFO contract provided in material part as follows:

> "[PSO] herein after called the Buyer has entered into a contract with [FAL] (herein after called the 'Seller') for the supply of Petroleum Products, more particularly described in the contract (herein after called HSFO) upon terms, conditions and covenants agreed between them and whereas the Seller has signed an agreement ref. contract no. PSO/FO/IMPORTS/085/2011 (hereinafter called the 'Contract').
>
> And whereas [the Bank], in consideration of the supply of HSFO by the Seller to the Buyer has agreed upon to be the guarantor for the due performance of the Seller of its obligations in accordance with the terms, conditions and covenants of the contract including any covenants and alterations therein as may be mutually agreed between the Buyer and the Seller and to secure all of the Seller's obligations, liabilities under the contract for and in connection with the supply of HSFO including particular [*sic*] Seller's obligations to arrange the supply in period(s) specified in the contract.
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> ...
>
> Now this deed witnesseth that in consideration of the aforesaid, if the seller fails to perform or commits a breach of any of its obligations aforesaid, then the Bank, upon the first written demand of the Buyer stating that the Seller has failed to perform and comply with any of the terms and conditions of the contract, irrevocably binds itself to make unconditional payment to [PSO] of the above sum [i.e., USD 7,771,600/-], without reference to the Seller, in whole or in part and any demand made hereunder by the Buyer shall be conclusive evidence of the Seller's said default.
>
> ...
>
> The obligation of the bank herein shall be that of a Principal debtor and shall be an unconditional and continuing obligation ... notwithstanding any time given, indulgence or forbearance shown and notwithstanding any amendments or alterations made in the obligation or the terms conditions and covenants between the buyer and the seller, without assent of the bank, or otherwise and notwithstanding that any claim by the Buyer against the Seller is disputed or contested or referred to arbitration by the Seller. ..."

8. Learned counsel for PSO accepted, quite properly in my view, that an arbitration agreement embedded as a clause in the main (or matrix) contract was a separate agreement in its own right, which operated on its own independent footing and could even be severed from the main contract. However, learned counsel submitted, that principle did not apply here, especially in relation to the performance bonds. The reference to contractual obligations in the bonds (and any breach thereof by FAL) referred to both the main contracts and the arbitration agreements and therefore the bonds could

be encashed on account of a breach of the latter. The principle of severability only applied if it was contended that the main contract had become unenforceable, void or voidable or suffered from any illegality or other fatal infirmity, and the issue was whether the arbitration agreement nonetheless survived. In other words, the severability principle applied only in certain limited and special contexts, and it was submitted that none were relevant for the case at hand. The performance bonds could therefore be encashed for breach of the arbitration agreements and the interim order made in the Suit ought to be vacated and the miscellaneous applications dismissed. At the conclusion of the hearing I had allowed learned counsel to submit written synopses. Learned counsel for PSO did so, referring therein to a number of decisions.

9. Learned counsel for FAL, exercising his right of reply, submitted that any loss suffered by PSO on account of the breach of the arbitration agreements had been quantified by the arbitrator and since PSO stood ready to pay this amount there was no need or occasion for encashment of the performance bonds.

10. I have heard learned counsel as above, examined the record and considered the case law relied upon. It will be seen that the controversy has narrowed considerably. There is no dispute on whether the Award should be enforced under section 6 of the Act. The principal question now is only whether the performance bonds can be encashed for breach of the arbitration agreements. If the answer is in the affirmative, then the miscellaneous applications must be dismissed and the interim order recalled and vacated. If the answer is in the negative, the converse position would apply. This is the issue that must now be addressed. (Since, as presently relevant, both contracts and the performance bonds are exactly the same, for convenience, I will largely use the singular herein below.)

11. In my view, the first question that needs to be examined is whether damages can be awarded for breach of an arbitration agreement. English law gives an affirmative answer although it seems that the point has arisen but rarely. It arose in *Mantovani v Carapelli SpA* [1980] 1 Lloyd's Rep. 375, where the Court of Appeal acknowledged the novelty of the issue. It was observed that "in principle there must be a right to bring an action for damages in respect of breach of such a clause" (pg. 383, *per* Browne, LJ). Megaw, LJ also expressed the same view: "I can see no basis for the suggestion that in an appropriate case, where damages can be proved to have followed from a breach of contract of the nature with which we are here concerned damages should not be recoverable" (pg. 384). (It must be kept in

mind that Megaw, LJ did qualify the generality of the foregoing statement in the immediately following passage. It is not necessary however, to consider that passage for present purposes.) The point was affirmed in *Schiffahrtsgesellschaft Detlev Von Appen GmbH v Voest Alpine Intertrading GmbH* [1997] 2 Lloyd's Rep. 279 (CA) where Hobhouse, LJ, while observing that "the aggrieved party also has the option to sue for damages for breach of contract" also noted that "this is rarely a satisfactory remedy" (pg. 285). Reference can also be made to two decisions cited by learned counsel for PSO, *Donohue v. Armco* [2002] 1 Lloyd's Rep 425, [2001] UKHL 64 (HL) and *Union Discount Co. Ltd. v. Zoller* [2002] 1 All ER 693 (CA), although strictly speaking, those were cases involving an exclusive jurisdiction clause. In my view, the position under Pakistani law as to whether a party can sue for damages for breach of an arbitration agreement ought to be regarded as being the same.

12. The damages to which an aggrieved party may be so entitled can of course be granted by the court in a suitable action. However, can such damages also be awarded by an arbitrator? In principle, the answer ought to be in the affirmative, but it must be more nuanced than a simple yes. As already seen (see para 4 above), in the present case the arbitrator noted that FAL accepted that he had the power to decide whether or not the proceedings by way of the Suit constituted a breach of the arbitration agreement. This statement must of course, be given due effect insofar as the present case is concerned. However, it must be kept in mind that this is not the application of any general principle. In my view, if breach of an arbitration agreement (whether a clause in a main contract or a standalone agreement) is alleged, but subsequently a reference does proceed under the said agreement, the arbitrator cannot be regarded as having the power, for that reason alone, to also adjudicate upon the question of whether there was a breach of the arbitration agreement. Since an arbitration agreement is an agreement in its own right (in this para referred to as the "principal agreement") it necessarily follows that a dispute as to whether this agreement has been breached can only be arbitrated if there is an agreement to arbitrate in this regard (in this para referred to as the "secondary agreement"). The dispute(s) that come within the scope of the principal agreement cannot be regarded as including a dispute whether this agreement has itself been breached. (Of course, a suitably worded arbitration agreement could perhaps so provide but very clear words would be needed; these are certainly not to be found in the present case.) If the parties agree to have a dispute relating to the principal agreement also referred to arbitration they must specifically reach agreement for this purpose (i.e., there must be a secondary agreement). Since the secondary agreement would itself be an arbitration agreement, it would have to comply with all the requirements of,

inter alia, the law by which it is governed. If there is a secondary agreement, the parties may, for convenience, choose to have the dispute under it (i.e., whether the principal agreement was breached) arbitrated before the same arbitrator(s) as are hearing the dispute under the principal agreement (i.e., whether the main contract was breached). This may have the appearance of there being a reference within a reference, but in law there would be two distinct references. It is emphasized that the arbitrator considering the dispute under the principal agreement in relation to the main contract could not, by reason of his having entered upon this reference, claim or assert any such authority with regard to the other dispute. FAL's acceptance of the arbitrator's power in the present case (to which PSO obviously had no objection) ought therefore, in my view, to be regarded as a secondary agreement between the parties, viz., to refer the dispute (i.e., whether there had been a breach of the principal agreement by reason of the Suit having been filed) to arbitration before the same arbitrator, and nothing more. In other words, there were, in law, two sets of arbitration proceedings before the arbitrator. One was in relation to the disputes on the main contracts regarding the supply of the HSFO and LSFO. Those disputes came within the scope of the arbitration agreements embedded in the said main contracts. The second set of proceedings was in relation to whether the arbitration agreements themselves had been breached. These latter disputes were referred to arbitration before the same arbitrator. As regards the first set of proceedings, the arbitrator rejected FAL's claim and also PSO's counterclaim. As regards the second set of proceedings, the arbitrator concluded that FAL was in breach of the arbitration agreements in filing the Suit and awarded a certain sum to PSO (£19,610.50). The arbitrator left this arbitration open for consideration of the loss that PSO claimed to have suffered on account of breach of the arbitration agreements, subject to proper quantification. However, it is crucial to keep in mind that this was only in relation to what I have described as the second set of arbitration proceedings. Insofar as the first set of proceedings is concerned, the Award has become final and there is no issue left outstanding. This is made clear by the arbitrator himself in the last sentence of para 107 of the Award.

13. This brings me to the nub of the matter: can the performance bonds be encashed on account of PSO's claim for breach of the arbitration agreements, both for the £19,610.50 already awarded and for any amount that the arbitrator may award in future? In my view, for the reasons herein after stated, the answer ought to be in the negative.

14. Learned counsel for PSO, referring to the nature of performance bonds as demand guarantees, laid emphasis on the autonomy principle applicable to

such guarantees, namely that they were independent contracts that had nothing to do with any dispute on the underlying contract and had to be honored on their own terms. Learned counsel submitted that the Bank was committed to making payment on "the first written demand of [PSO] stating that [FAL] ha[d] failed to perform and comply with any of the terms and conditions of the contract". That obligation, it was contended, was clear on the face of it and included a demand on the basis of breach of the arbitration agreement, since it was embedded as a clause in the main contract. Learned counsel relied on *National Construction Ltd. v. Aiwan e Iqbal Authority* PLD 1994 SC 311, *Shipyard K Damen International v. Karachi Shipyard and Engineering Works Ltd.* PLD 2003 SC 191, *Toyo Menka Kaisha Ltd v. Ferro Alloys Pakistan Ltd.* 1988 CLC 418 (LHC), and also a judgment of the Indian Supreme Court. It is not necessary to consider the cited cases in any detail, since the principle is well established. However, with respect, the autonomy principle does not explain what it is that the performance bond relates to. It may be payable on "first written demand", but a demand in relation or with reference to what? This is the crucial question that needs to be addressed. For ease of reference, the paragraph from the performance bond that sets out what has been guaranteed by the Bank is again reproduced below (emphasis supplied):

> "Now this deed witnesseth that in consideration of the aforesaid, if the seller fails to perform or commits a breach of any of its *obligations aforesaid*, then the Bank, upon the first written demand of the Buyer stating that the Seller has failed to perform and comply with any of the terms and conditions of the contract, irrevocably binds itself to make unconditional payment to [PSO] of the above sum, without reference to the Seller, in whole or in part and any demand made hereunder by the Buyer shall be conclusive evidence of the Seller's said default."

In my view, the key words for present purposes are "obligations aforesaid". It is the "aforesaid" obligations of FAL that are being guaranteed by the Bank. What does this refer to? It obviously refers to obligations under the main contract. But does it also include obligations in respect of the arbitration agreement? 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 summarised 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.

15. In my view, the relevant background or matrix for present purposes must be regarded as having three crucial elements. Firstly, as noted above, the law is well settled that an arbitration agreement embedded as a clause in the main contract is an independent, separate and (if necessary) severable contract in its own right. It has its own existence and takes effect accordingly. This principle has been described as "part of the very alphabet of arbitration law" (*Lesotho Highlands Development Authority (Respondents) v. Impregilo SpA and others* [2005] 3 All ER 789 (HL), at [21]). The common law principles have been incorporated in section 7 of the (UK) Arbitration Act, 1996. Although learned counsel for PSO sought to limit the applicability of this rule of law to cases where the question was whether the arbitration agreement survived failure (for whatever reason) of the main contract, I can see no reason why this should be so. The fact that the issue has generally arisen in such a context cannot and does not detract from the width of the principle, and the fundamental place it now occupies in arbitration law. Secondly, the nature of the obligation being undertaken by the Bank must also be kept in mind. It is on a performance bond (i.e., demand guarantee). These instruments have been aptly described as part of the lifeblood of international trade and modern commerce. This is especially so in relation to international sales of goods. As has been observed, the commercial purpose of a performance bond "is to provide a security which is to be readily, promptly and assuredly realisable

when the prescribed event occurs; a purpose reflected in the provision that the bond should be payable "on first demand"" (see *Siporex Trade S.A. v Banque Indosuez* [1986] 2 Lloyd's Rep 146). It is for this reason that certain special rules, such as the autonomy principle, apply to them. Thirdly, the specific context in which the performance bonds came to be issued in the present case must also be kept in mind. It was for the importation of petroleum products. Such importation is of crucial importance to any non-oil exporting economy, and Pakistan is no exception. It is widely known that PSO has an important place in the energy sector, being a key public sector organization, and in particular, has a vital role to play in the importation of petroleum products. The Bank itself (Standard Chartered) is a sophisticated institution that must be regarded as being fully aware of the manner in which international trade patterns flow in relation to the Pakistani economy and in particular, the norms and practices that are followed by banking and financial institutions while participating in and facilitating such trade.

16. The foregoing factors are in my view the crucial elements that form part of the background knowledge or matrix in which, objectively speaking, a reasonable person must be regarded as understanding, construing and applying an instrument such as the performance bonds at hand. The word "aforesaid", which qualifies "obligations" obviously refers back to something appearing earlier in the instrument. In my view, that could only be the first recital of the performance bond (the second paragraph reproduced above in para 7). Those are the obligations of FAL with reference to which the Bank has undertaken its obligation under the performance bond. It will be noted that the first recital repeatedly refers expressly to the principal obligation under the main contract, namely the timely supply of the HSFO in accordance with the terms thereof. Thus, it specifically states that the performance bond is being given "in consideration of the supply of HSFO by the Seller" and to secure FAL's obligations under the contract "for and in connection with the supply of HSFO" including, in particular, its obligations to "arrange the supply in period(s) specified in the contract". As a sophisticated financial institution, the Bank would be regarded by a reasonable person as fully aware of the legal implications of undertaking an obligation on an instrument such as the performance bond. It will also be recalled that the performance bond has been issued in a format prepared and required by PSO. In my view, the attention of all the parties is fully (and quite understandably) focused on the most crucial aspect of the transaction, namely, the timely supply of the HSFO and LSFO products. A reasonable person would not, against the foregoing backdrop, construe the reference to "obligations" as including the obligation under the arbitration agreement to arbitrate disputes under the main contract. Performance bonds facilitate international trade by providing a ready, prompt

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and assuredly realizable security that is detached from the underlying transaction and operates independently of it. A dispute on the underlying contract is of no concern to the financial institution that is the surety. But for precisely this reason, the obligation undertaken by the financial institution is the one that constitutes the trade or commerce that requires such protection. It would be going too far to conclude that the performance bond also provides such security in relation to breach of an obligation regarding the dispute resolution mechanism that the parties have selected (i.e., arbitration) especially when such mechanism is contained in what is a separate and independent agreement in its own right. In my view, such a construction of a performance bond (unless there is very clear language that would unambiguously and categorically lead to such conclusion) would be contrary to its clear commercial sense, which emerges from the background and matrix in which such bonds are normally and generally issued.

17. There is another, related reason why the obligation to arbitrate under the arbitration agreements ought not to be regarded as guaranteed under the performance bonds. It is a well settled principle of interpretation of guarantees that they should be strictly construed, in the sense that no liability is to be imposed on the surety unless it is clearly and distinctly covered by the terms thereof. This is especially so where, as here, the format of the guarantee is provided by the creditor. In such cases, the *contra proferentem* rule may also be applicable. Where two constructions are reasonably possible, the one that reduces or minimizes the liability of the surety will be preferred. This will be all the more so where such a conclusion also supports, or (at least) is not inconsistent with, the business or commercial sense of the guarantee. The modern approach generally to be taken in interpreting contracts of guarantee has been stated in a leading treatise, *Law of Guarantees* by Geraldine Andrews and Richard Millett (6th ed., 2011) where, at para 4-002 (pg. 119) the learned authors agree with the view taken in *Chitty on Contracts* (30th ed., 2008, Vol. II, para 44-059): "the courts should still in general require evidence of clear intention from the words used in a contract of guarantee to justify the nature and extent of the liability undertaken by a surety". These are general rules of construction and I see no reason why they should be regarded as having been displaced in the case of demand guarantees, whether on account of any special rules that apply thereto or otherwise. In my view, they are fully applicable to the performance bonds at hand. The main contracts, in law, contain separate and distinct arbitration agreements. The words used in the performance bonds are general in nature, and the construction that they also guarantee the obligation to arbitrate under the arbitration agreements is, at best, an alternate reasonable interpretation. However, this latter interpretation imposes a greater obligation of the Bank than the other possible construction,

which limits the Bank's liability to the obligations under the main contract. The latter interpretation should therefore be preferred. Furthermore, this interpretation is consistent with the *contra proferentem* rule since the format for the bonds was provided by PSO. It is also, for the reasons stated above, consistent with the business and commercial sense of the bonds. For all of these reasons therefore, I am of the view that the Bank did not guarantee FAL's obligation to arbitrate under the arbitration agreements.

18. Learned counsel for PSO submitted that the encashment of a performance bond could only be restrained if fraud, to the knowledge of the surety, was pleaded and proven. It was submitted that there was no such claim here, and a number of decisions were cited. It is not necessary to consider them in any detail. The reason is that in my view, the claim for encashment fails at a more fundamental level: the Bank only guaranteed performance by FAL of its obligations under the main contract. It simply did not guarantee the obligation to refer matters to arbitration under the embedded arbitration agreement. Learned counsel also submitted (though he denied that this would ever be the case) that should PSO make a claim on the performance bonds in excess of what it was entitled (on account of damages recoverable for breach of the arbitration agreements) FAL would be able to recover the balance in a suitable action. Again, this submission is predicated on the performance bonds covering the breach of the arbitration agreements. Since I have concluded that this is not so, no further consideration is required of this submission.

19. In view of what has been stated in the foregoing, I conclude that PSO is not entitled to encash the performance bonds. It cannot do so in respect of the breach by FAL on the main contracts since the arbitrator has dismissed the counterclaim that was filed by PSO. Insofar as this issue is concerned, the Award is final and PSO has taken no objection to its enforcement. PSO also cannot make a claim in respect of the breach by FAL on the arbitration agreements because, although the arbitrator has found that there was such a breach, this obligation is not covered by the performance bonds. In my view, FAL has been able to show a prima facie case for interim relief. The balance of convenience clearly lies in its favor, especially since it has expressly stated that it will deposit the amount already awarded to PSO with the Nazir of the Court. Finally, it will suffer irreparable loss and injury because if the interim injunction is not granted, the performance bonds would be encashed on a basis and for a reason that is wholly extraneous to the obligation undertaken by the Bank. The "remedy" of pursuing PSO by means of an action for recovery may well prove illusory. Needless to say, the observations herein above, as relate to the encashment of the performance bonds, are tentative and will not affect the merits should Suit 1139/2011 go to trial.

20. Accordingly, I dispose off the matters that have been considered by me in the following terms:

A. As to JM 57/2013

a. The Award is made rule of the Court and the office is directed to draw up a decree in the following terms: (1) The claim of FAL Oil Company Ltd. against Pakistan State Oil Company Ltd. be and is hereby dismissed. (2) The counterclaim of Pakistan State Oil Company Ltd. against FAL Oil Company Ltd. be and is hereby dismissed. (3) FAL Oil Company Ltd. be and is hereby bound to pay the costs of the arbitration, in the sum of £50,599.31 or such other amount as may be certified by LCIA. (4) FAL Oil Company Ltd. be and is hereby bound to pay a sum of £19,610.50, as awarded by the arbitrator in terms of para 109 of the Award.

b. CMA 13569/2013 is disposed off as infructuous on account of what is herein after stated.

B. As to Suit 1139/2011

c. CMA 9408/2011 is allowed in terms that the order dated 19.09.2011 is confirmed, but this is subject to what is stated in sub-paragraph (d) below, and is conditional upon FAL: (i) producing such documentation, within eight weeks hereof, as the Nazir finds satisfactory that the aforesaid sum of £50,599.31 has been paid; and (ii) depositing with the Nazir within three weeks hereof a sum of £19,610.50 (in foreign currency). Once both these conditions are met, the Nazir shall issue an appropriate certificate, which shall be presented by FAL to the Bank. Should such certificate not be issued by the Nazir within eight weeks, then the interim order shall stand automatically vacated and recalled, and the Bank shall be bound to act accordingly.

d. Should there be further proceedings before the arbitrator as contemplated in terms of para 107 of the Award and should the arbitrator: (i) conclude that PSO has been able to quantify the loss it has suffered on account of breach of the arbitration agreements; (ii) make an award in respect of such loss; and (c) conclude that were the performance bonds to be governed by English law then on their true and proper construction the Bank must be regarded as having guaranteed due performance by FAL of its obligations under the arbitration agreements as well, then PSO may apply to this Court in the Suit to have the interim order recalled and vacated.

JUDGE

Announced by me

4/6/

4.6.2014