
(2006) 08 GUJ CK 0068
In the Gujarat High Court
Case No : First Appeal No. 262 of 1982

Bank of Baroda

APPELLANT

Vs

Ruby Sales Corpn (Agency) and Another

RESPONDENT

Date of Decision : 08-08-2006

Acts Referred:

Citation : AIR 2006 Guj 251

Hon'ble Judges : M.R. Shah, J

Bench : Single Bench

Advocate : Darshan M Parikh, for the Appellant; Suresh M Shah, for the Respondent

Final Decision : Allowed

Judgement

M.R. Shah, J.—Present appeal has been filed by the appellant herein original defendant No.1 (hereinafter referred to as "the defendant No.1") challenging the judgment and decree passed by the learned City Civil Court at Ahmedabad dated 30-4-1981 passed in Summary Civil Suit No.3074 of 1976 by which the learned trial Court has directed the defendant No.1 to pay Rs. 11,800/- to the plaintiff with 6% interest on the principal amount of Rs. 10000/-.

2. The respondent No.1 - original plaintiff (hereinafter referred to as "the plaintiff") a partnership firm filed the aforesaid summary civil suit in the learned City Civil Court at Ahmedabad claiming Rs. 10,000/- and the interest at the rate of 21% of the said amount for the period from 11-10-73 to 30-9-76, in all Rs. 16,025/-. The aforesaid suit was filed against two defendants. It was averred in the plaint that with respect to certain dealings with defendant No.2, the plaintiff was required to procure a bank guarantee for Rs. 10,000/- and hence, the plaintiff obtained from the defendant No.1 bank guarantee bond dated 10-10-72. It was further averred in the plaint that the plaintiff deposited a sum of Rs. 10,000/- by way of fixed deposit with the defendant bank and signed a counter guarantee dated 10-10-72. It was further averred that the defendant No.2 by its letter dated 15-5-73, which was addressed to defendant No.1, falsely alleged

that the plaintiff had failed to honour the "Hundi" dated 16-10-1972 for Rs. 23,767.11 paisa and called upon defendant No.1 to pay to the defendant No.2 a sum of Rs. 10,000/- as per the said guarantee and the defendant No.2 also sent a copy of the said letter to the plaintiff and requested the plaintiff to give instructions in the matter. It was further averred in the plaint that by letter dated 7-6-73 through their advocate, the plaintiff replied to the defendant No.1 and pointed out to the bank that allegations made by the defendant No.2 were not correct and it was defendant No.1 who had committed the breach of contract and hence he was not entitled to any amount from the plaintiff and it was specifically pointed out in the letter that the articles supplied by M/s R. Mohanlal & Co. i.e. defendant No.2 were defective and useless and hence the same were rejected by the plaintiff and in these circumstances, the plaintiff was not bound to pay any amount to the defendant No.2. It was also further pointed out in the said letter that the bank had undertaken to indemnify M/s R. Mohanlal & Co. against any loss or damage caused to or suffered by M/s R. Mohanlal & Co. by reason of any breach by the plaintiff of any of the terms and conditions contained in the agreement dated 10-10-72 and as the plaintiff has not committed any breach of the terms and conditions of the said agreement, there was no question of M/s R. Mohanlal & Co. suffering any loss or damages by reasons of any such alleged breach of any of the terms and conditions contained in the agreement and it was further averred in the said plaint that defendant No.1 bank was accordingly informed not to pay any amount to M/s R. Mohanlal & Co. i.e. defendant No.2 by discharging bank guarantee and it was further assured to the bank that in case of any liability incurred by the defendant No.1 because of the instructions given in the said letter, the plaintiff would indemnify the defendant bank against any loss suffered by the defendant bank. It was further averred in the plaint that the bank received another letter dated 27-7-73 from the defendant No.1 a copy whereof was forwarded by the defendant No.2 to the plaintiff, and the defendant No.1 bank addressed a letter dated 6th August, 1973 to the plaintiff intimating them that the defendant bank was taking advice of their advocate at Ahmedabad in that matter and thereafter the defendant bank by letter dated 11-10-73 intimated the plaintiff that the defendant bank had paid and remitted the sum of Rs. 10,000/- to defendant No.2 by its demand draft by discharging bank guarantee and the bank had also recovered from the plaintiff a sum of Rs. 50/- as legal fees payable to the bank's advocate. It was further averred in the plaint that in spite of the instructions by the plaintiff to the bank by letter dated 7-6-73 not to discharge the bank guarantee and/or not to make any payment to the defendant No.2 as there was no breach of terms and conditions of the agreement dated 10-10-72 at the instance of the plaintiff and in spite of that the bank discharged the bank guarantee and paid the amount of Rs. 10,000/- under the said bank guarantee to the defendant No.2 and the fixed deposit of Rs. 10,000/- was appropriated by the defendant bank against the payment of Rs. 10,000/- under the bank guarantee and the said amount of Rs. 10,000/- was wrongly paid to the defendant No.2 and/or there was negligence on the part of the bank to discharge the bank guarantee and therefore, the aforesaid suit came to be filed

for the aforesaid amount of Rs. 10,000/- which according to the plaintiff was wrongly paid to the defendant No.2.

3. The suit was resisted by the defendant No.1 bank. Written statement was filed at Exh-17. It was contended that the suit of the plaintiff was not bona fide. The defendants relied upon the guarantee and the counter guarantee for their true interpretation. It was asserted by the defendant No.1 that they have not wrongly paid Rs. 10,000/- to the defendant No.2. It was submitted that the defendant No.1 made the aforesaid payment of Rs. 10,000/- to the defendant No.2 by virtue of the guarantee executed by the defendant No.1 bank in favour of the defendant No.2 when they made demand in respect thereof and that the said and other incidental amount was recovered by the defendants from the plaintiff by virtue of the counter guarantee executed by the plaintiff in favour of the defendants and the said transactions were perfectly legal, valid and binding to the parties.

4. Defendant No.2 though served, failed to appear. It is required to be noted at this stage that so far as the claim against defendant No.2 is concerned, the plaintiff did not press the same and accordingly the suit of the plaintiff against defendant No.2 came to be dismissed as not pressed.

5. The learned trial Court raised the issues at Exh-37. The plaintiff examined Shashikant Chhaganlal Dhruva, a partner of the plaintiff firm at Exh-38. The defendant No.1 bank examined Pankajbhai Natwarlal Jha, an Accountant of the Bank at Exh-89. A copy of the guarantee bond executed by the bank in favour of the defendant No.2 dated 10-10-72 was produced at Exh-87, a copy of the notice given by the plaintiff dated 24-9-76 was produced at Exh-91 and the copy of the claim statement was at Exh-98. Copies of the guarantee deed, counter guarantee deed and the correspondence between the defendants were also produced on record. The plaintiff also filed a pursis at Exh-88, wherein the plaintiff has stated about certain arbitration proceedings filed in the Court against defendant No.2 and which ultimately failed. In short, case of the plaintiff was that there was no breach of any of the terms and condition of the agreement between the plaintiff and the defendant No.2 dated 10-10-1972 by the plaintiff and though the bank was informed accordingly and though the bank was informed not to make the payment by discharging bank guarantee, the bank discharged the bank guarantee and paid the amount of Rs. 10,000/- to the defendant No.2 wrongly and/or negligently and accordingly the appropriation of Rs. 10,000/- which was lying by way of fixed deposit as a counter guarantee was bad. On the other hand the case on behalf of the defendant No.1 bank was that on demand by the defendant No.2, the bank was duty bound to discharge the bank guarantee and was not required to enter into any dispute between the plaintiff and the defendant No.2 and the payment made by the bank by discharging bank guarantee was a bona fide act. The learned trial Court after considering the oral as well as documentary evidence partly allowed the suit directing the defendant No.1 bank to pay Rs. 11,800/- to the plaintiff by holding that the payment of Rs.

10,000/- to the defendant No.2 by the bank was not proper and it was a negligent act on the part of the bank to discharge the bank guarantee when there was no agreement dated 10-10-1972 in existence and therefore, there was no breach of any of the terms and conditions of the agreement dated 10-10-1972. Being aggrieved and dissatisfied with the judgment and decree passed by the learned trial Court, the defendant No.1 has preferred the present appeal.

6. Shri Darshan Parikh, learned advocate appearing on behalf of the appellant bank has vehemently submitted that the learned trial Court has materially erred in holding that there was no agreement dated 10-10-1972 and therefore there is no question of any breach of the terms and conditions of the agreement dated 10-10-1972 and therefore the bank has wrongly paid the amount of Rs. 10,000/- to the defendant No.2 by discharging the bank guarantee. Relying upon various documents, more particularly, the letter dated 31-5-1973, Shri Parikh has submitted that the very plaintiff has relied upon the agreement dated 10-10-1972 and even in the bank guarantee and the counter bank guarantee there is a specific reference to the agreement dated 10-10-72 and therefore, the learned trial Court has materially erred in holding that there was no agreement dated 10-10-1972 in agreement between the plaintiff and the defendant No.2 and the learned trial Court has proceeded on a wrong promise that there was no agreement dated 10-10-1972. It is submitted by him that when there was a demand by the defendant No.2 for discharging bank guarantee and the proper documents were produced, it was not for the bank to enter into any dispute between the plaintiff and the defendant No.2 and the bank was bound to discharge the bank guarantee and accordingly the bank guarantee was discharged. It is submitted that the suit was filed by the plaintiff in collusion with the defendant No.2 and as such no efforts were made by the plaintiff to resolve the dispute with regard to breach of terms and conditions of the agreement dated 10-10-1972 and in fact the claim against the defendant No.2 was not pressed. He has relied upon following decisions in support of his submission that the bank is nothing to do with the dispute between the plaintiff and the defendant No.2; it is not permissible for the bank to refuse payment on the ground that the buyer is claiming that there is no breach of contract; nor can the bank try to decide the question of breach at the time of discharging bank guarantee and refuse payment to the seller; and the bank is bound to discharge the bank guarantee on production of relevant documents and on demand, unless there is a fraud.

1. Ansal Engineering Projects Ltd. Vs. Tehri Hydro Development Corporation Ltd. and Another,
2. I.T.C. Limited Vs. Debts Recovery Appellate Tribunal and Others,
3. U.P. Cooperative Federation Ltd. Vs. Singh Consultants and Engineers (P) Ltd.,
4. Makharia Brothers Vs. State of Nagaland and Others,

5. Federal Bank Ltd. Vs. V.M. Jog Engineering Ltd. and Others,

Relying upon the aforesaid decisions of the Hon"ble Supreme Court, Shri Parikh has submitted that the bank has rightly discharged the bank guarantee and made the payment of Rs. 10,000/- to the defendant No.2. It is submitted that if as per the plaintiff, there was no breach of terms and condition of the agreement dated 10-10-1972 and/or goods which were supplied were defective and/or there was a breach of terms and condition on the part of the defendant No.2, in that case, the proper remedy for the plaintiff was to file a suit against the defendant No.2 and could have recovered the said amount from the defendant No.2 which was paid to the defendant No.2. It was submitted that on demand by the defendant No.2, the bank acted bona fide and made the payment of Rs. 10,000/- to the defendant No.2 in discharging the bank guarantee and therefore, it is requested to allow the present appeal, more particularly when the claim against defendant No.2 was not pressed.

7. Shri Suresh M. Shah, learned advocate appearing on behalf of the original plaintiff has submitted that when by communication dated 7-6-1973, the bank was specifically informed that there was no breach of terms and conditions of the agreement dated 10-10-1972 by the plaintiff and the goods which were supplied were defective and the bank was advised not to make the payment to the defendant No.2 by discharging bank guarantee, the action on the part of the defendant No.1 bank to make the payment of Rs. 10,000/- by discharging bank guarantee and consequently appropriating the amount of Rs. 10,000/- lying with the bank by way of fixed deposit (counter guarantee) was not bona fide and/or was negligent act. It is submitted that the guarantee bond dated 10-10-72 was a conditional one i.e. on breach of terms and conditions of the agreement dated 10-10-1972 only, the amount of Rs. 10,000/- was to be paid to the defendant No.2 and in the present case, there was no breach of terms and condition of the agreement dated 10-10-1972 proved and therefore, when the condition of the guarantee bond itself was not specified, the defendant No.1 bank was not justified in making the payment of Rs. 10,000/- to the defendant No.2 and therefore, the consequential action on the part of the defendant No.1 bank to appropriate the amount of Rs. 10,000/-, which was lying with the bank by way of fixed deposit as counter guarantee, was bad and therefore, the plaintiff was entitled to an amount of Rs. 10,000/-, which was wrongly paid to the defendant No.2 and therefore, it is requested to dismiss the present appeal. When it was pointed out to Shri Shah, learned advocate appearing on behalf of the original plaintiff that the finding of the learned trial Court that there was no agreement dated 10-10-1972 in existence and therefore, there was no question of any breach of terms and conditions of the agreement dated 10-10-1972, is not a correct finding in view of the correspondence between the plaintiff and the defendants in which there is a reference to the agreement dated 10-10-1972, Shri Shah had in fact no answer, however, in the alternatively he has submitted that either the matter should be remanded to the learned trial Court for deciding the issue with regard to breach of terms and conditions of the agreement dated

10-10-1972 and/or for deciding the claim against defendant No.2, as the same was not pressed at the relevant time as the plaintiff was to succeed against the defendant No.1 bank. It is submitted that either the entire matter be remanded and/or for the limited issue, the matter may be remanded. He has relied upon the judgment of this Court in the case of Adani Exports Limited v. Marketing Service Incorporated and Ors. reported in 2005(2) GLH 156 in support of his submission and submitted that in view of the letter dated 7-6-1973 and the dispute with regard to the defective supply of goods, the bank ought not to have discharged the bank guarantee and ought not to have paid the amount of Rs. 10,000/- to the defendant No.2. Relying upon the aforesaid judgment, it is submitted that by way of interim injunction, this Court restrained the bank from discharging the bank guarantee and therefore, present is a fit case in which it should be held that the bank has committed wrong in discharging the bank guarantee in spite of the correspondence/letter dated 7-6-1973. Therefore, it is requested to dismiss the present appeal.

8. Heard the learned advocates appearing on behalf of the parties.

9. It is not in dispute that there was a guarantee bond issued by defendant NO.1 bank in favour of defendant No.2 dated 10-10-72 (Exh-76). The guarantee bond reads as under:

In consideration of M/s R. Mohanlal & Co. having agreed to exempt M/s Ruby Sales Corporation (Agencies) from the demand under the terms and conditions of an Agreement dated 10th October, 1972 made between M/s R. Mohanlal & Co. and M/s Ruby Sales Corporation (Agencies) for supply of Electrolux LA 21 Refrigerators of security deposit for the due fulfillment by the said Sole Distributors of the terms and conditions contained in the said Agreement on production of a Bank Guarantee for Rs. 10,000/- (Ten thousand only), we Bank of Baroda do hereby undertake to indemnify and keep indemnified M/s R. Mohanlal & Co. to the extent of Rs. 10,000/- against any loss or damage caused to or suffered by M/s R. Mohanlal & Co. by reason of any breach by the said Sole distributors of any of the terms or conditions contained in the said Agreement.

We, Bank of Baroda, further agree that the guarantee herein contained shall remain in full force and effect during the period that would be taken for the performance of the said Agreement and that it shall continue to be enforceable till all the dues of M/s R. Mohanlal & Co. under or by virtue of the said agreement have been fully paid and its claims satisfied or discharged or till M/s R. Mohanlal & Co. certifies that the terms and conditions of the said Agreement have been fully and properly carried out by the said Sole distributors and accordingly discharges the Guarantee, subject, however, that M/s R. Mohanlal & Co. shall have no rights under this bond after the expiry of 12 months from the date of its execution. We Bank of Baroda lastly undertake not to revoke this guarantee during its currency except with the previous consent of M/s R. Mohanlal & Co. in writing."

10. It is also not in dispute that the plaintiff also gave counter guarantee dated 10-10-72. It has also come on record that by communication dated 10-10-72 (Exh-75), the plaintiff informed the bank that they have made certain modifications in the contract with the defendant No.2 on 10-10-72 and therefore, it is requested to cancel the previous guarantee and to issue a fresh guarantee on 10-10-72. Even vide communication/letter dated 7-6-73, it was the case of the plaintiff that the guarantee bond was to be discharged on breach of terms and condition of the agreement dated 10-10-72 and that there was no breach of terms and condition of the agreement dated 10-10-72 by the plaintiff. Not only that but in the guarantee bond itself, there is a reference to the agreement between the plaintiff and the defendant No.2 dated 10-10-72. Considering the aforesaid documentary evidences and even the case of the plaintiff in letter dated 7-6-73, it cannot be said that the agreement dated 10-10-72 was not in existence at all. Learned trial Court has passed the aforesaid decree by holding that there was no agreement dated 10-10-72 in existence between the plaintiff and defendant No.2 and therefore, there is no question of breach of any of the terms and condition of the agreement dated 10-10-72 and therefore, the bank has committed wrong in making the payment of Rs. 10,000/- to the defendant No.2. Such a finding by the learned trial Court is absolutely perverse and/or not tenable considering the evidence on record. The case of the plaintiff itself has that there is no breach of terms and condition of the agreement dated 10-10-72 and therefore, the bank ought not to have made the payment. When that has the case of the plaintiff itself and that in the guarantee bond itself there was a reference to the agreement dated 10-10-72, the learned trial Court has committed an error in holding that there was no agreement dated 10-10-72. As stated above, the learned advocate appearing on behalf of the plaintiff has also fairly conceded that the finding of the learned trial Court to that extent is not proper and/or it is inaccurate.

11. Now considering the aforesaid facts and circumstances, what is required to be considered by this Court is whether the appellant bank was justified in discharging the guarantee bond and making the payment of Rs. 10,000/- to the defendant No.2 or not. It was the contention on behalf of the plaintiff that there was no breach of terms and condition of the agreement dated 10-10-72 by the plaintiff and in fact defective goods were supplied and therefore, there was no cause to discharge the bank guarantee as according to Shri Shah learned advocate appearing on behalf of the plaintiff, guarantee bond itself was a conditional one and only of proving the breach of the terms and condition contained in the agreement dated 10-10-72, by the defendant No.2, the guarantee bond was to be discharged. At this stage, it is required to be noted that except the arbitration proceedings which had in fact failed, no further steps were taken by the plaintiff against the defendant No.2 with regard to the alleged supply of defective goods and/or to recover the amount of Rs. 10,000/- wrongly paid to the defendant No.2. It is also required to be noted that though initially the claim was against the defendant No.2 also in the present suit but for

whatever be the reason, the plaintiff did not press the claim against the defendant No.2. Under the circumstances, except the assertion on the part of the plaintiff that there was no breach of terms and condition of the agreement dated 10-10-72 by the plaintiff, there is no further material available and/or such a case is not substantiated.

11. In the case of Makharia Brothers (supra), the Hon''ble Supreme Court on considering the enforcement of claim under bank guarantee observed that bank guarantee has to be read in conjunction with the terms of the contract in pursuance of which it is issued, but that is not to say that the rights and obligations of the contract at whose instance the bank guarantee is issued become the right and obligation of the bank. The Hon''ble Supreme Court has further observed that it needs to be remembered that a bank guarantee is issued by a bank after the party at whose instance it is issued has put the banks in funds. No bank can be compelled to furnish a bank guarantee without adequate funds to fall back upon should the bank guarantee have to be honoured. In Ansal Engineering Projects Limited (supra), the Hon''ble Supreme Court has observed that in terms of the bank guarantee the beneficiary is entitled to invoke the bank guarantee and seek encashment of the amount specified in the bank guarantee. It does not depend upon the result of the decision in the dispute between the parties, in case of the breach. The Hon''ble Supreme Court further observed that bank is bound to encash the bank guarantee on demand and beneficiary cannot be restrained by Court/arbitrator from encashing till decision of arbitrator/court on amount due and payable to the beneficiary unless fraud or special equity is prima facie made out. Bank is only to verify whether the amount claim is within the terms of the bank guarantee, and bank is not concerned with the dispute between the beneficiary and the persons at whose instance, the guarantee was furnished in respect of the primary contract. In a dispute at the time of encashment of the bank guarantee whether the goods were actually supplied or not, the Hon''ble Supreme Court in ITC Limited (supra), considering the judgment of the Hon''ble Supreme Court in the case of U.P. Cooperative Federation Ltd. Vs. Singh Consultants and Engineers (P) Ltd., , has held that at the time of discharging the bank guarantee, the dispute whether the goods were supplied or not, is not for the bank. In U.P. Cooperative Federation Ltd. (supra), in para 45, the Hon''ble Supreme Court has held and observed as under:

The letter of credit has been developed over hundreds of years of international trade. It was most commonly used in conjunction with the sale of goods between geographically distant parties. It was intended to facilitate the transfer of goods between the distant and unfamiliar buyer and seller. It was found difficult for the seller to rely upon the credit of an unknown customer. It was also found difficult for a buyer to pay for goods prior to their delivery. The Bank's letter of credit came into existence to bridge this gape. In such transactions, the seller (beneficiary) receives payment from issuing Bank when he presents a demand as per terms of the document. The Bank must pay if the documents are in order and the terms of credit are satisfied. The Bank, however, was not allowed to

determine whether the seller had actually shipped the goods or whether the goods conformed to the requirements of the contract. Any dispute between the buyer and seller must be settled between themselves. The Courts, however, carved out an exception to this rule of absolute independence. The Courts held that if there has been "fraud in the transaction" the Bank could dishonour beneficiary's demand for payment. The Courts have generally permitted dishonour only on the fraud of the beneficiary, not the fraud of somebody else.

In Federal Bank Limited (supra), the Hon"ble Supreme Court observed as under:

The Bank is to honour the demand for encashment if the seller prima facie complies with the terms of the Bank Guarantee or Letter of credit, namely, if the seller produces the documents enumerated in the Bank Guarantee or Letter Credit. If the Bank is satisfied on the face of the documents that they are in conformity with the list of documents mentioned in the Bank Guarantee or Letter of Credit and there is no discrepancy, it is bound to honour the demand of the seller for encashment. While doing so it must take reasonable care. It is not permissible for the Bank to refuse payment on the ground that the buyer is claiming that there is a breach of contract. Nor can the Bank try to decide this question of breach at that stage and refuse payment to the seller. Its obligation under the document having nothing to do with any dispute as to breach of contract between the seller and the buyer.

12. It is submitted on behalf of the respondents that all the aforesaid decisions are dealing with the question, whether injunction against the encashment of the bank guarantee should be granted or not and therefore, they are not applicable. Such a contention cannot be accepted. If no injunction can be granted restraining the bank from discharging the bank guarantee even at the interim stage, at the final stage, certainly the bank cannot be restrained from discharging the bank guarantee. Even while dealing with the question with regard to injunction should be granted or not against discharging bank guarantee, the observation made by the Hon"ble Supreme Court are with regard to restraining the bank from discharging the bank guarantee. Shri Shah, learned advocate appearing on behalf of the respondents relied upon the judgment of this Court (Coram: K.S. Jhaveri, J.) in Adani Exports Limited v. Marketing Service Incorporated and others reported in 2005(2) GLH 156 and has submitted that in the said case, this Court granted the injunction. On going through the entire judgment, it cannot be said that any law is laid down by this Court in the said judgment. The said judgment and order is in the facts and circumstances of that case, where the learned trial Court gave a prima facie finding with regard to fraud. Under the circumstances, the said judgment will not be helpful to the respondents.

13. Now considering the aforesaid decisions of the Hon"ble Supreme Court, at the time of discharging the bank guarantee on producing the same by the beneficiary, the bank is not required to consider whether in fact there is a breach of contract or not. Even in a case, where the proceedings are pending, the bank

is not required to wait till the outcome of the proceedings between the buyer and the seller. On production of the document, unless it is a case of fraud, the bank is bound to discharge the bank guarantee. Under the circumstances, considering the facts of the present case, the appellant bank has not committed any wrong in discharging the bank guarantee and making the payment of Rs. 10,000/- to the defendant No.2. As stated above, no proceedings have been initiated against the defendant No.2 for alleged breach of contract. Under the circumstances, the action of the bank in discharging the bank guarantee cannot be faulted with and under the circumstances, the learned trial Court has committed an error in decreeing the suit, directing the appellant bank to pay an amount of Rs. 10,000/- to the plaintiff. In view of the above facts and the proposition of the law laid down by the Hon'ble Supreme Court in the aforesaid decisions, the submission on behalf of the respondent No.1 herein, original plaintiff to remand the matter to the learned trial Court, also is not required to be accepted.

14. For the reasons stated above, the appeal succeeds. The judgment and decree passed by the learned City Civil Court at Ahmedabad dated 30-4-1981 passed in Summary Civil Suit No.3074 of 1976 is hereby quashed and set aside. No costs. Ad interim relief if any stands vacated.