
(1987) 08 MAD CK 0027
In the Madras High Court

Binny Limited

APPELLANT

Vs

The Controller of Stores and purchase, Karnataka State Road
Transport Corporation and Another

RESPONDENT

Date of Decision : 24-08-1987

Acts Referred:

Citation : (1989) 1 LW 106 : (1988) 2 MLJ 464

Hon'ble Judges : P.K. Sethuraman, J

Bench : Division Bench

Judgement

P.K. Sethuraman, J.—Plaintiff is the appellant. This is an appeal against the order passed by the learned VIII Additional Judge, City Civil

Court, Madras, in the petition C.M.P. No. 1301 of 1981 in O.S.No. 2889 of 1981 (which was originally numbered as Application No. 37 of

1981 in C.S.No. 753 of 1980 on the file of this Court) filed by the second defendant/first respondent herein u/s 34 of the Arbitration Act.

2. The plaintiff filed the suit C.S.No. 753 of 1980 on the file of this Court, under Order 14, Rule 8 of the Original Side Rules read with Order 39,

Rule 1, C.P.C. praying for an injunction restraining first defendant viz., the State Bank of India, from paying any monies under the suit guarantee

and also an injunction restraining the second defendant viz., Karnataka State Road Transport Corporation, from receiving payment under the suit

guarantee Thereupon the second defendant filed Application No. 37 of 1981 u/s 34 of the Arbitration Act for stay of the further proceedings in the

suit C.S.No. 753 of 1980. The plaintiff opposed the application, as not maintainable since the suit has been filed in respect of suit guarantee which

is an independent contract between the parties and the arrangement between the plaintiff and the first defendant never matured into a contract and

there is no concluded contract even between the plaintiff and the second defendant and as such Clause 16 of the agreement will not come into play

and the application also is not maintainable since the applicant/second defendant had already taken steps in the proceedings within the meaning of

Section 34 of the Arbitration Act and cannot therefore file the petition, and in any event the ingredients of Section 34 of the Arbitration Act not

having been complied with, particularly in the absence of averments that the second defendant is ready and willing to refer to arbitration, the

application is liable to be dismissed in limine.

3. The said application along with the suit was also transferred to the file of the City Civil Court and it had been numbered as C.M.P.No. 1301 of

1981. The learned VIII Additional Judge, City Civil Court, Madras, after considering the contentions on either side allowed the application filed by

the second defendant u/s 34 of the Arbitration Act for stay of further proceedings in the suit C.S.No. 753 of 1980 on the file of this Court, which

has been transferred to the file of the City Civil Court, Madras, and numbered as O.S.No. 2889 of 1981. Hence the present appeal.

4. The appellant has now come forward with this appeal contending that the order passed by the learned 8th Additional Judge, City Civil Court, is

contrary to law and the learned Judge committed an error in treating the bank guarantee as part of the letter of intent whereas the bank guarantee

constitutes an independent contract between three parties, namely, the plaintiff, the defendant and the bank. As the bank is not a party to the sale,

the contract of guarantee has to be treated as distinct, separate and independent of the contract between the plaintiff and the defendant and the

invocation of a guarantee depends upon the express terms contained in the contract of guarantee and therefore the express terms contained in the

contract of guarantee have to be taken into consideration and no reliance has to be made with reference to any other contract. The learned judge

has also failed to appreciate the contention of the plaintiff that the second defendant has taken a step in the proceedings by taking time for filing

counter in the application for injunction viz., I.A.No. 5255 of 1982 which will disentitle the defendant to invoke Section 34 of the Arbitration Act.

The learned Judge ought to have held that inasmuch as there is no written agreement between the parties for reference to arbitration, there is no

valid arbitration agreement. Accordingly it is now contended that the order passed by the 8th Additional Judge, City Civil Court, staying the further proceedings of the suit has to be set aside.

5. The points that now arise for consideration in this appeal are as to

(1) Whether the bank guarantee constitutes a separate contract and is not part of letter of intent and in the absence of written agreement the parties cannot make any reference to arbitration?

(2) Whether the first respondent/second defendant has taken a step in the proceedings by taking time for filing counter in the injunction application and therefore is not entitled to invoke Section 34 of the Arbitration Act?

6. Before discussing the points in controversy in this appeal, a brief narration of the events leading to the filing of the suit and the subsequent

application for stay of the suit filed by the first respondent/second defendant, u/s 34 of the Arbitration Act, may be useful. The Binny Limited viz.,

the appellant herein, filed the suit O.S.No. 2889 of 1981 for an injunction against the second respondent herein viz., the first defendant, not to

make any payment under the suit guarantee and for an injunction against the first respondent herein viz., the second defendant, not to receive any

payment under the suit guarantee and according to the plaintiff the second defendant floated public tenders on 2-11-1978 inviting offers for the

supply of Khaki-Matty, White Drill, Blue Drill and Khaki Drill in different quantities and the plaintiff submitted quotations. The plaintiff made it clear

that the price quoted therein will be kept open for 60 days and the deliveries indicated therein are subject to the order being placed on the plaintiff

before 27-1-1979. It was also provided that if for any reason placing of order was delayed beyond the above date revised deliveries will be

indicated later. There was a telephonic conversation between the plaintiff and the second defendant and the period was extended by the plaintiff

upto 30-6-1979 and 15-5-1979 the second defendant issued a letter of intent for the purchase of materials mentioned in the said letter of intent,

stipulated their own terms and conditions disregarding the terms and conditions stipulated by the plaintiff in their letter of offer. The letter of intent

provided for delivery schedule mentioned therein. The letter of intent also provided for a security deposit of Rs. 1,75,000 being approximate 10

per cent value of the proposal order either in cash or by way of bank guarantee

initially valid for 12 months period for the good and faithful

performance of the supplies within 15 days from the date of receipt and an agreement as per to the tender was also asked to be executed

Annexure ""E"" enclosed/within 15 days from the date of receipt of the letter of intent.

7. In pursuance of the letter of intent there was correspondence between the plaintiff and the second defendant, and the plaintiff informed the

second defendant that they would make every effort to execute the order within 8 to 12 weeks, but reserved their right to give a definite indication

of delivery only after the Mills reopened since there was closure of the Mills due to strike. According to the plaintiff the second defendant had not

indicated regarding the communication sent on such lines, but the plaintiff forwarded a bank guarantee executed by the first defendant State Bank

of India in favour of the second defendant for a sum of Rs. 1,75,000 stating that the bank guarantee shall come into effect on materialisation of the

agreement and remain in force for a period of one year from the date of issue. The second defendant had acknowledged the draft agreement and

informed the plaintiff that they were taking steps to execute the agreement and the second defendant has not at all sent any draft agreement nor did

it return the draft agreement. The plaintiff in the meanwhile had also despatched the goods to the second defendant and the second defendant had

also accepted the deliveries. After accepting such deliveries, the second defendant has made a claim on the first defendant by the letter dated

28.11.1980, which is beyond the period of one year, and in that letter he has made a claim for penalty in the sum pf Rs. 2,04,162.92 provisionally

and called upon the first defendant to make payment of Rs. 1,75,000 guaranteed under the said bank guarantee within 10 days from the receipt of

the said claim. A copy of the said letter was sent to the plaintiff indicating that after deducting the sum of Rs. 1,75,000 payable by the first

defendant the balance sum of Rs. 29,169.92 to be remitted by the plaintiff. The letter did not disclose how the penalty was computed and it was

not in accordance with penal clause contained in the tender. Under such circumstances the suit had been filed.

8. The main grounds on which the suit had been filed are

1. The guarantee specifically providing for a signed agreement between the

purchaser and the seller becomes non est in law in the absence of such signed agreement;

2. The claim having been made only on 28-11-1980, it is beyond the grace period of three months given under the guarantee for filing a suit or

action to enforce a claim;

3. The claim for penalty is arbitrary and capricious.

Along with the plaint, the plaintiff had also filed an injunction application and the second defendant had filed vakalat and had taken time for filing

counter. Thereafter the second defendant had filed C.M.P.No. 1301 of 1981 u/s 34 of the Arbitration Act in which the impugned order had been passed.

Points 1 and 2:

9. The facts discussed above clearly indicate that the first respondent/second defendant called for tenders and the appellant submitted tender for

the supply of goods and there had been correspondence between the appellant and the first respondent regarding the delivery schedule and other

matters, and the purchase order had been placed by the first respondent and supplies also were made which were taken delivery by the first

respondent. The appellant had also furnished bank guarantee as stipulated in the tender notice and the appellant had also sent a draft agreement

which according to the appellant had not been formally executed between the parties. Under the terms and conditions of the relevant tender issued

by the first respondent Clause 8 deals with furnishing of security deposit and therein it is seen that the security deposit had to be furnished by the

successful tenderer, equal to 10 per cent of the total value of the order in cash or Government promissory note or demand draft as specified in

tender condition 7(a) or banker's guarantee. The bank guarantee furnished by the appellant was sought to be invoked by the first respondent since

the first respondent has come forward with the claim of penalty against the plaintiff. The letter of intent was sent on 15-5-1979 and there was a

reply by the plaintiff on 6-6-1979 informing about the strike and also stating that delivery will be made later. But in the meanwhile bank guarantee

had been furnished, as already stated, and draft agreement was also sent by the plaintiff to the first respondent, and two consignments were also

sent by the plaintiff. Under such circumstances, the plaintiff has contended that the bank guarantee furnished by the plaintiff cannot be invoked since the bank guarantee comes into operation only after the agreement is executed. Therefore, according to the appellant as there was no concluded contract, the terms of the agreement cannot now be enforced, on the other hand it is the contention of the first respondent that the tender terms had been accepted by the appellant and consignments were sent and delivery also had been taken and the bank guarantee furnished was in pursuance of the tender condition and therefore the contention that the bank guarantee is an independent transaction cannot be accepted.

10. Learned Counsel for the appellant placed reliance on the following decisions in support of the contentions:- In the decision reported in Birla

Jute Manufacturing Co. Ltd. Vs. Dulichand Pratapmull, , among other aspects it has been laid down that a dispute as to the validity of a contract

cannot be held to be within an arbitration agreement contained in the contract itself and such a dispute cannot be referred to arbitrators or dealt

with by them under such an agreement on the basis that it is a "matter agreed to be referred." As regards Section 34 of the Arbitration Act it is laid

down therein that Section 34 confers a discretion on the court, but it is only a discretion to stay or not to stay the suit after the conditions laid down

in the section are found to be satisfied but it is not discretion to stay the suit even if one of the conditions may be unsatisfied. It is also stated that no

useful purpose can be served by the Court proceeding to decide on the application u/s 34 whether there is a valid arbitration agreement and

necessarily, except where the alleged invalidity of the contract cannot affect the agreement, whether there is a valid contract. In the case reported in

Harprashad & Co. v. Sudarshan Steel Rolling Mills (1985) 58 Comp. Cas. 531 rendered by the Delhi High Court, while dealing with the

enforcement of a Bank Guarantee it is stated that a bank guarantee is a contract between the issuing bank and the person in whose favour the

guarantee had been furnished and it is a bilateral contract between the banker and the party in whose favour the guarantee had been furnished. It is

also further laid down therein that the existence of an arbitration clause in the contract between the parties cannot prevent the bank guarantee being

invoked by the party in whose favour is it furnished. The provisions in that contract cannot be incorporated into the bank guarantee. In the case

reported in *Gopilal J. Nichani Vs. Trac Industries and Components Ltd., Madras and Others*, , which is a decision dealing with Section 128 of the

Contract Act rendered by Govindan Nair, Chief Justice and Varadarajan, J., it has been laid down that Section 128 of the Contract Act provides

only that the liability of the guarantor is co-extensive with that of the principal debtor and the word "coextensive" denotes extent and can relate only

to the quantum of the principal debt. A contract of guarantee is a separate contract between the creditor and the guarantor. In that decision the

Tamil Nadu Relief Undertaking (Special Provisions) Act was dealt with and it has been pointed out further that there is nothing in that Act and

particularly in Section 4 (b) thereof which suspends such a contract or the obligations arising therefrom. Therefore it is stated that on the suspension

of the contract between the principal debtor and its creditor u/s 4 (b) though a suit against the debtor would be barred but a suit by the creditor

against the guarantor of the debtor a petition by him to adjudge the guarantor as insolvent can be proceeded with. In the case reported in *Adamsab*

v. Gurushinddaya, AIR 1967 Mys. 147 the applicability of Sections 133 to 139 of Contract Act, 1872 to the surety bond executed in favour of

Court has been dealt with. The decision reported in *Arul Murugan Traders Vs. Rashtriya Chemicals and Fertilisers Ltd., Bombay and Another*,

deals with Order 31, Rules 1 and 2, C.P.C. with regard to enforcement of bank guarantee and interference by Court. The facts in that decision

revealed that the plaintiff who was appointed as a dealer by the first defendant, who were manufacturers of fertilizers, filed a suit on the file of the

Sub Court, Gobichettipalayam, for grant of permanent injunction to restrain the defendant from recovering the sum from the State Bank of India

under the bank guarantee till they establish the claim against the plaintiff in a Court of law. In that case the learned single judge laid down that there

is no absolute rule prohibiting grant of interim injunction relating to bank guarantees and in exceptional cases Courts will interfere with the

machinery of irrevocable obligations assumed by banks. It has been further pointed out by the learned Judge that the concerned suit involved

serious questions to be tried, and particularly, relating to the plea of fraud, which was a significant factor to be taken into account and claim for

interdicting the enforcement of bank guarantee should have been allowed.

11. Learned Counsel for the respondents submitted the following decisions: In the decision reported in Union of India (UOI) Vs. A.L. Rallia Ram, it has been laid down that in order to constitute an "arbitration agreement" within the meaning of Section 2(a) of the Arbitration Act, there must be a valid agreement to submit present or future differences to arbitration and the agreement must be in writing and must be accepted by the parties. However it is not a condition of an effective agreement that it must be incorporated in a formal agreement executed by both the parties thereto, nor is it required to be signed by the parties. In that case the facts revealed that the Chief Director of Purchases (Disposals), Food Department, Government of India, had invited tenders for the purchase of the stock of American cigarettes lying in Calcutta and other places and the appellant had submitted his tender offering to purchase the entire stock. It had been pointed out by the Supreme Court that the execution of a formal document is not absolutely essential and valid contract may result from contract by correspondence. In the case reported in Fertilizer Corporation of India Limited Vs. Domestic Engineering Installation, also it has been held that no particular form is necessary for an agreement to constitute an arbitration agreement in writing, it is not necessary that it should be signed by the parties thereto. It is sufficient that the terms are reduced to writing and the agreement of the parties thereto is established. It is also held in that decision that a dispute, could form subject matter of the proceedings u/s 20 of the Act. The facts disclosed in that case are that tender had been accepted for the execution of certain work and work order had been given and the work order contained the terms of contract including the arbitration clause. Having regard to such circumstances it was held that inspite of the fact that formal agreement was signed at a later date, the parties themselves bound by the agreement from the date of work order. Therefore, an arbitration agreement was in existence from the date of the work order. In the case reported in Kumarbar-bar Behera Vs. Executive Engineer, P.H. Maintenance Division No. II, Bhubaneswar and Another, a single Judge of the Orissa High Court has held, following, the decision reported in Union of India (UOI) Vs. A.L. Rallia Ram, , that in order to constitute an arbitration agreement in writing it is not necessary that it should be signed by the parties and it is sufficient if the terms are reduced to writing and the agreement of the parties thereto is established. In the

case reported in *Srivenkateswara Constructions and Others Vs. The Union of India*, while dealing with Section 34 of the Arbitration Act relating to

stay of suit, the Andhra Pradesh High Court has stated that this section does not at all require any such specific averment and what is required is

that the Court should be satisfied that the applicant was ready and willing to proceed to arbitration at the commencement of the proceeding as also

at the time of the application. In the case reported in *F.C.I, v. Uday Engineer & Contractor* AIR 1982 S.C. 1302 it has been laid down by the

Supreme Court that each and every step taken in the proceedings cannot come in the way of the party seeking to enforce the arbitration agreement

by obtaining stay of proceedings. In our case the first respondent has only entered appearance and had taken time for filing counter in the injunction

application and having regard to the principles laid down by the Supreme Court it cannot be contended that the first respondent had taken steps in

the proceedings and so they cannot now seek to stay of the suit.

12. On a careful consideration of the materials available on record with regard to the facts of this case and also the principles laid down in the

decisions relied on by either side, i am unable to accept the contention put forward on behalf of the appellant that the bank guarantee does not

form part of the agreement between the parties since it was a term stipulated even in the tender and further the absence of formal agreement the

parties relating to the contract also cannot be put forward having regard to the letter of intent and the supplies made in pursuance thereof. Likewise

the mere appearance by the first respondent in the suit and taking time for filing counter also cannot be stated that the first respondent has taken

steps in the proceedings. Accordingly I find the points against the appellant.

13. In the result the civil miscellaneous appeal is dismissed with costs.