

(2008) 01 DEL CK 0065

In the Delhi High Court

Case No : OMP. 15 of 2008

Chola Turbo Machinery International Pvt. Ltd.

APPELLANT

Vs

Development Credit Bank and Another

RESPONDENT

Date of Decision : 24-01-2008

Acts Referred:

Citation : (2008) 3 BC 547 : (2008) 149 DLT 313

Hon'ble Judges : S. Ravindra Bhat, J

Bench : Single Bench

Advocate : Chetan Sharma and Manish Vashisht and Sameer Vashisht, for the Appellant; Valmiki Mehta and Deepak Tukral and Amit Singh for R-2 and Puneet Taneja, for R-1, for the Respondent

Final Decision : Dismissed

Judgement

S. Ravindra Bhat, J.—These are two proceedings u/s 9 of the Arbitration and Conciliation Act, 1996 (hereafter referred to as "the Act"). The petitioner seeks orders from this court, to restrain the respondents from encashing and realizing the proceeds of two bank guarantees issued at its request, by the respondent banks. With consent of counsel for the parties, the two petitions were heard today. Reasons are indicated by this order, today, as the Court concluded hearing at 4.15 P.M., and announced its decision, in open Court.

2. Briefly, the facts are that the petitioner and the second respondent (referred to hereafter as "the supplier" and "the purchaser" respectively) entered into an agreement on. 21st October 2007 for the design, supply, erection and commissioning of two 11 MW power plants at Afghanistan. Among others, the agreement contained the following condition, in Schedule 12, requiring the petitioner to furnish bank guarantees to the seller, in the following terms:

1. Payment Terms:

A. For supplies

- a) Performance Bond/Bank guarantee of 5% of the total contract supply of value shall be issued by the SELLER valid up to the end of the daily period.
- b) 10% of the contract supply price as interest-free advance together with the order, against bank guarantee of equal in amount. Value of the bank guarantee shall be adjusted to the extent of advance adjusted in the SELLERS bills on monthly basis.
- c) 10% of the contract supply price after submission of proof of placement of the orders on major equipment suppliers through LC.

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- g) 8% of the supply contract price shall be kept as guarantee value and shall be made 12 months after the successful commissioning of the powerplant. Sellers shall be able to draw this amount against the bank guarantee together with (e) above...

Schedule 11 dealt with supply price; it mentioned US\$ 18,300,000 (US dollars eighteen million, three hundred thousand) as the agreed supply price. Clause 11.2 stated that the price was based on US dollar - Indian rupee equivalent of 40 Rupees per dollar. The final price payable to the seller was to be adjusted according to the exchange rates prevailing on the date of Exim Bank loan sanction and an establishment of letter of credit. After that event, the contract price was to remain fixed. Effective date of contract, according to Clause 2.0, Schedule 2, was defined as follows:

The effective date of the Contract shall be

2.1 Signing of this contract with 10% advance against bank guarantee of equal amount.

2.2 Subject to the approval of Exim Bank of India, Buyer shall open a letter of credit (L/C). If the approval of the line of credit by Exim Bank of India to buyer is delayed beyond six weeks then the effective date of the contract shall be amended accordingly.

2.3 Soil Investigation report and Topography Survey report with drawings within four weeks of signing of contract.

If the buyer delay is the above, the effective date automatically gets extended by equal time.

The Delivery Schedule was outlined in Schedule 13; condition 13.1 stipulated that the petitioner would dispatch all the civil drawings, Bill of Quantities instructions and specifications within four months. Schedule 18 dealt with Liquidated Damages, in terms of Clause 18.1 such liquidated damages are payable for delayed delivery; Clause 18.2 deals with liquidated damages for shortfall in performance. The last part of Clause 18.2 reads thus:

the total amount of all liquidated damages for delayed supply and shortfall in

performance shall not exceed 8% of the FOB supply price.

There is no dispute that the purchaser released the advance payment equivalent to Rs. 8 crores, to the petitioner.

3. In OP No. 15/2008, the Development Credit Bank (first respondent referred to as "the bank") issued a guarantee, dated 29-11-2007, containing, inter alia, the following terms:

WHEREAS the Purchaser has entered into a contract dated 21-10-2007 with M/s Chola Turbo Machinery International Pvt. Ltd., a company Registered under the Companies Act, 1956 and having its registered office at 401, Trade Center 45/7, Dickinson Road, Bangalore, India, (hereinafter referred as the "SELLER" or "SUPPLIER") for Design, Engineering, Manufacturing, Testing, Supply, Supervision of civil works, Erection and Commissioning of 2 X 11 MW Coal Based Power Plant on Turnkey basis excluding Erection and Civil Job Execution (hereinafter referred to as the Contract)

AND WHEREAS in terms of the contract, the seller has agreed to furnish and a bank guarantee for US \$ 1,424,000 (One Million, Four Hundred and twenty four thousand only) to secure suppliers obligations in regard to arranging completion of schedule and against any loss or damage caused to or suffered by the purchaser by reasons of quantifiable breach of the terms and conditions of the said order on the part of the supplier and to cover an equal portion of (US \$ 1,424,000) of advance payment already received by the seller.

AND WHEREAS at the request of the Seller the bank has agreed to give this Bank Guarantee in the manner hereinafter appearing.

1. NOW, Therefore, IN CONSIDERATION OF THE PREMISES, the Guarantor does hereby guarantee to the Purchaser the payment of an amount not exceeding S \$ 1,424,000 (One Million, Four Hundred and twenty four thousand only) against the written demand of the purchaser stating that the sum mentioned therein is due to the Purchaser on account of the seller's failure to fulfill the seller's obligations relating with the said contract, such statement in the demand being binding on the guarantor with regard to the amount due. The Guarantor also increased that such the mind may be made or routed through the Bankers of the purchaser.

2. The Guarantor undertake to make payment against the said demand without any demur, discussions, or objections and irrespective of any dispute between the supplier and the Purchaser which is not subject to arbitration. The Guarantor does hereby declare that the obligation of the Guarantor hereunder are intended to be and shall be treated and construed as per terms of "the Contract" and the Guarantor shall not be entitled to withhold or delay payment of the net amount due to the Purchaser in the manner aforesaid as per the enumerated in the manner aforesaid as per the enumerated in the said contract and its schedules 1 to 28 all inclusive. This guarantee shall not be impaired or discharged or released

by any amendment or change or modification to the terms of the said purchase order or by any alteration or amendment in the obligations undertaken by the supplier there under or any allied documents or by any change in the constitution of the Bank or the supplier or by any arrangement made between the Supplier or the Purchaser without the assent of the Bank or by any forbearance as to time, performance or otherwise shown or extended by the purchaser to the supplier..."

In OP No. 19/2008, the South Indian Bank (first respondent referred to as "the bank") issued a bank guarantee, dated 24-12-2007 containing, inter alia, the following terms:

WHEREAS the Purchaser has entered into a contract dated 21-10-2007 with M/s Chola Turbo Machinery International Pvt. Ltd., a company Registered under the Companies Act, 1956 and having its registered office at 401, Trade Center 45/7, Dickinson Road, Bangalore, India, (hereinafter referred as the "SELLER" or "SUPPLIER") for Design, Engineering, Manufacturing, Testing, Supply, Supervision of civil works, Erection and Commissioning of 2 X 11 MW Coal Based Power Plant on Turnkey basis excluding Erection and Civil Job Execution (hereinafter referred to as the Contract)

AND WHEREAS in terms of the contract, the seller has agreed to furnish and a bank guarantee for US \$ 356,000 (Three Hundred and fifty six thousand only) to secure suppliers obligation in regard to arranging completion of schedule and against any loss or damage caused to or suffered by the purchaser by reasons of quantifiable breach of the terms and conditions of the said order on the part of the supplier and to cover an equal portion of (US \$ 356,000) of advance payment already received by the seller.

AND WHEREAS at the request of the Seller the bank has agreed to give this Bank Guarantee in the manner hereinafter appearing.

1. NOW, Therefore, IN CONSIDERATION OF THE PREMISES, the Guarantor does hereby guarantee to the Purchaser the payment of an amount not exceeding US \$ 356,000 (Three Hundred and fifty six thousand only) again the written demand of the purchaser stating that the sum mentioned therein is due to the Purchaser on account of the seller's failure to fulfill the seller's obligations relating with the said contract, such statement in the demand being binding on the guarantor with regard to the amount due. The Guarantor also increased that such the mind may be made or routed through the Bankers of the purchaser.

2. The Guarantor undertake to make payment against the said demand without any demur, discussions, or objections and irrespective of any dispute between the supplier and the Purchaser which is not subject to arbitration. The Guarantor does hereby declare that the obligation of the Guarantor hereunder are intended to be and shall be treated and construed as per terms of "the Contract" and the Guarantor shall not be entitled to withhold or delay payment of the net amount due to the Purchaser in the manner aforesaid as per the enumerated in the manner aforesaid as per the enumerated in the said contract and its schedules 1

to 28 all inclusive. This guarantee shall not be impaired or discharged or released by any amendment or change or modification to the terms of the said purchase order or by any alteration or amendment in the obligations undertaken by the supplier there under or any allied documents or by any change in the constitution of the Bank or the supplier or by any arrangement made between the Supplier or the Purchaser without the assent of the Bank or by any forbearance as to time, performance or otherwise shown or extended by the purchaser to the supplier...

4. On 6-1-2007, the Purchaser issued identically phrased demands to the two banks, claiming the amounts guaranteed, requesting that the amounts i.e. US \$ 1,424,000 and US \$ 356,000/- should be paid to it by the concerned bank. These demands contained the following statement:

In view of the breach of the contract dated 21-10-2007 between us and Chola Turbo Machinery International Pvt. Ltd., a constituent of yours, on whose behalf the above Bank Guarantee has been issued in our favor, we hereby invoke the subject Bank Guarantee. This letter may please be treated as the notice of invocation.

5. The petitioner claimed that the invocation of the bank guarantees was unsupportable in law as it amounted to a fraud; it claimed irretrievable injustice and filed OMP No. 15/2008, u/s of the Act, since the contract contained an arbitration clause. By an interim order dated 9th January 2008, this court restrained the supplier from encashing the guarantee for US \$ 1,424,000 and listed the case, after notice on 1st February. The petitioner filed the second proceeding u/s 9 i.e. OMP 19/2008, challenging the invocation of the guarantee issued by the South Indian Bank, for US \$ 356,000/-. Ex-parte injunction was refused; the petition was heard for some time on 14-1- 2008. It was also recorded that the petitioner was willing to furnish a bank guarantee for the sum equivalent to 10% of the contract in accordance with schedule 12 to the contract, towards interest free advance, containing advertence (reference) to that condition; and that the existing guarantees would be substituted. Counsel for the respondent purchaser had then indicated according to instructions that such course of action was acceptable and that the matters could be resolved. Both petitions were listed, with consent of counsel for the parties, for further proceedings and possible hearing today. In the course of hearing, today, both parties leveled accusations against each other; the respondent's counsel, upon instructions from the Chief Executive Officer of the said party, submitted that a resolution of the dispute was not possible. Therefore, with the consent of counsel for the parties, the petitions were heard together.

6. Mr. Chetan Sharma, learned senior counsel relied on the pleadings and submitted that ex-facie, the Bank guarantees were conditional; Clauses 1 and 2 clearly referred to conditions of the contract between the parties, i.e. the Supplier and Purchaser. Therefore, the bank was under an obligation to be satisfied that invocation of the guarantee was in accordance with its terms; that the invocation had to spell out, in some basic detail about the failure or breach of

the contract. The invocation of the guarantees, in general terms, without mentioning what breaches were committed by the supplier, did not comply with the terms of the guarantee. The bank was Therefore not obliged to comply with the demand. Counsel submitted that to permit the purchaser to encash the guarantees, in these circumstances, would result in irretrievable injustice. Therefore, the order restraining the purchaser from receiving proceeds and restraining the bank from paying the amounts, had to be issued.

7. Learned counsel next adverted to the pleadings to say that the delivery dates mentioned in the contract had not even passed. Therefore, the purchaser could not justifiably allege breach. It was contended that in fact the petitioner-supplier had furnished technical drawings to the purchaser. He also relied upon copies of some correspondence exchanged between the purchaser and the seller. It was further contended that though the purchaser had paid the advance amount equivalent to 10%, the same was duly secured by the two bank guarantees in question. It was submitted that on the other hand, the purchaser had not obtained the essential requirement of having to secure the EXIM Bank's approval for the line of credit to be made available to the supplier. Therefore, according to Clause 2.2, Schedule 2, the effective date of the contract had not even taken place or occurred. Counsel urged that seen from the backdrop of these facts, the purchaser's demand for encashing the bank guarantees was not only unjustified, but utterly unlawful; it amounted to an egregious fraud, enabling this court to issue the injunction claimed, for the duration of pendency of arbitration proceedings.

8. Learned counsel urged that the respondent- purchaser was driven by ill-motives to encash the guarantees, since the supplier had already dispatched the technical and engineering drawings. The invocation of the bank guarantees was a ruse to circumvent the obligation to pay fees or charges, for cancellation of the contract, agreed to by the parties, according to Schedule 26 to the contract. In terms of the relevant clause, the petitioner would be entitled to 50% of the value of the contract if cancelled by the purchaser, in the present case. Learned counsel placed reliance on *Hindustan Construction Co. Ltd. Vs. State of Bihar and Others*, and submitted that in guarantees like the present one, the court has to construe the intention of the parties not only to discern whether they wanted incorporation of the terms of the main contract, in the bank guarantee, but also whether in such case, the guarantee itself is invoked in terms of the contract. It would not be enough if the beneficiary blandly asserts about breach; there should be some mention about the nature of the breach and the attendant facts. In their absence, the invocation is suspect.

9. Mr. Valmiki Mehta, learned senior counsel for the respondent- purchaser opposed the petitions. According to counsel, a plain reading of the payment Clause (Schedule 12) would reveal that three different kinds of guarantees were to be furnished. Firstly, a guarantee for the sum equal to 10% of the contract value, to secure the advance payment made by the purchaser had to be

furnished. Secondly, a 5% performance bond/bank guarantee to secure due performance of the contract had to be furnished. Lastly, 8% of the supply contract price had to be kept as guarantee value and payment of the said amount can be made 12 months after the successful commissioning of the power plant. Counsel submitted that the true intention of the supplier not to fulfill its obligations was apparent, since the bank guarantees issued by it were not in accordance with the contract. The guarantees made a composite, rolled up statement about their issuance, "to secure suppliers obligation in regard to arranging completion of schedule and against any loss or damage caused to or suffered by the purchaser by reasons of quantifiable breach of the terms and conditions of the said order on the part of the supplier and to cover an equal portion ofof advance payment already received by the seller."

The guarantees were neither for securing 10% advance, nor amounted to the 5% performance guarantee; it could not also be construed as securing amounts payable for quantifiable breach, for which a maximum of 8% of the value of the contract was payable. It was urged that the supplier had to furnish guarantee for at least 15% of the contract value; instead it issued documents, which were unclear, and also fell short of the agreed stipulations. On the other hand, the supplier had enjoyed the benefit of vast sums of money paid as advance. In these circumstances, the purchaser acted within the bounds of commercial prudence in invoking the bank guarantees, on a fair construction of the contract.

10. Learned counsel relied upon the judgments of the Supreme Court reported as Mahatma Gandhi Mahatma Gandhi Sahakra Sakkare Karkhane Vs. National Heavy Engg. Coop. Ltd. and Another, and Himadri Chemicals Industries Ltd. Vs. Coal Tar Refining Company, and submitted that wherever the Court is called upon to injunct the encashment of an unconditional bank guarantee, the fundamental principle to be kept in mind is not the bank cannot rely of the term underlying contract between the parties. The bank furnishing such a guarantee is bound to honour it irrespective of any disputes raised by its customer, since it is an independent contract, absolute in nature. Counsel also contended that mere mention of fraud is not sufficient, for a case to fall within the exception, empowering the Court to injunct operation of a bank guarantee. The evidence must be clear, both as to the fact of fraud and to the bank's knowledge. It was urged that there is nothing on record even remotely suggesting that a fraud had been played upon the petitioner by the respondent which would entitle this Court issue interim injunction.

11. The above discussion would show that parties to these proceedings entered into a contract for supply of design, engineering specifications and commissioning of 11 MW power plants in Afghanistan. It is not in dispute that contemporaneously or immediately after the agreement, the purchaser paid an advance amount aggregating 10% of the value of the contract i.e. about US \$ 1.8 million. The supplier/petitioner furnished two bank guarantees which are in question. It alleges that in addition, it supplied drawings and some specifications

to the purchaser. According to the contentions made on its behalf, when even the initial part of the time schedule has not lapsed and without even obtaining EXIM Bank's approval, (which would in term render the contract effective), the respondent/purchaser has without cause and fraudulently invoked the guarantee. It is contended on its behalf that the guarantees issued were conditional as they are premised upon mutual obligations under the contract; it is also alleged that the ground for invoking the guarantees i.e. failure to issue guarantees in accordance with the contract, is a ground not available. Apart from fraud, irretrievable injustice has also been urged.

12. Now, a reading of the bank guarantees which is subject matter of the present cases, no doubt shows that there is some mention of the contract between the parties. Yet, if one sees the recital and the unequivocal declaration of the bank in Clause 1 (extracted above), there can be no doubt that the obligation to pay his absolute and unconditional, if a demand is made by the beneficiary, i.e. the purchaser. This Court is of the opinion that the mere advertence to the underlying contract between the parties without any other internal evidence - as in the present case does not automatically lead to the inference that all contractual terms would have to be necessarily scrutinized by the bank or that the guarantee are conditional. Clause 2 of the guarantees is to a certain extent inelegant as it refer to the guarantors disentitlement to withhold or pay the net amount due to the purchaser. But, if one understands the nature of the bank guarantee, what is secured is the amount mentioned in each of them and not the entirety of the contract amount. This Court accordingly rules against the petitioner on the issue of the nature of the bank guarantees i.e. that being conditional; it is held that the instruments are unconditional.

13. So far as the other grounds raised, on behalf of the petitioner with regard to the alleged fraud (since some drawings had been supplied) and that the defect in the guarantees and furnishing of guarantees being not a condition enabling invocation of the two instruments are concerned, it must be remembered, what must be kept in mind is that the bank guarantees are autonomous commercial documents. The Court's power interdict and prevent the beneficiary from receiving its proceeds has to be exercised in exceptional and rare circumstances where a clear case of fraud has been made out. Such is the purport of the law declared consistently by the Supreme Court for these last 25 years, from *United Commercial Bank Vs. Bank of India and Others*, down to the decision *Himadri Chemicals Industries Ltd.* (supra) referred to above. The rationale invoking the bank guarantees given on behalf of the respondents was that according to the contract, a clear bank guarantee for securing 10% of the advance amounts had to be furnished; likewise a clear bank guarantee, by way of performance bond (for 5% contract value), in terms of Clause 11 too had to be furnished. The bank guarantees furnished by the petitioner were rolled up as they mentioned the intention to secure advances paid, towards performance and also towards commissioning (which was the subject matter of the right to retain 8% of the contract value). They covered only 10% of the contract.

14. In a normal commercial dispute, if this court were go into the merits of all the contentions, it could perhaps be open for the petitioner to contend that the termination of contract on such ground without further ado is not justified. However, that is not the case here; those are matters for trial. What this court has to determine is whether the invocation on that ground amounts a fraud or would be a factor resulting in irretrievable injustice, empowering the Court to issue injunction.

15. The authorities have consistently ruled that the beneficiary is entitled to realise a bank guarantee in its terms of irrespective of any pending disputes upon the construction or performance of the contract. The bank cannot rely upon the terms of the contract to embark upon an enquiry about the justification of the invocation. Courts should be slow and circumspect in issuing injunction restraining operation of bank guarantees. Fraud which is carved out as an exception, has been emphasised as one which should be "egregious" in nature, committed in notice of the bank, which would sully the foundation of the guarantee or that the invocation would result in injustice which would make it impossible for the guarantor to be compensated later or result in irretrievable harm. The decision to invoke the two guarantees was based upon a commercial determination that not furnishing proper guarantees amounted to a breach of the contract. That decision cannot by any stretch of the imagination be called a fraud.

16. One last limb of the arguments made on behalf of the petitioner was that the impugned invocations are motivated since they would result in circumventing the obligation of the purchaser under Schedule 26 to pay cancellation charges. This contention in the opinion of this Court is unmerited since the recovery of such charges can always be a subject matter of arbitration proceedings; in any event no special equities or materials in support of such a plea have been shown in this regard.

17. For the above reasons, this petition has to fail. The interim order made in OMP 15/2008 on 9.1.2008 is hereby vacated. The petitions i.e. OMP 15/2008 and OMP 19/2008 are accordingly dismissed without any order on costs.