
(1995) 12 DEL CK 0014

In the Delhi High Court

Case No : Interim Application No. 11008 of 1995 and Suit No. 2494A of 1995

Coronation Marketing Services Ltd.

APPELLANT

Vs

MMTC Ltd.

RESPONDENT

Date of Decision : 01-12-1995

Acts Referred:

Civil Procedure Code, 1908 (CPC) — Order 39 Rule 1

Citation : (1996) 61 DLT 61 : (1995) 35 DRJ 658

Hon'ble Judges : S.K. Mahajan, J

Bench : Single Bench

Advocate : Arun Jaitley, Anil Sapra, Milan Banerjee, Jagdeep Kishore and Rekha Anand, for the Appellant;

Judgement

S.K. Mahajan, J.

(1) By a contract entered into between the petitioner and respondent No.1 bearing No.MMTC/95- 96/FZ(U)/2 dated 15th March 1995, the petitioner agreed to sell the quantity of 1,00,000 Mt plus minus 5% Urea (Bulk) - 46% Nitrogen Fertilizer Grade at the rate of US\$ 234 PMT. The shipment schedule specified in the contract was from 1st April, 1995 to 31st May, 1995. The origin of supply of the said Urea was Confederation of Independent States (in short CIS) which included Russia as well as Ukraine. It is stated by the petitioner that only port of shipment of goods from the said countries was Yuzhny. The petitioner was required to furnish a performance bank guarantee to the tune of 2% of the value of the contract. On account of certain difficulties, the petitioner requested for extension of time for furnishing the performance bank guarantee and the same was furnished on 1st May, 1995. The said performance bank guarantee was furnished by respondent No.2 on behalf of Union Bank of India, Switzerland, New York for a sum of US\$ 4,68,000.00 . On receipt of the said guarantee a letter of credit was opened by respondent No.1 on 9th May, 1995. The petitioner was not able to supply the entire quantity of 1,00,000 Mt and had supplied only 37,000 Mt of Urea leaving 63,000 Mt undelivered to respondent No.1.

(2) The case of the petitioner is that the delay in shipment of the balance quantity was caused on account of the reasons beyond the control of the petitioner because during the period 10th May, 1995 to 10th June, 1995 the Government of Ukraine had prohibited the provision of wagons for transport of any cargoes including fertilizers due to great congestion of carriages at Yuzhny port. The petitioner, Therefore, submits that it was entitled to extension of time on account of existence of "Force Majeure" Clause in the agreement.

(3) On account of failure of the petitioner to supply the balance quantity of 63,000 Mt of urea, respondent No.1 by notice dated 15th June, 1995 informed the petitioner that the contract had come to an end and the shipment period could not be extended.

(4) Because of the alleged unreasonable stand of respondent No.1 not to accept fertilizers beyond the specified time, the petitioner states that disputes had arisen between the parties and the same were liable to be referred to arbitration in accordance with the arbitration agreement existing between the parties. Petitioner, Therefore, has filed this petition u/s 20 of the Arbitration Act for reference of these disputes to arbitration.

(5) Along with the petition, the petitioner has filed an application u/s 41 read with schedule Ii of the Arbitration Act and Order 39 Rules 1 & 2 read with Section 151 CPC alleging, inter alia, that the respondent was trying to invoke and encash the bank guarantee dated 29th April, 1995 for US\$ 4,68,000.00 on account of the inability of the petitioner to complete the supplies in terms of the contract between the parties. It is the case of the petitioner that alleged invocation is with malafide intentions and ulterior motives and the same is also fraudulent. Petitioner, Therefore, wanted an injunction to be issued against respondent No.1 from encashing the bank guarantee for Us \$ 4,68,000.00 dated 29th April, 1995 issued by respondent No.2 till the final adjudication/settlement of disputes between the parties.

(6) The case came up for hearing on 30th October, 1995 when notice was accepted by Mr.Jagdeep Kishore for respondent No.1. Reply has been filed by the said respondent No.1 and I have heard Mr.Arun Jaitley, Sr.Advocate appearing on behalf of the petitioner and the Attorney General of India on behalf of respondent No.1.

(7) It has been fairly conceded by Mr.Jaitley that unless the petitioner is able to make out a prima facie case of established fraud, special equity and irretrievable injury, he may not be entitled to the grant of an injunction restraining the other party from encashing the bank guarantee. To bring his case within the said parameters, the contention of the petitioner is that in view of the existence of the "Force Majeure" Clause in the agreement and in view of the fact that the Government of Ukraine was not allowing the movement of wagons for carriage of fertilizers from Ukraine to Yuzhny port due to congestion of wagons, it was a clear case where time automatically stood extended by the period during which

this embargo continued and consequently respondent No.1 could not refuse to take delivery of the fertilizers after 5th June, 1995. In order to appreciate the contentions of the petitioner, it will be useful to incorporate Clause Xiii and xviii of the contract as under : - Clause Xiii - Default

"IN the event of failure of delivery of material within the time stipulated in the contract, it is agreed that the buyers shall have the option : a)To recover as liquidated damages and not by way of penalty for the period after this material was due until actual delivery or until the buyers secure the material from other sources, a sum equivalent to 2% of the contract value of the undelivered material for each month, or part of month's delay. b)To purchase from other sources without notice to the sellers at the risk and account of the Sellers the material not delivered or other material of similar description (where material exactly complying with the particulars are not, in the opinion of the buyers, readily procurable, such option being final) without cancelling the contract in respect of the consignment(s) not yet due for delivery; or c)To cancel the contract or a portion thereof and, if so desired, to purchase the material at the risk and cost of the sellers". Clause xviii - Force Majeure "If at any time during the existence of this contract either party is unable to perform in whole or in part any obligations under this contract because of war, hostility, civil commotions, sabotage, guarantee restrictions, acts of God and acts of Govt. (including but not restricted to prohibition of exports or import), fires, floods, explosions, epidemics, strikes, embargoes, then the date of fulfillment of engagement shall be postponed during the time when such circumstances are operative. Any waiver/extension of time in respect of the delivery of any Installment or part of the goods shall not be deemed to be waiver/extension of time in respect of the remaining deliveries. If operation of such circumstances exceed three months, each party shall have the right to refuse further performance of the contract in which case neither party shall have the right to claim eventual damages. The party which is unable to fulfill its engagements under the present contract must within 15 days of occurrence of any of the causes mentioned in this clause shall inform the other party of the existence of the circumstances preventing the performance of the contract. Certificate issued by a Chamber of Commerce in the country of sellers or the buyers shall be sufficient proof of the existence of the above circumstances and their duration. Non-availability of raw material will not be an excuse to the sellers for not performing their obligations under this contract."

(8) The argument is that certificate issued by the Chamber of Commerce in the country of sellers or buyers shall be sufficient proof of the existence of the circumstances that the petitioner was not able to perform its obligations during the period in question. Reliance is, Therefore, placed by the petitioner upon a certificate dated 22nd May, 1995. The said certificate appears to have been issued by the manufacturer informing respondent No.1 that due to rail road congestion of the port Yuzhny during 10th to 20th May, 1995 rail cars were unable to move approximately 60,000 Mt of urea to the port and as the situation

was normalising it was awaiting arrival of empty railcars to move approximately 60,000 Mt of urea to the load port. At the bottom of this letter, there is a stamp of the Chamber of Commerce. Another letter is issued by the Odessa port plant to respondent no.1 informing him that from 10th May, 1995 to 10th June, 1995 Odessa Railway was prohibited from moving carriages with cargos including fertilizers due to great accumulation of carriages. The submission, Therefore, is that as the letter dated 22nd May, 1995 has been countersigned by the Chamber of Commerce, it will be deemed to be a certificate in terms of clause 18 of the contract and the effect of this certificate was that date of fulfillment of the contract was postponed during the period the circumstances mentioned in the letter continued to operate. It is also contended by Mr.Jaitley that as the petitioner was not able to perform the contract for reasons beyond its control, the contract became void and consequently any guarantee given for performance of such a void contract could not be invoked. It is, Therefore, submitted that invocation of the bank guarantee is for collateral purposes and not on account of inability of the petitioner to perform the contract and the same is, Therefore, alleged to be a fraud on the powers of MMTC and consequently the petitioner claims to be entitled to the grant of an injunction.

(9) Reliance has been placed by Mr.Jaitley upon a judgment reported as Boothalinga Agencies Vs. V.T.C. Poriaswami Nadar, to support his contention that on account of the ban on the movement of carriages, the contract could not be performed and was frustrated. It is also the contention of Mr.Jaitley that as respondent No.1 was entitled to recover by way of liquidated damages an amount equivalent to 2% of the contract value on account of delay in supply of material, time could never be the essence of the contract. Reliance for this purpose has been placed upon a judgment reported as Hind Construction Contractors by its Sole Proprietor Bhikamchand Mulchand Jain (Dead) by Lrs Vs. State of Maharashtra, . This was a case relating to the construction contract and it was in those circumstances that the Court had said that in case an amount had been specified to be paid by way of liquidated damages for the delay caused by the parties to the contract, the time could not be the essence of the contract. In my opinion, this judgment will not be applicable to the facts and circumstances of present case.

(10) The only question, to my mind, which arise for consideration is whether the Court, at the time of deciding the issue of stay of bank guarantee, is required to go into the terms and conditions of the principal contract to find out whether there has been a breach of the principal contract which would entitle the party to invoke the bank guarantee. To appreciate the contentions of the parties, it will be useful first to understand the law which has been laid down by Hon''ble the Supreme Court on this subject.

(11) In Svenska Handelsbanken Vs. M/s. Indian Charge Chrome and others, , it was held that a confirmed bank guarantee cannot be interfered with unless there is an established fraud and irretrievable injustice involved in the case.

Irretrievable injury has to be of the nature noticed in Itek Corporation Case 566 Fed. Supp. 1210. Mere irretrievable injustice without prima facie case of established fraud will be of no consequence in restraining the encashment of bank guarantee.

(12) In U.P. Cooperative Federation Ltd. Vs. Singh Consultants and Engineers (P) Ltd., , the Supreme Court while dealing with a case relating to the letter of credit had held 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 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 gap. In such transactions, the seller (beneficiary) receives payment from issuing bank when he presents a demand as per terms of the documents. 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 the 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.

(13) The earlier decision of the Court in United Commercial Bank Vs. Bank of India and Others, was quoted with approval by the Supreme Court in U.P. Cooperative Federation Limited's case. In United Commercial Bank's case, the Court had held as under : -

"...THE rule is well established that a bank issuing or confirming a letter of credit is not concerned with the underlying contract between the buyer and seller. Duties of a bank under a letter of credit are created by the document itself, but in any case it has the power and is subject to the limitations which are given or imposed by it, in the absence of the appropriate provisions in the letter of credit. It is somewhat unfortunate that the High Court should have granted a temporary injunction, as it has been done in this case, to restrain the appellant from making a recall of the amount of Rs.85,84,456 from the Bank of India in terms of the letter of guarantee or indemnity executed by it. The Courts usually refrain from granting injunction to restrain the performance of the contractual obligations arising out of a letter of credit or a bank guarantee between one bank and another. If such temporary injunctions were to be granted in a transaction between a banker and a banker, restraining a bank from recalling the amount due when payment is made under reserve to another bank or in terms of the letter of guarantee or credit executed by it, the whole banking system in the

country would fail. In view of the banker's obligation under an irrevocable letter of credit to pay, his buyer-customer cannot instruct him not to pay."

(14) While dealing with a case of a performance guarantee Lord Denning M.R. held : -

"SO, as one takes instance after instance, these performance guarantees are virtually promissory notes payable on demand. So long as the Libyan customers make an honest demand, the banks are bound to pay and the banks will rarely, if ever, be in a position to know whether the demand is honest or not. At any rate they will not be able to prove it to be dishonest. So they will have to pay. And said : All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit. A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contractual obligation or not; nor with the question whether supplier is in default or not. The bank must pay according to its guarantee, on demand if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice."

(15) HON"BLE the Supreme Court in U.P. Cooperative Federation Limited's case held that the Court should not lightly interfere with the operation of irrevocable letter of credit. The observations of Sir John Donaldson, M.R. in *Bolivinter Oil Sa Vs. Chase Manhattan Bank* reported as 1984 (1) Aer 351 are that : -

"THE wholly exceptional case where an injunction may be granted is where it is proved that the bank knows that any demand for payment already made or which may thereafter be made will clearly be fraudulent. But the evidence must be clear, both as to the fact of fraud and as to the bank's knowledge. It would certainly not normally be sufficient that this rests on the uncorroborated statement of the customer, for irreparable damage can be done to a bank's credit in the relatively brief time which must elapse between the granting of such an injunction and an application by the bank to have it discharged."

(16) Applying the principles laid down by the Supreme Court of India to the facts of the present case, I feel, what the Court has to see at this stage is whether any case of irretrievable injustice with, prima facie case of established fraud has been made out. In my opinion, to look into the question as to whether a prima facie case of established fraud has been made out, it will not be appropriate for the Court to go into the question as to whether the principal contract which had been arrived at between the petitioner and respondent No.1 had been frustrated. This is a question which is ultimately to be decided by the arbitrator. In case, the arbitrator comes to the conclusion that the contract stood frustrated, the petitioner may be entitled to some damages and may also be entitled to the amount of the bank guarantee invoked by respondent No.1 and there will be no problem for effecting recovery in such a case as respondent No.1 is a

Government company and nothing has been pointed out to show that the decree that may be ultimately passed in favor of the petitioner cannot be executed against respondent No.1. I, Therefore, need not dwell upon the question as to whether there has been a frustration of contract and whether there was automatic extension in the performance of the petitioner's obligation on account of existence of "Force Majeure" Clause in the agreement. These are the questions to be decided by the arbitrator. Prima facie, I feel that there is no question of the contract having become void on account of the alleged inability of the petitioner to perform its obligations under the contract. I am also not giving any opinion on the question as to whether the certificates which appear at page 59 and 69 are the certificates issued by the Chamber of Commerce in accordance with "Force Majeure" Clause existing in the agreement as, in my opinion, these certificates are not relevant to decide the question as to whether it is a case of irretrievable injury and established fraud.

(17) In case, the Court has to look to the principal contract to find out as to whether there has been any breach of the terms thereof, in my opinion, the whole purpose of providing the bank guarantee will be defeated. The question as to whether the goods could have been shipped or not during the period, the petitioner was required to ship the same for reasons beyond his control and the question whether there was an automatic extension of time because of the existence of "Force Majeure" Clause, cannot, in my opinion, be considered for deciding as to whether the petitioner was entitled to the stay of invocation of bank guarantee. As held in *United Commercial Bank Vs. Bank of India* (Supra), the bank issuing the bank guarantee is not concerned with the underlying contract between the buyer and the seller. Bank is also not concerned with the question as to who is in default in the performance of its obligations under the principal contract. The bank must pay according to its guarantee, without proof or conditions, the only exception being a case of clear fraud of which the bank has notice. In my opinion, the petitioner has not been able to make out any case of fraud and special equities in the form of preventing irretrievable injustice to it.

(18) Moreover, in the petition, the petitioner has not given details of any fraud. To enable to party to succeed on the ground of fraud, the details of fraud must have been given in the petition. What has been stated in the petition is that the performance bank guarantee furnished by the petitioner is rendered incapable of being invoked on account of the contract having been frustrated and invocation, Therefore, is fraudulent and liable to be quashed. Beyond this nothing more has been pleaded to show that act of the respondent in invoking the bank guarantee is fraudulent. The pleadings should have been more specific to show as to what were the acts of fraud committed by a party and a mere allegation that on account of the contract having been frustrated, the invocation of bank guarantee is fraudulent is not enough for the petitioner to have the bank guarantee stayed.

(19) It is lastly contended by Mr.Jaitley that admittedly 37,000 Mt of urea had been supplied and it was only 63,000 Mt of urea which remained to be supplied

by the petitioner to respondent No.1 and even assuming that respondent No.1 could invoke the bank guarantee, it could only invoke the same for an amount proportionate to 63% of the contract and not for the entire amount. To support his contention Mr.Jaitley refers to clause Xiii (a) under which respondent No.1 had an option to recover as liquidated damages a sum equivalent to 2% of the contract value of the undelivered material for each month or part of a month's delay. The contention is that bank guarantee was equivalent to 2% of the entire contract value and it was given keeping in view clause Xiii (a) of the contract and as 37% of the material had already been supplied, it was only balance in respect of 63% that the bank guarantee could be invoked. He, Therefore, states that it was complete non-application of mind on the part of the respondent in invoking the entire bank guarantee. In my opinion, the argument is not well founded. Under clause Xiii it is not only clause (a) that the buyer had an option to recover as liquidated damages a sum equivalent to 2% of the contract value but under clause (c) it also had an option to cancel the contract or a portion thereof and if so desired, to purchase the material at the risk and cost of the sellers. The contention of Attorney General is that contract could have been cancelled under any of the paras of Clause Xiii including para (c) and, Therefore, there was no impediment on the part of respondent to invoke the entire bank guarantee. Moreover, the demand of respondent No.1 is under the bank guarantee and as per the terms thereof. The supply of 37% of the material by the petitioner has no relevance to the liability of the bank under the guarantee. The liability of the bank remained intact irrespective of the supply of some material under the principal contract.

(20) In General Electric Technical Services Company Inc. Vs. M/s. Punj Sons (P) Ltd. and another, , the appellant had entered into a contract with respondent No.1 for getting the work of construction and fabrication of aircraft testing center/ engine repair centre for Indian Airlines. As per the contract, respondent was required to furnish a bank guarantee to secure the mobilisation advance of 25% of the contract value. On the failure of respondent to complete the project, the appellant terminated the same and sought to encash the bank guarantee of Rs.1,06,12,500.00 issued to the appellant by the Bank. In a suit for injunction filed by the appellant, single Judge of High Court of Delhi dismissed the application for injunction against which order an appeal was preferred to the Division Bench. The Division Bench of the High Court of Delhi allowed the appeal and stayed the encashment of the bank guarantee till the disposal of the suit. On the question whether the Court was justified in restraining the bank from paying the appellant under the bank guarantee at the instance of the respondent Hon"ble the Supreme Court allowing the appeal held as under : -

"IN the instant case, the High Court has misconstrued the terms of the bank guarantee and the nature of the inter-se rights of the parties under the contract. The mobilisation advance is required to be recovered by the appellant from the running bills submitted by the respondent. If the full mobilisation advance has not been recovered, it would be to the advantage of the respondent. Secondly,

the Bank is not concerned with the outstanding amount payable by the appellant under the running bills. The right to recover the amount under the running bills has no relevance to the liability of the Bank under the guarantee. The liability of the Bank remained intact irrespective of the recovery of mobilisation advance or the non-payment under the running bills. The failure on the part of the appellant to specify the remaining mobilisation advance in the letter for encashment of bank guarantee is of little consequence to the liability of the Bank under the guarantee. The demand by the appellant is under the bank guarantee and as per the terms thereof. The Bank has to pay and the Bank was willing to pay as per the undertaking. The Bank cannot be interdicted by the Court at the instance of respondent 1 in the absence of fraud or special equities in the form of preventing irretrievable injustice between the parties. The High Court in the absence of prima facie case on such matters has committed an error in restraining the Bank from honouring its commitment under the bank guarantee."

(21) It is, Therefore, clear that the question of either the adjustment of the mobilisation advance as in the case decided by the Supreme Court or the supply of material as in the present case, will have no relevance to the invocation of bank guarantee by respondent No.1 in whose favor it has been issued by the bank.

(22) HON"BLE the Supreme Court has also repeatedly observed that the nature of the fraud that the Courts talk about is fraud of an egregious nature as to vitiate the entire underlying transaction. It is a fraud of the beneficiary, not the fraud of somebody else. There has to be a, prima facie, case of fraud and special equities in the form of preventing irretrievable injustice between the parties. Mere irretrievable injustice without, prima facie, case of established fraud is of no consequence in restraining the encashment of the bank guarantee.

(23) In the present case, the petitioner has not been able to make out a, prima facie, case of fraud and special equities in the form of preventing irretrievable injustice to the petitioner. Petitioner is not entitled to any injunction. The application is, Therefore, dismissed. Interim order passed on 30th October, 1995 is vacated.

(24) Anything observed in this order will not affect the merits of the disputes to be decided by the arbitrator. Suit No.2494-A/95

(25) There is no dispute amongst the parties that as disputes have arisen between the parties, the same are liable to be referred to the arbitrator in terms of the arbitration agreement existing between the parties. In terms of the arbitration agreement, the matter is to be referred to two arbitrators, one each to be nominated by the parties and in case of the said arbitrators not agreeing then to an umpire to be appointed by the arbitrators in writing.

(26) I, Therefore, direct that arbitration agreement be filed in Court and further direct the parties to appoint one arbitrator each in terms of the arbitration agreement, within thirty days of passing of this order. The arbitrators shall then

appoint an umpire in accordance with the arbitration agreement. The parties will be at liberty to raise their disputes before the arbitrators irrespective of the disputes which might have been mentioned by the petitioner in the petition or in any of his letters to respondent No.1.

(27) With these observations, the suit as well as application is disposed of.

(28) In the circumstances of the case, I leave the parties to bear their own costs.