
(1979) 08 DEL CK 0014

In the Delhi High Court

Case No : First Appeal No. 36 of 1979

Harparshad and Co. Ltd.

APPELLANT

Vs

Sudarshan Steel Mills, Punjab National Bank

RESPONDENT

Date of Decision : 01-08-1979

Acts Referred:

Citation : AIR 1980 Delhi 174 : (1980) 50 CompCas 709 : (1980) 17 DLT 502

Hon'ble Judges : V.S. Deshpande, C.J.; Harish Chandra, J

Bench : Division Bench

Advocate : A.B. Divan, Shailender Swaroop, S.K. Paul, P.K. Sinha and Jagdeep Kishore, for the Appellant;

Judgement

V.S. Deshpande, C.J.

(1) General proposition do not solve concrete cases. Justice Holmes has said. While the law generally stated is that liability arising out of the unilateral contracts of commercial credits, such as letters of credit, bank guarantees and performance bonds is absolute, the intention of the parties as gathered from a reasonable construction of the language of the particular contract must ultimately govern the decision of the court as to the arising of the liability there under. The terms of a particular document may even constitute an exception to the general rule. /- (2) The bank guarantee furnished by the Punjab National Bank (defendants-respondents 2 and 3) in favor of M/s. Harprashad & Co. Ltd. (appellant-defendant No. 1) contains the following material words :

"IN case M/s. Sudershan Steel Rolling Mills fails in the judgment of M/s. Harprashad & Company Ltd. to carry out fulfill any of the obligations assumed under the said contract, we undertake to promptly pay the Punjab National Bank, Parliament Street, New Delhi, in favor of M/s. Harprashad & Company Ltd. or to their order merely upon receipt of first written notice, any amount up to Rs. 2,13,618.00 that may be claimed by them for any reason or purpose at their own discretion without it being necessary for M/s. Harprashad & Company Ltd. to

issue a declaration or take action through administration legal, or any other channels, or to prove the default of M/s. Sudershan Steel Rolling Mills and/or the veracity of the affirmations made by them".

When the appellant defendant No. 1 invoked the bank guarantee Sudershan Steel Rolling Mills (plaintiff respondent No. 1) filed Suit No. 933 of 1978 and obtained an order of temporary injunction against defendants I to 3, restraining defendant No. 1 from recovering the amount guaranteed by the bank, defendants 2 and 3 by the bank guarantee. This appeal by the appellant defendant No. 1 is against the order of the learned single Judge granting the temporary injunction.

(3) Mr. Anil Diwan, learned counsel for the appellant urged the following contentions in support of the appeal. 1. The contract referred to in the bank guarantee was the agreement between the plaintiff and defendant No. 1. dated 22nd June, 1977 under which the plaintiff was responsible for the preparation of documents, such as bills of lading under which the goods were to be exported to the foreign buyer. These documents were negotiated by the Punjab National Bank through the State Bank of India with the foreign buyer. This was done "under reserve", because the bills of lading described the appellant as "M/s. Harprashad & Company" without the addition of the word "Limited" after it. The bank told the appellant that "if payment of documents is refused on account of any discrepancy "The sale proceeds of the goods received by the foreign buyer and credited to the account of the appellant would be recalled. The appellant in his judgment regarded this as a failure on the part of respondent No. 1 to carry out and fulfill any of the obligations assumed under the said contract. The appellant was, Therefore, entitled to invoke the bank guarantee and recover the amount of it from the bank. 2. This bank guarantee, dated 14th July, 1976 was to be effective on execution of the contract between the appellant and defendant No. 1, which was the agreement later arrived at on 22nd June, 1977. Clause 7 of the agreement referring to the bank guarantee was as follows:

" THAT the "Exporter" has furnished a performance guarantee of the value of the 10% of the "Goods" to be supplied to "Foreign Buyer under the "purchase contract", of the Punjab National Bank, Parliament Street, New Delhi. The said performance guarantee has been furnished by the Punjab National Bank against a counter-guarantee of the contractor. It is clearly agreed and understood that in the event of any amount being paid or payable under the performance guarantee of the "Exporter" to the "Foreign Buyer" due to fault of the "Contractor", the "Contractor" through its counter-guarantee or otherwise shall make good the payment made pursuant to the aforesaid bank guarantee by Punjab National Bank and any such payment shall be exclusively and solely to the account of "Contractor" and the Punjab National Bank's certificates in respect of payment made under the performance-guarantee shall be final and binding upon the "Contractor".

By reading the bank guarantee with clause 7 of the agreement it was clear that

the right of the appellant to invoke the bank guarantee was absolute and the recovery of the amount of the bank guarantee by the appellant could not be restrained by a temporary injunction on the ground that respondent No. 1 had not committed any default in the performance of the contract due to which the appellant had to pay any amount under the performance guarantee given by the appellant to the foreign buyer.

(4) For these two reasons it was contended that the order of temporary injunction given by the learned single Judge should be set aside and other appellant should be allowed to recover the amount of the bank guarantee from the bank. We may now examine these contentions as below. Contention (1)

(5) That the liability under a bank guarantee is absolute and cannot be evaded by raising disputes is illustrated by several decisions. But a perusal of each of these decisions would show that the absolute nature of the liability depended on the language of the guarantee in that particular case. In *Tarapore and Co. Vs. V/O Tractoroexport and Another*, , letter of credit was opened by the Indian firm in favor of the Russian firm. The letter of credit was "subject to the Uniform customs and Practice for Documentary Credits (1962 Revision), International Chamber of Commerce Brochure No, 222". Article 3 of the Brochure makes the bank liable to pay the amount secured by the letter of credit "Provided that all the terms and conditions of the credit are complied with." Presumably this was done in that case. Therefore, the liability of the bank because absolute and the Indian firm could not obtain a temporary injunction against the Russian firm and the bank preventing the former from recovering the money of the latter. In support of this decision the court .referred to Chalmers on "Bills of Exchange" stating the legal position as follows:

" IT can hardly be over emphasised that the banker is not bound or entitled to honour such bills of exchange unless they, and such accompanying documents as may be required there under, are in exact compliance with the terms of the credit. Such documents must be scrutinised with meticulous care the maxim *de minimis non curat lex* cannot be invoked where payment is made by the letter of credit. If the seller has complied with terms of the" letter of credit, however, there is an absolute obligation upon the banker to pay irrespective of any disputes there may be between the buyer and the seller.""

(6) It is to be noted that the liability of the bank to pay the amount of the letter of credit became absolute only after the terms of the letter of credit were fulfilled .This decision is not, Therefore, an authority for the proposition that the liability under the letter of credit is by itself absolute without reference to the terms of the letter of credit.

(7) In *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.* (1978) 1 All. E. R. 976, the performance guarantee required the bank to pay money on first demand without any conditions or proof. This is why the guarantee was likened by Lord Denning M. R. to a promissory note. These facts are to be

contrasted with the facts of our case because the money under the bank guarantee in our case is not payable on demand like a promissory note. In *Texmaco Ltd. Vs. State Bank of India and Others*, , also the amount was payable by the bank under the guarantee on first demand and without contestation, demur or protest and without reference to any party and without questioning the legal relationship between the parties and was regarded as absolute.

(8) The crucial conditions creating liability of the bank in the bank guarantee before us may be analysed from the bank guarantee as below :

(1) In case M/s. Sudershan Steel Rolling Mills fails; (2) In the judgment of M/s. Harparshad & Co. Ltd., (3) To carry out and fulfill any of the obligations assumed under the said contract; (4) We undertake to pay merely upon receipt of first written notice, any amount covered by the bank guarantee that may be claimed by M/s. Harparshad & Co Ltd. for any reason or purpose, at their own discretion without it being necessary to issue declaration or take action through administration, legal or any other channels or to prove the default of M/s. Sudershan Steel Rolling Mills and/or the veracity of the affirmation made by them".

(9) The first thing for Appellant No. 1 was to give a written notice to the bank. According to the written statement filed by the bank a written notice was given by the appellant to the bank. But neither the appellant nor the bank has produced that written notice or any copy of it. Can it be said that the mere giving of a written notice, whatever it may contain, is a sufficient compliance with the terms of the bank guarantee? For, the law is well settled that the amount due even on an irrevocable commercial credit can be recovered "provided that the terms and conditions of the credit are complied with." (Chitty on Contracts, Vol. 2 24th Edn. para 2598). The terms of the bank guarantee are analysed above. The very first and third terms are "in case M/s. Sudershan Steel Rolling Mills fails to carry out and fulfill any of the obligations assumed under the said contract." It is true that the second term says that such a failure to carry out any of the terms of the contract is to be "in the judgment of M/s. Harparshad & Co. Ltd." The power of judgment given to the appellant thereby has to be exercised by the appellant. The judgment has to be that the respondent No. 1 has failed to carry out any of the obligations imposed upon it by the agreement, dated 22nd June, 1977. Unless the notice in writing sent by the appellant to the bank said so, the notice was not in compliance with the terms of the bank guarantee. Unless the terms of the bank guarantee were complied with the liability of the bank to pay the amount to the appellant did not arise. The first rule of the construction of a contract or a document is to ascertain the intention of the parties to it (Chitty on Contracts Vol. 1. 24th Edn. para 698). What was the intention of the parties conveyed by the language of the bank guarantee? If the argument of the appellant that the liability there under is absolute is to be accepted, then the appellant was entitled to recover the amount of the bank guarantee from the bank without complying with the terms of the bank guarantee. If that had been

the intention of the parties the bank guarantee would not have said that the liability would arise on failure of respondent No. 1 in the judgment of the appellant to fulfill the terms -of the contract. There is a distinction between the absolute liability, as contended by the appellant, and the absolute liability which arises after the terms of the bank guarantee are fulfilled .The intention of the parties according to the language of the bank guarantee was that the absolute liability should arise only after the terms of the bank guarantee are fulfilled .It was necessary for the appellant to show that it had become entitled to recover the amount under the bank guarantee because in its judgment respondent No. 1 had failed to perform any of the obligations under the contract. The appellant has made no attempt to show that it has complied with the conditions of the bank guarantee. In the written statement filed by it in the suit or in the memorandum of appeal before us, the appellant had not stated that in its judgment respondent No. 1 has failed to comply or carry out any of the particular obligation under the contract. Nor has the appellant said that the judgment of the appellant so arrived at regarding the failure of respondent No. 1 to fulfill any obligations under the contract was conveyed to the bank in the written notice sent by the appellant to the bank.

(10) In this connection we may point out that the Punjab National Bank in this case, as every other bank issuing a bank guarantee, has a duty to perform. The bank must not, take up the position that it would be willing to pay the amount of the bank guarantee on a mere demand simply because its customer who has got the bank guarantee issued in favor of the other party to the contract has already secured the bank against any loss that may be caused by the recovery of the amount of the bank guarantee from the bank by the other party in the contract. The bank has itself a duty to satisfy itself that the demand by the beneficiary under the bank guarantee is made in accordance with the terms of the bank guarantee. For instance, if in the present case the appellant has simply called upon the bank to pay the money under the bank guarantee, such a notice in writing is not in accordance with the terms of the bank guarantee. It is the duty of the bank to satisfy itself that the demand is made on the ground that in the judgment of the appellant respondent No. 1 has failed to fulfill any of the obligations under the contract. Further, the bank has to see that the judgment is exercised in respect of some definite obligation to be performed by respondent under the contract. It is not sufficient for the appellant merely to reiterate parrot-like words of the bank guarantee. The statement by the appellant in the notice in writing that respondent No. 1 has failed "to carry out and fulfill any of the obligations assumed under the said contract" would simply be unintelligible "Any of the obligations" are meaningless words unless and until a reference is made to some particular obligation to which respondent No. 1 has failed to carry out in the judgment of the appellant. The duty of the appellant in making the demand on the bank is like the duty of the plaintiff to disclose the cause of action in the plaint. Just as a plaint is liable to be rejected for non-disclosure of the cause of action, a demand by the beneficiary of the bank guarantee is liable to be rejected

by the bank if it does not state the facts showing that the conditions of the bank guarantee have been fulfilled. Just as the allegations in the plaint have to be assumed to be true at the stage of plaint is to be entertained, similarly the allegations in the demand would have to be assumed to be true by the bank provided that the proper allegations are made just as a proper pleadings has to be made in the plaint. The bank is not to enquire into the truth of the allegations just as the court is not to enquire into the truth of the pleadings at the stage of the filing of the plaint.

(11) This is in all that is meant by the words in the judgment of M/s. Harparshad & Co. Ltd. While these words give the right to the appellant to decide if respondent No. 1 has failed to carry out the obligation under the contract, they do not dispense with the necessity of the appellant stating in the demand which particular obligation under the contract respondent No. 1 has failed to carry out in the judgment of the appellant. The statement of the facts referring to some definite obligations under the contract is necessary just as the statement of the cause of action is necessary in the plaint. We think that the commercial banks as also the beneficiaries under the bank guarantees should make themselves aware of this elementary obligation on their part in dealing with bank guarantees. It is only after this obligation is performed by the beneficiary that the liability of the bank becomes absolute.

(12) The argument of the appellant that the liability of the bank is absolute even without showing whether the appellant has stated in the notice in writing that in its judgment respondent No. 1 has failed to fulfill an obligation under the contract after describing some particular obligation there under would amount to saying that the effect of the bank guarantee is to deliver the amount of money secured by the bank guarantee to the beneficiary. This is not so, until the terms of the bank guarantee are fulfilled the amount is not placed into the pockets of the beneficiary. It still remains with the bank. It is no use for the beneficiary to say that the amount under the bank guarantee is payable to the beneficiary on demand if the demand must be preceded by a proper statement in the demand notice. Contention (2)

(13) Since the bank guarantee itself says that it would become effective only after the execution of the contract which was executed on 22nd June, 1977 and since the averment in the demand notice invoking the bank guarantee has to refer to the failure of respondent No. 1 to fulfill some definite obligation under the contract, a perusal of the agreement becomes necessary. Under the agreement, it was the duty of respondent No. 1 to prepare shipping document such as bills of lading. Under clause 7 of the contract the liability of respondent No. 1 under the bank guarantee was to arise if due to its fault the appellant had to pay any amount to the foreign buyer under the performance guarantee given by the appellant to the foreign buyer. The only failure to fulfill an obligation under the contract on the part of respondent No. 1 alleged by the appellant is that respondent No. 1 supplied defective documents to the bank. This contention

ignores the fact that if a bill of lading is defective, then the bank negotiating the bill of lading would not accept it. For, the bank becomes liable to pay the price of the goods in the bill of lading by negotiating the bill of lading and enabling the foreign buyer to receive the goods. Once the goods are received by the foreign buyer after the bill of lading is negotiated by the bank) no question arises of any defect having been there in the bill of lading. The sale proceeds were credited to the account of the appellant by the bank about a year ago which shows that the bills of lading were negotiated and the goods were accepted by the foreign buyer more than a year ago. It is primarily for the banker of the foreign buyer to examine the documents submitted by respondent No. 1. The right of the banker is described by Chitty on Contracts, Vol. 2, 24th Edn. in paragraph 2622 as follows:

" THE banker's right to examine the documents Before accepting a tender made under a commercial credit the banker is entitled to examine the documents. Article 8d. of the U.C.P. provides that the banker has a reasonable time for this examination. If, the examination disclosed that the documents do not comply with the terms of the credit. "Notice to that effect, stating the reasons Therefore, must, without delay, be given by cable or other expeditious means to the bank from which the documents have been received (the remitting bank) and such notice must state that the documents are being held at the disposal of such bank or are being returned thereto. If the issuing bank fails to hold the documents at the disposal of the remitting bank, or fails to return the documents to such bank, the issuing bank shall be precluded from claiming that the relative payment, acceptance or negotiation was not effected in accordance with the terms and conditions of the credit."

(14) Further in para 2624 it is stated as follows :

" IN considering whether, in certain circumstances, the general principles of the common law may confer on the banker a right of recourse against the seller, a distinction must be drawn between three types of cases. First the banker may wish to recover an amount paid to the seller, if the tender was effected with fraud. In this type of case the banker should be entitled to claim against the seller in deceit. Secondly, the banker may wish to reclaim payment from the seller if the buyer fails. It is, however, difficult to see on what principle he may establish such a claim especially as a commercial credit constitute a security given by the banker to the seller. Thirdly, the banker may wish to seek recourse to the seller if he was accepted, by mistake, a faulty set of documents tendered by the seller. It is, however, to be doubted whether the banker should be allowed to claim the amount back as money paid under a mistake of fact. In most cases the seller would change his position by parting with the documents against the banker's acceptance or payment and it may be argued that the banker should be estopped from claiming that the money was paid under a mistake of fact. Article 8f. of the U.G.P. supports this contention: "if the issuing bank fails to hold the documents at the disposal of the remitting bank, or fails to return the documents

to such bank, the issuing bank shall be precluded from claiming that the relative payment, acceptances or negotiation was not effected in accordance with the credit." Moreover, the issuing banker is under a duty to examine the documents tendered to him. The seller is, thus, entitled to presume that, if the banker accepts the documents tendered, the set is regular. In this situation the seller may perhaps be entitled to claim that the banker has waived inquiry and that he should, Therefore, be precluded from claiming that he paid the amount of the credit under a mistake of fact. An American authority supports the view that, if the banker accepts a tender of documents, he is not entitled to reclaim payment from the seller, even if the banker, due to a mistake, overlooked the irregularity of the documents."

(15) It would be seen that the banker did not dispute the correctness of the bills of lading on any of the grounds described in Chitty and did not take any steps against the seller as described in Chitty. A strong presumption has arisen that the documents submitted by the seller have been accepted by the bank of the foreign buyer and the said bank is now entrapped from disputing the correctness of the documents. All that the Punjab National Bank has told the appellant is that if the foreign buyer and its bank refuses to make payment on the documents submitted by respondent No. 1, then the amount credited by the bank to the account of the appellant would have to be recalled by the bank. There is absolutely no prospect of this being done inasmuch as the goods have been along accepted by the foreign buyer through its bank. Neither the foreign buyer nor its bank can now raise any dispute regarding the defects in the documents. What was the defect in the document? -the mere omission of the word "limited". This was so insignificant and technical that the foreign buyer and its bank ignored it and accepted the goods and made substantial payments also. It would appear that this must have been the reason why the Punjab National Bank has not yet recalled any money paid by it to the appellant. No cause of action has arisen in favor of the appellant against respondent No. 1 in terms of the bank guarantee because the Punjab National Bank has neither recalled any of the amounts paid to the appellant nor is it likely to do so because the only ground on which it could do so has neither arisen nor is likely to arise.

(16) By an application made on 30th July, 1979 respondent No. 1 states that the Punjab National Bank has withdrawn the reserve under which the payment of the sale proceeds had been credited to the account of respondent No. 1. If this is true a (question into which we do not wish to go for the purpose of this case), then it would show that there is no justification at all for the appellant to invoke the bank guarantee.

(17) The agreement dated 22nd June, 1977 has been read with the bank guarantee only to understand the terms of the bank guarantee and not to override the terms of the bank guarantee. No dispute raised under the agreement of 22nd June, 1977 can be a reason for non-payment of the amount due under the bank guarantee. The bank guarantee is an autonomous and

independent contract and must have effect according to its own terms. The main reason why we have rejected the contentions advanced in appeal is that the terms of the bank guarantee have not been fulfilled and the amount under the bank guarantee has not, Therefore, become due for payment to the appellant.

(18) We may also note in passing that the grant of a temporary injunction is an equitable and extraordinary remedy. The plaintiff respondent No. 1 had to satisfy the conscience of the court before obtaining the temporary injunction. Since it has been able to show that no amount of the sale proceeds credited by the bank to the account of the appellant has been recalled or is likely to be recalled by the bank, the Court was rightly satisfied that it was but just and fair that the appellant should not be allowed to recover the amount of the bank guarantee. To do so would be seeking the help of the court to perpetuate injustice. The appellant is simply seeking to grab the amount of the bank guarantee without any equity or justice in its favor merely as a means of unjust enrichment. Such an attempt was properly foiled by the grant of temporary injunction. The terms of the order made by the learned single judge are eminently well considered and fair to both the parties.

(19) The appeal is, Therefore, dismissed with costs. Counsel fee Rs. 500.00