

(2005) 03 DEL CK 0062

In the Delhi High Court

Case No : OMP 74 of 2005

Hindustan Engineering and Industries Limited

APPELLANT

Vs

Container Corporation of India Limited and Another

RESPONDENT

Date of Decision : 11-03-2005

Acts Referred:

Citation : (2005) 3 BC 352 : (2005) 119 DLT 81 : (2005) 81 DRJ 317

Hon'ble Judges : T.S. Thakur, J

Bench : Single Bench

Advocate : Arun Jaitley and Parag Tripathi, Ajay Bhargava, Ramesh Singh, S.S. Patra and Vikram Bajaj, for the Appellant; B.Datta, ASG Sr. Advocate, R.K.Joshi and Jyotindra Kumar, for the Respondent

Final Decision : Dismissed

Judgement

T.S. Thakur, J.—In the world of commerce, a contracting party often insists on the furnishing of a bank guarantee to ensure due and proper discharge of the contractual obligations cast upon the other party. Such guarantees when furnished may be conditional or otherwise but are more often than not inviolable at the instance of the party to whom the same have been furnished. Should the contract run into rough waters and the beneficiary of the guarantee decides to invoke the guarantee as it would invariably do, the party that has furnished the guarantee often rushes to knock at the doors of the court for an injunction restraining such encashment. The principles that would govern the grant or refusal of an injunction in such situations have been authoritatively settled by a catena of decisions rendered by the Apex Court. Their lordships have, in these pronouncements broadly speaking, identified two situations in which the court may step in to prevent encashment of the guarantees. These two situations are stated to be the only exception to the general rule that the courts should be slow in granting an injunction restraining realisation of a bank guarantee even when there may be a dispute requiring adjudication between the parties. The first exception is where the bank guarantee is vitiated by fraud so that the beneficiary

is seen to be taking undeserved advantage which the court may restrain him for doing. The second exception is where the encashment of an unconditional bank guarantee would result in irretrievable harm or injustice to one of the parties and the harm or injustice is of such an exceptional and irretrievable nature as would override the terms of the guarantee and the adverse affect of an injunction on commercial dealings between the parties. The law on the subject is succinctly summarised by the Supreme Court in AIR 1997 1644 (SC) in the following words:-

"The law relating to invocation of such bank guarantees is by now well settled. When in the course of commercial dealings an unconditional bank guarantee is given or accepted, the beneficiary is entitled to realize such a bank guarantee in terms there of irrespective of any pending disputes. The bank giving such a guarantee is bound to honour it as per its terms irrespective of any dispute raised by its customer. The very purpose of giving such a bank guarantee would otherwise be defeated. The courts should, Therefore, be slow in granting an injunction to restrain the realization of such a bank guarantee. The courts have carved out only two exceptions A fraud in connection with such a bank guarantee would vitiate the very foundation of such a ban guarantee. Hence if there is such a fraud of which the beneficiary seeks to take the advantage, he can be restrained from doing so. The second exception relates to cases where allowing the encashment of an unconditional bank guarantee would result irretrievable harm or injustice to one of the parties concerned. Since in most cases payment of money under such a bank guarantee would adversely affect the bank and its customer at whose instance the guarantee is given, the harm or injustice contemplate under this head must be of such an exceptional and irretrievable nature as would override the terms of the guarantee and the adverse effect of such an injunction on commercial dealings in the country."

2. To the same effect are the decisions of the Supreme Court in Svenska Handelsbanken Vs. M/s. Indian Charge Chrome and others, , Larsen and Toubro Limited Vs. Maharashtra State Electricity Board and others, and The State Trading Corporation of India Ltd. Vs. Jainsons Clothing Corporation and another, .

3. In Maharashtra State Electricity Board, Bombay Vs. Official Liquidator, High Court, Ernakulam and Another, , their lordships declared that an injunction against the encashment of a bank guarantee which has the affect of jeopardizing the sanctity attached to the commercial transactions, shall not issue. Dealing with the nature of evidence required to prove fraud as a ground for restraining encashment of the bank guarantee, the Supreme Court in Dwarikesh Sugar Industries Ltd. Vs. Prem Heavy Engineering Works (P) Ltd., and another, quoted with approval the following observations of Sir John Donaldson, M.R. In Bolivinter Oil SA v. Chase Manhattan Bank (1984) 1 ALL ER 351, CA:-

"...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."

4. Their lordships also deprecated the tendency of the courts in ignoring the settled principles of law and granting injunctions against the encashment of bank guarantees. Such orders were held to be whimsical judicial adventurism for granting wrongful and unwarranted relief to one of the parties. The court observed that it was high time that such tendency among the courts stopped. The following passage is, in this regard, a grim reminder of how essential it is for all courts to adhere to judicial rectitude and shun judicial indiscipline.

"When a position, in law, is well settled as a result of judicial pronouncement of this Court, it would amount to judicial impropriety to say the least, for the subordinate courts including the High Courts to ignore the settled decisions and then to pass a judicial order which is clearly contrary to the settled legal position. Such judicial adventurism cannot be permitted and we strongly deprecate the tendency of the subordinate courts in not applying the settled principles and in passing whimsical orders which necessarily has the effect of granting wrongful and unwarranted relief to one of the parties. It is time that this tendency stops."

5. It is, in the light of the above, unnecessary to dilate on the principles applicable any further or to burden this judgment with reference to all the decisions that have been rendered by the Supreme Court on the subject over the past two decades or so.

6. Time now to state the facts in brief:-

7. The petitioner company is engaged in the business of manufacture and sale of railway products like wagons, bogies, couplers, draft, gears etc. Respondent No. 1 is, on the other hand, a wholly owned Government of India undertaking which allotted to the petitioner a contract for supply of bogie container flat wagons in June, 2001. The petitioner company was in accordance with the terms of the contract between the parties, required to furnish a performance guarantee apart from guarantees for the advance payment which it would receive from the respondent from time to time. In compliance with the said contractual requirements, the petitioner company provided to respondent No. 1 corporation a performance bank guarantee being bank guarantee No. 57/2001 is used by respondent No. 2 bank for a sum of Rs. 7,36,95,270/-. The guarantee was unconditional and obliged the bank to pay to the respondent corporation the amount guaranteed upon the said company making a written demand declaring the petitioner to be in default under the contract. The petitioner also furnished to the respondent corporation two bank guarantees No. 35/2002 for a sum of Rs.14,19,18,480/- subsequently reduced to Rs. 9,19,24,470/- and bank guarantee No. 84/2001 for a sum of Rs. 15,79,44,600/ subsequently reduced to

Rs.10,08,89,100/-for the amount received by it towards the advance for the contracted supplies to be made by it. These guarantees were also issued by the second respondent unconditionally agreeing to deposit with the respondent corporation the amount covered by the same.

8. It is common ground that the contractual terms negotiated between the parties envisaged the supplies of wagons commencing April, 2002 and to be completed in December, 2002. The petitioner does not appear to have made any supplies for the months of April and May, 2002. Even from June, 2002 onwards till December, 2002 the actual supplies received from the petitioner were far less than what was stipulated under the contract. It is common ground that by the end of December, 2002, the petitioner company had failed to supply 855 wagons out of a total of 1320 wagons which it was required to supply. The petitioner company, Therefore, appears to have requested for extension of time which was granted more than half a dozen times resulting in the extension of the contractual period up to November 30, 2004. Despite such extensions, however, the petitioner company was unable to complete the supplies. The result was that at the end of seven extensions totaling a period of 23 months, the supplies made by the petitioner were short by as many as 270 wagons. Noticing this persistent default on the part of the petitioner and the inordinate delay in the supply of wagons, the corporation gave a last opportunity to the petitioner company up to February 22, 2005 to supply the balance of 270 wagons by the said date making it clear that this extension was final and time for completion of the supply the essence of the contract. The company, however, failed to complete the supply even during the extended period with the result that the respondent corporation terminated the contract by an order dated February 23, 2005. The termination order specifically pointed that the company had failed to supply balance of 270 wagons during the extended period and that the corporation reserved its right to purchase the balance of the supplies at the risks at the risk and cost of the company in accordance with clause 24 of the general conditions of contract. The corporation simultaneously called upon respondent No. 2 bank to remit to its account a sum of Rs. 7,36,95,270/- towards the performance guarantee furnished to the corporation. It also invoked the advance bank guarantees for a sum of Rs. 2,90,28,780/- and Rs.3,09,36,600/- only after adjustment of the portion of the advance payment recovered from the bills of the company. Aggrieved by the letter of invocation, the petitioner company has rushed to this court with the present petition u/s 9 of the Arbitration and Conciliation Act, 1996 for an injunction restraining the respondent corporation from giving effect to its purported letter of termination dated 23rd February, 2005 and from receiving any money or part thereof under bank guarantees No. 57/1001, 84/2001 and 35/2002 pursuant to invocation letters all dated 23rd February , 2005 issued to respondent No. 2.

9. Appearing for the petitioner company, Mr. Arun Jaitley, learned senior counsel argued that the petitioner was entitled to an interim order against encashment of the bank guarantees on the twin grounds of guarantee having been vitiated by

fraud and also on the ground that the petitioner would be irretrievably prejudiced in case the the guarantee amounts are recovered from the bank by the corporation. He submitted that the facts and circumstances of the present case constituted commission of a fraud upon the company inasmuch as the invocation of the guarantees and recovery of a huge amount running into crores of rupees would commercially and financially cripple the company without there being any justification for such a drastic and precipitate action against it. He submitted that the petitioner company had made almost 80 per cent of the contracted supplies its best efforts to purchase wheels and axles necessary for fabrication of the remaining wagons but was unable to procure the said supplies forcing it to look beyond the frontiers of the country for securing the essential components which signified a critical requirement for fabricating the contracted wagons. Alternatively, he argued that the recovery of the amount pursuant to the letter of invocation would irretrievably prejudice the petitioner company and make reimbursement of the amount to it impossible in future no matter the respondent corporation is a wholly owned government undertaking running in profit.

10. On behalf of the respondent it was, on the other hand, argued by Mr. B. Datta, ASG that the case in hand did not fall in anyone of the two exceptions in which this court could intervene. He urged that neither was there any fraud in the finalisation of the contract between the parties or in providing the bank guarantees nor was the plea of irretrievable prejudice based on facts or apprehensions that could be termed genuine. He argued that the material on record proved manifest failure on the part of the company in discharging its contractual obligations which left no option for the corporation except to terminate the contract and to make alternate arrangements for the supply of wagons without which the respondent corporation was facing great difficulties. He submitted that the respondent corporation was a profit making corporation which had granted interest free advances to the company running into crores of rupees a part whereof was covered by the advance guarantees furnished by the petitioner company. The amount covered by these advance guarantees in essence secured the amount advanced to the petitioner company the recovery whereof could not be grudged especially after the contract stood terminated. He contended that the performance guarantee was meant to enable the corporation to recover the losses which it is bound to suffer on account of the failure of the company to make the contracted supplies. It was, Therefore, premature for the petitioner company to argue that the invocation of the performance was in excess of the liability of the company hence unjustified.

11. I have given my anxious consideration to the submissions made at the bar. The short question that falls for determination is whether the petitioner has made out a case for intervention of this court in a restraint action on the ground of fraud or irretrievable prejudice which, as noticed earlier, are the only two situations in which such intervention would be justified. A closer and careful reading of the petition would reveal that the petitioner has not laid any foundation in the pleadings for the argument that was advanced on its behalf at

the bar. The petition does not allege leave alone by reference to any details or particulars of any fraud either in regard to the execution of the agreement between the parties or the invocation of the bank guarantees. The petition is blissfully silent about the commission of any fraud at any stage of the legal relationship that was brought about between the parties by the agreements executed by them or the guarantees that were furnished and subsequently invoked. It is, in that view, difficult to appreciate how a plea of fraud may be advanced by the petitioner or countenanced by the court. The fact of the matter is that the petitioner has, at every stage of the process of allotment of the contract, participated in the same and even benefited from the terms under which the respondent had advanced crores of rupees to it. Even according to the petitioner's own version, it has made 80 per cent supply of the wagons under the contract. In that scenario, it is difficult to conceive of a possible fraud which the petitioner could allege or prove either against the respondent or the bank who had issued the guarantees for its benefit. There is no allegation of fraud even in relation to the furnishing or invocation of the bank guarantees in question. The fact that these guarantees were demanded in accordance with the terms of the contract executed between the parties and that the same were inviolable at the instance of the respondent corporation, is not denied. As noticed earlier, the party seeking a restraint order against encashment must furnish clear evidence both as to the fact of the fraud having vitiated the contract between the parties as also the fact that the bank had knowledge of such fraud having been committed. No case for injunction can be made out on the uncorroborated statement of a customer that either the contract or the invocation of the bank guarantee was fraudulent. The court can insist upon not only a clear-cut plea on the question of fraud but also evidence to prima facie substantiate the commission of the same. The present case, in my opinion, falls short of that critical requirement. There is neither any plea regarding fraud nor any evidence to substantiate the same. The first limb of the argument advanced by Mr. Jaitley, Therefore, fails and is accordingly rejected.

12. That leaves me with the only other question whether there is any irretrievable prejudice involved in the invocation of the bank guarantees. Here again, the facts stated in the petition do not meet the requirement of a clear-cut pleading. All that the petition alleges is that the delivery schedule could not be adhered to by the petitioner for reasons beyond its control. The delay, according to the petitioner, was for reasons wholly unforeseeable. It is also alleged that since one of the guarantees furnished by the petitioner was a performance guarantee, the respondent could, at best, encash the same proportionate to the short supplies made by the petitioner. The invocation of the bank guarantee for the entire amount of Rs.7,36,95,270/- was, according to the petitioner, unjustified and bound to cause an irretrievable damage to the petitioner. There is, in my opinion, no merit in that contention either. The performance bank guarantee as the expression itself suggests was intended to ensure due and proper discharge of the contractual obligations by the petitioner and complete

performance of the contract between the parties. Neither, the terms of the guarantee nor those contained in the contract, envisaged a partial or proportionate invocation of the same by the respondent. The language employed in the guarantee created an unconditional and unqualified obligation for the bank to pay the amount guaranteed no sooner the respondent declared the petitioner supplier to be in default under the contract.

This is evident from the following paragraph from the performance guarantee:-

"THEREFORE WE hereby affirm that we are guarantors and responsible to you, on behalf of the supplier, up to a total of Rs. 7,36,95,270/- (Rupees Seven crore thirty six lacs ninety five thousand two hundred seventy only) and we undertake to pay to you, upon your first written demand (declaring the Supplier to be in default under the contract) and without cavil or argument, any sum or sums within the limit of Rs.7,36,95,270/- (Rupees Seven crore thirty six lacs ninety five thousand two hundred seventy only) as aforesaid, without your needing to prove or to show grounds or reasons for your demand or the sums specified therein."

13. The argument that the petitioner having supplied 80 per cent of the wagons, the invocation of the bank guarantee could be only for the balance 20 per cent and not the entire amount runs contrary to the terms of the guarantee and the contract executed between the parties. The true position is that once the petitioner was found to be in default, the respondent was entitled to invoke the bank guarantee regardless of the extent of the supplies made to it. The amount so recovered would thus be available to it for arranging the supplies from other sources at the risk and cost of the petitioner. At the stage of invocation of the bank guarantee, it would be premature for any one of the parties to estimate the excess expenditure that may require to be reimbursed to the respondent on account of any such alternative purchases. Suffice it to say that in the absence of any impediment either in the terms of the contract or the guarantees restricting the right of the respondent to invoke the guarantee for the full amount, it is difficult to see how such an invocation could be said to be either illegal, unjustified or inequitable so as to provide to the petitioner the argument that it would suffer any irretrievable damage or prejudice. That is more so in the case of guarantees covering the advance payment received by the petitioner under the contract. These guarantees were meant to secure the interest of the respondent qua the advance payments which the petitioner had received from the Corporation. Encashment of these guarantees would, Therefore, only result in reimbursement of the advance amount which the petitioner had received but against which it had not been able to make any supplies.

14. Mr. Jaitley, however, argued that the encashment of the advance guarantees was unjustified having regard to the fact that the amount advanced to the petitioner had been invested in purchasing raw material necessary for the making of the supplies. He urged that given time the petitioner would make such a supply even now. There is no merit in that contention either. The submission

runs contrary to the petitioner's version as set out in its letter dated 16th February, 2005 where the petitioner has emphasised its inability to make any supplies except two rakes which would be ready as soon as the wheel sets were received by it. The petitioner had asked for short closure of the balance of four rakes which clearly implied that it was not either ready or in a position to make the supplies of the balance four rakes comprising nearly 200 wagons. Such being the position, the argument that it had invested the advance amount in raw material procured for manufacture of the wagons is clearly belied by the admission made by it in the above communication.

15. Mr. Datta appearing on its behalf, made a candid statement that the respondent was a profit making corporation capable of reimbursing to the petitioner any amount that may be found due to it in case the matter is eventually referred to arbitration and any amount held payable by it. There was, Therefore, no question of any irretrievable prejudice to the petitioner if the guarantees were encashed. That submission cannot be lightly brushed aside. The question of irretrievable prejudice is intimately inked with the capacity of the party encashing the bank guarantee to refund or reimburse the amount in case the court comes to the conclusion that such refund or reimbursement is due. In cases where the respondent's capacity to refund is suspect the court may make an order to balance equities and ensure that one party does not gain an undeserved advantage over the other. The present is not, however, one such case. The respondent's capacity to reimburse any amount held payable to the petitioner has not been disputed before me. There is, Therefore, no question of any irretrievable damage or prejudice to the respondent on account of a possible failure of any such reimbursement.

16. While hearing and reserving the matter for pronouncement of orders, this court had orally instructed the respondent's counsel not to precipitate the encashment of the bank guarantees as per the invocation letters dated 23rd Feb, 2005. The petitioner had mentioned the matter and pointed out that despite the said direction of this court, the bank guarantee amounts had been remitted into the account of the respondent. Counsel for the respondent Corporation had, however, allayed the apprehensions of the petitioner by filing an undertaking to the effect that the amount of the three bank guarantees remitted by respondent No. 2 bank shall be kept in a separate account and shall not be dealt with or appropriated in any manner whatsoever until this court passed an order on the application filed by the petitioner. is No. 1688/2005 has been filed by the petitioner seeking a direction to respondent No. 1 to return the guarantee amount transferred to its account by respondent No. 2 bank.

17. The petitioner has also filed is No. 1687/2005 seeking a direction for appointment of a sole arbitrator and for reference of the disputes between the parties to him for arbitration. A reference to arbitration could indeed be made if only the parties agreed on the name of the person to be appointed as arbitrator. No such agreement could be readily arrived at between the parties. That being

so, the proper course for the petitioner would be to file an independent petition u/s 11 of the Act or nomination of an arbitrator and reference of the disputes to him for adjudication.

18. In the result, this petition fails and so do IAs 1687/2005 and 1688/2005. The respondent corporation shall stand relieved of the undertaking furnished by it to this court.

19. No costs.