

(2012) 05 BOM CK 0032

In the Bombay High Court

Case No : Arbitration Petition (L) No. 606 of 2012

Karam Chand Thapar and Bros. (Coal Sales) Ltd.

APPELLANT

Vs

Hindustan Construction Company Ltd.

RESPONDENT

Date of Decision : 04-05-2012

Acts Referred:

Arbitration and Conciliation Act, 1996 — Section 9
Civil Procedure Code, 1908 (CPC) — Order 39 Rule 1
Contract Act, 1872 — Section 17

Citation : (2013) 2 ALLMR 344 : (2012) 6 BomCR 441

Hon'ble Judges : G.S. Godbole, J

Bench : Single Bench

Advocate : Milind Sathe, assisted with Mr. Zal Andharjina, Ms. Jyoti Singh, Ms. Madhumita Kothari and Mr. K. Dastoor instructed by Phoenix Legal, for the Appellant; Kevic Setalvad a/w. Rakesh Mandavkar instructed by . Harish Joshi and Co., for the Respondent

Final Decision : Dismissed

Judgement

G.S. Godbole, J.—This Petition u/s 9 of the Arbitration and Conciliation Act, 1996 has been filed by a sub-contractor against the contractor and principal relief which is sought is that the Respondent shall not invoke, encash or receive any monies under the Performance Bank Guarantee of Rs. 15.95 Crores issued by the HSBC Bank on behalf of the Petitioner to the Respondent. It is not dispute that Sardar Sarovar Narmada Nigam Limited (SSNNL) has awarded a contract of Constructing, Canal Earthwork, Canal Lining, Structures and Services Roads of Distributaries and minors of Limbdi branch Canal including maintenance and operation for 5 years to the Respondent HCC Ltd. The Contract Agreement is dated 26th April, 2011. Clause 62 of the Contract provides that entire contract shall not be assigned or sublet, but the Chief Engineer may allow to sublet the part or portion of the work not exceeding up to 40% of Tender costs, if the sub-contractor satisfies the requirement of the work to be sub-let. The said clause further provides that if the contractor shall assign or sub-let his contract or

attempt to do so, the Engineer-in-charge may rescind the contract by a notice in writing.

2. The Respondent thereafter issued a Letter of Intent in respect of the said main contract in favour of the Petitioner appointing the Petitioner as a sub-contractor. The said Letter of Intent is at Exh. C and the same clearly recites as under:

KCT has confirmed that they have received the complete set of the main contract documents, gone through and have understood the same.

Clause (A) of the LOI defines what is "Main Contract", clause (B) defines the word "Employer" as being SSNNL and clause (C) defines the word "Subcontractor" as Petitioner. Clause 8 of this LOI provides for a Performance Bank Guarantee (PBG) for a sum of Rs. 13.15 Crores. It is an admitted position that the amount of Bank Guarantee has been subsequently increased to Rs. 15.95 Crores. Clause 19 provides for arbitration in case of disputes. It is also not in dispute that a formal contract has been subsequently executed between the Petitioner and the Respondent on 22nd February, 2012.

3. The PBG dated 19th August, 2011 has been issued by the HSBC Bank in favour of the Respondent and the relevant clauses of the PBG read thus:

We the Bank do hereby undertake to pay the amounts due and payable under this guarantee without any demur, merely on demand from the Beneficiary stating that the amount claimed is due by way of loss and damage caused to or suffered or would be caused to or suffered by the Beneficiary by reason of any breach and/or failure to perform the obligations of Subcontract or any part thereof. Any such demand made on the bank shall be conclusive, as regards the amount due and payable by the bank under this guarantee.

We, the Bank undertake to pay to the Beneficiary any money so demanded notwithstanding any dispute or disputes raised by the Subcontractor in any suit or proceedings pending before any Court or Tribunal relating thereto, our liability under this presents being absolute and unequivocal.

As stated above, the amount of Bank Guarantee has been enhanced from Rs. 13.15 Crores to Rs. 15.95 Crores by a subsequent letter.

4. Disputes and differences have arisen between the SSNNL, on one hand and the Respondent, on the other hand and this has resulted in issuance of show cause notice dated 27th February, 2012 by SSNNL to the Respondent complaining about extremely slow progress of work. In turn, the Respondent forwarded the said show cause notice to the Petitioner and the dispute arose between the Petitioner and Respondent about the alleged slow progress of work. The Petitioner sent a reply on 1st March, 2012 to the Respondent and it is the case of the Petitioner that accepting the statement in the said reply, the Respondent in turn, sent a reply dated 7th March, 2012 to SSNNL and thus, according to the Petitioner, all the explanation offered by the Petitioner has been accepted by the Respondent. In fact, the Respondent has filed CMA No. 28 of

2012 in the District Court at Gandhinagar in Gujarat against the SSNNL u/s 9. According to the Petitioner, entire explanation offered by the Petitioner is reproduced in the Section 9 Petition filed by the Respondent and hence, the Respondent is estopped from contending that the Petitioner has committed a breach. The SSNNL thereafter issued a notice dated 3rd April, 2012 to the Respondent calling upon it to show cause as to why the contract was sublet contrary to clause 62 of the Agreement between SSNNL and the Respondent.

5. Two principal submissions were advanced by Dr. Milind Sathe, learned Sr. Advocate for the Petitioner. According to him, the PBG in question is not an unconditional bank guarantee and is a conditional Bank Guarantee since the Bank has accepted the liability only in case of a loss or damage caused or suffered by reason of any breach and or failure to perform obligations of the sub-contract or any part thereof. It was therefore submitted that if the explanation offered by the Petitioner has been accepted in toto by the Respondent, then, obviously, the Respondent cannot be heard to contend that there is any breach and/or failure to perform the obligation of sub-contractor by the Petitioner.

6. The second submission of Dr. Sathe was to the effect that a fraud has been played by the Respondent in as much as though the Respondent, by virtue of Clause 62 of the main contract was prohibited from assigning the contract; without disclosing this prohibition in the main contract, the Respondent has assigned the entire contract in favour of the Petitioner, which is a fraud, which has been played by the Petitioner and hence a case for grant of injunction against the invocation of Bank Guarantee is said to have been made out.

7. On the other hand, Mr. Setalwad, learned Sr. Advocate for the Respondent submitted that the PBG in question is an unconditional and irrevocable Bank Guarantee. He submitted that the Respondent was entitled to invoke the PBG even in case of a possible loss or damage, which may be caused or suffered by the Respondent on account of any breach or failure to perform the obligations. He submitted that the Bank Guarantee being unconditional, on account of the settled law regarding power to grant injunction restraining invocation of Bank Guarantee, it was not a case where an injunction can be granted by this Court. He pointed out that the Petitioner was completely aware about the main contract, was given copies of the main contract and, hence, plea of fraud is completely without any substance. He submitted that no particulars of the alleged fraud have been given. It was further submitted that it is also settled law that fraud has to be to the knowledge of the Bank giving Bank Guarantee and mere bald allegation of fraud was not sufficient to grant an injunction.

8. I have carefully considered the rival submissions and in my opinion, it is not possible to accept the submissions of Dr. Sathey. In support of the first submission, Dr. Sathe relied upon the Judgment of the Supreme Court in case of Hindustan Construction Co. Ltd. Vs. State of Bihar and Others, and observations in paragraphs 13 and 14 thereof were relied upon. I am afraid that the ratio of the said Judgment will have no application to the facts of this case. In the said

Judgment, on an interpretation of the relevant clauses of the Bank Guarantee the Supreme Court had come to a conclusion that the Bank Guarantee could not be said to be unconditional or unequivocal so that the Defendant could be said to have had unfettered rights to invoke the guarantee and demand payment thereof from the Bank. In the present case, from a careful reading of the two clauses of the PBG, which are reproduced hereinabove, it is clear that the Guarantee is unconditional and irrevocable and can be invoked by the Respondent who is the beneficiary under the Bank Guarantee even in the case of a possible future loss or damage, which was likely to be caused or suffered by the beneficiary by reason of any breach or failure to perform obligations of the said contract. It is obvious that whether in fact there is any breach or failure committed by the Petitioner or not as subcontractor is not a matter which can be gone into or enquired into by the Bank and the apprehension or satisfaction of the Respondent that there was a breach or there could be a breach is sufficient for invocation of Bank Guarantee. In view of this, the Judgment relied upon by Dr. Sathe in the case of HCCL(supra) is clearly distinguishable. I therefore find that there is no merit in the first contention of Dr. Sathe.

9. This takes me to the second contention about a fraud having been committed by the Respondent. Section 17 of the Indian Contract Act, 1872 defines the term "fraud". According to the Petitioner, there was an active concealment of Clause 62 of the main contract and contrary to the said clause sub-contract has been executed. It is difficult to accept this submission for various reasons. The letter of intent issued by the Respondent to the Petitioner clearly shows that the Petitioner has confirmed that it has received complete set of the main contract documents, gone through it and had understood the same. The Petitioner was clearly put to notice that the principal contract was between Respondent and SSNNL and that the main contract dated 26th April, 2011 executed between SSNNL and the Respondent as a contractor would govern the rights of the parties.

10. Mr. Kevic Setalwad, learned Sr. Advocate was justified in relying upon the observations made in the following Judgments:

a) BSES Ltd. (Now Reliance Energy Ltd.) Vs. Fenner India Ltd. and Another, , in which it is observed in paragraph-10 as under:

10. There are, however, two exceptions to this rule. The first is when there is a clear fraud of which the bank has notice and a fraud of the beneficiary from which it seeks to benefit. The fraud must be of an egregious nature as to vitiate the entire underlying transaction. The second exception to the general rule of non-intervention is when there are "special equities" in favour of injunction, such as when "irretrievable injury" or "irretrievable injustice" would occur if such an injunction were not granted. The general rule and its exceptions has been reiterated in so many judgments of this Court, that in U.P. State Sugar Corporation v. Sumac International Ltd., (hereinafter "U.P. State Sugar Corporation") this Court, correctly declared that the law was "settled".

b) AIR 1997 1644 (SC) , wherein the relevant observations are in paragraphs 12 to 14 which read thus:

12. 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 thereof 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 bank guarantee. Hence if there is such a fraud of which the beneficiary seeks to take 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 in irretrievable harm or injustice to one of the parties concerned. Sine 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 contemplated 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. The two grounds are not necessarily connected, though both may co-exist in some cases. In the case of U.P. Cooperative Federation Ltd. Vs. Singh Consultants and Engineers (P) Ltd., , which was the case of works contract where the performance guarantee given under the contract was sought to be invoked, this Court, after referring extensively to English and Indian cases on the subject, said that the guarantee must be honoured in accordance with its terms. The bank which gives the guarantee 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 the supplier is in default or not. The bank must pay according to the tenor of its guarantee on demand without proof or condition. There are only two exceptions to this rule. The first exception is a case when there is a clear fraud of which the bank has notice. The fraud must be of an egregious nature such as to vitiate the entire underlying transaction. Explaining the kind of fraud that may absolve a bank from honouring its guarantee, this Court in the above case quoted with approval the observations of Sir John Donaldson, M.R. in *Bolivinter Oil SA v. Chase Manhattan Bank* (1984 (1) AER 351 352):

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 charged.

This Court set aside an injunction granted by the High Court to restrain the realisation of the bank guarantee.

13. The same question came up for consideration before this Court in *Svenska Handelsbanken Vs. M/s. Indian Charge Chrome and others*, . The Court once again reiterated that a confirmed bank guarantee/irrevocable letter of credit cannot be interfered with unless there is established fraud or irretrievable injustice involved in the case. Irretrievable injury has to be of the nature noticed in the case of *Itek Corporation v. The First National Bank of Boston etc.* (566 Fed Supp. 1210). On the question of fraud this Court confirmed the observations made in the case of *U.P. Cooperative Federation Ltd.* (supra) and stated that the fraud must be that of the beneficiary, and not the fraud of anyone else.

14. On the question of irretrievable injury which is the second exception to the rule against granting of injunctions when unconditional bank guarantees are sought to be realised the court said in the above case that the irretrievable injury must be of the kind which was the subject-matter of the decision in the *Itek Corporation* case (supra). In that case an exporter in the U.S.A. entered into an agreement with the Imperial Government of Iran and sought an order terminating its liability on stand by letters of credit issued by an American bank in favour of an Iranian Bank as part of the contract. The relief was sought on account of the situation created after the Iranian revolution when the American Government cancelled the export licences in relation to Iran and the Iranian Government had forcibly taken 52 American citizens as hostages. The U.S. Government had blocked all Iranian assets under the jurisdiction of United States and had cancelled the export contract. The court upheld the contention of the exporter that any claim for damages against the purchaser if decreed by the American Courts would not be executable in Iran under these circumstances and realisation of the bank guarantee/Letters of credit would cause irreparable harm to the plaintiff. This contention was upheld. To avail of this exception, therefore, exceptional circumstances which make it impossible for the guarantor to reimburse himself if the ultimately succeeds, will have to be decisively established. Clearly, a mere apprehension that the other party will not be able to pay, is not enough. In the *Itek* case (supra) there was a certainty on this issue. Secondly, there was good reason, in that case for the court to be prima facie satisfied that the guarantors i.e. the bank and its customer would be found entitled to receive the amount paid under the guarantee.

c) *Federal Bank Ltd. v/s. V.M. Jog Engineering Ltd. and Ors.* (2001) 1 SCC 663, wherein it is observed in paragraphs 55 and 56 as under:

55. In several judgment of this Court, it has been held that Courts ought not to grant injunction to restrain encashment of Bank guarantees or Letters of Credit, Two exceptions have been mentioned-(i) fraud and (ii) irretrievable damage. If

the plaintiff is prima facie able to establish that the case comes within these two exceptions, temporary injunction under Order 39, Rule 1, CPC can be issued. It has also been held that the contract of the Bank guarantee or the Letter of Credit is independent of the main contract between the seller and the buyer. This is; also clear from Arts. 3 and 4 of the UCP (1983 Revision). In case of an irrevocable Bank guarantee or Letter of Credit the buyer cannot obtain injunction against the Banker on the ground that there was a breach of the contract by the seller. The Bank is to honour the demand for encashment if the seller prima facie complies with the terms of the Bank Guarantee or Letter of Credit, namely, if the seller produces the documents enumerated in the Bank Guarantee or Letter of Credit. If the Bank is satisfied on the face of the documents that they are in conformity with the list of documents mentioned in the Bank Guarantee or Letter of Credit and there is no discrepancy, it is bound to honour the demand of the seller for encashment. While doing so it must take reasonable care. It is not permissible for the Bank to refuse payment on the ground that the buyer is claiming that there is a breach of contract. Nor can the Bank try to decide this question of breach at that stage and refuse payment to the seller. Its obligation under the document having nothing to do with any dispute as to breach of contract between the seller and the buyer. As to its knowledge of fraud or forgery, we shall presently deal with it,

Knowledge of fraud :

56. Decided cases hold that In order to obtain an injunction against the Issuing Bank, it is necessary to prove that the Bank had knowledge of the fraud.

11. The Law in relation to the grant of injunction against invocation of Bank Guarantee is thus well settled. There are only 2 exceptions, namely, fraud and irretrievable damage. In the present case, the second exception is not even sought to be invoked by the Petitioner. In so far as first exception of fraud is concerned, from the aforesaid Judgment, it is clear that the fraud has to be to the knowledge of the concerned bank. It is not even the case of the Petitioner that the HSBC Bank had knowledge of the alleged fraud. A careful perusal of the averments in the Petition shows that it does not establish even a prima facie case of fraud.

12. Even if the Bank Guarantee is invoked and the amounts are recovered by the Respondent, the Petitioner can always establish in the arbitration proceedings between the parties that the invocation was wrongful and in such a case, the Petitioner will be entitled to get an award for refund of the amount together with interest. In this view of the matter, it is not possible to hold that an irreparable loss or injury would be caused to the Petitioner, if injunction as prayed for, is not granted. In my opinion, the Petitioner has failed to show either prima facie case or any irreparable loss and the balance of convenience is entirely in favour of the Respondent. Hence there is no merit in the Arbitration Petition and the same is dismissed.