

(1991) 09 DEL CK 0013

In the Delhi High Court

Case No : I.A. No. 2088 of 1991 in Suit No. 818 of 1991

M/s. Triveni Engineering Works Ltd.

APPELLANT

Vs

M/s. Belganga Sahakari Sakhar Karkhana Ltd. and another

RESPONDENT

Date of Decision : 10-09-1991

Acts Referred:

Citation : (1992) ILR Delhi 601

Hon'ble Judges : A.D. Singh, J

Bench : Single Bench

Advocate : Rajiv Sawhney and Sanjiv Anand, for the Appellant; Vinod Bobde U.A. Rana and D.L. Fray, for the Respondent

Judgement

1. This is a plaintiff's application under O. 39 Rules I and 2, CPC wherein inter alia, it is prayed that the defendant No. 1 be restrained from encashing bank guarantees Nos. 316/ 89/41 and 316 / 89/42 for a sum of Rs. 18.20 lakhs each issued by Standard Chartered Bank defendant No. 2 in favor of defendant No. 1 on behalf of the plaintiff. It is an admitted case of the parties that defendant No. 1 is running a sugar plant and in order to increase the capacity of the plant from 1250 TCD to 2500 TCD it entered into an agreement dt. July 4, 1988 with the plaintiff whereunder the plaintiff undertook to erect and supply additional plant and machinery and also agreed to render various other services for raising the capacity of the plant for which the plaintiff was to be paid a sum of Rs. 364 lacs by defendant No. 1. Under the contract, the plaintiff was required to furnish two bank guarantees in terms of the agreement; one in respect of timely delivery, erection and commission of the expanded plant as provided under clause 17.2 and the second in terms of clause 17.3 of the agreement in respect of guaranteed performance of the plant and machinery. Both the guarantees were furnished as stipulated in the agreement. The bank guarantees were for a sum of Rs. 18.20 lacs each. These bank guarantees have been invoked by a letter of the defendant No. 1 dt. Jan. 18, 1991. In this letter it is stated that Tribeni Engineering Works failed to deliver and commission the plant and also did not

give the guaranteed performance of the plant. The plaintiff on coming to know of the invocation of the bank guarantee filed a suit for declaration and for permanent and mandatory injunction. It is in this suit that the present application has been filed.

RE: BANK GUARANTEE NO. 316/ 89/ 42

Mr. Sawhney, learned counsel for the plaintiff submitted that defendant No. I could not invoke the bank guarantee as the plant gave the guaranteed performance as stipulated in the agreement that is to say that it crushed 2500 TCD per day working 22 hours a day for 10 consecutive days. In this regard he invited my attention to the daily performance reports of the factory. Mr. Sawhney further contended "that since the plant had performed according to the stipulation made in the agreement it would be fraudulent on the part of defendant No. I to invoke the bank guarantee.

2. On the other hand, Mr. Bobde, learned counsel appearing for the defendant No. I submitted that this court cannot go into the question as to whether the plaintiff was able to give the guaranteed performance in accordance with the standard laid down in the agreement or not. It was his contention that the bank guarantee makes the defendant No. I the sole judge of the performance of the plant. He further submitted that the bank guarantee is an unconditional one.

3. I have considered the rival contentions of the learned counsel for the parties. It is not disputed that the plaintiff entered into a contract with the defendant No. I and furnished a bank guarantee to the latter for due performance of the same. The guarantee contains a clause whereby the decision of defendant No. I as to the question of default in performance of the plant is made binding on the bank without proof of such default and the said defendant has been made the sole judge in this regard. At this stage, it would be necessary to notice a few clauses of the bank guarantee :

"I. In consideration of the premises the Guarantor hereby undertakes to pay to the purchasers within Thirty days of demand and without demur such sum not exceeding Rs. 18,20,000/- (Rupees Eighteen lac twenty thousand only) representing 5% of the contract price as the Purchasers may demand and if the Guarantor shall fail to pay the same within the said period the Guarantor shall also pay on the sum demanded interest at the bank lending rate then prevailing reckoned from the date of payment.

2. The Guarantor shall pay to the Purchasers on demand the sum under clause I above without demur and without requiring the Purchasers to invoke any legal remedy that may be available to them it being understood and agreed to be the sole judge of the question as to whether the Sellers have committed any breaches of the terms and conditions of the agreement and the extent of losses, damages, costs, charges and expenses caused to or suffered by or that may be caused to or suffered by Purchasers from time to time shall be final and binding on the guarantor and SECONDLY that the right of the Purchasers to recover from

the Guarantor any amount due to the Purchaser under this guarantee shall not be effected or suspended by reason of the fact that any disputes have been raised by the Sellers with regard to their liability or that proceedings are pending before any Tribunal. Arbitrator(s) or Court with regard thereto or in connection therewith, and THIRDLY that the Guarantor shall" immediately. pay the aforesaid guaranteed amount to the purchasers on demand and it shall not be open to the Guarantor to know the reasons of or to investigate or to go into the merits of the demand or to question or to challenge the demand or to know any fact effecting the demand, the LASTLY that it shall not be open to the Guarantor to require proof of the liability of the sellers to pay the amount, before paying the aforesaid guaranteed amount to the PURCHASERS."

4. According to the aforesaid clauses the bank is required to pay without demur an amount of Rs. 18.20 lacs representing 5% of the contract price to the purchaser defendant No. I on demand. It is also manifest from a bare reading of Cl. 2 that the defendant has been made the sole Judge of the question as to whether the plaintiff seller has committed any breach of terms and conditions of the agreement. It is also in the province of defendant No. 1 to assess the extent of the loss and damage etc. resulting from breach of the agreement. The decision of the defendant No. I in this regard has been made final. In view of Cl. 2 It is not open to the plaintiff to argue that the guarantee should not be enforced as disputes have been raised by them with regard to their liability. The guarantee also interdicts the bank from investigating into merits of the demand which may be raised by the purchaser-defendant No. 1. Furthermore according to the terms of the guarantee the seller-plaintiff cannot ask for proof of its liability before the bank releases the payment in favor of defendant No. 1.

5. A perusal of the letter of invocation would show that the guarantee is being invoked according to the terms thereof. It is well settled that when the bank guarantee is an unconditional one it must be honoured by the bank and no defense can be raised by it. To a very large extent the edifice of the commercial activity is built on the footing that the bank guarantee is an independent contract which is to be honoured irrespective of the disputes amongst the parties to the underlying contract.

6. The position with regard to bank guarantees have been settled by a catena of authorities of the Supreme Court. In U.P. Cooperative Federation Ltd. Vs. Singh Consultants and Engineers (P) Ltd., , it has been held that the bank guarantee is an independent contract and cannot be affected by the disputes between the parties to the underlying transaction.

7. A fortiori disputes between the parties to the underlying contract as to whether the seller-plaintiff has committed any breach of the agreement or the plant has given guarantee performance cannot affect the power of the purchaser-defendant No. I to invoke the bank guarantee. The bank guarantee being an independent contract between the bank and defendant No. 1, payment whereunder to the beneficiary (defendant No. 1) is not to be suspended or

stopped by reason of existence of disputes between the plaintiff-seller and defendant No.]-purchaser, as is explicitly provided in the bank guarantee itself. Parties entered into the bargain on the footing that an unconditional and irrevocable bank guarantee will be honoured in its letter and spirit. Even when the bank guarantee was furnished as a result of the underlying contract, the same cannot be said to be a part and parcel of the principal contract between the seller and the purchaser. The bank guarantee is a distinct and special type of agreement creating obligations and commitments directly between the bank and the beneficiary. The bank guarantee cannot be rendered otiose by asking the beneficiary to supply proof of breach/ default of the seller with regard to the underlying contract.

8. The question as to whether the plant gave the stipulated performance as required by the agreement cannot be gone into in these proceedings. The matter can be settled by the mode which has been laid down in the agreement. The parties have agreed to refer the disputes, if any, between them to arbitration. It will be for the arbitrator to decide as to whether the plant was capable of crushing sugar cane to the extent of 2500 TCD. It is not for this Court to investigate at this stage whether or not adequate quantity of sugarcane was available with the factory or whether the plant acquired crushing speed of 2500 TCD per day working 22 hours a day. These disputes are essentially for the arbitrator to resolve on the basis of evidence which may be lead before him.

9. The Supreme Court of India approve the observations of Court of Appeal in England *Hamzeh Malas and Sons v. British Imex Industries Ltd.*, (1958) 2 QBD 127 in the following words:

"The Court of Appeal emphasised that an elaborate commercial system had been built up on the footing that a confirmed letter of credit constituted a bargain between the banker and the vendor of the goods, which imposed upon the banker an absolute obligations to pay irrespective of any dispute there might be between the parties whether or not the goods were up to contract. The principle was that commercial trading must go on on the solemn guarantee either by the letter of credit or by bank guarantee or irrespective of any dispute between contracting parties whether or not the goods were up to contract. The banks cannot be absolved of their responsibility to meet the obligations. Lord Jenkins, L.J. observed that a vendor of goods selling against a confirmed letter of credit was selling under the assurance that nothing would prevent it from receiving the price. That was of no mean advantage when goods manufactured in one country were sold in another. Though, in this case no international trade was involved, bank guarantee was irrevocable and on that assurance parties have bargained. This principle enunciated by Lord Justice Jenkins has been invoked by this Court in some decisions in case of confirmed bank guarantee."

10. At another place, referring to the decision in *United Commercial Bank Vs. Bank of India and Others*, and *Centax (India) Ltd. Vs. Vinmar Impex Inc. and Others*, , it was observed by the Court as under:

"28. I am, however, of the opinion that these observations must be strictly considered in the light of the principle enunciated. It is not the decision that there should be a prima facie case. In order to restrain the operation either of irrevocable letter of credit or of confirmed letter of credit or of bank guarantee, there should be serious dispute and there should be good prima facie case of fraud and special equities in the form of preventing irretrievable injustice between the parties. Otherwise the very purpose of bank guarantees would be negated and the fabric of trading operation will get jeopardised.

31. The Court however, observed that the opening of a confirmed letter of credit constituted a bargain between the banker and the seller of the goods which imposed on the banker an absolute obligation to pay. The banker was not bound or entitled to honour the bills of exchange drawn by the seller unless they and such accompanying documents as might be required there under, were in exact compliance with the terms of the credits.

32. This principle was again reiterated by this Court in *Centax (India) Ltd. Vs. Vinmar Impex Inc. and Others*, where the appellant entered into a contract with the respondent company of Singapore for supply of certain goods to it. The contract, inter alia stipulated that the bills of lading should mention shipping mark 5202. Pursuant to the contract, at the request of the appellant the Allahabad Bank opened a letter of credit, in favor of the respondent. The respondent thereupon dispatched the goods covered by the bills of lading.

33. This Court was concerned with the bank guarantee and referred to the previous decision of this Court in *United Commercial Bank Vs. Bank of India and Others*, . This Court found that this case was covered. The Court observed that the Court should not, in transaction between a banker and banker, grant an injunction at the instance of the beneficiary of an irrevocable letter of credit, restraining the issuing bank from recalling the amount paid under reserve from the negotiating bank acting on behalf of the beneficiary against a document of guarantee, indemnity, at the instance of the beneficiary.

34. On the basis of these principles I reiterate that commitments of banks must be honoured free from interference by the courts. Otherwise, trust in commerce internal and international would be irreparably damaged. It is only in exceptional cases that is to say in case of fraud or in case of irretrievable injustice be done, the Court should interfere."

11. In *Bhasin Association Limited v. Hyundai Heavy Industries Company Ltd.* (1991) 3 Delhi Law 43, D. P. Wadha, J. took pains to cull out the principles laid down by the Supreme Court in *U.P. Cooperative Federation Ltd. Vs. Singh Consultants and Engineers (P) Ltd.*, which are as follows:

"I. A confirmed letter of credit and the bank guarantee stand on the same footing. The obligations assumed by the bank in a bank guarantee are irrevocable.. Bank must honour its commitments according to the terms of the bank guarantee. A bank guarantee constitutes a bargain between the banker and

the creditor (seller in the case of letter of credit) which imposes on the banker an absolute obligation to pay.

2. An irrevocable letter of credit has a definite implication. It is independent of and unqualified by the contract of sale or other underlying transactions. These observations a fortiori apply to a bank guarantee because on the bank guarantee revolve many of the internal trade and transactions in a country. Otherwise the very purpose of bank guarantees would be negated and the fabric of trading operation will get Jeopardised.

3. The contractual duty owned by an issuing or confirming bank to the buyer to honour the credit notified by him on presentation of apparently conforming documents by the seller is matched by a corresponding contractual liability on the part of the bank to the seller to pay him the amount of the credit on presentation of the documents. This principle is same in the case of bank guarantee.

4. Bank 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 obligations 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 of conditions. The only exceptions being (1) when there is clear fraud by one of the parties of which the bank has notice or the bank guarantee has been obtained by misrepresentation or concealment of material facts, and (2) Injunction can be granted to prevent irretrievable injustice but only in very special and exceptional cases and, of course, depending upon the facts of that case.

5. Also a bank guarantee providing for payment on demand without proof or conditions is in the nature of a promissory note payable on demand and where the plaintiff has not established fraud on the part of the defendant, the bank is required to honour the bank guarantee on demand made by the defendant.

6. It is not material if the injunction sought is against the bank or the party invoking the bank guarantee as the net effect would be restraining the bank from performing the bank guarantee. That cannot be done. One cannot do indirectly what one is not free to do directly. Frame of the suit by not impleading the bank cannot make any difference in the position of law.

7. If the bank guarantee is invoked and on that account the person giving the bank guarantee is ruined he is not without remedy. He is not to suffer any injustice which is irretrievable. He can sue the party invoking wrongly the bank guarantee for damages.

8. When it is said that in the presence of "special equities" arising from a particular situation which might entitle the party on whose behalf bank guarantee is given to an injunction restraining the bank in performance of bank guarantee, the words "special equities" only mean a situation where the injunction is sought

to prevent injustice which is irretrievable.

9. The view that in a given case the matter will still be referred to arbitration and in those circumstances if bank guarantee was permitted to be encashed, it would be improper, cannot be sustained in view of the, well settled principles on which the bank guarantees are operated.

10. It is not the rule that there should be a prima facie. In order to restrain the operation either of irrevocable letter of credit or of bank guarantee, there should be serious dispute and there should be a good prima facie case of fraud and special equities to prevent irretrievable injustice between the parties. 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".

12. In General Electric Technical Services Company Inc. Vs. M/s. Punj Sons (P) Ltd. and another, , again the questions relating to the bank guarantee came up for the consideration of the Supreme Court. Where the Supreme Court observed as follows (at pp. 1998-99 of AIR):

"9. The question is whether the Court was justified in restraining the Bank from paying to GETSCO under the bank guarantee at the instance of respondent No. 1. The law as to the contractual obligations under the bank guarantee has been well settled in a catena of cases. Almost all such cases have been considered in a recent judgment of this court in U.P. Cooperative Federation Ltd. Vs. Singh Consultants and Engineers (P) Ltd., where in Sabyasachi Mukhaiji, J. as he then was, observed (at 189) that in order to restrain the operation either of irrevocable letter of credit or of confirmed letter of credit or of bank guarantee, there should be serious dispute and there should be good prima facie case of fraud and special equities in the form of preventing irretrievable injustice between the parties. Otherwise, the very purpose of bank guarantees would be negated and the fabric of trading operations will get jeopardised. It was further observed that the Bank must honour the bank guarantee free from interference by the Courts. Otherwise trust in commerce internal and international would be irreparably damaged. It is only in exceptional cases that is to say in case of fraud or in case of irretrievable injustice, the Court should interfere. In the concurring opinion one of us (K. Jagannatha Shetty, J.) has observed that whether it is a traditional bond or performance guarantee, the obligation of the bank appears to be the same. If the documentary credits are irrevocable and independent, the bank must pay when demand is made. Since the bank pledges its own credit involving its reputation, it has no defense except In the case of fraud. The Bank's obligations of course should not be extended to protect the unscrupulous party, that is, the party who is responsible for the fraud. But the banker must be sure of his ground before declining to pay. The nature of the fraud that the Courts talk about is fraud of an "grievous nature as to vitiate the entire underlying transaction". It is fraud of the beneficiary, not the fraud of somebody else".

13. The submissions of the learned counsel for the parties have to be considered and appreciated in the light of the observations of the Supreme Court and the principles deduced by D. P. Wadhwa, J. in Bhasin Associates 1991 (3) Delhi Law 43 there from read in conjunction with the terms of the present bank guarantee. Applying the law laid down by the Supreme Court and having regard to the terms of the Bank Guarantee. I feel it is not a fit case in which the defendant-purchaser should be restrained from encashing the bank guarantee.

14. Let me now examine the submission of the learned counsel for the plaintiff to the effect that since the plant has given guaranteed performance, the invocation of bank guarantee by the purchaser-defendant No. I is fraudulent. In this regard he argued that this was a case of fraud of the purchaser defendant No. I which vitiates the underlying contract and if restraint order is not confirmed the plaintiff would suffer irretrievable loss and damage. III my opinion if such a plea, in absence of a strong case of fraud, is entertained it will be very easy to frustrate the object and purpose for which the bank guarantees are furnished and no sanctity would be attached to the solemn undertakings given by the banks jeopardising international and national trade which is carried on the faith and efficacy of the letters of credit and bank guarantees. Fraud which vitiates the underlying contract has to be of egregious nature. A fraud which is so blatant and potent in magnitude that it will be unfair to allow unscrupulous purchaser to encash the bank guarantee furnished by an innocent seller. The present case does not fall in this category. The question as to whether the plant gave the required performance or not is a question of fact which will depend upon the evidence which may be adduced by the parties before the arbitrator. At this stage there seems to be no answer to the question that if the defendant No. I was guilty of such a fraud why the plaintiff extended the bank guarantee in the first place, especially, when the plant, according to them, was giving the guaranteed performance from the very beginning. My attention has not been drawn to any correspondence with regard to practice of fraud by the purchaser on the seller. Again if the action of the purchaser was fraudulent the seller would have not agreed to replace the defective parts of the plant and machinery. In General Electric Technical Services Company Inc. Vs. M/s. Punj Sons (P) Ltd. and another, one of the arguments before the Supreme Court was that since GETSCO failed to make a reference to the mobilisation advance in the letter seeking encashment of bank guarantee, their action tantamounted to suppression of material facts in as much as the mobilization advance under the contract was to be recovered from the running bills. Despite the allegation of suppression of material facts the Supreme Court held that failure on the part of the GETSCO to specify the outstanding mobilisation advance in the letter of encashment of bank guarantee was of little consequence to the liability of the bank under the guarantee.

15. It has also not been disclosed by the plaintiff as to how and in what manner it will incur irretrievable loss in the event of the stay order being vacated. if the arbitrator comes to the conclusion that the plant has given the stipulated performance as contemplated by the agreement between the seller-plaintiff and

purchaser-defendant No. 1 the amount received by the latter under the bank guarantee would be refunded to the former. In U.P. Cooperative Federation Ltd. Vs. Singh Consultants and Engineers (P) Ltd., the Supreme Court held that the party was not to suffer any injustice if it could sue for damages. It is a case of commitment of the bank which must be honoured.

16. Having regard to the aforesaid judgment of the Supreme Court and also terms of the bank guarantee the stay operating with regard to invocation of bank guarantee No. 316/89/42 is hereby vacated.

RE: BANK GUARANTEE NO. 316/ 89/ 41

17. So far as the delivery and commissioning guarantee is concerned it is asserted by learned counsel for the plaintiff that a settlement was arrived at between the parties according to which the plaintiff was required to supply mill gear and pinion to the defendant No. 1 and with the handing over of the same the bank guarantee was deemed to have been discharged. It is the case of the plaintiff that the mill gear and pinion were duly supplied to defendant No. 1. However, learned counsel for the defendant No. 1 submitted that the mill gear and pinion which were handed over turned to be defective with the result the defendant No. 1 had to procure the same from other sources. These questions are again not for this court to determine. The appropriate forum for resolution of these disputes will be arbitration.

18. It was also contended by the learned counsel for the plaintiff that the bank guarantee has expired. An affidavit has also been filed on behalf of defendant No. 2 wherein it is stated that the bank guarantee is not alive and has expired on Jan. 31, 1991. In view of this position there is no point in continuing the interim order dt. March 8, 1991 relating to invocation of bank guarantee No. 316/ 89/ 41 which is not alive according to the plaintiff and defendant No. 2. Accordingly the order dt. March 8, 1991 staying the operation of the letter dt. Jan. 8/ 19, 1991 (Annexure 36) is vacated. However it will be open to the parties to raise such appropriate pleas as may be available to them before the arbitrator as and when appointed. The arbitrator will also be entitled to decide the question as to whether the bank guarantee No. 316/89/41 was alive at the time of invocation of the same or not. It is clarified that the above order pertaining to Bank Guarantee No. 316/ 89/41 may not be construed as one directing the bank to encash the bank guarantee. The bank will be at liberty to take an appropriate view in the matter.

19. In the light of the above observations, the application is disposed of but without any order as to costs.

20. Order accordingly.