

(1981) 08 DEL CK 0020
In the Delhi High Court
Case No : First Appeal No. 78 of 81

Premier Tyre Ltd.

APPELLANT

Vs

State Trading Corporation

RESPONDENT

Date of Decision : 18-08-1981

Acts Referred:

Citation : (1981) RLR 138

Hon'ble Judges : Rajinder Sachar, J;O.N. Vohra, J

Bench : Division Bench

Advocate : S.S. Ray, D.S. Dang, Ashok Tandon, S.N. Kacker and A.N. Parikh, for the Appellant;

Judgement

Sachar, J.

(1) What sanctity and effectiveness is to be attached to the Bank guarantees which are also called performance guarantees is the question that calls for decision in this appeal?

(2) This is an appeal against the order of the learned single judge by which he refused the application for the appellant for interim injunction (arising out of a suit filed by appellant) restraining the respondent from Realizing any amount in pursuance of the bank guarantee dated 6.3.1979 furnished to it by the appellant from the Bank of India.

(3) The plaintiff is a manufacturer of tyres. One of the raw materials which is used in the manufacture of tyres is natural rubber. The import of natural rubber is canalised through respondent. For their requirements the appellant entered into an agreement with the respondent for the supply by the respondent of 360 Mt of SMR-20 quality of natural rubber Along with the registration application a bank guarantee from the Bank of India for Rs. 3.6 lakhs was furnished which was calculated Rs. 1,000/ per Mt for the quantity indented. By clause 10 (viii) of the Conditions of allotment the appellant had agreed to make payment for goods allotted and for taking the delivery of goods within the time prescribed by the ;

Stc, it had further agreed that in case of default in either case the Stc shall be free to forfeit the earnest money or invoke the bank guarantee or can take any other action as the Stc may deem fit without any reference to the appellant.

(4) The defendant allocated 360 Mt of material to the plaintiffs vide their letter of 9.5.1979. One of the conditions was that the appellant was to make payment of the full amount allotted by 25.5. 1979. It is common case that the period for making the said payment was later on extended to 24.6. 1979.

(5) The appellant made payments for 200 Mt by 20.6.1979. It appears that 170 tonnes was lifted by the appellant without any difficulty. However differences seem to have arisen regarding the balance of 30 Mt as would appear from the letter of 27.6.1979 written by the appellant to the defendant indicating that it was unable to lift the balance 30 tonnes, as there seems to be some damage to the stock. On 6.7.1979 the appellant was informed by the Deputy Marketing Manager, (STC), Delhi that as it (appellant) had failed to make payment for 160 Mt within the extended period the earnest money of one lakh sixty thousand proportionately to the default of 150 Mt stand forfeited as per terms of the allotment order. The parties of course were at variance as to who was at fault. The appellant maintained that out of the last installment of 50 tonnes, could not be delivered to it by the schedule time because there was no stock and though it may be technically in default by not having made full payment by 24.6.1979 the time for delivery should be extended by another month i.e. up to 27.7.1979. The respondent however, took a different view of the default and wrote to the Bank of India on 16.10.1979 stating that the appellant had failed to observe the terms and conditions of the allocation order issued for the supply of 360 Mt and has defaulted in making the payment of 160 MTs and that it Therefore invoked the bank guarantee to the extent of Rs. 1,60,000.00 of the default committed by the appellant and requested the Bank to remit the said amount within a week of the said letter. The bank naturally informed the appellant that a demand has been made by the respondent to encash the bank guarantee. The appellant protested at this action, as will appear from its letter of 21.10.1979 in which it took the stand that it was the fault of the respondent who was not in a position to supply the full quantity. It was also suggested that the representative of the appellant met the representative of the respondent and that some kind of an agreement was also made between them that the Stc will not enforce the forfeiture of earnest money and encash the bank guarantee. It is in those circumstances that the suit has been filed seeking a permanent injunction to restrain the defendant from Realizing any amount in pursuance of the bank guarantee.

(6) The allegation of having no stock with it or having agreed not to invoke the bank guarantee is denied by the respondent. The respondent has taken the stand that in spite of the Chairman of the plaintiff company promising to make payment by 24.7.1979 of the balance of 160 tonnes the said amount was not paid and Therefore the respondent is entitled to invoke the bank guarantee. The allegation that the quality was defective is denied and is stated to be motivated with a view

to cover the plaintiff's own default in its failure to make payment within the extended period and to cover its own financial difficulties. The charge of non-availability of the stock is denied. Rather it is alleged that it is breach of contract by the plaintiff.

(7) As mentioned above the appellant sought an interim injunction which has been refused by the single judge and the plaintiff has come up in appeal against that order.

(8) Mr. Ray the learned counsel for the appellant took us through the correspondence which had been exchanged between the appellant and the respondent and urged that there was a *prima facie* arguable matter as to who was at fault for the supply or non-supply of the goods and Therefore the respondent should be restrained from seeking to realise the bank guarantee. This argument however, proceeds on the assumption as if the amount payable under the bank guarantee is an integral part of the dispute arising between the parties and Therefore if it could be shown that there were arguable matters to be tried in the suit, payment under the bank guarantee could be restrained in the meanwhile and for this Mr. Ray referred us to some of the observations made in Suit No. 567 A/79 Decided by Kapur, J. on October 11, 1979. In our view reliance on those observations which, we say with great respect, were more or less casual, can be of no assistance to Mr. Ray. It is now well settled that performance guarantee stands on a similar footing to an irrevocable letter of credit. A Bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer ; nor with the question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not The bank must pay according to its guarantee, on demand if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the bank has notice, (see Lord Denning. (1978) 1 All. Er 976.

(9) Similarly an irrevocable letter of credit constitutes an independent contract between the issuing banker and the seller, and is not qualified by or subject to the terms of the contract of sale, made between the buyer and the seller, or the contract between the issuing banker and the buyer. (Vide Chitty on Contracts, 24th edition para 2620),

(10) Now the law, Therefore, is that whether a bank guarantee can be enforced or not by the beneficiary will depend upon the terms of the performance guarantee, the contract between the bank- and the respondent. It is an independent autonomous one. The efficacy of this contract is not controlled by another independent contract between the appellant and the respondent. The encashment of the bank Guarantee has nothing to do with the alleged dispute between the appellant and the respondent which must be decided independently on the basis of the terms of that contract, without involving the contract of bank guarantee.

(11) In the present case the guarantee given by the Bank of India is in the following terms ; "In consideration of your having agreed to register the Raw Rubber requirement of Premier Tyres Ltd. Merchant Chamber 41, Sir, V. Thackersey Marg, Bombay-400020 (hereinafter referred to as "Actual User/allotted"). We, Bank of India, 70-80 M. Gandhi Road, Bombay., as also our successors and assignee, bind ourselves unconditionally and irrevocably that in the event of any default, failure on the part of the Actual User/allotted to observe all or any of the conditions prescribed /to be prescribed by you in regard to the above said registration and/or allocation order that may be issued by you, we shall on your first "demand without protest or demur and without reference to the Actual User/allotted and notwithstanding any contestation by Actual User/allotted or existence of any dispute whatsoever between you and the Actual User/allotted pay forthwith to your successors and assigns any sum up to Rs. 3,60,000.00 (Rupees Three Lacs sixty thousand) that you may demand. We agree that a letter from you under the signature of any one of your Chief Marketing Manager to the effect that there has been a default/failure on the part of the Actual User/allotted shall be final, conclusive, and binding on us....."

(12) It will be noticed that by this guarantee bank has undertaken to pay on first demand without protest or demur or without reference to actual user any sum up to Rs. 3,60,000.00. In (1978) 1 All Er 976 Edward Owen v. Barclays Banks International; the English suppliers had entered into a contract with a Libyan purchaser. The bank had given a guarantee in favor of the Libyan customer undertaking to pay an amount on first demand by them. The Libyan customer having invoked the bank guarantee the English suppliers issued a writ against the Bank asking for interim injunction on the ground that the default was not of English supplier but of Libyan Customers. The court of Appeal though Prima facie of" the opinion that Libyan customer were in default and the English supplied was not at fault nevertheless. held that Performance Guarantees are virtually Promissory notes payable on demand, and it was said at Page 983 that

"SO There it is . Barolalay BANK. INTER- NATIONAL, has given its guarantee, I might almost say is Promise to pay , to Umma Bank on demand without proof or conditions. They gave that Promise the demand was made. The Bank must honour it this court cannot interfere with the obligation of the Bank."

12 A. A still nearer parallel is to be found in Texmaco Ltd. Vs. State Bank of India and Others, ", in written the Stc was sought to be injected iron regard moony on a bank guarantee. The guarantee in that case was more or less in similarities as in the infant case ; the bank had irrevocably and unconditionally guaranteed free payment in the event of Taxmaco"s failure concerned their contractual obligation on rust demand without any contestation, demur or protest.. The decision of the Stc as to the liability of the bank under the guarantee and the amounts payable there under was to be final and binding on the bank. The learned single Judge refused the injunction and the matter was taken up in appeal and is reported in 83 C.W.N. 807 Taxmaco Ltd. v. State Bank. Similar arguments as in that case

were raised before us by Mr. Ray-namely that there was prima facie dispute and that there was special equity in favor of the appellant and that the action of the Stc was arbitrary and it could not just invoke the bank guarantee without proving prima facie that there was a default committed by appellant in the carrying out of the contract which had been entered into between the appellant and the respondent for supply of 360 MTs of Natural rubber. The argument was rejected with the observation which are equally applicable in the present case that the terms of the performance guarantee are very wide indeed. The performance guarantee is a distinct and a separate contract to which only the respondent State Bank of India and the Stc are parties and under the terms of the performance guarantee, the Stc is the sole arbiter to decide whether the respondent bank was liable and obliged to pay any sum under the guarantee . In that view the appellate Bench refused the interim injunction. It is common case that special leave application against Tuxmaco Judgment was dismissed in liming by the Supreme Court, thus the argument that the performance guarantee even in terms as wide as the ; present is to be treated as an integral part of the main contract between the buyer and the seller is now a non-starter and an exploded one. In each case when a party is sought to be injected from encashing the bank guarantee what has to be looked to are the terms of the bank guarantee as this contract is a separate and distinct one and is not dependant on the other independent contract. In the present case the bank guarantee that is given is in the widest terms. The terms and conditions are snore or less similar to what obtained in the I axrnaco case. A Division Bench of this court in Harparshad and Co. Ltd. Vs. Sudarshan Steel Mills, Punjab National Bank, accepted the correctness of Taxmaco Case (,supra), and it was emphasised that the guarantee was to make payment on first demand and without contest and the liability under the bank guarantee was Therefore absolute. Mr. Ray made an effort to invoke Har 140 prashad"s case (supra), to his aid for his argument that the distinguishing feature in that case should be held applicable to the present case also. In our view the facts in Harprashad"s case (supra), were totally different. The Division Bench had found that according to one of the terms the bank had undertaken to pay upon receipt of a written notice from the beneficiary that a default had been committed. The bench found that notice in writing was not sent by the appellant to the bank. It was for that reason that it was held that as the bank had a duty to satisfy itself that the demand by the beneficiary was made under the terms of the bank guarantee and that as one of the terms was that notice that a default had been committed was to be given by the beneficiary and as the said terms had not beenfulfilled,the amount under the bank guarantee had not become payable. It may however, be noticed that it was accepted that no dispute raised under the main agreement can be a reason for non-payment of the amount due under the bank guarantee, which is an autonomous and independent contract and must have effect according to its own terms.

(13) Reference in this connection may also be made to Texmaco"s case (Supra)Where under one of the conditions of the bank guarantee the bank

agreed that the decision of the purchaser as to whether the contractor had made a default in repayment of the said advance was binding on the bank. The court held that such a clause clearly implied that the decision of the purchaser shall be binding and the bank will not be entitled to raise any dispute on the decision of the purchaser in this regard but shall on demand pay the sum of money due forthwith without any objection of demur (page 806). In the present case also the bank has agreed that a letter from the defendant that there had been a default will be final, conclusive and binding on them. In terms of the bank guarantee, Therefore, whether a dispute has been raised by the appellant is a totally irrelevant circumstance so far as it concerns the right of the respondent to proceed against the bank guarantee in accordance with its terms. All the arguments in seeking to restrain the respondent from encashing the bank guarantee arise from an effort to integrate the contract of bank guarantee with an independent contract of the appellant and respondent which is a distinct one. If the two contracts are treated distinct as in law they are, it is immediately clear that the respondent could only be restrained from invoking the bank guarantee if the conditions in the bank guarantee were not adhered to. That is not the position here. Here an irrevocable commitment has been made by virtue of the bank guarantee and prima facie there appears to be no reason to enjoin the respondent from realizing the amount of bank guarantee. We may in this connection refer to a decision in Suit No. 14-A/1980 by one of us (Vohra. J.) where an application for interim injunction seeking to restrain the encashment of bank guarantee on the ground that Corporation cannot become a Judge in its own cause was dismissed with the observation, "that these bank guarantees create positive obligations and are irrevocable and that the obligation arising under the bank guarantees are independent of the obligations arising out of contract between the parties". These observations have our full agreement.

(14) Mr. Ray even made a half hearted attempt to distinguish the cases noted above by saying that in the present case the bank has not been impleaded as a party and no injunction is sought against the bank from paying the amount, but only to restrain the respondent from recovering the amount in terms of the bank guarantee. We are unable to perceive any distinction. Here when the plaintiff prays for an injunction restraining the defendant from realizing the amount under the bank guarantee, it in reality has the effect of enjoining also the bank from not making the payment because obviously the bank cannot make any payment under the guarantee unless the same is asked for by the respondent and if the respondent is enjoined from seeking to recover any amount under the bank guarantee, the obvious consequence is that there is a freezing of the bank guarantee. This attempt to do indirectly for restraining the respondent from realizing the bank guarantee as against the direct attempt to seek an injunction against the bank is a difference between tweekledum and twiddled and also suffers from the infirmity of unacceptability on the ground of well known rule of construction that what can not be done directly cannot be allowed to be done indirectly. To accept such an argument of the appellant would be to seriously

dilute the strength and efficacy of the irrevocable bank guarantee.

(15) In our view such a course is fraught with grave consequences to the smoothness of trade which in any developed and also developing country like ours will seriously harm the economy. In this connection it would be apposite to note the observations of Jenkins, L.J. and of a judge of New York Supreme Court, Shionteg, which met with the approval of the Court of Appeal in Edward Owen's case (supra) that "...it seems to be plain that the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes on the banker an absolute obligation to pay, irrespective of any dispute which there may be between the parties on the question whether the goods are up to contract or not. An elaborate commercial system has been built up on the footing that banker's confirmed credits are of that character, and in my judgment. it would be wrong for this court in the present case to interfere with that established practice and further it is well established that a letter of credit is independent of the primary contract of sale between the buyer and the seller. The issuing bank agrees to pay upon presentation of documents, not goods. The rule is necessary to preserve the efficiency of the letter of credit as an instrument for the financing of trade.

(16) Mr. Ray had also tried to invoke Section 126 of the Contract Act which defines a contract of guarantee as a contract to perform the promise or discharge the liability of a person in case of his default to urge that bank was in the position of a surety and unless the principal debtor (i.e. the appellant) was first held liable the bank cannot be made to pay This is again in another form the same argument of treating the bank guarantee as an integral part of the main contract, which we have rejected. Now the payment under a bank guarantee like payment under the letter of irrevocable credit becomes due on the happening of a contingency on the occurrence of which the guarantee becomes enforceable but it is wrong to treat such a bank guarantee, as a guarantee u/s 126 of the Contract Act. which speaks of three persons with reference to the contract, it is rather in the nature of contract of indemnity, u/s 124 of the Contract Act which requires two person, in a contract of guarantee the surety undertakes an obligation at the request express or implied of the principal debtor. The obligation of the surety depends substantially on the principal debtor's default ; under a contract of indemnity liability arises from loss caused to the promisee by the conduct of the promisee himself or the conduct of another person : "vide Punjab National Bank Ltd. v. Sri Bikram Cotton Mills AIR 1979 S. C. 1973 Here the bank guarantee is a contract between the bank and respondent. The reason why the bank guarantee may have been given no doubt was because of the requirement of the principal contract between the appellant and the respondent but that contract is independent and distinct from the contract of bank guarantee (which is between the bank and the respondent) and the terms of this bank guarantee alone must be looked upon to determine the rights of parties in this litigation. The rights under that distinct contract are not germane to the decision of the present proceedings.

(17) Thus, if the banker, at the instruction of the buyer issues an irrevocable credit, then despite any dispute that the buyer may thereafter have with the seller under the contract of sale, the buyer cannot of his own will compel the Banker to cancel the credit, "vide page 262 of Chitty on Contracts (24th Edition) Volume II "specific Contracts".

(18) "THE contract thus created between the seller and the banker is separate from, although ancillary to, the original contract between the buyer and the seller, by reason of the banker's undertaking to the seller, which is absolute the buyer is not entitled to an injunction the seller from dealing with the letter of credit if the goods are defective, "...vide page 102 of Halsbury's Laws of England (4th Edition) Volume 3.

(19) In the present case the guarantee promises to make the payment on demand without any demur or reference to the actual user and also agrees that the intimation from the respondents that there has been a default shall be final and binding. In our view Section 126 does not stand in the way of the bank guarantee being invoked by the respondent when the terms of the guarantee are satisfied. This plea of the appellant fails.

(20) One desperate last attempt was made by Mr. Ray to make a distinction between the cases cited above by urging that these cases related to contract of international trade while the instant case is of internal trade. We cannot find any distinction. The first assumption that the present case is a case of internal trade is factually not correct. Admittedly the natural rubber which is supplied to the appellant is imported by S.T.C. Had the natural rubber not been canalised the appellant would have had to enter into an agreement with a foreign exporter, and the payment would have to be made abroad. The only effect of canalization is that instead of the individual users making direct contract with the foreign exporters S.T.C. had made the said contract and undertaken the liability to pay foreign contractor. In fact the same compulsion of international trade is to be found in the present contract. That apart we do not see how any distinction can be made as to the obligation under a bank guarantee in the matter of an international trade or internal trade. No doubt the expansion of the international trade led to the great development of banker's commercial credit. The inherent difficulties of overseas transactions were otherwise aggravated by the reluctance of both the sellers and buyers to tie up capital during shipment and the traders Therefore availed themselves of the facilities afforded by the bankers. But the facilities of the bank guarantee in helping the quickness and the certainty of the trade also led to the corresponding use of the same in the development in the internal trade. The bank guarantee is a recent development which because of the complications of industries and trade have obtained a great importance inside the country. The beneficiary like the respondent who is the seller is assured of payment by the bank, once he complies with the terms and conditions of the bank guarantee. Again the bank guarantee has been held to be an important instrument in the internal trade of a country. Sometimes it also plays a useful

role in the international trade ; vide *The Minerals and Metals Trading Corporation V. Sehi* 74 C.W.N. 990. The whole significance and importance of the bank guarantee lies in as much as it permits a business to be done even by persons who do not have ready cash of their own, but are able to prevail upon the banks to give the guarantee. The use of the bank guarantee has now become quite common. In almost all the big contracts which are issued by the government the bank guarantee of a particular percentage of contract amount is always insisted upon as a measure of assurance that the contractor will perform his contract, in many matters even in cases where stays are given for recovery of income tax or excise duty courts usually insist upon bank guarantee before stay is given. Similarly in many matters stays are given subject to the furnishing of the bank guarantee. Actually the facility of the bank guarantee being used by different agencies is because there is underlying assurance that in case the terms of the bank guarantee are fulfilled by persons in whose favor the guarantee was given there will be no difficulty in the way of the said person in recovering the said amount. It would be indeed a pity if the solid support and strength that is envisaged in the giving of a bank guarantee and on the basis of which large number of transactions are entered into was to suffer by the courts interference in the encashment of bank guarantee even though the terms of the bank guarantee were satisfied on the alleged dispute being raised relating to an independent contract between the buyer and the seller. If a bank guarantee given in the widest terms as in the present case was not to be treated as irremovable letter of credit and the beneficiary was still to be embroiled in a litigation simply because a dispute was raised by the buyer, much of the stream of trade will dry up thus causing a great economic loss to the society and the nation. In this matter of keeping the stream of trade un-hindered and unpolluted we can see no reason to draw a distinction between the international trade and the internal trade. As a matter of fact the courts have consistently held that a payment under a bank guarantee in favor of seller cannot be stopped in international trade even though the buyer may have defaulted in his part of the contract as was the case before the Court of Appeal. In such a case a seller has obviously a great disadvantage in recovering the said amount from the buyer because of different laws and jurisdiction as was recognised in the appeal court case. But that situation does not arise when the parties both belong inside the country. All that may happen is that if an irrevocable bank guarantee like the present is allowed to be encashed, it may at the most give immediate advantage to the seller but the buyer is under no such great constraints or complications in seeking to recover the amount if he ultimately succeeds in the litigation. From that point of view there is less justification to interfere in this settled commercial practice that has grown up around irrevocable bank guarantees in internal trade, rather than international trade. In case of later, the laws of foreign country may some times be so discriminatory and harsh towards foreigners that the denial to issue injunction may probably cause serious harm, yet broader consideration of international trade and interdependence of world economy compels the court from refraining to issue injunction. We feel that the same kind of self-restraint

and avoidance to trespass on this delicate field of trade, even internal must govern the consideration of with the courts unless in the exceptional case of a probable case of fraud. No such exceptional case is made out to take different line.

(21) As the judgment was reserved, Mr. Tandon, counsel for the appellant appeared and informed us that a judgment in I.A. 2454 of 1980 in Suit No. 225/80 has been announced on 12.8.1980 by Khanna, J. which according to him supported the appellant's contention. We have gone through the judgment. In our view the judgment rather goes against the appellant. The learned judge has specially accepted in para 50 that the bank guarantee is autonomous and an independent contract and must have effect according to its own terms, and that the bank is only concerned to ensure that the terms of its mandate and confirmation are complied with and is in no way concerned with any contractual dispute which may have arisen between the buyer and seller. In this case a bank guarantee had been given with regard to the first two months' supply. As that was not lifted the interim order had permitted the bank guarantee to be encashed at the rate of Rs. 1,000.00 per Metric ton as provided in the agreement and this part was affirmed by the learned judge by his order dated 12.9.80. The defendant however wanted to utilise the bank guarantee for supply subsequent to two months. The case of the plaintiff was that no such guarantee was given for the period subsequent to two months. It was in that context that the learned judge held that the formal bank guarantee cannot be availed of for settling the liability for further two months. This does not in any way suggest as contended by Mr. Ray that the bank guarantee forms integral part of the main contract.

(22) We must also appreciate that this is an appeal against the interim order refusing injunction. The learned judge has on consideration of various aspects exercised his discretion and refused injunction. He was fair enough in directing that if ultimately the party succeeded, the amount will carry interest at the rate of 10%. This was also the rate allowed by the Supreme Court in the matter as noticed by Kumar, J. in his order dated 8.11.1979 passed on I.A. 1948/79 in Suit No. 709/79. We do not find any sufficient reason to interfere with the discretionary order of the learned single judge.