
(1980) 08 DEL CK 0015
In the Delhi High Court
Case No : Appeal F.A.O. (OS) 78 of 1980

Premier Tyres Ltd.

APPELLANT

Vs

State Trading Corporation of India Ltd.

RESPONDENT

Date of Decision : 18-08-1980

Acts Referred:

Contract Act, 1872 — Section 124, 126

Citation : (1981) 51 CompCas 316 : (1986) ILR Delhi 317

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

Bench : Full Bench

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

Final Decision : Dismissed

Judgement

J.D. Jain, J.—This is an application under O. 39, rr. 1 and 2 read with Section 151 of the CPC made by the plaintiff-company for the grant of an ad interim injunction restraining the defendant, the State Trading Corporation of India Ltd. (hereinafter referred to as the " Corporation "), and its officers, servants and agents from Realizing any amount under or pursuant to the bank guarantee No. G/73/261 dated March 6, 1979 (hereinafter referred to as the " performance bank guarantee "), till the final disposal of the suit. An ex parte injunction as prayed for was issued by this court (Sultan Singh J.) on November 6, 1979. The defendant-Corporation seeks vacation of the said order.

2. The facts germane to the disposal of the application succinctly are that the plaintiff is engaged in the business of manufacture and sale of automobile tyres, tubes and flaps. The defendant-Corporation is a Govt. of India company and the import of natural rubber is canalised through the defendant for distribution to actual users in India on commission basis. On March 6, 1979, the plaintiff applied to the defendant for allotment of 360 metric tonnes of SMR-20 quality natural rubber (hereinafter referred to as " the material "). The plaintiff also furnished performance bank guarantee from the Bank of India in the sum of Rs. 3'6 lakhs

at Rs. 1,000 per MT for the due performance of the contract. The defendant allocated 360 MT of material to the plaintiff, vide letter dated May 9, 1979, at Rs. 10,400 per MT ex-defendant's Madras Warehouse, inter alia, subject to the condition that the allottee made payment of the full quantity allotted to them by May 25, 1979, and that non-payment for the material within the aforesaid period would entail the allocation being cancelled and earnest money forfeited automatically without any notice whatsoever. The plaintiff purchased 100 MT of material against payments made for lots of 50 MT each on May 14, 1979, May 19, 1979, and sought extension of time for deposit of money for the balance quantity of 260 MT. Accordingly, the time was extended by one month. Thereafter, the plaintiff deposited further price for 50 MT of material each on June 12, 1979, and June 20, 1979. The plaintiff again sought extension for another one month in respect of the balance quantity. The contention of the plaintiff is that the defendant agreed to extend the time by one month subject to payment of additional 2"5% of the price on account of what the defendant described as " carrying cost ". Further, the plaintiff found that 20MT of the material out of the last lot was water-contaminated. Moreover, the defendant could not and did not deliver the balance 30 MT of material, for which payment had been made, till July 28, 1979, for want of stock of natural rubber of the quality conforming to the allotment letter. Some negotiations followed between the plaintiff and the defendants. However, vide letter dated July 6, 1979, the defendant purported to forfeit Rs. 1,60,000 out of the amount for which performance bank guarantee had been furnished by the plaintiff on the ground that the plaintiff had failed to deposit the balance sale price in respect of 160 MT of the material. It is the further case of the plaintiff that the defendant had agreed to waive the forfeiture of the earnest money which had been done by them unilaterally and (now) demanded the price for the balance 160 MT of material at Rs. 12,410 per MT, to which the plaintiff would not agree for obvious reasons. However, the plaintiff was astonished to find that defendant had falsely and wrongly alleged, vide its letter dated October 16, 1979, addressed to the bank that the plaintiff had failed to observe the terms and conditions of the allotment letter and that the proportionate amount of the earnest money, Rs. 1,60,000, be paid to them i.e., the defendant. Thus, the contention of the plaintiff is that the defendant was not possessed of the requisite and stipulated quantity of material in stock up till July 28, 1979, and as such they had evidently defaulted in the due performance of the contract. Hence they could not complain of the plaintiff not having lifted the material in time and use this as an excuse to impose a penalty of Rs. 1,60,000 on the plaintiff. Secondly, it is urged that the defendant had informed the plaintiff's representative of its decision to withdraw the purported forfeiture and levy of penalty, and that [nothing happened thereafter to warrant or entitle the defendant to reimpose the penalty.

3. The defendant contests this application primarily on the ground that as per the terms and conditions agreed upon by the plaintiff the payment for the entire allotment of 360 MT of the material had to be made to the defendant by May 25,

1979, and failure to make the payment within the stipulated time entailed forfeiture of earnest money. However, the plaintiff failed to pay the price of the entire allotted material even by the extended date and as such it entailed forfeiture of earnest money. It is further urged that the performance bank guarantee furnished by the plaintiff to the defendant clearly stipulated that the bank was liable to pay to the defendant the amount guaranteed or any portion thereof on first demand without protest or demur and without reference to the actual user/allottee and notwithstanding any contestation by the actual user/allottee of the existence of any dispute whatsoever between the parties. Moreover, under its terms and conditions the decision of the defendant that there had been default by the allottee would be final, conclusive and binding on the plaintiff. As a necessary corollary, it is pointed out, the performance bank guarantee is a separate and independent contract, the terms of which have to be strictly construed, and the plaintiff not being a party to the same, cannot claim any relief in respect of the said contract or guarantee. They assent that the plaintiff was unable to meet the financial commitments despite the extension granted to them by the defendant as communicated by them in the telex No. 607 dated June 25, 1979, when they sought further extension of time for paying the price of the balance material.

4. Annexure " B " is a copy of the allocation order for natural rubber issued by the defendant on May 9, 1979, allotting 360 MT of material to the plaintiff. It was subject to standard terms and conditions covering such allocations communicated to the plaintiff earlier. Annexure " I " embodies the terms and conditions for the allocation of natural rubber. It, inter alia, provides that the allottee should make payment of the full quantity allotted to them latest by May 25, 1979, and non-payment for non-lifting of the material within the period allowed will entail the allocation being cancelled and earnest money forfeited automatically without any notice whatsoever. Annexure " E " is letter dated July 6, 1979, according to which the earnest money of Rs. 1,60,000 being proportionate to the quantity of 160 MT in respect of which the plaintiff had defaulted was forfeited. It was mentioned that out of 360 MT (total allotment) they had made payment for 100 MT only within the original validity period and for another 100 MT within the extended period leaving the balance of 160 MT. It is beyond the pale of controversy that no amount was paid by the plaintiff to the defendant over and above that mentioned in the said letter.

5. However, as stated above, the contention of the plaintiff is that the defendant had itself committed default in not supplying the last lot of 50 MT of material even though the price thereof had been deposited because they were not in possession of the requisite quantity of material. In this context the learned counsel for the petitioner has adverted to the letter dated June 27, 1979, written by the plaintiff to the defendant (annex. C), and the reply of the latter dated July 10, 1979, to the same (annex. DD). In the former the plaintiff expressed their inability to lift the balance of 30 MT since the available stock appeared to be damaged by water and they requested for delivery of the balance of 30 MT from

other stock. In their reply the defendant-Corporation informed the plaintiff that arrangements were being made for segregation of the stock at Chrompete and that they would arrange to deliver the balance stock in due course. In the alternative they would consider allotting the balance stock from any of the incoming shipment.

6. The learned counsel for the appellant has canvassed rather fervently that these letters are indicative of non-availability of the requisite quantity of the material with the defendant at the relevant time and as such the defendant could not make a grievance of non-payment of the price of the balance quantity of the material, viz., 160 MT. On the other hand, the learned counsel for the defendant has emphasised that the shoe is on the other leg inasmuch as the plaintiff was facing financial stringency and as such it was not in a position to pay the balance amount as would be manifest from their telex dated June 25, 1979 (copy attached to the written statement). I do not think that it is either necessary or relevant to consider at this stage the respective contentions of the parties to determine as to which of the parties is ex facie guilty of default and whether failure of the defendant to deposit the balance price of the material within the extended period entailed the consequence of forfeiture of earnest money. On a parity of reasoning I need not decide whether the defendant subsequently agreed to waive forfeiture and offered to supply the balance material at a higher rate. Evidently, these are matters falling within the realm of merits, and, as shall be presently seen, do not have a direct bearing on the competence of the defendant-Corporation to enforce payment of the earnest money proportionate to the unpaid price of material having regard to the terms and conditions of the performance bank guarantee which, as alleged, constitutes an independent and distinct contract between the defendant and the bank, the plaintiff having no right whatsoever to intervene in the same.

7. Annexure A is a copy of the bank guarantee furnished by the bank to the defendant in consideration of the latter having agreed to register the raw rubber requirement of the plaintiff as an actual user/allottee. Its perusal will show that the bank bound itself unconditionally and irrevocably and undertook that in the event of any default/failure on the part of the allottee to observe all or any of the conditions prescribed in regard to the aforesaid registration or allocation order that may be issued by the defendant they shall on their first demand without protest or demur and without reference to the plaintiff and notwithstanding any contestation by the actual user/allottee or existence of any dispute whatsoever between the plaintiff and the defendant pay forthwith to the defendant or their assigns any sum up to Rs. 3,60,000 which they may demand. Not only that, the bank further agreed that a letter from the defendant to the effect that there had been a default/failure on the part of the plaintiff would be final, conclusive and binding on them and that the guarantee given by them would not be affected by any indulgence of any kind shown by the defendant to the plaintiff or any change in the conditions of registration/allocation prescribed by the latter.

8. A bare reading of the aforesaid letter would thus show that the performance guarantee is couched in the widest possible terms and is absolutely unqualified as regards the liability of the bank for payment of the amount guaranteed forthwith against first demand by the defendant. Not only that, it makes the word of the defendant, as to the liability of the bank for payment of the amount in question, final and binding and the bank cannot take notice of any contestation of their liability to forfeit the earnest money (deposited) by the plaintiff. In other words, the bank is bound to honour its commitment as soon as the defendant certifies that there has been a breach of the contract on the part of the plaintiff and the latter has incurred forfeiture of the earnest money entitling the defendant to enforce the performance guarantee.

9. Similar questions cropped up before the Queen's Bench Division in *R. D. Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd.* [1977] 2 All ER 862. The plaintiffs therein had contracted with the Egyptian buyers for the sale of a quantity of goods under three separate contracts ; each of which provided that the plaintiffs were to be paid by the buyers by means of irrevocable confirmed letters of credit and that the plaintiffs were to establish a guarantee confirmed by a bank of 5% of the price in favor of the buyers. The guarantees were in effect performance bonds, their purpose being to provide security to the buyers for the fulfillment by the plaintiffs of their obligations under the contracts. That was done by the plaintiffs instructing their own bank to confirm the guarantees to the respective Egyptian banks, which in turn confirmed the guarantees to the buyers. The guarantees were backed by counter-indemnities by the plaintiffs to the bank. The plaintiffs agreed to indemnify the bank in the widest terms and gave irrevocable authority for payment under the guarantees and to debit the plaintiff's account accordingly. The guarantees themselves simply provided that payment would be made on the buyers' " first demand " without proof of any breach of contract by the plaintiffs or any other safeguard against abuse by the buyers. Some disputes having arisen between the plaintiffs and the buyers, the latter demanded payment under the guarantee in each case and the bank took the view that it had no option but to pay. However, the plaintiffs on learning of the bank's intention, instituted proceedings against the bank, the Egyptian banks and the buyers contending that there was no justification whatsoever for the demand under the guarantees. They obtained an ex parte interim injunction restraining the bank and the Egyptian banks from paying and the buyers from obtaining payment under the guarantees. The bank subsequently applied for the discharge of the injunction issued against it. On these facts, it was held by Kerr J. thus (headnote of [1977] 2 All ER 862 :

" (i) Only in exceptional cases would the courts interfere with the machinery of irrevocable obligations assumed by banks. In the case of a confirmed performance guarantee, just as in the case of a confirmed letter of credit, the bank was only concerned to ensure that the terms of its mandate and confirmation had been complied with and was in no way concerned with any contractual disputes which might have arisen between the buyers and sellers.

Accordingly, since demands for payment had been made by the buyers under the guarantees and the plaintiffs had not established that the demands were fraudulent or other special circumstances, there were no grounds for continuing the injunctions. "

10. The learned judge further observed as under (p. 870) :

" I need only briefly refer to a few authorities. They were mostly concerned with confirmed letters of credit, but they equally apply to confirmed performance guarantees. In both cases the banks are only concerned to ensure that the terms of their mandate and confirmations are complied with, e.g., of the conformity of the documents presented, and in this case of the fact that a demand for payment had been made by the buyers under their existing guarantee. This is unfortunate for the plaintiffs, but it is what they have agreed. Banks are not concerned with the rights or wrongs of the underlying disputes but only with the performance of the obligations which they themselves have confirmed."

11. This authority was noticed recently by a Division Bench of the Calcutta High Court in *Texmaco Ltd. v. State Bank of India* [1979] 83 CWN 807, where a performance bank guarantee which had been furnished by the plaintiff/appellant, M/s. Texmaco Ltd., provided, amongst others, that the decision of the beneficiary, State Trading Corporation, as to the liability of the bank, under the guarantee, and the amount payable there under shall be final and binding on the bank, and the bank shall pay forthwith the amount demanded by the State Trading Corporation notwithstanding any dispute between the said Corporation and the promisors, TEXMACO, under an export contract, it was held that the said clause was binding on the bank notwithstanding any dispute between the beneficiary of the bank guarantee and the manufacturer under the export contract. The following observation of their Lordships are very pertinent to note :

" In the instant case by the performance guarantee the State Bank undertook irrevocably and unconditionally, obligations without any contestation, demur, or protest and/or without any reference to the manufacturer, and/or without questioning the legal relationship subsisting between the exporter and the manufacturer, to pay the sum of money under the guarantee, on first demand being made by the exporter. In such cases their terms of the performance guarantee are very wide. The performance guarantee is a distinct and separate contract to which only the bank and the exporter are parties. By and under the said guarantee the bank irrevocably and unconditionally undertook to pay to the exporter the guaranteed amount on first demand whenever the exporter decided that the bank was liable to pay under the guarantee. The plaintiff manufacturer at whose instance this performance guarantee was executed knew that under the terms of this performance guarantee the exporter was the sole arbiter to decide as to whether there was any liability foisted on the bank under the : guarantee, and in such circumstances it must be held, that in terms of this performance guarantee, the beneficiary exporter is the sole arbiter to decide as to whether the respondent-bank was liable and obliged to pay the money under the

guarantee. Performance bond stand on a similar footing to a letter of credit."

12. It is thus manifestly clear that a performance bank guarantee has been for all intents and purposes equated with a confirmed letter of credit and the bank is merely concerned to ensure that the terms of their mandate and confirmation are complied with. In the instant case too, the bank guarantee imposes an absolute obligation on the bank to pay irrespective of any dispute which may be there between the parties as regards payment of the price or delivery of the material. The obligation of the bank is to the beneficiary and no third party comes into the picture inasmuch as the performance guarantee is a distinct and separate contract to which only the defendant and the bank are parties. Needless to say that the plaintiff at whose instance this performance bank guarantee was executed knew well that under the terms of this performance guarantee the defendant was the sole arbiter to decide as to whether there was any liability foisted on the bank to pay any money under this guarantee. So looking, from this angle, there is no shadow of doubt that, notwithstanding any disputes, real or imaginary, between the parties, the plaintiff cannot interfere in the discharge of the performance guarantee by the bank by making payment to the defendant on first demand in accordance with the terms and conditions incorporated therein. It is nobody's case that the demand made by the defendant on the bank is vocative of the terms and conditions of their performance guarantee.

13. The grant of an interim injunction being discretionary with the court and being in the nature of an equitable relief the court, as per settled law, has to satisfy itself about : (a) prima facie existence of a right in the plaintiff and its infringement by the defendant ; (b) balance of convenience ; and (c) irreparable injury to the plaintiff in case the injunction is not granted. It has already been seen that the plaintiff has no prima facie case entitling him to the grant of an ad interim injunction. Even the balance of convenience is not in his favor because the payment is to be made by the bank and not by the plaintiff. No doubt the plaintiff may be eventually saddled with the liability to reimburse the bank for the payment made by it but that aspect of the matter has no direct bearing on the question of enforcement by the defendant of its right to claim forfeiture of the earnest money and payment by the bank. Similarly, the question of the plaintiff suffering any irreparable injury if the injunction is not granted does not arise. It is true that the main relief sought in the suit is for an injunction and the suit may become infructuous in case relief of interim injunction is not granted but that again would not be a ground to confirm the ex parte injunction. Indeed, the court has ample powers to impose terms on the defendant while declining an ad interim injunction. Hence, while vacating the ex parte injunction issued, vide order dated November 6, 1979, I direct that in case any order is made eventually for the restitution of the amount covered by the bank guarantee in question or any part thereof, the defendant shall refund the amount along with interest at 10% per annum. The application stands disposed of accordingly but no order is made as to costs.

14. Before concluding I may mention that during the course of arguments the learned counsel for the plaintiff invited my attention to the fact that he had paid full court fee ad valorem on the amount involved in the suit and prayed that he be given some time to make an application for amendment of the plaint. In the interests of justice he is allowed to make such an application in accordance with law within a month failing which the suit shall stand dismissed, as having become infructuous.

15. The applicant preferred an appeal to a Division Bench.

JUDGMENT

SACHAR, J.

16. What sanctity and effectiveness is to be attached to bank guarantees which are also called performance guarantees is the question that calls for decision in this appeal.

17. This is an appeal against the order of the learned single judge by which he refused the application of the appellant for an interim injunction (arising out of a suit filed by appellant) restraining the respondent from Realizing any amount in pursuance of the bank guarantee dated May 6, 1979, furnished to it by the appellant/plaintiff from the Bank of India.

18. The plaintiff/appellant 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 the respondent/defendant. 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. 36 lakhs was furnished which was calculated at 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 the goods allotted and for taking delivery of the goods within the time prescribed by the S.T.C., and it had further agreed that in case of default, in either case, the S.T.C. shall be free to forfeit the earnest money or invoke the bank guarantee or could take any other action as the S.T.C. may deem fit without any reference to the appellant.

19. The defendant allocated 360 MT of material to the plaintiffs, vide their letter of May 9, 1979. One of the conditions was that the appellant was to make payment of the full amount allotted by May 25, 1979. It is common case that the period for making the said payment was later on extended to June 24, 1979.

20. The appellant made payments for 200 MT by June 20, 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 June 27, 1979, written by the appellant to the defendant indicating that it was unable to lift the balance of 30 tonnes, as there seemed to be some damage to the stock. On July 6, 1979, the appellant was informed by

the Deputy Marketing Manager, (S.T.C.), 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 160 MT stands forfeited as per the 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, 30 tonnes could not be delivered to it by the scheduled time because there was no stock and though it may be technically in default by not having made full payment by June 24, 1979, the time for delivery should be extended by another month, i.e., up to July 27, 1979. The respondent however, took a different view of the default and wrote to the Bank of India on October 16, 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 MT and that it, Therefore, invoked the bank guarantee to the extent of Rs. 1,60,000 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 October 21, 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 S.T.C. will not enforce the forfeiture of earnest money and encash the bank guarantee. It is in these 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.

21. 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 the payment by July 24, 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 was a breach of contract by the plaintiff.

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

23. 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 these 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 footing similar 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, *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.* [1978] 1 All ER 976 : [1978] 1 QB 159 (CA).

24. 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 Edn., para. 2620).

25. 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 S.T.C., 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 disputes 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.

26. In the present case, the guarantee given by the Bank of India is in the following terms :

" The State Trdg. Corpn. of India Ltd.,

Chandralok, 36, Janpath,

New Delhi-110 001.

Dear Sirs,

In consideration of your having agreed to register the raw rubber requirement of Premier Tyres Ltd., Merchant Chamber, 41, Sir V. Thackersey Marg, Bombay-400 020 (hereinafter referred to as " actual user/allottee"). We, the Bank of India,

70-80, M. Gandhi Road, Bombay, as also our successors and assigns, bind ourselves unconditionally and irrevocably that in the event of any default/failure on the part of the actual user/allottee 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/allottee and notwithstanding any contestation by actual user/allottee or existence of any dispute whatsoever between you and the actual user/allottee pay forthwith to you or to your successors and assigns any sum up to Rs. 3,60,000 (rupees three lakhs sixty thousand) that you may demand.

We agree that a letter from you under the signature of any one of your Chief Marketing Managers to the effect that there has been a default/ failure on the part of the actual user/allottee shall be final, conclusive, and binding on us....."

27. It will be noticed that by this guarantee the 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, In *Edward Owen Engg. Ltd. v. Barclays Bank International* [1978] 1 All ER 976 : [1978] 1 QB 159 (CA), 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 the English supplier but of the Libyan customers. The Court of Appeal, though prima facie of the opinion that the Libyan customers were in default and the English supplier was not at fault, nevertheless held that performance guarantees are virtually promissory notes payable on demand, and it was said at page 983 thus [1978] 1 (QB) 172 :

" So there it is :- Barclays Bank international has given its guarantee --I might almost say its 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 obligations of the bank."

28. A still nearer parallel is to be found in *Texmaco Ltd. Vs. State Bank of India and Others*, , in which the S.T.C. was sought to be enjoined from Realizing money on a bank guarantee. The guarantee in that case was more or less in similar terms as in the instant case ; the bank had irrevocably and unconditionally guaranteed the payment in the event of Tex-maco's failure to perform their contractual obligation on first demand without any contestation, demur or protest. The decision of the S.T.C. 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 [1979] 83 CWN 807 (*Texmaco Ltd. v. State Bank of India*). Similar arguments as in that case were raised before us by Mr. Ray, namely, that there was a prima facie dispute and that there was special equity in favor of the appellant and that the action of the S.T.C. was arbitrary

and it could not just invoke the bank guarantee without proving prima facie that there was a default committed by the appellant in the carrying out of the contract which had been entered into between the appellant and the respondent for supply of 360 MT 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 were very wide indeed. The performance guarantee was a distinct and separate contract to which only the respondent State Bank of India, and the STC were parties and under the terms of the performance guarantee, the STC was 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 the special leave application against the Texmaco judgment was dismissed in limine 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 enjoined 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 more or less similar to what obtained in the Texmaco's case. A Division Bench of this court in Harparshad and Co. Ltd. Vs. Sudarshan Steel Mills, Punjab National Bank, , accepted the correctness of Texmaco Ltd. Vs. State Bank of India and Others, , and it was emphasised that the guarantor 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 Harparshad's case 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 Harparshad's case 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 the default had been committed. The Bench found that the 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 a notice that the default had been committed was to be given by the beneficiary and as the said terms had not been fulfilled ,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.

29. Reference in this connection may also be made to Texmaco's case ; 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 or demur. 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 or not 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 the respondent which is a distinct one. If the two contracts are treated as distinct, as in law they are, it is immediately clear that the respondent could be restrained from invoking the bank guarantee only 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 injunct 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 a bank guarantee on the ground that the 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 the contract between the parties....." These observations have our full agreement.

30. 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 imp ledged 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 injuncting 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 injuncted 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 by restraining the respondent from Realizing the bank guarantee as against the direct attempt to seek an injunction against the bank is the difference between tweedledum and tweedledee and also suffers from the infirmity of unacceptability on the ground of the well-known rule of construction that what cannot 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.

31. 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 the New York Supreme Court, Shientag J., which met with the approval of the Court of Appeal in *Edward Owen's case* [1978] 1 All ER 976 ; [1978] 1 QB 159, 169 (CA) :

".....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 bankers' 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 (at p. 169) : " 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. This rule is necessary to preserve the efficiency of the letter of credit as an instrument for the financing of trade."

32. 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 the 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 for 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 a contract of indemnity, u/s 124 of the Contract Act, which requires two persons. 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 promisor himself or the conduct of another person--vide *Punjab National Bank Ltd. v. Shri Vikram Cotton Mills Ltd.* [1970] 40 Comp Cas 927 . Here the bank guarantee is a contract between the bank and the 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.

" 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 Edn.), Vol. II, " Specific Contracts ".

" 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 from the seller from dealing with the letter of credit if the goods are defective....."--vide page 102 of Halsbury's Laws of England (4th Edn.), Vol. 3.

33. In the present case, the guarantor 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.

34. 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 contracts under international trade while the instant case is one 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 the 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 canalisation 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 the foreign contract. 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 bankers' 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 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 *Minerals and Metals Trading Corporation of India Ltd. v. Surajbalaram Sethi* [1970] 74 CWN 990 (Cal). The whole significance and importance of the bank guarantee lies, inasmuch 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 (sic). 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 the 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 an 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 court's interference in the encashment of the 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 an irrevocable 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 great economic loss to the society and the nation. In this matter of keeping the stream of trade unhindered 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 a buyer 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 the matter of internal trade rather than international trade. In the case of the latter, the laws of the foreign country may

sometimes be so discriminatory and harsh towards foreigners that the denial to issue an injunction may probably cause serious harm, and yet a broader consideration of international trade and inter-dependence of world economy compels the court from refraining to issue an 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 the courts unless in the exceptional case of a probable case of fraud. No such exceptional case is made out to take a different line.

35. As the judgment was reserved, Mr. Tandon, counsel for the appellant, appeared and informed us that a judgment in I.A. No. 2454 of 1980 in Suit No. 225/80 has been announced on August 12, 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. 30 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 was in no way concerned with any contractual dispute which may have arisen between the buyer and seller. In that 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 encased at the rate of Rs. 1,000 per metric tonne as provided in the agreement and this part was affirmed by the learned judge by his order dated August 12, 1980. 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 an integral part of the main contract.

36. We must also appreciate that this is an appeal against the interim order refusing injunction. The learned judge has on a 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 November 8, 1979, passed in I.A. No. 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.

37. As a result, the appeal is dismissed with costs.