

\* IN THE HIGH COURT OF DELHI AT NEW DELHI

+ FAO(OS) No.536/2010 & CM No.15324/2010

HUMBOLDT WEDAG INDIA PVT. LTD. ....Appellant through  
Mr. Preetesh Kapur  
with Ms. Anuradha,  
Mr. Om Prakash &  
Mr. Sampath, Advs.

versus

DALMIA CEMENT VENTURES LTD. ....Respondent through  
Mr. Jayant Bhushan,  
Sr. Adv. with Mr. Anil  
Dutt & Ms. Saman  
Ahsam, Advs. for  
Respondent No.1

% Date of Hearing : September 23, 2010

Date of Decision : September 24, 2010

CORAM:

\* HON'BLE MR. JUSTICE VIKRAMAJIT SEN

HON'BLE MS. JUSTICE MUKTA GUPTA

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|--------------------------------------------------------------------------|-----|
| 1. Whether reporters of local papers may be allowed to see the Judgment? | No  |
| 2. To be referred to the Reporter or not?                                | Yes |
| 3. Whether the Judgment should be reported in the Digest?                | Yes |

VIKRAMAJIT SEN, J.

1. This Appeal challenges the legality of the Order dated 4.8.2010 passed by the learned Single Judge under Section 9 of the Arbitration & Conciliation Act, 1996 (A&C Act for short) restraining Respondent No.2 from invoking the subject Bank Guarantees, viz. dated 19.3.2008 for ₹ 2,50,00,000/- and 26.3.2008 for ₹ 14,10,80,000/-, aggregating to ₹ 16,60,80,000/-.

By Order dated 24.9.2009, the learned Single Judge then seised of the docket, observed that – “the contract awarded to the petitioner was cancelled by the respondent due to recession. The respondent had given advances to the petitioner to the extent the petitioner has executed the bank guarantee in favour of the respondent. There is no doubt that in view of the cancellation of the contract, the petitioner would be liable to recover expenses/liability in terms of the contract from the respondent. Looking into the high cost (around Rs.27 lac) of maintenance of bank guarantee of Rs.16,60,80,000/- and that the petitioner has staked a claim of Rs.28 crores, I consider it would be appropriate that the petitioner instead of giving a bank guarantee of full amount of Rs.16,60,80,000/- gives a bank guarantee of Rs.9 crore so as to reduce the expenses of the petitioner. .... The respondent shall not encash this bank guarantee till further orders. The interim order passed is conditional on furnishing fresh bank guarantee”. By the impugned Order dated 4.8.2010, the succeeding learned Single Judge has been pleased to “dismiss the present petition and direct the petitioner to provide further bank guarantee in the sum of Rs. 7,60,80,000/- within a period of four weeks from today on the same terms and conditions on which the petitioner’s earlier bank guarantee were provided. The bank

guarantee of Rs.9 crores furnished by the petitioner and the additional bank guarantee shall be kept alive till the passing of further orders by the arbitral tribunal. The restraint against the encashment of the bank guarantee contained in the order dated 24.09.2009 stands vacated”.

2. At the time of the hearings before us, it was admitted that the Bank Guarantee for ₹ 9,00,00,000/- (nine crores) has been invoked and payment of this amount has been received in the coffers of the Respondent. We are, therefore, now concerned only with the Bank Guarantee for the sum of ₹ 7,60,80,000/- required to be furnished as per the impugned Order.

3. The facts of the case are that the parties had entered into a contract pertaining to the manufacture and supply of Raw Mill, Pyro Processing, Clinker Mill Systems for 4500 tpd Split located cement project in Belgaum, Gulbarga 1, Gulbarga 2 & Meghalaya. The Appellant was the supplier and Respondent No.1 was the purchaser. The contract for both design and engineering as well as equipment supply was ₹ 166.08 crores; after amendment on 15.9.2008, the price was reduced to ₹ 159.08 crores. Simultaneous with the Appellant furnishing Bank Guarantees for the aforementioned ₹ 16,60,80,000/-, Respondent No.1 paid ₹ 96,93,100/- on 23.5.2008 and ₹ 62,14,900/- on 24.9.2008. The subject

Contract contains a Clause which sets out that neither party shall be considered to be in default with respect to its obligations under the Contract to the extent that the default is due to any event of *force majeure*. However, no event of *force majeure* was to relieve either party from liability for an obligation which had arisen before its occurrence. Clause 26 of the contract protects the rights of the Respondent to terminate it by thirty days' notice in which contingency "a reasonable amount in respect of loss of profit not exceeding 10% of the total amount due under the Contract to the extent that such profit has not already been paid" is provided for. We are not concerned with the claim for damages. It bears repetition that the Appellant has furnished Bank Guarantee for the total sum of ₹ 16,60,80,000/- and, in return, has received this very sum in cash from the Respondent as an advance.

4. The salient stipulation in the two Bank Guarantees read thus:-

We, Deutsche Bank AG, having its Registered Office at 222, Kodak House, Dr. D.N. Road, Fort, Mumbai – 400 001 (hereinafter referred to as the 'Bank', which expression shall unless repugnant to the context or meaning thereof mean and include its successors in interest, executors, administrators and permitted assigns), at the request of the Supplier, hereby irrevocably and unconditionally guarantee and

undertake to pay you, Dalmia Cement Ventures Ltd., the Purchaser, without demur, dispute or delay, on your first written demand, an amount or amounts not exceeding a total sum of Rs.14,10,80,000/- (INR Fourteen Crores Ten Lacs and Eighty Thousands only), **provided that you confirm to us at the same time in writing, that the Supplier has not fulfilled all or any of his Contractual Obligations** as stipulated in the Contract including but not limited to delivery of the agreed quantity and/or the shipment of the Product on the date agreed upon with the Purchaser. The liability of the Bank as contained herein shall automatically get reduced proportionately to the value of such parts of the Product (including all machinery and equipment) that may have been successfully delivered as certified by the Purchaser based on which the advance or on account amount paid by the Purchaser have been adjusted in the corresponding invoices of the Supplier raised with respect to the Contract. This Bank Guarantee shall expire latest on 04<sup>th</sup> July, 2009 (Guarantee Expiry Date), unless the Purchaser discharges the Guarantee earlier.

(emphasis supplied)

5. By letter dated 17.11.2008, Respondent No.1 informed the Appellant that – “Due to the unforeseen financial crisis across the world, leading to difficulties in financial closures of Projects, we are canceling our Order for Raw Mill, Cement Mill for Plant 3 and Pyro for Plant 4. .... The Raw Mill, Cement Mill and Pyro of Plant 1 and the Raw Mill, Cement Mill of Plant 2 are being

presently put on "Hold" due to the uncertainties in the economy". Thereafter, there have been several exchanges of correspondence. This constrained the Appellant to file the aforementioned Petition under Section 9 of the A&C Act on 3.7.2009. We have already narrated the substance of the Orders dated 24.9.2009 as well as the impugned Order dated 4.8.2010.

6. Eventually, by letter dated 20.8.2010, Respondent No.1 informed its Banker/Respondent No.2 that the contract between the parties had been terminated. A brief summation of Court proceedings in OMP No.343/2009 was given. The Bank Guarantee for the sum of ₹ 9,00,00,000/- was invoked, stating – "we confirm that the Supplier has not fulfilled its contractual obligations". The sum of ₹ 9,00,00,000/- has been paid by Respondent No.2 to Respondent No.1. The Bank Guarantee for the sum of ₹ 7,60,80,000/- furnishable by the Appellant in favour of Respondent No.1 in compliance with the impugned Order is not yet furnished.

7. The law regarding invocation/encashment of Letters of Credit and Bank Guarantees has been crystallized as far back as in 1970 in *Tarapore and Co., Madras -vs- V.O Tractors Export Moscow*, AIR 1970 SC 891. Their Lordships elaborately and perspicuously explained the scope and ambit of judicial interference in such matters in these words--

The scope of an irrevocable letter of credit is explained thus in Halsbury's Laws of England (Vol.34, Paragraph 319 at page 185):

“It is often made a condition of a mercantile contract that the buyer shall pay for the goods by means of a confirmed credit, and it is then the duty of the buyer to procure his bank, known as the issuing or originating bank, to issue an irrevocable credit in favour of the seller by which the bank undertakes to the seller, either directly or through another bank in the seller's country known as the correspondent or negotiating bank, to accept drafts drawn upon it for the price of the goods, against tender by the seller of the shipping documents. The contractual relationship between the issuing bank and the buyer is defined by the terms of the agreement between them under which the letter opening the credit is issued; and as between the seller and the bank, the issue of the credit duly notified to the seller creates a new contractual nexus and renders the bank directly liable to the seller to pay the purchase price or to accept the bill of exchange upon tender of the documents. The contract thus created between the seller and the bank is separate from, although ancillary to, the original contract between the buyer and the seller, by reason of the bank's undertaking to the seller, which is absolute. Thus the bank is not entitled to rely upon terms of the contract

between the buyer and the seller which might permit the buyer to reject the goods and to refuse payment therefor; and, conversely, the buyer is not entitled to an injunction restraining the seller from dealing with the letter of credit if the goods are defective.”

Chalmers on “Bills of Exchange” explains the legal position in these words

“The modern commercial credit serves to interpose between a buyer and seller a third person of un-questioned solvency, almost invariably a banker of international repute; the banker on the instructions of the buyer issues the letter of credit and thereby undertakes to act as paymaster upon the seller performing the conditions set out in it. A letter of credit may be in any one of a number of specialised forms and contains the undertaking of the banker to honour all bills of exchange drawn thereunder. It can hardly be over-emphasised that the banker is not bound or entitled to honour such bills of exchange unless they, and such accompanying documents as may be required thereunder, are in exact compliance with the terms of the credit. Such documents must be scrutinised with meticulous care, the maxim *de minimis non curat lex* cannot be invoked where payment is made by the letter of credit. If the seller has complied with the terms of the letter of credit, however, there is an absolute obligation upon the banker to pay irrespective

of any disputes there may be between the buyer and the seller as to whether the goods are up to contract or not”

Similar are the views expressed in 'Practice and Law of Banking' by H.B. Sheldon, "the Law of Bankers Commercial Credits" by H.C. Gutteridge, "the Law relating to Commercial Letters of Credit" by A.G. Devis' "the Law Relating to Bankers' Letters of Credit" by B.C. Mitra and in several other text books read to us by Mr. Mohan Kumaramangalam, learned Counsel for the Russian Firm. The legal position as set out above was not controverted by Mr. M.C. Satalvad, learned Counsel for the Indian Firm. So far as the Bank of India is concerned it admitted its liability to honour the letter of credit and expressed its willingness to abide by its terms. It took the same position before the High Court.

.....

10. A case somewhat similar to the one before us came up for consideration before the Queens Bench Division in England in Hamzeh Walas and Sons v. British Imex Industries Ltd., 1958-2 QB 127. Therein the plaintiffs, a Jordanian firm contracted to purchase from the defendants, a British firm, a large quantity of reinforced steel rods, to be delivered in two instalments. Payment was to be effected by opening in favour of the defendants of two confirmed letters of credit with the Midland Bank Ltd., in London, one in respect of each instalment. The letters of credit were duly

opened and the first was realised by the defendants on the delivery of the first instalment. The plaintiffs complained that that instalment was defective and sought an injunction to bar the defendants from realizing the second letter of credit. Donovan, J., the Trial Judge refused the application. In appeal Jenkins, Sellers and Pearce L., JJ. Confirmed the decision of the Trial Judge. In the course of his judgment Jenkins, L.J., who spoke for the Court observed thus:

“We have been referred to a number of authorities, and it seems to be plain enough that the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes upon the banker an absolute obligation to pay, irrespective of any dispute there may be between the parties as to 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.

There is this to be remembered, too. A vendor of goods selling against a confirmed letter of credit is selling under the assurance that nothing will prevent him from receiving the price. That is of no mean advantage when goods manufactured in one country are being sold in another. It is, furthermore, to be observed that vendors are

often reselling goods bought from third parties. When they are doing that, and when they are being paid by a confirmed letter of credit, their practice is - and I think it was followed by the defendants in this case--to finance the payments necessary to be made to their suppliers against the letter of credit. That system of financing these operations, as I see it, would break down completely if a dispute as between the vendor and the purchaser was to have the effect of "freezing" if I may use that expression the sum in respect of which the letter of credit was opened."

In *Urquhart Lindsay and Co. Ltd. v. Eastern Bank Ltd.*, 1922-1 KB 318 the King's Bench held that the refusal of the defendants bank to take and pay for the particular bills on presentation of the proper documents constituted a repudiation of the contract as a whole and that the plaintiffs were entitled to damages arising from such a breach. It may be noted that in that case the price quoted in the invoices was objected to by the buyer and he had notified his objection to the bank. But under the terms of the letter of credit the bank was required to make payments on the basis of the invoices tendered by the seller. The court held that if the buyers had an enforceable claim that adjustment must be made by way of refund by the seller and not by the way of retention by the buyer.

11. Similar opinions have been expressed by the American Courts. The leading American case on the subject is Dulien Steel Products Inc., of Washington v. Bankers Trust Co., Federal Reporter 2<sup>nd</sup> Series, 298 p.836. The facts of that case are as follows:

The plaintiffs, Dulien Steel Products Inc., of Washington, contracted to sell steel scrap to the European Iron and Steel Company. The transaction was put through M/s. Marco Polo Group Project, Ltd. who were entitled to commission for arranging the transaction. For the payment of the the commission to Marco Polo, plaintiffs procured an irrevocable letter of credit from Seattle First National Bank. As desired by Marco Polo this letter of credit was opened in favour of one Sica. The defendant-bankers confirmed that letter of credit. The credit stipulated for payment against (1) a receipt of Sica for the amount of the credit and (2) a notification of Seattle Bank to the defendants that the plaintiffs had negotiated documents evidencing the shipment of the goods. Sica tendered the stipulated receipt and Seattle Bank informed the defendants that the Dulien had negotiated documentary drafts. Meanwhile after further negotiations between the plaintiffs and the vendees the price of the goods sold was reduced and consequently the commission payable to Marco Polo stood reduced but the defendants were not informed of this fact. Only after notifying the defendants about the

negotiation of the drafts drawn under the contract of sale, the Seattle Bank informed the defendants about the changes underlying the transaction and asked them not to pay Sica the full amount of the credit. The defendants were also informed that Sica was merely a nominee of Marco Polo and has no rights of his own to the sum of the credit. Sica, however, claimed payment of the full amount of the credit. The defendants asked further instructions from Seattle Bank but despite Seattle Bank's instructions decided to comply with Sica's request. After informing Seattle Bank of their intention, they paid Sica the full amount of the credit. Plaintiffs thereupon brought an action in the District Court of New York for the recovery of the moneys paid to Sica. The action was dismissed by the trial Court and that decision was affirmed by the Court of Appeals. That decision establishes the well known principle that the letter of credit is independent of and unqualified by the contract of sale or underlying transaction. The autonomy of an irrevocable letter of credit is entitled to protection. As a rule Courts refrain from interfering with that autonomy.

8. In *United Commercial Bank -vs- Bank of India*, (1981) 2 SCC 766 : AIR 1981 SC 1426 the Apex Court has reiterated that Courts ought not to grant injunctions restraining the performance of the contractual obligations flowing out of a

Letter of Credit or a Bank Guarantee between one Bank and another. It observed 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. A banker issuing or confirming an irrevocable credit usually undertakes to honour drafts negotiated, or to reimburse in respect of drafts paid, by the paying or negotiating intermediate banker and the credit is thus in the hands of the beneficiary binding against the banker. A letter of credit constitute the sole contract with the banker and a bank issuing or confirming a letter of credit is not concerned with the underlying contract between the buyer and seller. Duties of a bank under a letter of credit are created by the document itself, but in any case it has the power and is subject to the limitations which are given or imposed by it, in the absence of the appropriate provisions in the letter of credit. The banker owes a duty to the buyer to ensure that the documents tendered by the sellers under a credit are complied with those for which the credit calls and which are embodied in terms of paying or negotiating bank. The description of the goods in the relative bill of exchange must be the same description in the letter of credit, that is, the

goods themselves must in each be described in identical terms, even though the goods differently described in the two documents are, in fact, the same. It is the description of the goods that is all important and if the description is not identical it is the paying bank's duty to refuse payment.

9. The Respondent has placed reliance on ***U.P. Coop. Federation –vs- Singh Consultants & Engineers (P) Ltd.***, (1988) 1 SCC 174 which also enunciates the law on this subject. The Lordships opined thus:-

45. The letter of credit has been developed over hundreds of years of international trade. It was most commonly used in conjunction with the sale of goods between geographically distant parties. It was intended to facilitate the transfer of goods between distant and unfamiliar buyer and seller. It was found difficult for the seller to rely upon the credit of an unknown customer. It was also found difficult for a buyer to pay for goods prior to their delivery. The Bank's letter of credit came into existence to bridge this gap. In such transactions, the seller (beneficiary) received payment from issuing bank when he presents a demand as per terms of the documents. The bank must pay if the documents are in order and the terms of credit are satisfied. The bank, however, was not allowed to determine whether the seller had

actually shipped the goods or whether the goods conformed to the requirements of the contract. Any dispute between the buyer and the seller must be settled between themselves. The courts, however, carved out an exception to this rule of absolute independence. The courts held that if there has been fraud in the transaction the bank could dishonour beneficiary's demand for payment. The courts have generally permitted dishonour only on the fraud of the beneficiary, not the fraud of somebody else.

46. It was perhaps for the first time the said exception of fraud to the rule of absolute independence of the letter of credit has been applied by Shientag, J. in the American case of *Sztejn v. J. Henry Schroder Banking Corporation* (31 NYS 2d 631). Mr. Sztejn wanted to buy some bristles from India and so he entered into a deal with an Indian seller to sell him a quantity. The issuing Bank issued a letter of credit to the Indian seller that provided that, upon receipt of appropriate documents, the bank would pay for the shipment. Somehow, Mr. Sztejn discovered that the shipment made was not crates of bristles, but crates of worthless material and rubbish. He went to his bank which probably informed him that the letter of credit was an independent undertaking of the bank and it must pay.

.....

53. Whether it is a traditional letter of credit or a new device like performance bond or performance guarantee, the obligation of banks appears to be the same. If documentary credits are irrevocable and independent, the banks must pay when demand is made. Since the bank pledges its own credit involving its reputation, it has no defence except in the case of fraud. The bank's obligations of course should not be extended to protect the unscrupulous seller, that is, the seller 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 egregious nature as to vitiate the entire underlying transaction. It is fraud of the beneficiary, not the fraud of somebody else. If the bank detects with a minimal investigation the fraudulent action of the seller, the payment could be refused. The bank cannot be compelled to honour the credit in such cases. But it may be very difficult for the bank to take a decision on the alleged fraudulent action. In such cases, it would be proper for the bank to ask the buyer to approach the court for an injunction.

10. In ***Hindustan Steel Works Construction Ltd. -vs- Tarapore & Co.***, AIR 1996 SC 2268 : (1996) 5 SCC 34, the following observations are to be found:

We are, therefore, of the opinion that the correct position of law is that commitment of banks must be honoured free from interference by the courts and it is only in exceptional cases, that is to say, **in case of fraud or in a case where irretrievable injustice would be done if bank guarantee is allowed to be encashed, the court should interfere.** In this case fraud has not been pleaded and the relief for injunction was sought by the contractor/Respondent 1 on the ground that special equities or the special circumstances of the case required it. The special circumstances and/or special equities which have been pleaded in this case are that there is a serious dispute on the question as to who has committed breach of the contract, that the contractor has a counter-claim against the appellant, that the disputes between the parties have been referred to the arbitrators and that no amount can be said to be due and payable by the contractor to the appellant till the arbitrators declare their award. In our opinion, these factors are not sufficient to make this case an exceptional case justifying interference by restraining the appellant from enforcing the bank guarantees. The High Court was, therefore, not right in restraining the appellant from enforcing the bank guarantees.

11. Mr. Jayant Bhushan has contended that the exposition of the law made by the Supreme Court does not mandate that the

assertions articulated in the Instrument of Invocation have to be made good to the concerned Bank by the Claimant; a Statement of Claim is all that is envisaged by law. He has relied on *U.P. State Sugar Corporation -vs- Sumac International Limited*, AIR 1997 SC 1644 : (1997) 1 SCC 568 and *Dwarikesh Sugar Industries Ltd. -vs- Prem Heavy Engineering Works (P) Ltd.*, (1997) 6 Supreme Court Cases 450 in this regard, which we shall shortly advert to.

12. In ***Sumac International***, the circumstances in which the invocation of a Bank Guarantee or payments made pursuant thereto could be interdicted, had been Restated. While spelling out the essentials of fraud and/or irretrievable injustice in this context, the Apex Court had recorded the following observations which have been read before us by Mr. Jayant Bhushan, learned Senior Counsel for Respondent No.1, to posit that fraud stands restricted or confined only to the invocation of the Bank Guarantee :-

12. The law relating to invocation of such bank guarantees is by now well settled. When in the course of commercial dealings an unconditional bank guarantee is given or accepted, the beneficiary is entitled to realize such a bank guarantee in terms thereof irrespective of any pending disputes. The bank giving such a guarantee is bound to honour it as per its terms

irrespective of any dispute raised by its customer. The very purpose of giving such a bank guarantee would otherwise be defeated. The courts should, therefore, be slow in granting an injunction to restrain the realization of such a bank guarantee. The courts have carved out only two exceptions. A fraud in connection with such a bank guarantee would vitiate the very foundation of such a bank guarantee. Hence if there is such a fraud of which the beneficiary seeks to take advantage, he can be restrained from doing so. The second exception relates to cases where allowing the encashment of an unconditional bank guarantee would result in irretrievable harm or injustice to one of the parties concerned. Since in most cases payment of money under such a bank guarantee would adversely affect the bank and its customer at whose instance the guarantee is given, the harm or injustice contemplated under this head must be of such an exceptional and irretrievable nature as would override the terms of the guarantee and the adverse effect of such an injunction on commercial dealings in the country. The two grounds are not necessarily connected, though both may coexist in some cases.

.....

14. On the question of irretrievable injury which is the second exception to the rule against granting of injunctions when unconditional bank

guarantees are sought to be realised the court said in the above case that the irretrievable injury must be of the kind which was the subject-matter of the decision in the Itek Corpn. case, 566 Fed Supp 1210. In that case an exporter in USA entered into an agreement with the Imperial Government of Iran and sought an order terminating its liability on stand by letters of credit issued by an American Bank in favour of an Iranian Bank as part of the contract. The relief was sought on account of the situation created after the Iranian revolution when the American Government cancelled the export licences in relation to Iran and the Iranian Government had forcibly taken 52 American citizens as hostages. The US Government had blocked all Iranian assets under the jurisdiction of United States and had cancelled the export contract. The Court upheld the contention of the exporter that any claim for damages against the purchaser if decreed by the American Courts would not be executable in Iran under these circumstances and realisation of the bank guarantee/letters of credit would cause irreparable harm to the plaintiff. This contention was upheld. To avail of this exception, therefore, exceptional circumstances which make it impossible for the guarantor to reimburse himself if he ultimately succeeds, will have to be decisively established. Clearly, a mere apprehension that the other party will not

be able to pay, is not enough. In Itek case (supra) there was a certainty on this issue. Secondly, there was good reason, in that case for the Court to be prima facie satisfied that the guarantors i.e. the bank and its customer would be found entitled to receive the amount paid under the guarantee.

15. Our attention was invited to a number of decisions on this issue -- among them, to Larsen & Toubro Ltd. v. Maharashtra SEB, (1995) 6 SCC 68 and Hindustan Steel Workers Construction Ltd. v. G.S. Atwal & Co. (Engineers) (P) Ltd., (1995) 6 SCC 76 as also to National Thermal Power Corpn. Ltd. v. Flowmore (P) Ltd., (1995) 4 SCC 515. The latest decision is in the case of State of Maharashtra v. National Construction Co., (1996) 1 SCC 735 where this Court has summed up the position by stating:

The rule is well established that a bank issuing a guarantee is not concerned with the underlying contract between the parties to the contract. The duty of the bank under a performance guarantee is created by the document itself. Once the documents are in order the bank giving the guarantee must honour the same and make payment ordinarily unless there is an allegation of fraud or the like. The courts will not interfere directly or indirectly to withhold payment, otherwise

trust in commerce internal and international would be irreparably damaged. But that does not mean that the parties to the underlying contract cannot settle the disputes with respect to allegations of breach by resorting to litigation or arbitration as stipulated in the contract. The remedy arising ex contractu is not barred and the cause of action for the same is independent of enforcement of the guarantee.

13. Reference may also be made by Mr. Bhushan to the observations of B.N.Kirpal, J. (as the Chief Justice of India then was) in ***Dwarikesh***, and the terse deprecation contained therein to the Courts' interdicting the normal operation of Bank Guarantees and Letters of Credit.

21. Numerous decisions of this Court rendered over a span of nearly two decades have laid down and reiterated the principles which the courts must apply while considering the question whether to grant an injunction which has the effect of restraining the encashment of a bank guarantee. We do not think it necessary to burden this judgment by referring to all of them. Some of the more recent pronouncements on this point where the earlier decisions have been considered and reiterated are Svenska

Handelsbanken v. Indian Charge Chrome, Larsen & Toubro Ltd. v. Maharashtra SEB, Hindustan Steel Workers Construction Ltd. v. G.S. Atwal & Co. (Engineers) (P) Ltd. and U.P. State Sugar Corpn. v. Sumac International Ltd. The general principle which has been laid down by this Court has been summarised in the case of U.P. State Sugar Corpn. As follows: (SCC p.574, para 12)

The law relating to invocation of such bank guarantees is by now well settled. When in the course of commercial dealings an unconditional bank guarantee is given or accepted, the beneficiary is entitled to realize such a bank guarantee in terms thereof irrespective of any pending disputes. The bank giving such a guarantee is bound to honour it as per its terms irrespective of any dispute raised by its customer. The very purpose of giving such a bank guarantee would otherwise be defeated. The courts should, therefore, be slow in granting an injunction to restrain the realization of such a bank guarantee. The courts have carved out only two exceptions. A fraud in

connection with such a bank guarantee would vitiate the very foundation of such a bank guarantee. Hence if there is such a fraud of which the beneficiary seeks to take the advantage, he can be restrained from doing so. The second exception relates to cases where allowing the encashment of an unconditional bank guarantee would result in irretrievable harm or injustice to one of the parties concerned. Since in most cases payment of money under such a bank guarantee would adversely affect the bank and its customer at whose instance the guarantee is given, the harm or injustice contemplated under this head must be of such an exceptional and irretrievable nature as would override the terms of the guarantee and the adverse effect of such an injunction on commercial dealings in the country.

Dealing with the question of fraud it has been held that fraud has to be an established fraud. The following observations of Sir John Donaldson, M.R. In *Bolivinter Oil SA v. Chase Manhattan Bank* are apposite:

... The wholly exceptional case where an injunction may be granted is where it is proved that the bank knows that any demand for payment already made or which may thereafter be made will clearly be fraudulent. But the evidence must be clear, both as to the fact of fraud and as to the bank's knowledge. It would certainly not normally be sufficient that this rests on the uncorroborated statement of the customer, for irreparable damage can be done to a bank's credit in the relatively brief time which must elapse between the granting of such an injunction and an application by the bank to have it discharged.

The aforesaid passage was approved and followed by this Court in *U.P. Coop. Federation Ltd. v. Singh Consultants and Engineers (P) Ltd.*

22. The second exception to the rule of granting injunction, i.e., the resulting of irretrievable injury, has to be such a circumstance which would make it impossible for the guarantor to reimburse himself, if he ultimately succeeds. This will have to be decisively established and it must be proved to the satisfaction of the court that

there would be no possibility whatsoever of the recovery of the amount from the beneficiary, by way of restitution.

28. Coming to the allegation of fraud, it is an admitted fact that in the plaint itself, there was no such allegation. It was initially only in the first application for the grant of injunction that in a paragraph it has been mentioned that the appellant herein had invoked the bank guarantee arbitrarily. This application contains no facts or particulars in support of the allegation of fraud. A similar bald averment alleging fraud is also contained in the second application for injunction relating to Bank Guarantee No. 40/47. This is not a case where Defendant 1 had at any time alleged fraud prior to the filing of injunction application. The main contract, pursuant to which the bank guarantees were issued, was not sought to be avoided by alleging fraud, nor was it at any point of time alleged that the bank guarantee was issued because any fraud had been played by the appellant. We have no manner of doubt that the bald assertion of fraud had been made solely with a view to obtain an order of injunction. In the absence of established fraud and not a mere allegation of fraud and that also having been made only in the injunction application, the court could not, in the present case, have granted an

injunction relating to the encashment of the bank guarantees.

14. Mr. Preetesh Kapur, learned counsel for the Appellant, has placed reliance on *Hindustan Construction Co. -vs- State of Bihar*, (1999) 8 SCC 436. In that case, the concerned Bank had agreed “unconditionally and irrevocably to guarantee as primary obligator and not as surety merely, the payment of the Executive Engineer .... on his first demand without his first claim to the contractor, in the amount not exceeding Rs 10,00,000 (Rupees ten lakhs only) in the event that the obligations expressed in the said clause of the above-mentioned contract have not been fulfilled by the contractor giving the right of claim to the employer for recovery of the whole or part of the advance mobilisation loan from the contractor under the contract”. It was in those circumstances that their Lordships enunciated the law in the following manner:-

14. This condition clearly refers to the original contract between HCCL and the defendants and postulates that if the obligations, expressed in the contract, are not fulfilled by HCCL giving to the defendants the right to claim recovery of the whole or part of the “advance mobilisation loan”, then the Bank would pay the amount due under the guarantee to the Executive Engineer. By referring specifically to clause 9, the Bank has qualified its liability to pay the amount

covered by the guarantee relating to “advance mobilisation loan” to the Executive Engineer only if the obligations under the contract were not fulfilled by HCCL or HCCL has misappropriated any portion of the “advance mobilisation loan”. It is in these circumstances that the aforesaid clause would operate and the whole of the amount covered by the “mobilisation advance” would become payable on demand. The bank guarantee thus could be invoked only in the circumstances referred to in clause 9 whereunder the amount would become payable only if the obligations are not fulfilled or there is misappropriation. That being so, the bank guarantee could not be said to be unconditional or unequivocal in terms so that the defendants could be said to have had an unfettered right to invoke that guarantee and demand immediate payment thereof from the Bank. This aspect of the matter was wholly ignored by the High Court and it unnecessarily interfered with the order of injunction, granted by the Single Judge, by which the defendants were restrained from invoking the bank guarantee.

.....

22. We have scrutinised the facts pleaded by the parties in respect of both the bank guarantees as also the documents filed before us and we are, prima facie, of the opinion that the lapse was on the part of the defendants who were not possessed of sufficient funds for completion of the work. The allegation of the defendants that HCCL itself had abandoned the work

does not, prima facie, appear to be correct and it is for this reason that we are of the positive view that the “special equities” are wholly in favour of HCCL.

15. It will be apposite to allude to *Federal Bank Limited -vs- V.M. Jog Engineering Limited*, (2001) 1 SCC 663 wherein the Apex Court had recorded the following exposition of the law --

In several judgments of this Court, it has been held that courts ought not to grant injunction to restrain encashment of bank guarantees or letters of credit. Two exceptions have been mentioned - (i) fraud, and (ii) irretrievable damage. If the plaintiff is prima facie able to establish that the case comes within these two exceptions, temporary injunction under Order 39 Rule 1 CPC can be issued. It has also been held that the contract of the bank guarantee or the letter of credit is independent of the main contract between the seller and the buyer. This is also clear from Articles 3 and 4 of UCP (1983 Revision). In case of an irrevocable bank guarantee or letter of credit the buyer cannot obtain injunction against the banker on the ground that there was a breach of the contract by the seller. The bank is to honour the demand for encashment if the seller prima facie complies with the terms of bank guarantee or the letter of credit, namely, if the seller produces

the documents enumerated in the bank guarantee or the letter of credit. If the bank is satisfied on the face of the documents that they are in conformity with the list of documents mentioned in the bank guarantee or the letter of credit and there is no discrepancy, it is bound to honour the demand of the seller for encashment. While doing so it must take reasonable care. It is not permissible for the bank to refuse payment on the ground that the buyer is claiming that there is a breach of contract. Nor can the bank try to decide this question of breach at that stage and refuse payment to the seller. Its obligation under the document having nothing to do with any dispute as to breach of contract between the seller and the buyer.

16. It is evident that despite the clarity and consistency in the decisions of the Hon'ble Supreme Court, injunctions for the encashment of Bank Guarantees and Letters of Credit are nevertheless granted. Very recently in *National Highways Authority of India –vs- Ganga Enterprises*, (2003) 7 SCC 410, the Apex Court again adumbrated the law on this subject in the following passage:

It is settled law that a contract of guarantee is a complete and separate contract by itself. The law regarding enforcement of an “on-

demand bank guarantee” is very clear. If the enforcement is in terms of the guarantee, then courts must not interfere with the enforcement of bank guarantee. The court can only interfere if the invocation is against the terms of the guarantee or if there is any fraud. Courts cannot restrain invocation of an “on-demand guarantee” in accordance with its terms by looking at terms of the underlying contract. The existence or non-existence of an underlying contract becomes irrelevant when the invocation is in terms of the bank guarantee. The bank guarantee stipulated that if the bid was withdrawn within 120 days or if the performance security was not given or if an agreement was not signed, the guarantee could be enforced. The bank guarantee was enforced because the bid was withdrawn within 120 days. Therefore, it could not be said that the invocation of the bank guarantee was against the terms of the bank guarantee. If it was in terms of the bank guarantee, one fails to understand as to how the High Court could say that the guarantee could not have been invoked. If the guarantee was rightly invoked, there was no question of directing refund as has been done by the High Court.

17. From the above discussion, it is manifestly clear that there is no room for debate that the Courts are not to interfere with the encashment of the Letter of Credit or the Bank Guarantee unless the case falls within the purview of exceptions laid down by the Apex Court. The first exception which has been carved out by the Courts is that the fraud perpetrated must be of egregious nature meaning that the said fraud would lead to gross injustice which shakes the conscience of the Court and the said fraud should be known to the parties and the concerned Bank. If the said fraud is manifest or evident, the Court can restrain the encashment of the bank guarantee. In ***U.P. Cooperation Federation*** also it was held that the fraud pleaded must be of an egregious nature so as to vitiate the entire underlying transaction of the Bank Guarantee. It is fraud of the beneficiary and not the fraud of somebody else that would impel the Court to grant the Order of injunction as asked for.

18. To counter to the argument of Mr. Jayant Bhushan to the effect that fraud has been restricted by the Supreme Court to the opening of the Bank Guarantee, Mr. Kapur has drawn our attention to paragraph 18 of ***Hindustan Steel Works*** :-

18. What Mukherji, J. has stated in para 34 of his judgment, namely, that: "It is only in exceptional cases that is to say in case of fraud or in case irretrievable injustice be done, the courts should interfere" is really

the ratio of the decision of this Court in *U.P. Coop. Federation Ltd* (1988) 1 SCC 174. Therefore, fraud cannot be said to be the only exception. In a case where the party approaching the court is able to establish that in view of special equities in his favour if injunction as requested is not granted then he would suffer irretrievable injustice, the court can and would interfere. It may be pointed out that fraud which is recognised as an exception is the fraud by one of the parties to the underlying contract and which has the effect of vitiating the entire underlying transaction. A demand by the beneficiary under the bank guarantee may become fraudulent not because of any fraud committed by the beneficiary while executing the underlying contract but it may become so because of subsequent events or circumstances. We see no good reason why the courts should not restrain a person making such a fraudulent demand from enforcing a bank guarantee.

Predicated on this paragraph, it is posited that fraud throughout the dealings between the parties is relevant and there is no basis or justification for restricting fraud only to the opening of the Bank Guarantee, as Mr. Bhushan has sought to contend. Having carefully cogitated upon the contrary contentions, our understanding of the law is that any fraud committed at any stage of the dealings between the parties is a relevant factor to be kept in perspective before granting or declining an injunction against the invocation of the Bank Guarantee. Of course, the

fraud must be of egregious proportions so as to warrant the exceptional and extraordinary interference with the contractual obligations resting on a Bank Guarantee. It must be borne in mind that in almost all cases only the beneficiary and the banker are *privy* to an unconditional Bank Guarantee. We are mindful of the fact that it is Respondent No.1 who had put an end to a part of a contract and kept another part in abeyance. It is trite that fraud vitiates all solemn acts. *Prima facie*, therefore, it was incorrect and fraudulent for Respondent No.1 to state to its Banker/Respondent No.2 that the Appellant had not fulfilled its contractual obligations. Accordingly, it appears to us that the learned Single Judge has committed an error of law in coming to the conclusion that a fraud of egregious nature had not been disclosed by the Appellant which warranted the passing of the injunction prayed for.

19. We must also deal with the argument made by Mr. Kapur that the Order dated 24.9.2009 could not have been varied by the impugned Order. The earlier Order as has already been adumbrated, permitted the Appellant to substitute the two Bank Guarantees by a fresh Bank Guarantee of ₹ 9,00,00,000/-, in respect of which Respondent No.1 had been restrained from taking action for its encashment. Mr. Bhushan started with his submission that a restitution can always be granted by a Court

on the strength of *Kavita Trehan -vs- Balsara Hygiene Products Ltd.*, (1994) 5 SCC 380 and *South Eastern Coalfields Ltd. -vs- State of MP*, (2003) 8 SCC 648 and, therefore, it was of little consequence whether the initial Order was Interim or Final. Mr. Bhushan is also right in arguing that the earlier Order would have been Final had the Petition itself been disposed of on that date. The argument of Mr. Kapur that the Order dated 24.9.2009 is invariable and unchangeable is rejected.

20. There is no gainsaying that injunctions are in the species of equitable relief. At the present moment, as against the advance/mobilization payment of the supply contract, a sum of ₹ 9,00,00,000/- stands adjusted. Theoretically and conceivably, either party may succeed in proving their claims against the other. It does not appear to us to be equitable to ordain that the party rescinding the contract should be placed in a position where the advance paid should be restituted to it in full measure. So far as the Appellant/Supplier is concerned, he is, at present, retaining the sum of ₹ 7,60,80,000/- *albeit* that a Bank Guarantee for this very sum has been made available.

21. We, therefore, direct the Appellant to furnish a Bank Guarantee of ₹ 7.60 crore and to ensure that the said Bank Guarantee of ₹ 7,60,80,000/- remains current for a period of ninety days after the passing of the Arbitral Award. We clarify

that the Arbitral Tribunal shall be free to pass directions in respect of the Bank Guarantee as it considers expedient, lawful and just. The concluding paragraph of the impugned Order is ambiguous on the question of whether the Bank Guarantee in the sum of ₹ 7,60,80,000/- can be invoked or not. If the learned Single Judge was of the opinion that it could be encashed, he need not have ordered for the furnishing of a Bank Guarantee and could easily have clarified the position or simply directed the Petitioner/Appellant to pay this amount to the Respondent. In this way, restitution would have been brought about. We think that the learned Single Judge had intended that the Bank Guarantee for ₹ 7,60,80,000/- should be kept alive to await the Orders of the Arbitral Tribunal. This, in any case, seems to us to maintain and balance the equities between the parties.

22. The Appeal along with pending application is disposed off in these terms.

23. There shall be no order as to costs.

( VIKRAMAJIT SEN )  
JUDGE

( MUKTA GUPTA )  
JUDGE

September 24, 2010  
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