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IN THE HIGH COURT OF DELHI AT NEW DELHI

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Date of decision : January 21, 2015

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FAO(OS) 36/2015

SVEC CONSTRUCTIONS LTD.

..... Appellant

Represented by: Ms.Perna Singh, Advocate with
Mr.Guntur Pramod Kumar and
Mr.Prashant Mathur, Advocates

versus

BHARTIYA RAIL BIJLEE COMPANY
LTD. & ANR.

..... Respondents

Represented by: None

CORAM:

HON'BLE MR. JUSTICE PRADEEP NANDRAJOG

HON'BLE MS. JUSTICE PRATIBHA RANI

PRADEEP NANDRAJOG, J. (ORAL)

CM No.1228-29/2015

Allowed.

FAO (OS) No.36/2015

1. The law concerning grant of an injunction on a bank guarantee could be stated thus : if egregious fraud or irretrievable injury or special equity could be shown, then alone would a Court be justified in granting an injunction to restrain the beneficiary from invoking the bank guarantee, and if invoked, to restrain the issuing bank from paying under the bank guarantee.

2. 'Fraud', 'irretrievable injury' and 'special equity' are expressions found in a catena of judicial opinions penned by Learned and Hon'ble Judges and notwithstanding a plethora of case law on the subject, the debate goes on.

3. Where the guarantee is limited (on its terms) we have no problem, for the enforcement of the guarantee has to be within the conditions (limitations) contained in the guarantee. But where a guarantee is couched in a language which makes it unconditional and the guarantor binds himself to give money to the beneficiary on demand, without demur or protest; and the guarantor is not even permitted to probe into the dispute between the parties, an area of fertile litigation has grown because most common law jurisdictions recognize primacy to justice as an integral part of law enforcement.

4. Though opinions on bank guarantees span half a century, we plunge mid-stream and commence our discussion with the celebrated decision of the Supreme Court reported as 1987 (2) SCALE 1149 U.P.Coop.Federation Ltd. Vs. Singh Consultants & Engrs. (P) Ltd. The decision has noted the prior landmark decisions on the subject and throws considerable light on what would be '*special circumstances*' or '*special equity*' justifying issuance of an injunction to restrain the bank from paying under the guarantee issued by it, which decision has been constantly followed in latter decisions of the Supreme Court.

5. Two guarantees, one a performance guarantee and the other by way of security for monies advanced were the subject matter before the Supreme Court in an action for injunction.

6. Holding that the language of the two guarantees made it crystal clear that the guarantees were unconditional, the Supreme Court proceeded to note prior decisions and culled out the exceptions whereunder a Court would be justified in issuing an injunction restraining invocation or payment under an unconditional guarantee.

7. The Supreme Court noted that 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. That it was intended to facilitate the transfer of goods between distant and unfamiliar buyer and unknown customer. It was noted that it was difficult for a buyer to pay for goods prior to their delivery. The bank's letter of credit came into existence to bridge the gap. In such transactions, the seller (beneficiary) receives 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 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.

8. The reason of the aforementioned opinion is obvious. The letter of credit is a contract. The bank promises to pay the '*beneficiary*' – traditionally a seller of goods – on demand if the beneficiary presents whatever documents may be required by the letter. They are normally the only two parties involved in the contract. The bank which issues a letter of credit acts as a principal, not as agent for its customer, and engages its own credit. The letter of credit thus evidences an irrevocable obligation to honour the draft presented by the beneficiary upon compliance with the terms of the credit. The Supreme Court noted that whether it is a traditional letter of credit or a new device like performance bond or performance guarantee, the obligation of the guarantor (usually a bank) is the same.

9. One exception to the rule of absolute independence of a bank guarantee was thereafter noted. It was traced to the opinion of Shientag J. in

a case in U.S.A. reported as Sztejn Vs. J.Henry Schroder Banking Corpn. 31 NYS 2d 631.

10. The year was 1941. Injunctions against payments under letters of credit were not issued by courts. Mr.Sztejn had wanted to buy quality bristles from Indian and struck a deal for a quantity with an Indian seller. Payment was secured to the seller by means of a letter of credit which provided that upon receipt of appropriate documents the bank would pay for the shipment. Somehow Mr.Sztejn discovered that the shipment made was crates of worthless rubbish. He went to the bank with a request not to pay and received a response that being a letter of credit it was an independent undertaking of the bank and hence it must pay. Mr.Sztejn went to Court. He sought an injunction against the issuing bank to restrain it from paying under the letter of credit. He made, prima facie, good his allegations that as against the contracted goods i.e. bristles, worthless material and was shipped. Noting a fraud in the transaction the Court issued an injunction against payment.

11. The Supreme Court noted that the exception of fraud created by Shientag J. had been subsequently accepted by Courts in England in the decisions reported as (i) (1958) 2 QBD 127 Hamzen Milas & Sons. v. British Imex Industries Ltd., (ii) (1977) 2 All E. 862 R.D. Harbottle Mercantile) Ltd. & Anr. v. National West Minister Bank Ltd., (iii) (1978) 1 All E.R. 976 Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.; and (iv) (1982) 2 All E.R.720 UCM (Investment) v. Royal Bank of India. The last case is of the House of Lords where Lord Diplock in his speech said (at p.725):

“The whole commercial purpose for which the system of confirmed irrevocable documentary credits has been developed

in international trade is to give to the seller an assured right to be paid before he parts with control of the goods and that does not permit of the any dispute with the buyer as to the performance of the contract of sale being used as a ground of non-payment or reduction or deferment of payment.

*To this general statement of principles as to the contractual obligations of the confirming bank to the seller, there is one established exception: that is, where the seller, for the purpose of drawing on the credit, fraudulently presents to the confirming bank documents that contain, expressly or by implication, material representations of fact that to his knowledge are untrue. Although there does not appear among the English authorities any case in which this exception has been applied, it is well established in the American cases, of which the leading or 'landmark' case is *Sztejn Vs. Henry Schroder Banking Corpn.* This judgment of the New York Court of Appeals was referred to with approval by the English Court of Appeal *Edward Owen Engineering Ltd. V. Barolays Bank International Ltd.* though this was actually a case about a performance bond under which a bank assumes obligations to a buyer analogous to those assumed by a confirming bank to the seller under a documentary credit. The exception for fraud on the part of the beneficiary seeking to avail himself to the credit is a clear application to the maxim *ex trupi cause non oriture* or if plain English is to be preferred, 'fraud unravels all', the courts will not allow their process to be used by a dishonest person to carry out a fraud."*

12. We may note that the exception of fraud has been codified in Sections 5-114 of the Uniform Commercial Code.

13. With respect to the question : Can an injunction be issued upon a plea that the beneficiary is in breach of the contract? Law on the subject was thereafter noted by the Supreme Court with reference to a decision of the Court of Appeal in England reported as (1985) 2 Q.B.D. 127 *Hamzon Melas & Sons Vs. British Imex Industries Ltd.*, wherein it was held the principle was that commercial trading must go on the solemn guarantee either by the

letter of credit or by bank guarantee or irrespective of any dispute between the contracting parties whether or not the goods were upon contract.

14. With reference to the decision of the House of Lords in UCM (Investment)'s case (supra) viz-a-viz a plea of fraud in invoking the guarantee and the opposite party being in breach of its obligations under the contract, the Supreme Court summarised the legal position as under:-

“The whole commercial purpose for which the system of confirmed irrevocable documentary credits had been developed in international trade was to give the seller of goods an assured right to be paid before he parted with control of the goods without risk of the payment being refused, reduced or deferred because of a dispute with the buyer. It followed that the contractual duty owed by an issuing or confirming bank to the buyer to honour the credit notified by him on presentation of apparently confirming documents by the seller was matched by a corresponding contractual liability on the part of the bank to the bank to the seller to pay him the amount of the credit on presentation of the documents. The bank's duty to the seller was only vitiated if there was fraud on the part of the seller.”

15. Thereafter, the decision noted that the irretrievable injustice was also a ground on which an injunction could be issued. The decision of Lord Denning M.R. reported as 1966(2) Lloyd's List Law Reports 495 Eliau & Rabbath (Trading as Elian & J. Rabbath Vs. Massas & Ors. was noted, where an injunction was issued to prevent irretrievable injustice.

16. Being relevant for a clarification of the issue raised in the instant case, the facts and the reason for the opinion in Eliu's case needs to be noted.

17. The first defendants' Greek motor vessel 'Flora M' was chartered by Lebanese charterers for carriage of plaintiffs' cargo (consigned to Hungary) from Bairut to Rijeka. Discharge was delayed at Rijeka and Ship owners exercised lien on cargo in respect of demurrage. Third defendant bank put

up guarantee in London in favour of second defendant (first defendants' London agents) to secure release of cargo. There was a claim by Yugoslavians to distrain on goods, involving ship in further delay and master of Flora M, on lifting original lien, immediately exercised another lien in respect of extra delay (which was raised when Hungarian buyers put up 2000). Two years later, shipowners claimed arbitration with charterers to assess demurrage for which first lien was exercised and claimed to enforce guarantee. Plaintiff claimed declaration that guarantee was not valid and injunction to restrain shipowners or their agents from enforcing guarantee. First and the second defendants appealed against the injunction granted by Blain, J. It was held by the Court of Appeal that it was a special case in which the Court should grant an injunction to prevent what might be irretrievable injustice. Lord Denning, M.R., observed that although the shippers were not parties to the bank guarantee, nevertheless they had a most important interest in it. If the Midland Bank Ltd., paid under this guarantee, they would claim against the Lebanese bank who in turn would claim against the shippers. The shippers would certainly be debited with the account. On being so debited, they would have to sue the shipowners for breach of their promise express or implied, to release the goods. Lord Denning, M.R., further posed the question were the shippers to be forced to take that course? Or can they shortcircuit the dispute by suing the shipowners at once for an injunction? He further observed at page 497 of the Report that this was a special case in which injunction should be granted. Lord Denning, M.R. went on to observe that there was a prima facie ground for saying that on telex messages which passed (and indeed, on the first three lines of the guarantee) the shipowners promised that, if the bank guarantee was given, they would release the goods. He further observed that the only lien they had in mind at that time was the lien for demurrage. But

would anyone suppose that the goods would be held for another lien? It can well be argued that the guarantee was given on the understanding that the lien was raised and no further lien imposed and that when the shipowners, in breach of that understanding imposed a further lien, they were disabled from acting on the guarantee.

18. The expression that it was a special case in which the Courts should grant an injunction to prevent what might be an irretrievable injustice caught the eye of the Supreme Court. In para 16 of the decision the Supreme Court noted that Lord Denning M.R. treated this as a very special case and in a later decision, being the opinion reported as 1978 (1) All. E.R. 976 Edward Owen Engineering Ltd. Vs. Barclays Bank International Ltd. Lord Denning M.R. expressed his views on the matter.

19. The facts of Edward Owen's case were that English suppliers entered into a contract with Libyan buyers to supply goods to them in Libya. The contract was subject to a condition precedent that the plaintiffs would arrange for a performance bond or guarantee to be given, for 10% of the contract price, guaranteeing performance of their obligations under the contract. Accordingly, the plaintiffs instructed the defendants, their bankers to give on their behalf a performance guarantee for the sum of £50,203. Acting on those instructions the defendants requested a bank in Libya to issue a performance bond to the buyers for that sum, and promised the Libyan bank that they would pay the amount of the guarantee on first demand, without any conditions or proof. The Libyan bank issued a letter of guarantee for £50,203 to the buyers. The contract between the plaintiffs and the buyers provided for payment of the price of the goods supplied by a confirmed letter of credit. The letter of credit opened by the buyers was not a confirmed letter of credit and did not, therefore, comply with contract.

Because of that non-compliance the plaintiffs repudiated the contract. Although it was the buyers who appeared to be in default and not the plaintiffs, the buyers nevertheless claimed on the guarantee given by the Libyan bank who in turn claimed against the defendants on the guarantee they had given. The plaintiffs issued a writ against the defendants claiming an injunction to restrain them from paying any sum under the performance guarantee. A judge granted the plaintiffs an interim injunction in the terms of the injunction claimed by the writ but subsequently another judge discharged the injunction. The plaintiff appealed to the court of appeal. Lord Denning M.R. held that the justice was right in discharging the injunction and reiterated that the bank must honour its commitment.

20. Therefore, in para 24 of its decision the Supreme Court clarified that it appears that special equities (circumstances) mentioned therein i.e. in Eliau's case (supra) may be a situation where the injunction was sought for to prevent injustice which was irretrievable in the words of Lord Denning M.R. In para 28 of the decision it was categorically opined :

“It is not the decision that there should be a prima facie case. In order to restrain the operation either of irrevocable letter of credit or of confirmed letter of credit or of bank guarantee, there should be serious dispute and there should be good prima facie case of fraud and special equities in the form of preventing irretrievable injustice between the parties. Otherwise the very purpose of bank guarantees would be negated and the fabric of trading operation will get jeopardised.”

21. Keeping in view the aforesaid law on the subject we note that the appellant was the successful bidder for construction of buildings concerning a thermal power project. The works were allotted at a price of ₹135,92,92,717/- crores.

22. At the asking of the appellant, the State Bank of India issued a bank guarantee in sum of ₹3,32,95,000/- towards performance. Bank guarantees were issued thereafter from time to time in sum of ₹5,43,70,000/- as and when mobilization advance was paid by the owner of the works to the appellant.

23. Case of the appellant is that the owner of the work was in default on various grounds : (i) not acquiring full land and thereafter placed the same at the disposal of the appellant to facilitate construction work; (ii) not identifying the boundaries of the acquired land resulting in people trespassing and squatting on the land; (iii) not making available electricity for construction purposes; (iv) steel to be used in RCC works required to be supplied by the owner of the work not be supplied; (v) the area being a naxalite prone area resulting in the staff of the appellant being threatened and intimidated and no police protection being made available; and (vi) quarrying being prohibited in the area in question, requiring sand, gravel etc. to be procured from outside at a higher cost resulting in price escalation.

24. As per the appellant whereas it was ready and willing to discharge all its obligations under the contract it was the respondent which had entirely contributed to the default and thus the termination notice dated January 14, 2014 was questionable.

25. It is not the case of the appellant that there is a fraud of an egregious nature in invocation of the bank guarantee. It is urged that irretrievable injustice/injury which would be caused to the appellant would be, it being blacklisted. It is urged that no bank would ever issue a bank guarantee at the asking of the appellant if the performance guarantee and twelve other bank guarantees towards mobilization advance are permitted to be invoked.

26. Unfortunately for the appellant the law on the subject as noted above would not entitle the appellant to the grant of an injunction as prayed for.

27. The view taken by the learned Single Judge in the impugned order dated January 19, 2015 to vacate the ad-interim injunction granted on February 04, 2014 is correct in law. Petition filed by the appellant under Section 9 of the Arbitration and Conciliation Act, 1996 registered as OMP No.153/2014 has been rightly dismissed.

28. No costs.

29. Copy of the order be supplied dasti today itself to learned counsel for the appellant under signatures of the Court Master.

CM No.1227/2015

Dismissed as infructuous.

(PRADEEP NANDRAJOG)
JUDGE

(PRATIBHA RANI)
JUDGE

JANUARY 21, 2015
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