

*** IN THE HIGH COURT OF DELHI AT NEW DELHI**

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Judgment reserved on: 13th October, 2015
Judgment delivered on: 02nd November, 2015

FAO (OS) 537/2015

Zillion Infra Projects (P) Ltd.

..... Petitioner

versus

Fab-Tech Works & Constructions Pvt Ltd. & anr.....Respondents

Advocates who appeared in this case:

For the Petitioner : Ms Swati Bhushan Sharma with Mr Naveen Sharma, Advocates
For the Respondent : Mr M. Dutta with Mr Rajendra Beniwal, Advocates.

CORAM:-

**HON'BLE MR JUSTICE BADAR DURREZ AHMED
HON'BLE MR JUSTICE SANJEEV SACHDEVA**

JUDGMENT

SANJEEV SACHDEVA, J

1. The appellant impugns order dated 28.08.2015 passed in OMP(I) 489/2015 whereby the learned single judge, in a petition under section 9 of the Arbitration and Conciliation Act, 1996 (hereinafter referred to as the Act), has been pleased to restrain encashment of the bank guarantee No. 17/14 dated 28th May, 2014.

2. The Appellant had issued a Letter of Intent in favour of the Respondent No. 1 on 23.04.2014 for transportation of materials from

BHEL/B & R/Client Stores/Storage Yard to work site, erection, alignment, testing and commissioning, trial, operation and handing over of boiler structure and its auxiliaries including piping, insulation, final painting etc. for unit 4 of 2 x 660 MW NTPC, Mouda Project, District Nagpur on back to back basis.

3. In terms of the letter of intent, the Respondent No. 1 submitted with the Appellants, the Bank Guarantee No. 17/14 dated 28th May, 2014 with an aggregate limit of Rs. 36,64,392/-, in lieu of Cash Deposit against Security and due and faithful Performance of the said contract. The Bank Guarantee was issued by Canara Bank / Respondent No. 2.

4. The Bank Guarantee stipulated as under:

“We, CANARA BANK a body registered / constituted under the Banking Company (Acquisition and transfer of undertaking) Act, 1970 having registered and Head Office at 112, J.C. Road, Bangalore 560002 and Branch at Narayandas Chambers, Doodh Naka, Ulhasnagar – 421005 (MS) hereinafter called “the Bank”) at the request of the Contractor & with the intent to bind the Bank and its successors and permitted assigns, do hereby unconditionally & irrevocably guarantee of payment to the company of the unpaid balance upto an aggregate limit of Rs. 36,64,392/- (Rupees Thirty Six Lacs Sixty Four Thousand Three Hundred and ninety Two only) AND undertake to pay to the Company on demand and without

protest and demur the unpaid balance of said Security cum Performance Guarantee subject to the aggregate limit of the aforesaid Rs. 36,64,392/- (Rupees Thirty Six Lacs Sixty Four Thousand Three Hundred and ninety Two only).”

5. The appellant invoked the bank guarantee by its letter dated 25.08.2015 in the following terms:

“As M/s Fab-Tech Works & Constructions Pvt. Ltd has failed to honour the terms of the work contract awarded to them vide letter no. ZIPL: Fabtech:2014-15:LOA:01 dated April 23, 2014, we hereby invoke the Bank Guarantee no. BG-17/14 dated 28/5/2014 issued by you and request you to pay us the full sum guaranteed under this Bank Guarantee.....”

6. On 27.08.2015, the Respondent No 1 filed the Petition under section 9 of the Act seeking, *inter-alia*, an order restraining the appellant from encashing the Bank Guarantee and further restraining the respondent No. 2 from releasing any payment to the Appellant herein.

7. By the impugned order dated 28.08.2015, the learned single judge has been pleased to restrain the Appellant and the Respondent No. 2 from encashing the Bank Guarantee.

8. The Appellant has filed the present appeal contending that the restraint order issued by the learned single judge cannot be sustained in view of the settled legal principles governing Bank Guarantees.

9. The principles with respect to grant of an injunction in Bank Guarantee cases have been settled by the Supreme Court of India.

10. The Supreme Court in the case of **U.P. Coop. Federation Ltd. v. Singh Consultants and Engineers (P) Ltd.** (1988) 1 SCC 174 has held that in order to restrain the operation either of irrevocable letter of credit or of confirmed letter of credit or of Bank Guarantee, there should be serious dispute and there should be good prima facie case of fraud and special equities in the form of preventing irretrievable injustice between the parties. Otherwise, the very purpose of Bank Guarantees would be negated and the fabric of trading operation will get jeopardised. The Supreme Court further held that commitments of banks must be honoured free from interference by the courts. Otherwise, trust in commerce internal and international would be irreparably damaged. It is only in exceptional cases, that is, to say in cases of fraud and irretrievable injustice that the court could interfere.

11. The Supreme Court in the case of **U.P. State Sugar Corpn. v. Sumac International Ltd.,** (1997) 1 SCC 568 held that 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 be, therefore, 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, which 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.

12. The Supreme Court in **U.P. State Sugar Corpn. (Supra)** further held that where fraud is alleged it must be a clear fraud of which the bank has notice. The fraud must be of an egregious nature such as to vitiate the entire underlying transaction. Explaining the kind of fraud to be fraud of a nature that may absolve a bank from honouring its guarantee. 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. However, the evidence must be clear both as to the fact of fraud and as to the bank's knowledge.

13. On the question of irretrievable injury, the Supreme Court in **U.P. State Sugar Corpn. (Supra)**, held that to avail of this exception, the party seeking an injunction would have to show that exceptional circumstances exist which make it impossible for the guarantor to reimburse himself if he ultimately succeeds and this will have to be decisively established. Clearly, a mere apprehension that the other party will not be able to pay, is not enough. The existence of any dispute between the parties to the contract is not a ground for issuing an injunction to restrain the enforcement of Bank Guarantees. There must be a fraud in connection with the Bank Guarantee.

14. The Supreme Court in the case of **I.T.C. Ltd. v. Debts Recovery Appellate Tribunal**, (1998) 2 SCC 70 has laid down as under:

“22. What is necessary for the Bank to refuse payment is a case of clear “fraud” and the Bank's knowledge as to such fraud (Bolivinter Oil S.A. v. Chase Manhattan Bank N.A.) [(1984) 1 LLR 392]. As pointed by Lord Denning and Lord Lane in Edward Owen [(1978) 1 All ER 976 : 1978 QB 159 : (1977) 3 WLR 764, CA], the Bank cannot refuse payment merely because according to it the claim was “dishonest” or “suspicious” or it appeared to be a sharp practice but it must be established as “fraud”. Lord Ackner in United Trading Corpn. S.A. & Murray Clayton Ltd. v. Allied Arab Bank Ltd. [(1985) 2 LLR 554, CA] held that the Bank could object to pay not because the demand was not “honestly” made but was made fraudulently. Waller, J. in *Türkiye v. Bank of China* [(1996) 2 LLR 611] [LLR pp. (617-618)] said that the question was whether the demand for payment was “fraudulent”. Mere allegations and counter-allegations between the parties as to breach of contract, non-payment of advances or non-supply of machinery did not amount to fraud.”

15. The Supreme Court further in the case of **Himadri Chemicals Industries Ltd. v. Coal Tar Refining Co.**, (2007) 8 SCC 110 after considering various Supreme Court decisions laid down the following principles for grant or refusal to grant of injunction to restrain enforcement of a Bank Guarantee or a letter of credit:

- (i) While dealing with an application for injunction in the course of commercial dealings, and when an unconditional Bank Guarantee or letter of credit is given or accepted, the beneficiary is entitled to realise such a Bank Guarantee or a letter of credit in terms thereof irrespective of any pending disputes relating to the terms of the contract.
- (ii) The bank giving such guarantee is bound to honour it as per its terms irrespective of any dispute raised by its customer.
- (iii) The courts should be slow in granting an order of injunction to restrain the realisation of a Bank Guarantee or a letter of credit.
- (iv) Since a Bank Guarantee or a letter of credit is an independent and a separate contract and is absolute in nature, the existence of any dispute between the parties to the contract is not a ground for issuing an order of injunction to restrain enforcement of Bank Guarantees or letters of credit.
- (v) Fraud of an egregious nature which would vitiate the very foundation of such a Bank Guarantee or letter of credit and the beneficiary seeks to take advantage of the situation.
- (vi) Allowing encashment of an unconditional Bank Guarantee or a letter of credit would result in

irretrievable harm or injustice to one of the parties concerned.

16. Keeping these principles in mind and applying the same on the facts of this case, the conclusion that can be drawn is that the impugned order dated 28.08.2015 cannot be sustained.

17. The petition under section 9 was filed after the Bank Guarantee was invoked and as such, the contract of guarantee had come into operation. The Respondent no. 1 in the petition under section 9 of the Act has not even raised a plea of fraud leave alone aver facts to establish the plea of fraud. There is not even the plea of “irretrievable injury” or “irretrievable injustice”. The Respondent No. 1 has not even pleaded “special equities”. The Respondent No. 1 apart from raising disputes on merits has merely stated that “*the Petitioner would be highly prejudiced if the Bank Guarantee is invoked and the properties are alienated as the Petitioner has a prima facie case and is likely to succeed in the Arbitration*” and “*that the petitioner would in fact, suffer irreparable loss, in case the reliefs prayed for are not granted*”. Since none of the three mandatory pleas, fraud, irretrievable injury/injustice or special equities has been pleaded, the respondent no. 1 is not entitled to any order of restraint from invocation of bank guarantee.

18. The unconditional Bank Guarantee has been provided in the course of commercial dealings. The appellant is entitled to realize the Bank Guarantee in terms thereof irrespective of any pending dispute. The Respondent No. 2/bank is bound to honour the Bank Guarantee as per its terms irrespective of any dispute raised by its customer/the Respondent No. 1. Otherwise, the very purpose of giving such a Bank Guarantee would be defeated. The existence of any dispute between the Appellant and Respondent No. 1 with regard to the underlying contract cannot be a ground for issuing an injunction to restrain the enforcement of the Bank Guarantee.

19. The reliance placed by the Respondent No. 1 on the judgments of the Supreme Court in **U.P. State Sugar Corporation (Supra), BSES (Now Reliance Energy Limited) Versus Fenner India Limited (2006) 2 SCC 728**, and **Vinitec Electronics Private Limited Versus HCL Infosystems Limited JT 2007 (12) SC 480**, is misplaced. None of the judgments are applicable in the facts of the present case or support the case of the Respondent No.1.

20. In view of the above, the impugned order dated 28.08.2015 restraining the Appellant and respondent No. 2 from encashing the bank guarantee cannot be sustained and is accordingly set aside. The appeal is allowed.

21. We make it clear, that we have examined the appeal only from the standpoint of the law governing the invocation of bank guarantees and have not considered the merits of the claim of the respondent No. 1. This order would be without prejudice to the rights and contentions of the parties before the arbitral tribunal, the other reliefs claimed by the Respondent No. 1 in the section 9 petition and the right of the Respondent No. 1 to seek restitution of the amount covered by the Bank Guarantee in case the invocation is ultimately held to be invalid. There shall be no orders as to costs.

SANJEEV SACHDEVA, J

BADAR DURREZ AHMED, J

November 02, 2015

HJ