

HON'BLE SRI JUSTICE C.V. NAGARJUNA REDDY
&
HON'BLE SRI JUSTICE G. SHYAM PRASAD

C.M.A.No.667 of 2016

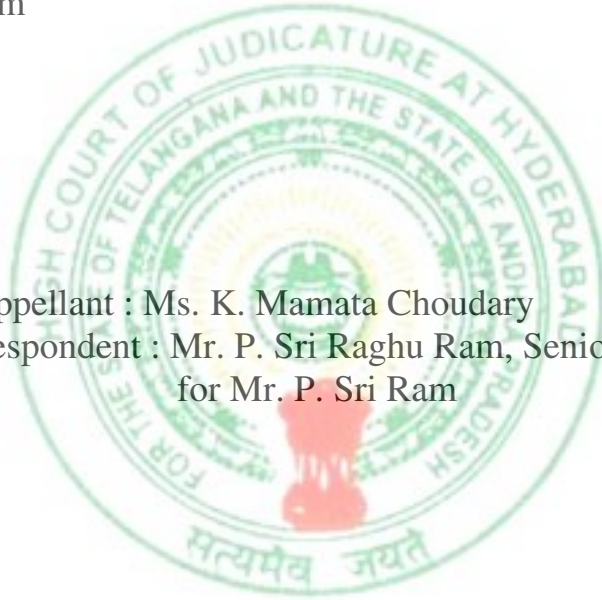
Date : 29-09-2016

M/s. AMRCL-HARSHA (JV),
Represented by its Authorised Representative,
Mr. Subbarami Reddy,
Hyderabad .. Appellant

And

Visakhapatnam Port Trust,
Represented by its Board of Trustees,
Visakhapatnam .. Respondent

Counsel for appellant : Ms. K. Mamata Choudary
Counsel for respondent : Mr. P. Sri Raghu Ram, Senior Counsel
for Mr. P. Sri Ram



The Court made the following :

JUDGMENT: (*per* Hon'ble Sri Justice C.V. Nagarjuna Reddy)

The unsuccessful petitioner in A.O.P.No.669 of 2013 on the file of the learned II Additional District Judge, Visakhapatnam, is the appellant in this Civil Miscellaneous Appeal.

We need to state a few relevant facts culminating in filing of this appeal. The appellant, a joint venture company, has successfully bagged the contract work described as "Extension of West qua Return end in replacement of existing RCC Lay by Jetty for coastal cargo and berthing of Harbour Crafts and construction of Return end for shore protection at the proposed WQ-8 end in the Northern arm of Inner Harbour of Visakhapatnam Port". For convenience, the said work is hereinafter referred to as "the contract work". The respondent has issued a Letter of Intent (LOI) dated 18-9-2010. On 22-9-2010 it has issued the work order as per which the contract period is stipulated as 18 months. A formal contract was executed between the parties on 27-11-2010. As per the contract, the appellant has furnished four Bank Guarantees, the details of which are as under :

1. Bank Guarantee dated 3-6-2010 for a sum of Rs.62,50,200/- towards EMD for due fulfillment of the terms and conditions contained in the Tender.
2. Bank Guarantee, dated 8-10-2010 for a sum of Rs.1,83,76,045/-, representing 5% of the contract value, for satisfactory performance of the work.

3. Bank Guarantee dated 23-11-2010 for a sum of Rs.2,36,00,000/-, towards mobilization advance for bringing the plant and machinery to the site of work.
4. Bank Guarantee for Security Deposit in lieu of cash deposit, dated 2-12-2011, for Rs.1,83,76,048/-, representing 5% of the contract value, for satisfactory performance of the work.

As per the contract, the work was to commence on 28-10-2010 and completed by 5-4-2012. When the work was not completed, the respondent has issued show cause notice dated 9-7-2013 indicating its intention to unilaterally rescind the contract due to slow progress of work and to entrust the execution of the balance works to a third party at the cost and risk of the appellant. On 19-7-2013, the respondent has issued a e-notice inviting Tenders. The appellant filed the above mentioned Arbitration O.P. under Section 9 of the Arbitration and Conciliation Act, 1996 (for short "the Act"), for an injunction against re-tendering of the balance works and invocation and encashment of the Bank Guarantees by the respondent. On 24-7-2013, ad interim injunction against invoking and encashment of Bank Guarantees was granted by the lower Court. The respondent entered appearance and contested the O.P. which was eventually dismissed by order dated 9-8-2016. The appellant filed W.P.No.28733 of 2016, with the grievance that the lower Court has not furnished certified copy of the order and that meanwhile the respondent was trying to encash the

Bank Guarantees. The said Writ Petition was disposed of by order dated 26-8-2016 with the direction to the lower Court to furnish a certified copy of the order in the O.P. A direction was also issued in the said order directing the lower Court to dispose of I.A.No.656 of 2016 filed for interim protection by 29-8-2016. It was further directed that the respondent shall not invoke and encash the Bank Guarantees till disposal of the said I.A. After a certified copy of the order in the A.O.P. was furnished, the appellant has filed the present Civil Miscellaneous Appeal.

Ms. K. Mamata, the learned Counsel for the appellant, submitted that due to the failure of the respondent to fulfill its contractual obligations, the appellant was unable to complete the work within the stipulated time and also the extended time and that therefore having committed defaults on various grounds in complying with its contractual obligations, the respondent cannot be permitted to take advantage of its own defaults and encash the Bank Guarantees furnished by the appellant. She has further submitted that special equities by way of 'irretrievable injustice' being one of the grounds on which an injunction order against encashment of Bank Guarantees can be granted, the lower Court has committed an error by declining the relief of injunction. She has argued that once the Bank Guarantees are invoked and encashed, the appellant will not be able to recover the loss sustained on account of such invocation as Clause 26 of the

contract prohibits grant of interest by the arbitrator. In support of her submissions, the learned Counsel has placed heavy reliance on the Judgments of the Supreme Court on **U.P. State Sugar Corporation Vs. Sumac International Ltd.¹, Hindustan Construction Company Ltd., Vs. State of Bihar², M/s. Gangotri Enterprises Ltd. Vs. Union of India³, National Highways Authority of India Vs. KMC Constructions Ltd., and another⁴, Union of India Vs. Raman Iron Foundry⁵ and ITEK Corporation Vs. The First National Bank of Boston⁶.**

Opposing the above submissions, Sri P. Sri Raghu Ram, the learned Senior Counsel, submitted that the jurisdiction of the Courts for granting an order of injunction is limited to two grounds, namely, (i) fraud, and (ii) irretrievable injustice, and that both the grounds being not in existence in the present case, the lower Court has rightly dismissed the Arbitration O.P. filed by the appellant. While denying the submission of the learned Counsel for the appellant that due to the default on the part of the respondent in complying with its contractual obligations the appellant could not complete the work within the time, he has submitted that though the appellant invoked Section 9 of the Act by filing the O.P. in July 2013, so far it has not invoked the

¹ (1997) 1 SCC 568

² (1999) 8 SCC 436

³ C.A.No.4814 of 2016, dated 5-5-2016

⁴ W.A.No.54 of 2007, dated 2-4-2007

⁵ (1974) 2 SCC 231

⁶ 566 F. Supp. 1210 (D. Mass. 1983)

remedy of Arbitration and that the present litigation is speculative in nature. In support of his submissions, the learned Senior Counsel has placed reliance on the following Judgments:

U.P. State Sugar Corporation (1-supra), Mahatma Gandhi Sahakara Sakkare Vs. National Heavy Engg. Coop. Ltd.⁷, Vinitech Electronics Pvt. Ltd. Vs. HCL Infosystems Ltd.⁸, Dwarikesh Sugar Industries Ltd. Vs. Prem Heavy Engineering Works (P) Ltd.⁹, Federal Bank Ltd. Vs. V.M. Jog Engineering Ltd. and another¹⁰, BSES Ltd. (Now Reliance Energy Ltd.) Vs. Fenner India Ltd. & another¹¹ and Hindustan Construction Company Ltd., (2-supra).

We have carefully considered the respective submissions of the learned Counsel for the parties.

The lower Court has devoted its substantial time on considering the rival pleadings of the parties regarding the aspect as to who between the two parties is responsible for non-completion of the work within the time limit. It has also arrived at a prima facie opinion that it is the appellant who is responsible for such non-completion. In our opinion, having regard to the nature of the proceedings instituted by the appellant, it is wholly unnecessary for the Court to deal with the said aspect, for, in a proceeding of this nature the Court cannot embark upon such enquiry.

⁷ (2007) 6 SCC 470

⁸ (2008) 1 SCC 544

⁹ (1997) 6 SCC 450

¹⁰ (2001) 1 SCC 663

¹¹ (2006) 2 SCC 728

The law on grant of injunctions in relation to Bank Guarantees is fairly well settled. The restriction on the Courts' power to grant injunctions against encashment of Bank Guarantees is based on the principle that commercial trading must go on, on the solemn guarantee either of the Letter of Credit or by Bank Guarantee, irrespective of any dispute between the contracting parties. This view, propounded by Lord Jenkins L.J., in **Hamzeh Melas & Sons Vs. British Imex Industries Ltd.**,¹², was repeated in all subsequent English decisions on the point (e.g, See: **R.D. Harbottle (Mercantile) Ltd. Vs. National Westminster Bank Ltd.**¹³, **Edward Owen Engineering Ltd. Vs. Barclays Bank International Ltd.**¹⁴).

The Courts have recognised only two exceptions to the principle that the beneficiary under a Bank Guarantee has unfettered right for its invocation, namely, (1) that the Bank Guarantee was obtained by fraud, or, (2) that the invocation of the Bank Guarantee would cause irretrievable injustice. Sabyasachi Mukharji, J in **U.P. Cooperative Federation Ltd. Vs. Singh Consultants and Engineers (P) Ltd.**¹⁵, in a scholarly exposition of the English and Indian law on the subject, made the following observations, at para-19:

“ Where, therefore, a bank had given a performance guarantee it was required to honour the guarantee according to

¹² (1958) 2 QBD 127

¹³ (1977) 2 All.E.R 862

¹⁴ (1978) 1 All. E.R. 976

¹⁵ (1988) 1 SCC 174

its terms and was not concerned whether either party to the contract which underlay the guarantee was in default. The only exception to that rule was where fraud by one of the parties to the underlying contract had been established and the bank had notice of the fraud....”

Referring to the Judgment of the House of Lords in **United City Merchants (Investments) Ltd. Vs. Royal Bank of Canada**¹⁶, the Court, at para-23, held, as under:

“Before, however, I deal with the decisions of India reference may be made to a decision of the House of Lords in *United City Merchants (Investments) Ltd. Vs. Royal Bank of Canada* where it was reiterated that 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 conforming documents by the seller was matched by a corresponding contractual liability on the part of 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, and the bank remained under a duty to pay the amount of the credit to the seller even if the documents presented, although conforming on their face with the terms of the credit, nevertheless contained in a statement of material fact that was not accurate. These principles must in my opinion apply in case of bank guarantees in internal trade within a country.”

The Court, having noticed some of the Judgments of the Indian Courts, including that of the Apex Court in **Tarapore & Co., Madras**

¹⁶ (1982) 2 All.E.R. 720

Vs. M/s. V/O Tractors Export, Moscow¹⁷, United Commercial Bank Vs. Bank of India¹⁸, Centax (India) Ltd. Vs. Vinmar Impex Inc,¹⁹ Texmaco Ltd. Vs. State Bank of India²⁰, State Bank of India Vs. Economic Trading Co. S.A.A.²¹, Union of India Vs. Meena Steels Ltd.²², Arul Murugan Traders Vs. Rashtriya Chemicals and Fertilizers Ltd., Bombay²³, at para-34, finally concluded as under :

“On the basis of these principles I reiterate 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 case of fraud or in case of irretrievable injustice be done, the court should interfere.”

In **U.P. State Sugar Corporation (1-supra)**, the Supreme Court did not approve of the approach of the High Court in entering into the terms of contract in order to find out whether invocation of bank guarantee was proper or not. The Apex Court observed that under the terms of contract it is stipulated that the respondent is required to give unconditional bank guarantees against advance payments as also a similar bank guarantee for due delivery of the contracted plant within the stipulated period and that in the absence of

¹⁷ (1969) 1 SCC 233

¹⁸ (1981) 2 SCC 766

¹⁹ (1986) 4 SCC 136

²⁰ AIR 1979 Cal. 44

²¹ AIR 1975 Cal. 145

²² AIR 1985 All. 282

²³ AIR 1986 Mad. 161

any fraud the appellant is entitled to realize the bank guarantees. Dealing with the question of irretrievable injury/injustice, the second exception to the rule against granting injunctions, the Supreme Court has applied the test in **ITEK Corporation (6-supra)**. It is appropriate in this context to discuss the facts in that case. An exporter in U.S.A. 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 realization of the bank guarantee/letters of credit would cause irreparable harm to the plaintiff. This contention was upheld. Referring to these facts in **ITEK Corporation (6-supra)**, the Supreme Court laid down, in para-14, as under :

“....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 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.”

After referring to the Judgments in **Larsen & Toubro Ltd. Vs. Maharashtra SEB²⁴** and **Hindustan Steel Workers Construction Ltd. Vs. G.S. Atwal & Co. (Engineers) (P) Ltd.²⁵** and also **National Thermal Power Corporation Ltd., Vs. Flowmore (P) Ltd.²⁶**, the Supreme Court relied upon the following passage in **State of Maharashtra Vs. National Construction Co.²⁷** :

“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 or 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.”

²⁴ (1995) 6 SCC 68

²⁵ (1995) 6 SCC 76

²⁶ (1995) 4 SCC 515

²⁷ (1996) 1 SCC 735

Having considered the Judgment in **Hindustan Steelworks Construction Ltd. Vs. Tarapore & Co.**²⁸ the Supreme Court, at para-16, had this to say :

“Clearly, therefore, 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. In the present case we fail to see any such fraud. The High Court seems to have come to the conclusion that the termination of the contract by the appellant and his claim that time was of the essence of the contract, are not based on the terms of the contract and, therefore, there is a fraud in the invocation of the bank guarantee. This is an erroneous view. The dispute between the parties relating to the termination of the contract cannot make invocation of the bank guarantee fraudulent. The High Court has also referred to the conduct of the appellant in invoking the bank guarantees on an earlier occasion on 12-4-1992 and subsequently withdrawing such invocation. The court has used this circumstance in aid of its view that the time was not of the essence of the contract. We fail to see how an earlier invocation of the bank guarantees and subsequent withdrawal of this invocation make the bank guarantees or their invocation tainted with fraud in any manner. Under the terms of the contract it is stipulated that the respondent is required to give unconditional bank guarantees against advance payments as also a similar bank guarantee for due delivery of the contracted plant within the stipulated period. In the absence of any fraud the appellant is entitled to realize the bank guarantees.”

A two-Judge Bench of the Supreme Court, in **Hindustan Construction Company Ltd. (2-supra)**, added a somewhat new dimension to the Court’s jurisdiction to grant an order of injunction. It has held that to exercise the unfettered right of invocation of bank guarantee by the beneficiary, the bank guarantee should be in

²⁸ (1996) 5 SCC 34

unequivocal terms, unconditional and must recite that the amount would be paid without demur or objection and irrespective of any dispute that might have cropped up or might have been pending between the beneficiary under the bank guarantee and the person on whose behalf the guarantee was furnished. The Court further held that since the bank guarantee represents an independent contract between the bank and the beneficiary, both the parties would be bound by the terms thereof and that the invocation therefore will have to be in accordance with the terms of the bank guarantee or else the invocation itself would be bad. In that case, the Supreme Court has referred to the following recitals of the bank guarantee :

“We, State Bank of India, incorporated under the State Bank of India Act, 1955, and having one of our branches at Nyayamurti C.N. Vaidya Marg, Fort, Bombay-400023 (hereinafter referred to as ‘the said Bank’), as instructed by the contractor, agree unconditionally and irrevocably to guarantee as primary obligator and not as surety merely, the payment of the Executive Engineer, Kharkai Dam Division II, Icha, Chaliama, Post Kesargarhi, District Singhbhum, Bihar, on his first demand without whatsoever right of objection on our part and 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 mobilization loan from the contractor under the contract.*”

Despite the recitals under which the bank has unconditionally and irrevocably guaranteed the State of Bihar for payment of the amount under the guarantee without any demur, based on the latter portion of

the recitals (extracted in italics), the Supreme Court held at paras 13 and 14 as under :

“The Bank, in the above guarantee, no doubt has used the expression “agree unconditionally and irrevocably” to guarantee payment to the Executive Engineer on his first demand without any right of objection, but these expressions are immediately qualified by following:

“ ... 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 mobilization loan from the contractor under the contract.”

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 mobilization 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 mobilization 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 mobilization loan”. It is in these circumstances that the aforesaid clause would operate and the whole of the amount covered by the “mobilization advance” would become payable on demand. The bank guarantee thus would 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 would 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.

(Emphasis is ours)

From the Judgments of the English and the Indian Courts the following legal principles emerge:

- (i) An unconditional bank guarantee is a solemn undertaking given by the bank which gives an unfettered right to the beneficiary under such guarantee for its invocation. The Courts shall not embark upon adjudication of dispute between the parties with reference to the terms of the contract, in pursuance of which bank guarantee is furnished by a party to the other. Such Dispute, however, shall be allowed to be raised separately by the party at whose instance the bank guarantee is given, before the forum available to it in law.
- (ii) The Courts shall not ordinarily interfere with the right of the beneficiary to invoke the bank guarantee except for the purpose of preventing fraud or irretrievable injustice being caused. While considering the plea of irretrievable injustice, the Courts must apply the test similar to that applied in **ITEK Corporation (6-supra)**.
- (iii) The Court must read the recitals in a bank guarantee as a whole. Even if the bank guarantee contains the recitals such as “unconditional” or “irrevocable”, the Court has to look into the other recitals before coming to the conclusion as to the true nature of the guarantee. If in spite of such words

“unconditional” or “irrevocable”, a bank guarantee contains any conditions which need to be fulfilled by the beneficiary, or where the invocation is conditional upon non-fulfillment of the obligation by the party at whose instance the bank guarantee is furnished, such guarantee cannot be treated as an “unconditional” or “irrevocable” guarantee and the Court can grant injunction, if the conditions, if any, stipulated in the bank guarantee are not satisfied by the party for invoking such guarantee.

Let us apply the above enunciated principles of law to the case on hand.

The learned Counsel for the appellant has fairly conceded that the three bank guarantees pertaining to the EMD, satisfactory performance of work and security deposit, did not contain any conditions to be fulfilled for their invocation. As regards the bank guarantee furnished for mobilization advance, out of the sum of Rs.2,36,00,000/- for which guarantee was furnished, the respondent has recovered only Rs.75 lakhs. Therefore, the appellant cannot invoke the principle laid down in **Hindustan Construction Company Ltd. (2-supra)**.

The appellant has not pleaded fraud. However, it has pleaded ‘irretrievable injustice’ based on Clause-26 of the “General directions

and conditions of contract works on percentage tender” contained in Section-III of the Notice Inviting Tenders. For proper appreciation, we feel the necessity of reproducing this Clause hereunder :

“The sole arbitrators appointed shall give an item wise speaking and/or reasons award in respect of each item of claim. Further the sole arbitrator is prohibited from making any order in the award relating to the payment of interest of any amount i.e., either belated or future payable to the contractor(s).”

The learned Counsel for the appellant submitted that as the arbitrators are prohibited from granting interest as per the above mentioned Clause, the loss that may be sustained by the appellant cannot be compensated by the arbitrators and therefore the invocation of the Bank Guarantees will cause ‘irretrievable injustice’ to her client.

This submission, in our opinion, is based on a thorough misconception of Clause-26. Payment of interest and damages for breach of contract are two different concepts. Though in some cases, interest may be awarded as a measure of damages, award of damages cannot be treated as award of interest. The right to claim damages flows out of various provisions of the Indian Contract Act, 1872, including Section 73 thereof. A party who suffered breach of contract is entitled to sue the other party which caused such breach, for compensation. In the instant case, Clause-26, which only prohibits grant of interest, cannot prevent the party which suffered the breach of

contract to claim compensation, a statutory right vested in it. Subject to the defences that may be available to the respondent, the appellant can claim damages if it is able to prove before the forum of competent jurisdiction that the former has committed breach of contract and unlawfully invoked the bank guarantees. Mr. P. Sri Raghu Ram, the learned Senior Counsel, has also not disputed the maintainability of such a claim before the Arbitrator. Therefore, on the facts of the present case, the appellant is not entitled to plead that the invocation of bank guarantees by the respondent would cause 'irretrievable injustice' to it.

The learned Counsel for the appellant has placed heavy reliance on the two-Judge Bench Judgment in **M/s. Gangotri Enterprises Ltd. (3-supra)**. We have carefully read the said Judgment. In that case, the Supreme Court, while observing that there can be no quarrel on the general propositions of law laid down in a catena of decisions placed before it, however granted injunction against invocation of the bank guarantee based on the facts involved therein. In our opinion, the said Judgment having turned on its own facts, bears no similarity with the facts in the instant case and it would not in any manner support the appellant's case.

In the light of the discussion undertaken hereinabove, we do not find any merit in this appeal. The Civil Miscellaneous Appeal is accordingly dismissed.

As a sequel to the dismissal of the Civil Miscellaneous Appeal, interim order dated 30-8-2016 is vacated and CMAMP No.1368 of 2016 is dismissed.

Justice C.V. Nagarjuna Reddy

Justice G. Shyam Prasad

Date : 29-09-2016

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