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

+ **FAO (OS) (COMM.) 24/2021**

SHAPOORJI PALLONJI & CO. PVT. LTD.Petitioner

Through: **Mr. Darpan Wadhwa, Senior
Advocate with Mr. Manik Dogra,
Mr. Animesh Sinha and Mr.
Ananya Mishra, Advocates**

Versus

THE INDURE PRIVATE LIMITED & ANR.....Respondents

Through: **Mr. Prashant Mehta with
Ms. Divita Vyas and Mr. Shantanu
Parashar, Advocates**

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Date of Decision: 10th February, 2021

CORAM:

HON'BLE MR. JUSTICE MANMOHAN

HON'BLE MS. JUSTICE ASHA MENON

J U D G M E N T

MANMOHAN, J (Oral):

CM APPL. 5255-5256/2021

Allowed, subject to just exceptions.

Accordingly, present application stands disposed of.

FAO (OS) (COMM.) 24/2021 & CM APPL. 5254/2021

1. Upon a special mentioning being allowed by Hon'ble the Chief Justice, the present appeal has been received from the Registry at 12:30 p.m. It has been immediately taken up for hearing.

2. The present appeal has been filed challenging the order dated 08th February, 2021 passed by learned Single Judge whereby the appellant/petitioner's application for stay of bank guarantee has been dismissed. The relevant portion of the impugned order reads as under:-

"5. Mr. Dogra, learned counsel appearing for the petitioner, submits that the claims made by Indure are unsustainable apart from being barred by limitation. He submits that even without going into the merits of the claims made by Indure, it is apparent that the PBG has been invoked only on the basis that it was not being extended. And, the said premise is wholly erroneous.

6. Mr Dogra referred a letter dated 01.12.2020 addressed by Indure to the Bank stating that the said letter be treated as a notice for invocation of the PBG. However, the said letter also states that in the event, PBG is extended for six months and the Original Bank Guarantee Extension Advice is received by the Bank, the claim may be treated as withdrawn, otherwise its claim stands and the amount I equivalent to 4 crores be remitted in favour of Indure. He states that the petitioner complied with the said demand and by a letter dated 19.12.2020 - which was prior to the expiry of the term of the PBG confirmed the extension as demanded by Indure. He submits that since the petitioner had complied with the demand of extension made by the Indure, it is not open for the respondent to insist that PBG be encashed.

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17. In this case, none of the above grounds for interjecting the Bank Guarantee are established. There is no allegation of egregious fraud much less the fraud that vitiates the underlying transaction.

18. This Court is of the view that even if the condition of

irretrievable injustice / injury and special equities are considered, disjunct from the condition of egregious fraud, no such conditions are also established in this regard.

*19. Reliance placed by the petitioner in the case of **Hindustan Construction Co. Ltd. and Ors. v. Satluj Jal Vidyut Nigam Ltd.**(supra), is also of little assistance to the petitioner. The said decision has been rendered in the peculiar facts of that case as the court found merit that the respondent was not adhering to the determination arrived at in terms of the agreed adjudicative process.*

20. In view of the above, an order restraining the encashment of the PBG cannot be granted.”

3. Learned senior counsel for appellant submits that the encashment of bank guarantee is fraudulent as it is for time barred claims. He states that as the project was commissioned in 2014, the bank guarantee has fulfilled its purpose.

4. He further states that the learned Single Judge had disregarded the crucial fact that the respondents had sought for encashment of the bank guarantee only if the same was not extended. He contends that as the appellant had extended the bank guarantee before the expiry of the existing bank guarantee till 30th June, 2021, there was no invocation of the bank guarantee. He also submits that the encashment letter is not in accord with the terms of the bank guarantee.

5. He emphasises that the bank guarantee is alive for the last ten years.

6. It is settled law that encashment of bank guarantee can be stayed on two grounds only, namely, fraud and irretrievable injustice/injury. In **U.P. State Bank Corporation vs. Sumac International Ltd., (1997) 1**

SCC 568, the Supreme Court has held that the Courts have carved out only two exceptions to stay the encashment of bank guarantees. The first is a case of a clear fraud of which the bank has notice and the fraud must be of egregious nature. The second exception relates to cases where allowing the encashment of an unconditional bank guarantee would result in irretrievable harm and injustice. Recently, in **Andhra Pradesh Pollution Control Board vs. CCL Products (India) Limited, 2019 SCC OnLine SC 985**, the Supreme Court has held as under:-

“23. The settled legal position which has emerged from the precedents of this Court is that absent a case of fraud, irretrievable injustice and special equities, the Court should not interfere with the invocation or encashment of a bank guarantee so long as the invocation was in terms of the bank guarantee.”

(emphasis supplied)

7. It has also been held in a catena of cases that the underlying contract is independent from the bank guarantee issued by the bank. The Supreme Court in **U.P. Cooperative Federation Ltd. vs. Singh Consultants and Engineers (P) Ltd., (1988) 1 SCC 174** has held as under:-

“19.The plaintiffs appealed to the Court of Appeal in England. It was held by a Bench consisting of Lord Denning, M.R., Browne and Geoffrey Lane, L.J. that a performance guarantee was similar to a confirmed letter of credit. Where, therefore, a bank had given a performance guarantee it was required to honour the guarantee according to 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. Accordingly, as the defendants' guarantee provided for payment on demand without proof or conditions, and was in the nature of a promissory note payable on demand, and the plaintiffs had not established fraud on the part of the buyers, the defendants were required to honour their guarantee on the demand made by the Libyan bank. It followed that the judge had been right to discharge the injunction and that the appeal would be dismissed.

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28. I am, however, of the opinion that these observations must be strictly considered in the light of the principle enunciated. 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.

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34. 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.

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44. The modern documentary credit had its origin from letters of credit. We may, therefore, begin the discussion with the traditional letter of credit. Paul R. Verkuil in an

article explains the salient features of a letter of credit in these terms:

“The letter of credit is a contract. The issuing party — usually a 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 — irrevocable obligation to honour the draft presented by the beneficiary upon compliance with the terms of the credit.”

45.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.

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49. This was also the view taken by this Court in United Commercial Bank case. There A.P. Sen. J. speaking for the Court, said (pages 323 and 324): (SCC pp. 783-84, paras 40-42)

“...the rule is well established that 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.....

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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 the 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.

(emphasis supplied)

8. Keeping in view the aforesaid, this Court is of the view that at the behest of a contractor, i.e., the appellant, this Court cannot examine the terms of the underlying contract and decide disputes between the parties in an arbitration proceeding seeking stay of encashment of bank guarantee. Consequently, the issue of limitation would have to be agitated before the designated forum, i.e., the arbitrator and not before this Court in the present appeal.

9. Further, this Court is of the view that appellant is estopped from contending that the encashment letter is premature, because, if that had been the situation, the appellant would not have filed the present petition seeking restraint on encashment of the bank guarantee.

10. During the course of hearing, this Court had also put a pointed query to learned senior counsel for the appellant as to whether the contention that the encashment letter was premature had been pleaded in the petition under Section 9 of the Arbitration and Conciliation Act, 1996 (for short “Section 9 petition”).

11. Learned senior counsel for appellant candidly admits that no such ground had been taken in Section 9 petition by the appellant. It is pertinent to mention that the Supreme Court in ***I.T.C. Limited vs. Debts Recovery Appellate Tribunal & Ors., (1998) 2 SCC 70*** has held that a clear right to sue should be shown in the plaint.

12. Consequently, as there is no averment in the petition that the encashment letter is premature, the said plea cannot be entertained in an appeal.

13. In fact, a Coordinate Bench of this Court in ***United Constructions Vs. Union of India, FAO (OS)(COMM.) 128/2020 decided on 23rd November, 2020*** of which one of us (Manmohan, J.) was a member, has held that letter of encashment of bank guarantee is not to be read like a plaint or a statute.

14. Consequently, this Court is in agreement with learned Single Judge that the aforesaid contentions and submissions of the appellant do not constitute a ground for stay of encashment of the bank guarantee.

15. Accordingly, the present appeal and application, being bereft of merits, are dismissed.

MANMOHAN, J

ASHA MENON, J

FEBRUARY 10, 2021

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