

Dwarikesh Sugar Industries Ltd.

Vs

Prem Heavy Engineering Works (P) Ltd. and Another

Civil Appeal No. 3376 of 1997

(K. Venkataswami, K. S. Paripoornan, B. N. Kirpal JJ)

07.05.1997

JUDGMENT

KIRPAL, J. –

1. Special leave granted.
2. Having been thwarted by orders of the court below in its attempt to get encashment of the bank guarantees, issued by the State Bank of India, Meerut Cantt. Branch (Respondent 2) Respondent 1 has led to the filing of this appeal by the aggrieved beneficiaries.
3. The appellant and Respondent 1 had entered into an agreement on 27-7-1994 whereby Respondent 1 was to supply boiling house equipment the cost of which was Rs. 5.23 crores. The supply of equipment and material was to start from 15-9-1994 and the same was to be completed by 10-8-1995, as per the schedule of the supply agreed to by the parties.
4. According to one of the clauses of the aforesaid agreement Respondent 1 had agreed to furnish bank guarantees in favour of the appellant. Out of the above six, only four bank guarantees were furnished including Bank Guarantee No. 40/51 dated 1-12-1994 for a sum of Rs. 26,15,000 and Bank Guarantee No. 40/47 dated 24-11-1994 for a sum of Rs. 35 lakhs. These are the bank guarantees with which we are concerned in the present case.
5. Bank Guarantee No. 40/51 was issued to ensure timely delivery of equipment and supply by Respondent 1. The relevant clauses of the said Bank Guarantee No. 40/51 are as follows :

"In consideration of the premises the guarantor hereby unconditionally and irrevocably undertakes to pay to the purchasers on their first written demand and without demur such a sum not exceeding Rs. 26,15,000 (Twenty-six lakhs fifteen thousand only) as the purchasers may demand representing 5% (five per cent) of the contract price, and if the guarantor fails to pay the sum on demand the guarantor shall also pay on the sum demanded interest at the bank lending rates then prevailing reckoned from the date of demand till the date of payment.

2. The guarantor shall pay to the purchasers on demand the sum under clause 1 above without demur and requiring the purchasers to invoke any legal remedy that may be available to them, it being understood and agreed firstly that the purchasers shall be

the sole judge of and as to whether the sellers have committed breach(es) of any of the terms and conditions of the said agreement and secondly that the right of the purchasers to recover from the guarantor any amount due to the purchasers shall not be affected or suspended by reasons of the fact that any dispute or disputes have been raised by the sellers with regard to their liability or that proceedings are pending before any tribunal, arbitrator(s) or court with regard to or in connection therewith, and thirdly that the guarantor shall immediately pay the aforesaid guaranteed amount on demand and it shall not be open to the guarantor to know the reasons of or to investigate or to go into the merits of the demand or to question or to challenge the demand or to know any facts affecting the demand, and lastly that it shall not be open to the guarantor to require the proof of the liability of the seller to pay the amount before paying the aforesaid guaranteed amount to the purchasers."

6. The other Bank Guarantee No. 40/47 was originally issued for a sum of Rs. 51,70,000 for securing advance payment. The agreement contemplated the liability being gradually reduced and on 28-8-1995 this bank guarantee was reduced for a diminished amount of Rs. 33 lakhs. The relevant clause of this bank guarantee is as follows :

"In consideration of the premises the guarantor hereby unconditionally and irrevocably undertakes to pay to the purchasers on their first written demand and without demur such a sum not exceeding Rs. 51,70,000 (Rupees Fifty-one lakhs seventy thousand only) as the purchasers may demand representing 10% (ten per cent) of the contract price, and if the guarantor fails to pay the sum on demand the guarantor shall also pay on the sum demanded interest at the bank lending rates then prevailing reckoned from the date of demand till the date of payment. Provided that liability of the guarantor hereunder shall reduce to the extent of the advance adjusted under clause 13 of the said agreement.

The guarantor shall pay to the purchasers on demand the sum under clause 1 above without demur and requiring the purchasers to invoke any legal remedy that may be available to them, it being understood and agreed firstly that the purchasers shall be the sole judge of and as to whether the sellers have committed any breach(es) of any of the terms and conditions of the said agreement and secondly that the right of the purchasers to recover from the guarantor any amount due to the purchasers shall not be affected or suspended by reasons of the fact that any dispute or disputes have been raised by the sellers with regard to their liability or that proceedings are pending before any tribunal, arbitrator(s) or court with regard thereto or in connection therewith, and thirdly that the guarantor shall immediately pay the aforesaid guaranteed amount on demand and it shall not be open to the guarantor to know the reasons of or to investigate or to go into the merits of the demand or to question or to challenge the demand or to know any facts affecting the demand, and lastly that it shall not be open to the guarantor to require the proof of the liability of the seller to pay the amount before paying the aforesaid guaranteed amount to the purchasers."

7. According to the appellant Respondent 1 did not supply the equipment at site within the time allowed, nor replaced any of the defective items which, according to the appellant, had resulted in the late commencement of the trial crushing in the mill. It is further the case of the appellant that it had to make direct purchases of many parts from other sources as Respondent 1 had failed to supply the equipment. Ultimately by letter dated 21-11-1995 written to Respondent 2, the appellant invoked

the bank guarantee. The material portion of this letter was as follows :

"We wish to inform you that M/s. Prem Heavy Engineering Works (P) Ltd., Rani Mill, Delhi Road, Meerut have failed to fulfil the conditions of our agreement dated 27-7-1994 insofar as timely supply of the machinery and equipment under order with them.

In view of their failure, we hereby invoke the bank guarantee in terms of clauses 1, 2 and 3 of the aforesaid guarantee and hereby demand payment of Rs. 26,15,000 (Rupees Twenty-six lakhs fifteen thousand only). You are, therefore, required to issue a demand draft drawn in favour of our company payable at Najibabad for Rs. 26,15,000 (Rupees Twenty-six lakhs fifteen thousand only). The original guarantee is enclosed which may please be acknowledged."

8. The respondent Bank did not make the payment, notwithstanding the receipt of the aforesaid letter dated 21-11-1995 but the effect which this letter had was that, on 23-11-1995, Respondent 1 filed Original Suit No. 1182 of 1995 before the Court of Civil Judge, Meerut, under Section 20 of the Indian Arbitration Act, 1940. In the said suit the appellant herein was impleaded as Defendant 1 while the State Bank of India was impleaded as Defendant 2. The only relief claimed in this suit was that the dispute between the parties should be referred to an arbitrator. Along with this suit Respondent 1 also filed an application for the grant of injunction restraining the appellant herein from encashing the aforesaid Bank Guarantee No. 40/51 which had been issued for a sum of Rs. 26,15,000.

9. It appears that there was some discussion between the representatives of the appellant and Respondent 1 in connection with the encashment of the said Bank Guarantee No. 40/51. Pursuant thereto letter dated 24-11-1995 was written by Respondent 1 to the appellant which was to the following effect :

"As discussed with your managing director Shri G.R. Mararka today at your Delhi guest house, we confirm that we shall despatch balance parts except lime elevator direct from our works by 26-11-1995 and shall arrange despatch of balance freight oil after payment except air compressor by 27-11-1995. We shall ensure commissioning of the two cooling towers of one complete shall of twin crystallizer and F.M. Piping by 30-11-1995 and F.M. Tonor with rouling by 10-12-1995. We request you to kindly keep the invocation of the above guarantee in abeyance till 10-12-1995."

10. According to the appellant it was not aware that Original Suit No. 1182 of 1995, along with an application for injunction had already been filed by Respondent 1 a day earlier to the respondent's letter dated 24-11-1995. Acting on the basis of the aforesaid letter of Respondent 1 the appellant wrote a letter dated 27-11-1995 to the Manager, State Bank of India, Meerut Cantt. After expressing its regret that the proceeds of the guarantee had not been paid to the appellant, it was stated in this letter that Respondent 1 had assured to make a complete supply of the ordered plant and machinery within next three or four days. In view of this it withdrew its letter of invocation dated 21-11-1995 but it was added that "it may, however, be noted that demand payment is being withdrawn without prejudice to our right of invocation under the guarantee".

11. Apparently having succeeded in persuading the appellant to write the aforesaid letter dated 27-11-1995 withdrawing the letter of invocation, Respondent 1 on the very next day, i.e., 28-11-1995

obtained an ex parte injunction from the Court of Civil Judge, Meerut, restraining the appellant from encashing the aforesaid Bank Guarantee No. 40/51.

12. According to the appellant, Respondent 1 did not make the requisite supplies with the result that vide letter dated 9-1-1996, written to the Assistant General Manager, State Bank of India, Meerut, it invoked Bank Guarantee No. 40/51 by, inter alia, stating as follows :

"As per clause 14 of the supply agreement M/s. Prem Heavy Engineering Works (P) Ltd., Meerut has failed to deliver the equipments and its commissioning within the scheduled time-frame.

Now we hereby invoke the aforesaid guarantee for Rs. 26,15,000 (Rupees Twenty-six lakhs fifteen thousand only) being 5% of the contract value and enclose herewith the original guarantee for your record. Kindly hand over the demand draft in our favour payable at Najibabad, Distt. Bijnor, Uttar Pradesh towards the invocation amount."

13. As on 28-11-1995 Respondent 1 had already obtained an ex parte injunction restraining the encashment of bank guarantee, no payment was made to the appellant by the Bank.

14. Respondent 1 then filed another injunction application dated 12-1-1996 with regard to the second bank guarantee dated 24-11-1994 which was for a sum of Rs. 33 lakhs. It obtained an ex parte injunction in respect thereto on the same day. Being ignorant of this the appellant wrote a letter dated 16-1-1996 to the respondent Bank invoking the said Bank Guarantee No. 40/47. In the said letter it was stated that Respondent 1 had failed to deliver the equipment as per the terms of the agreement and that the appellant had bought equipment from various markets due to which the advance amount which had been paid to Respondent 1, in respect of which this bank guarantee had been issued, remained unadjusted. The Bank was accordingly required to pay the said amount of Rs. 33 lakhs.

15. According to the appellant it is only after 16-1-1996 that it became aware of the filing of the aforesaid suit and the injunction application and it entered appearance in court on 18-1-1996 even though no notice had been served on it. As per the appellant, there was delay in the disposal of the injunction application, consequently it approached the High Court for appropriate directions and the Allahabad High Court vide order dated 10-5-1996 directed the Civil Judge, Meerut Cantt., to dispose of the suit within the time fixed by it.

16. By a detailed order dated 20-8-1996, the Second Civil Judge (Sr. Division), Meerut vacated the ex parte injunctions which had been granted and dismissed the injunction applications. In arriving at this conclusion it observed that Respondent 1 had not stated that the work had been completed and nor was there any allegation of cheating or fraud contained in the plaint which had been filed. The trial court referred to a number of decisions of this Court and came to the conclusion that there was no basis, in law, for the grant of any interim prohibitory order.

17. The appellant on 22-8-1996 again approached the respondent Bank for the encashment of the bank guarantees, but without success.

18. Respondent 1 then filed Revision Petition No. 257 of 1996 on 10-9-1996 before the Allahabad High Court challenging the order dated 20-8-1996 of the trial court. The Single Judge of the Allahabad High Court took up the revision petition and disposed it of on the same day and, after setting aside the order dated 20-8-1996 it remanded the matter back to the trial court for a fresh

decision but, at the same time, directed that till the disposal of injunction application the bank guarantees in question shall not be invoked or encashed. The trial court was directed to hear the parties within fifteen days of the receipt of the order and to dispose of the injunction application within fifteen days thereafter. Needless to state, due to dilatory tactics adopted by Respondent 1, which is evident from the documents available on the record of this case, the said injunction applications have not been disposed of till date with the result that the injunction granted by the Single Judge of the High Court vide order dated 10-9-1996 still continues.

19. While allowing the civil revision the Single Judge in his judgment did not think it necessary to refer to the judicial decisions which were cited before him. The Court observed that reference to the same was not necessary because the trial court, who had observed that the plaint did not contain any allegation with regard to fraud, had not noticed that allegation of fraud was contained in the injunction application. The learned Judge noticed that the liability of the Bank under the guarantee was absolute and that it was not supposed to question the authority of the beneficiary to encash the bank guarantee but observed that the same "could not be the guideline for allowing the defendant to encash the bank guarantee unless there was a finding that the defendant was having undue enrichment thereby".

20. The aforesaid decision of the High Court has been assailed by Shri Harish N. Salve, learned Senior Counsel for the appellant, who has contended that the High Court fell in serious error in ignoring and in not even referring to the decisions of this Court where the principles regarding the grant of injunction in matters relating to encashment of bank guarantees have been clearly spelt out. Had this been done, the learned counsel submits, the High Court could not, in law, have continued with the temporary injunction.

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, [(1994) 1 SCC 502] Larsen & Toubro Ltd. v. Maharashtra SEB [(1995) 6 SCC 68], Hindustan Steel Workers Construction Ltd. v. G.S. Atwal & Co. (Engineers) (P) Ltd. [(1995) 6 SCC 76] and U.P. State Sugar Corpn. v. Sumac International Ltd. [(1997) 1 SCC 568] The general principle which has been laid down by this Court has been summarised in the case of U.P. State Sugar Corpn. [(1997) 1 SCC 568] 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 Banks* [(1984) 1 All ER 351, CA] 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.* [(1988) 1 SCC 174]

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.

23. In the instant case, as has been already noticed there were two types of bank guarantees which were issued. Bank Guarantee No. 40/51 for Rs. 26,15,000 was issued to ensure timely performance of the agreement by Respondent i. The relevant terms of this guarantee firstly makes it clear that the Bank has unconditionally and irrevocably undertaken to pay to the appellant, on written demand and without demur, the amount demanded by it. Secondly, clause II of the said guarantee clarifies that the payment shall be made without demur and on the undertaking that the appellant is to be the sole judge whether the seller has committed any breach. Consequently the right of the appellant to recover the guaranteed amount is not to be affected or suspended by reason of any dispute which can be raised or pending before the courts, tribunals or arbitrator. Thirdly, the guarantor had no right to know the reasons of or to investigate the merits of the demand or to question or to challenge the demand or to know any facts affecting the demand and lastly it was not open to the Bank to require the proof of the liability of Respondent 1 to pay the amount before paying the aforesaid guaranteed amount to the appellant.

24. The letter of invocation issued by the appellant demanding the payment of Rs. 26,15,000 was in accordance with the terms of Bank Guarantee No. 40/51 and the Bank was, therefore, under an obligation to honour its undertaking and to make the payment. It, however, chose not to fulfil its obligation. If the Bank could not in law avoid the payment, as the demand had been made in terms of the bank guarantee, as has been done in the present case, then the court ought not to have issued an injunction which had the effect of restraining the Bank from fulfilling its contractual obligation

in terms of the bank guarantee. An injunction of the court ought not to be an instrument which is used in nullifying the terms of a contract, agreement or undertaking which is lawfully enforceable. In its aforesaid letter dated 24-11-1995 Respondent 1 had clearly admitted that entire supply had not been made. In view of this also the High Court was not justified in granting an injunction.

25. Bank Guarantee No. 40/97 dated 24-11-1994, which had been issued to secure the advance of Rs. 129.24 lakhs which had been given by the appellant, was also similar in terms to the earlier Bank Guarantee No. 40/51. The main contract between the parties contemplated that the amount of bank guarantee shall stand reduced on adjustment being made. It is contended by Shri Sudhir Chandra, learned counsel for the respondents, that the full amount which was given had been adjusted and no amount remained outstanding and, therefore, the Bank Guarantee No. 40/47 could no longer be regarded as alive. In support of this contention, the learned counsel relied on the observations of this Court in *Larsen & Toubro Ltd. v. Maharashtra SEB* [(1995) 6 SCC 68] where an injunction was granted where the bank guarantee which was issued was to be kept alive till the successful completion of trial operations. In our opinion, this decision can be of no assistance to Respondent 1 because in *Larsen & Toubro case* [(1995) 6 SCC 68] this Court found that the guarantee which had been given by the Bank was to enure only till the successful completion of the trial operations and the taking over of the plant. The documents revealed that the contractual term in this regard has been complied with and after successful completion of the trial operation, the plant had admittedly been taken over. In view of this, it was held by this Court that the terms of the bank guarantee did not permit its invocation once the trial operations had been successfully completed.

26. In the present case clause 3 of Bank Guarantee No. 40/47 relating to adjustment of the advance stipulated as follows :

"The guarantee shall come into force from the date thereof and shall remain valid till the full advance amount is adjusted under clause 13 of the said agreement which according to the terms and conditions of the said agreement is stipulated to be adjusted proportionately from each bill of the sellers against actual deliveries of the machinery and equipment at site but if the deliveries as aforesaid have not been completed by the sellers within the said period for any reason whatsoever the guarantor hereby undertakes that the sellers shall furnish a fresh or renewed guarantee on the purchaser's pro forma for such further period as the purchaser may intimate failing which the guarantor shall pay to the purchaser a sum not exceeding Rs. 51,70,000 (Rupees Fifty-one lakhs seventy thousand only) or the residual amount of balance unadjusted advance left after proportionate adjustment in accordance with clause 1 above as the purchaser may demand."

27. No plea was taken before the courts below, and no document has been shown to us by the respondents, which can prima facie indicate that the full amount of advance had been adjusted under clause 13 of the main contract between the appellant and Defendant 1. According to the appellants, the original guarantee was for Rs. 51,70,000 but the same, after adjustment of the advance, in terms of clause 13 of the main agreement, stood reduced to Rs. 33,00,000. This amount was still outstanding and, therefore, the bank guarantee had not come to an end and was rightly invoked.

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.

29. It is unfortunate that the High Court did not consider it necessary to refer to various judicial pronouncements of this Court in which the principles which have to be followed while examining an application for grant of interim relief have been clearly laid down. The observation of the High Court that reference to judicial decisions will not be of much importance was clearly a method adopted by it in avoiding to follow and apply the law as laid down by this Court. Yet another serious error which was committed by the High Court, in the present case, was not to examine the terms of the bank guarantee and consider the letters of invocation which had been written by the appellant. If the High Court had taken the trouble of examining the documents on record, which had been referred to by the trial court, in its order refusing to grant injunction, the court would not have granted the interim injunction. We also do not find any justification for the High Court in invoking the alleged principle of unjust enrichment to the facts of the present case and then deny the appellant the right to encash the bank guarantee. If the High Court had taken the trouble to see the law on the point it would have been clear that in encashment of bank guarantee the applicability of the principle of undue enrichment has no application.

30. We are constrained to make these observations with regard to the manner in which the High Court had dealt with this case because this is not an isolated case where the courts, while disobeying or not complying with the law laid down by this Court, have at times been liberal in granting injunction restraining encashment of bank guarantees.

31. It is unfortunate, that notwithstanding the authoritative pronouncements of this Court, the High Courts and the courts subordinate thereto, still seem intent on affording to this Court innumerable opportunities for dealing with this area of law, thought by this Court to be well settled.

32. When a position, in law, is well settled as a result of judicial pronouncement of this Court, it would amount to judicial impropriety to say the least, for the subordinate courts including the High Courts to ignore the settled decisions and then to pass a judicial order which is clearly contrary to the settled legal position. Such judicial adventurism cannot be permitted and we strongly deprecate the tendency of the subordinate courts in not applying the settled principles and in passing whimsical orders which necessarily has the effect of granting wrongful and unwarranted relief to one of the parties. It is time that this tendency stops.

33. Before concluding we think it appropriate to mention about the conduct of the respondent Bank which has chosen not to be represented in this case. From the facts stated hereinabove it appears to us that the respondent Bank has not shown professional efficiency, to say the least, and has acted in a partisan manner with a view to help and assist Respondent 1. At the time when there was no restraint order from any court, the Bank was under a legal and moral obligation to honour its commitments. It, however, failed to do so. It appears that the Bank deliberately dragged its feet so as to enable Respondent 1 to secure favourable order of injunction from the court. Such conduct of a

Bank is difficult to appreciate. We do not wish to say anything more lest it may feel that it will be prejudicial in the event of the appellant taking action against it.

34. For the aforesaid reasons this appeal is allowed. The judgment and order of the Allahabad High Court dated 10-9-1996 in Revision Petition No. 257 of 1996 is set aside and the order of the trial court dated 20-8-1996 dismissing the injunction application is restored. The appellant would be entitled to costs which are quantified at Rs. 20,000.