

SUPREME COURT OF INDIA

Hindustan Construction Co. Ltd.

Vs.

State of Bihar

(S Ahmed and D Wadhwa JJ.)

08.10.1999

ORDER

S. SAGHIR AHMAD, J.

1. Leave granted in both the Special Leave Petitions.

2. Hindustan Construction Company Limited (for short, 'HCCL') was awarded a contract for the construction of Icha Dam across the river Kharkai in village Kuju by the State of Bihar (for short, 'the defendants'). The contract was awarded in the sum of Rs. 39,71,31,019 on 25.4.1989. The period of contract was 42 months and the work was to be completed by 24th of October, 1992. In terms of the agreement, HCCL was required to furnish, and it did furnish, a Bank Guarantee for 10 per cent of the contract price as "Performance Guarantee" in the sum of Rupees Three Crores Ninety Seven Lakhs Thirteen Thousand One Hundred and Two only. Another Bank Guarantee which was required to be furnished by HCCL, and which it did furnish, was the Guarantee against "Mobilisation Advance" which was to be provided by the defendants from time to time to the HCCL during the course of the contract. HCCL has already furnished fifty "Mobilisation Advance" Bank Guarantees aggregating in all to Rs. 532 lacs. In addition to these Bank Guarantees, HCCL had also furnished another "Mobilisation Advance" Bank Guarantee dated 2.7.1991 for Rs. 40 lacs, for which no advance has been paid by the State of Bihar. This Bank Guarantee is, however, not in question in these proceedings.

3. Both the Bank Guarantees were invoked by the defendants and it was, at this stage, that HCCL filed a suit on 21.10.1992 in the Bombay High Court against State bank of India, State bank of Patiala and Indian Bank (defendants 1 to 3) and the State of Bihar and its officers (defendants 4 to 6) for various reliefs, including principal relief that defendants 1 to 3 may be restrained from

making payment of the amount covered by the aforesaid Bank Guarantees to defendants 4 to 6. An interim order was passed by the Single Judge in the suit on 27.10.1992 and under this interim order, the defendants were restrained from invoking the Bank Guarantees and the Banks were restrained from making payment of the amount covered by the Bank Guarantees to the defendants. The interim order was confirmed on 9.2.1996.

4. Defendants 4 to 6, who contested the suit, pleaded, inter alia, that HCCL had not adhered to the schedule of work and had rather abandoned the work after it had received "Mobilisation Advance" and it was for this reason that both the Bank Guarantees were invoked.

5. The order passed by the Single Judge was challenged in appeal by the defendants before the Division Bench and the Division Bench, by the impugned judgment dated 20.3.1998, vacated the injunction order in respect of Bank Guarantee relating to "Mobilisation Advance", but the injunction order in respect of the "Performance Guarantee" was maintained.

6. Mr. F.S. Nirman, Senior Advocate, appearing on behalf of HCCL has assailed the order of the Division Bench of the Bombay High Court on various grounds, including the ground that invocation of the Bank Guarantee relating to "Mobilisation Advance" was wholly illegal and the High Court was wrong in vacating the injunction order relating to that Guarantee. It is contended that this Bank Guarantee could be invoked only if the amount lent to HCCL as "Mobilisation Advance" had become payable in ' terms of Clause 9 of the principal contract which was specifically referred to in the Bank Guarantee and since the conditions contemplated by Clause 9 did not exist, the invocation itself was bad. The Single Judge, it is contended, was right in granting the injunction order which should not have been disturbed by the Division Bench.

7. The defendants have filed a separate appeal against that part of the order by which the injunction order in respect of the "Performance Guarantee" has been upheld by the Division Bench. It is contended on their behalf that the "Performance Guarantee", which constituted a separate and distinct contract between the defendants and the Bank, was unconditional and unequivocal and since the Bank had undertaken to pay the amount covered by that Guarantee to the defendants on their demand, the injunction order, granted by the High Court, was liable to be set aside.

8. Now, a Bank Guarantee is the common mode, of securing payment of money in commercial dealings as the beneficiary, under the Guarantee, is entitled to realise the whole of the amount under that Guarantee in terms thereof irrespective of any pending dispute between the person on whose behalf the Guarantee was given and the beneficiary. In contracts awarded to private individuals by the Government, which involve huge expenditure, as, for example, construction contracts, Bank Guarantees are usually required to be furnished in favour of the Government to secure payments made to the contractor as "Advance" from time to time during the course of the contract as also to secure performance of the work entrusted under the contract. Such Guarantees are excusable in terms thereof on the lapse of the contractor either in the performance of the work or in paying back to the "Government Advance", the Guarantee is invoked and the amount is recovered from the Bank. It is for this reason that the Courts are reluctant in granting an injunction against the invocation of Bank Guarantee, except in the case of fraud, which should be an established fraud, or where irretrievable injury was likely to be caused to the Guarantor. This was the principle laid down by this Court in various decisions. In U.P. Cooperative Federation Ltd. v. Singh Consultants & Engineers Pvt. Ltd. , the law laid down in *Bolivinter Oil SA v. Chase Manhattan Bank* [1984] 1 All E.R. 351 was approved and it was held that an unconditional Bank Guarantee could be invoked in

terms thereof by the person in whose favour the Bank Guarantee was given and the Courts would not grant any injunction restraining the invocation except in the case of fraud or irretrievable injury. In Svenska Handelsbanken v. Indian Charge Chrome ; Larsen & Toubro Ltd. v. Maharashtra State Electricity Board ; Hindustan Steel Works Construction Ltd. v. G.S. Atwal & Co. (Engineers) (P) Ltd. ; National Thermal Power Corporation Ltd. v. Flowmeore (P) Ltd. ; State of Maharashtra v. National Construction Co. ; Hindustan Steel Works Construction Ltd. v. Tarapore & Co. as also in U.P. State Sugar Corporation v. Sumac International Ltd. , the same principle has been laid down and reiterated.

9. What is important, therefore, is that the Bank Guarantee should be in unequivocal terms, unconditional and 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 or the person on whose behalf the Guarantee was furnished. The terms of the Bank Guarantee are, therefore, extremely material. Since the Bank Guarantee represents an independent contract between the Bank and the beneficiary, both the parties would be bound by the terms thereof. The invocation, therefore, will have to be in accordance with the terms of the Bank Guarantee; or else, the invocation itself would be bad.

10. In the instant case, the whole matter can be disposed of purely on the basis of the terms of the Bank Guarantee.

11. We will first consider the Bank Guarantee relating to "Mobilisation Advance". This Guarantee was furnished in terms of Clause 9 of the principal contract between the HCCL and the defendants which provides as under:

Advance Mobilisation Loan:

The Employer will make an advance loan to the Contractor at 13 per cent simple interest per annum for the costs of mobilisation in respect of the works in a lump sum amount equivalent upto 15 per cent of the Contract Price named in the Letter of Acceptance, payable in the proportionate amounts of foreign and local currencies as provided for in the Contract. Payment of the loan will be due under separate certification by the Engineer after (i) execution of the Form of Agreement by the parties thereto, (ii) Provision by the Contractor of the Performance security in accordance with Clause 5, and (iii) provision by the Contractor of a Bank Guarantee, by a Bank acceptable to the Employer in an amount equal to the advance loan, such Bank Guarantee to remain effective until the advance loan has been completely repaid by the Contractor out of current earnings under the Contract and certified accordingly by the Engineer. A form of bank guarantee acceptable to the Employer is indicated in Section

9. Annex. B. The advance loan shall be used by the Contractor exclusively for mobilisation expenditures, including the acquisition of Constructional Plant, in connection with the works. Should the Contractor misappropriate any portion of the advance loan, it shall become due and payable immediately, and no further loan will be made to the Contractor thereafter. The advance mobilisation loan, shall be paid within 15 days of the date of certification.

12. It was in terms of the above clause that the Bank Guarantee was furnished by the HCCL. It provides as under:

The Executive Engineer,
Kharkai Dam Division II, Icha,
Chaliama, Post Kesargarhia,
Dist. Singhbhum, Bihar.

Ref.: Construction of Icha Dam -
Subernarekha Multipurpose

Project - Contract/Tender

Notice No. SMP/ICC/CE-8/87

(Adityapur dt. 23.10.1987.

In accordance with the provisions of the Conditions of Contract, Clause 9 (Advance Mobilisation Loan) of the abovementioned contract, the Hindustan Construction Co. Ltd., incorporated in Bombay under the Companies Act, 1956, and having their registered officer at Construction House, Walchand Hirachand Marg, Ballard Estate, Bombay - 400 038 (hereinafter called 'the Contractor') shall deposit with the Executive Engineer, Kharkai Dam Division II, Icha, Chaliama, Post Kesargarhia, Dist. Singhbhum, Bihar, a bank guarantee to guarantee their proper and faithful performance under the said clause of the contract in an amount of Rs. 10,00,000 (Rupees Ten lakhs only).

We, the State bank of India, incorporated under State bank of India Act, 1955, and having one of our branches at Nyayamurti C.N. Vaidya Marg, Fort, Bombay - 400 023 (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 Kesargarhia, Dist. 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 abovementioned 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 Mobilisation Loan from the contractor under the contract.

We further agree that no change or addition to or other modification of the terms of the contract or of works to be performed thereunder or of any of the contract documents which may be made between the Executive Engineer, Kharkai Dam Division II, Icha, Chaliama, Post Kesargarhia, Dist. Singhbhum, Bihar, and the contractor, shall in any way release us from any liability under this guarantee, and we hereby waive notice of any such change, addition or modification.

Our liability under this guarantee is restricted to an amount not exceeding Rs.10,00,000 (Rupees Ten lakhs only) and the said guarantee shall remain in full force upto 11th October, 1990 with a claim period of six months thereafter i.e., upto 11th April, 1991 twelve months after the issuing of maintenance certificate, whichever is earlier. Unless demand or claim under this guarantee is made

on us in writing on or before 11th April, 1991 we shall be relieved and discharged from all liabilities thereafter.

This guarantee shall remain valid and in full effect from the date of the advance payment under the contract until the Executive Engineer, Kharkai Dam Division II, Icha, Chaliama, Post Kearagarhia, Dist, Singhbhum, Bihar, receives full repayment of the same amount from the contractor, but not later than 11th April, 1991 any case.

Dated at Bombay this 12th October, 1989.

For STATE BANK OF INDIA

Sd/-

MANAGER

Commercial Branch,

Bombay - 400 023

13. 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 abovementioned 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 Mobilisation Loan from the contractor under the contract.

14. This condition clearly refers to the original contract between the 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 Mobilisation 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 Mobilisation Loan" to the Executive Engineer only if the obligations under the contract were not fulfilled by HCCL or the HCCL has misappropriated any portion of the "Advance Mobilisation Loan". It is in these circumstances that the aforesaid clause would operate and the whole of the amount covered by the "Mobilisation Advance" would become payable on demand. The Bank Guarantee thus could 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 could 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.

15. Coming to the other appeal which has been filed by the defendants in respect of "Performance Guarantee", it may be stated that the Single Judge as also the Division Bench of the High Court

have maintained the injunction order and restrained the defendants from invoking the Guarantee. The Banks have also been restrained from making payment of the amount stipulated by the "Performance Guarantee" to the defendants.

16. The "Performance Guarantee" was furnished in terms of Clause 5 of the agreement which provides as under ;

(a) For the due performance of the contract, the Tender shall contain an undertaking by the Contractor to obtain when required a bond or guarantee of an insurance company or bank, or other approved sureties to be jointly and severally bound with the Contractor to the Employer, in a sum not exceeding that stated in the Letter of Acceptance for such bond or guarantee, the said insurance company or bank sureties and the terms of the said bond or guarantee shall be such as shall be approved by the Employer. The obtaining of such bond or guarantee or the provisions of such sureties and the cost of the bond or guarantee to be so entered into shall be at the expense in all respects of the Contractors unless the contract otherwise provides.

(b) The performance security shall be submitted by the Contractor within 30 days of issue of the Letter of Acceptance and shall be in the form of a bank guarantee or a bond (at the Contractor's option). The amount of the bank guarantee shall be 10 (ten) per cent of the Contract Price, or the amount of the bond provided by insurance or bonding company shall be 30 (thirty) per cent of the Contract Price, If the Performance Security is in the form of a Bank Guarantee, it shall be issued either (i) by a local bank or a foreign bank through a correspondent local bank, or (ii) directly by a foreign bank acceptable to the Employer. The performance security shall be denominated in the types and proportions of currencies in which the Contract Price is payable. The performance security will be released by the Employer not later than 30 days following the date of delivery of the Certificate of Completion of works by the Engineer.

17. The "Performance Guarantee" is in the following terms:

The Chief Engineer,

Subernrekha Multipurpose Project,

Icha Galudih Complex,

Adityapur, Jamshedpur,

Bihar.

WHEREAS M/S THE HINDUSTAN CONSTRUCTION COMPANY LIMITED, incorporated in Bombay, under the Companies Act, 1956, and having their Registered Office at Construction House, Walchand Hirachand Marg, Ballard Estate, Bombay-400 038 (hereinafter called "the CONTRACTOR") has undertaken, in pursuance of Contract/Tender Notice No. SMP/IGC/CE-8/87, Adityapur, dated 23.10.1987 to execute the work of construction of Icha Dam, Subernarekha Multipurpose Project (hereinafter called "the CONTRACT").

AND WHEREAS it has been stipulated by you in the said Contract that the Contractor shall furnish you with a Bank Guarantee by a recognised bank for the sum specified therein as security for

compliance with his obligations in accordance with the Contract.

AND WHEREAS WE, State Bank of India, incorporated under the State Bank of India Act, 1955, and having our commercial branches at Nyayamurthi G.N. Vaidya Marg, Bombay-400 023 (hereinafter referred to as the "BANK") have agreed to give the contractor such a Bank Guarantee.

NOW THEREFORE WE, State Bank of India, hereby affirm that we are the Guarantor and responsible to you, on behalf of the contractor upto a total of Rs. 3,97,13,102 (Rupees Three crores ninety seven lakhs thirteen thousand one hundred and two only) such sum being payable in the types and proportions of currencies in which the Contract price is payable and we undertake to pay you, upon your first written demand and without cavil or argument, any sum or sums within the limits of Rs. 3,97,13,102 (Rupees Three crores ninety seven lakhs thirteen thousand one hundred and two only) as aforesaid without your needing to prove or to show grounds or reasons for your demand for the sum specified therein.

We hereby waive the necessity of your demanding the said debt from the Contractor before presenting us with the demand.

We further agree that no change or addition to or other modification of the terms of the Contract or the Works to be performed thereunder or of any of the Contract documents which may be made between you and the Contractor shall in any way release us, from any liability under this guarantee, and we hereby waive notice of any such change, addition or modification.

Our liability under this guarantee is restricted to an amount not exceeding Rs. 3,97,13,102 (Rupees Three crores ninety seven lakhs thirteen thousand one hundred and two only) and the guarantee ' shall remain in force upto 16th October, 1992 with a claim period of one year thereafter i.e., upto 16th October, 1993 or twelve months after the issuing of maintenance certificate. Unless a demand or claim under the guarantee is made on us in writing on or before 16.10.1993, we shall be relieved and discharged from all our obligations thereafter.

Dated this 17th day of April, 1989,

For STATE BANK OF INDIA

Sd/-

Manager (Credit)

Commercial Branch

Bombay - 400-023

Seal

Dated 17th April, 1989

18. This Guarantee has been furnished to the Chief Engineer but was invoked by the Executive Engineer by a letter addressed to the Branch Manager of the State Bank of India, Commercial

Branch, Bombay reading as under:

The Branch Manager,

State Bank of India,

Commercial Branch,

Bombay.

Sub: Claim against the Bank Guarantee No. A/89/228 dated 17.4.1989 for Rs. 3,97,13,102.00 (Rs. Three Crores ninety seven lacs thirteen thousand one hundred two only) issued in favour of the Hindustan Construction Co. Limited W.H. Marg, Bombay for Earnest Money of Construction of Icha Main Dam.

Dear sir,

A sum of Rs. 3,97,13,102.00 (Rs. Three crores ninety seven lacs thirteen thousand one hundred two only) was granted to the Hindustan Construction Co. Limited W.H. Marg, Bombay against the Bank Guarantee No. A/89/228 dated 17.4.1989 the said Bank Guarantee is valid upto 16.10.1992 only. Its period of validity has not been extended as yet and no amount against the said Earnest Money has been paid by the Contractor.

You are therefore requested that the Bank Draft for Rs. 3,97,13,102.00 (Rs. Three crores ninety seven lacs thirteen thousand one hundred two only) drawn in favour of the Executive Engineer, Kharkai Dam Division No. 2, Icha Chaliama P.O. Kposherhariha Dist. West Singhbhum Chaibasa payable at State Bank of India Chaibasa may kindly be sent to the undersigned immediately as a claim against the said Bank Guarantee.

An early action in this matter is solicited.

Yours faithfully,

Sd/-

Executive Engineer,

Kharkai Dam Division No. 2,

Icha Chaliama

19. It is contended by Mr. Nariman that "Performance Guarantee" constituted an independent contract between the Bank and the Chief Engineer. The Guarantee was furnished by the Bank to the Chief Engineer and, therefore, it could be invoked only by the Chief Engineer and not by the Executive Engineer.

20. Learned Counsel appearing on behalf of the defendants has contended that in the general conditions of contract appended to the agreement between the HCCL and the State of Bihar, the

word "employer" has been defined to mean the Governor of Bihar acting through the Chief Engineer or his authorised representatives. The word "Engineer Incharge" or "Engineer" has been defined separately to mean Superintending Engineer or the Engineer appointed from time to time by the "employer" and notified in writing to the contractor to act as Engineer, It is contended that Executive Engineer who has invoked the guarantee would be covered not only by the definition of "employer" but also by the definition of "Engineer Incharge" or "Engineer" as set out in the general conditions of contract. We are not prepared to accept this contention.

21. As pointed out above, Bank Guarantee constitutes a separate, distinct and independent contract. This contract is between the Bank and the defendants. It is independent of the main contract between the HCCL and the defendants. Since the Bank Guarantee was furnished to the Chief Engineer and there is no definition of "Chief Engineer" in the Bank Guarantee nor is it provided therein that "Chief Engineer" would also include Executive Engineer, the Bank Guarantee could be invoked by none except the Chief Engineer. The invocation was thus wholly wrong and the Bank was under no obligation to pay the amount covered by the "Performance Guarantee" to the Executive Engineer.

22. We have scrutinised the facts pleaded by the parties in respect of both the Bank Guarantees as also the document filed before us and we are, prima facie, of the opinion that the lapse was on the part of the defendants who were not possessed of sufficient funds for completion of the work. The allegation of the defendants that HCCL itself had abandoned the work does not, prima facie, appear to be correct and it is for this reason that we are of the positive view that the "special equities" are wholly in favour of HCCL.

23. For the reasons stated above, the appeal arising out of SLP(C) No. 6985/98 is allowed. The judgment and order passed by the Division Bench of the Bombay High Court insofar as it purports to vacate the injunction order, granted by the Single Judge in respect of "Performance Guarantee", is set aside and the injunction order granted by the Single Judge in respect of both the Guarantees, namely, "Mobilisation Advance" and "Performance Guarantee" is maintained. The appeal arising out of SLP(C) No. 12143/98 is dismissed. There shall be no order as to costs.