SUPREME COURT OF INDIA

Vinitec Electronics Private limited

Vs.

HCL Infosystems Limited

C.A.No.5121 of 2007

(Altamas Kabir and B.Sudershan Reddy JJ.)

02.11.2007

JUDGMENT:

B.SUDERSHAN REDDY, J.

Leave granted.

2. The dispute between the parties relates to invocation of the bank guarantee furnished by the appellant to the respondent.

3. The appellant M/s. Vinitec Electronics Private Limited entered into agreement dated 10th May, 2000 with the respondent HCL Infosystem Limited under which the respondent agreed to buy UPS systems from the appellant for a consideration value of Rs.1,68,12,400/-. The method of payment and terms thereof are provided for in clause 15(a) and (d) in the said agreement.

Clause 15:

The payment terms will be :

(a) 30% Advance against a Bank guarantee from a Scheduled Bank of equivalent value. The BG shall be valid till the date of final delivery at the Company location(s).

(b) . . . . .

(c) . . . . .

(d) 10% after one year from the date of receipt of material at the customer site(s).

4. The case of the appellant was that it had supplied all the equipments to the respondent by 2nd August, 2000 but the respondent committed default in making the stipulated payment amounting to Rs.49,99,338/-. The said sum according to the appellant remained unpaid. The respondent agreed to pay the sum provided the performance bank guarantee of 10% value was furnished. That is how bank guarantee as required by the respondent was furnished which was amended on 20th August,

2001. The case of the appellant was that even after furnishing the bank guarantee the respondent made a payment of only Rs. 30 lakhs on 22nd August, 2001 and false assertion of payment of Rs.11,99,335/- was made. It was also alleged that a sum of Rs. 8 lakhs still remained unpaid.

5. The appellants case before the trial court was that the respondent under no circumstances is entitled to invoke the bank guarantee without paying the balance amount of Rs.11,99,335/- or at least 8 lakhs which is admittedly liable to be paid. The bank guarantee had become inoperative as the condition precedent for its invocation was not complied with.

6. The case of the respondent was that the original contract value was Rs.1,68,12,400/- out of which Rs.1,60,12,400/- , i.e., 95% of the contract value stood paid and all the obligations pursuant to clause 15(a) to (c) of the contract have been fulfilled and it is only then the bank guarantee in question was furnished to the respondent upon payment of 30% of the contract value to the appellant. It was asserted that the bank guarantee furnished as it stands is an unconditional one.

7. The learned Single Judge after elaborate consideration of the matter found no merit in the injunction application filed by the appellant and accordingly dismissed the same. The Division Bench of the Delhi High Court affirmed the order of the learned Single Judge.

8. The learned senior counsel Sh.Kailash Vasdev mainly submitted that the High Court committed an error in interpreting Paragraph 4 of the amended bank guarantee in isolation and divorced from the terms and conditions of the contract dated May 10, 2000 entered between the parties. It was submitted that the High Court instead of relying upon the operative portion of the bank guarantee ought to have taken all the clauses which are material to arrive at a real intention of the parties. The submission was that the respondent did not make full payment of Rs.49,99,335/- to the appellant and therefore the pre-condition embodied in the performance bank guarantee dated 10th August, 2001 as amended on 20th August, 2001 was never satisfied and as such the performance guarantee did not come into being at all, remained ineffective and unenforceable and therefore could not be invoked.

9. The learned counsel for the respondent submitted that after the amendment of the bank guarantee substituting clause 4 on 20th August, 2001, the conditional bank guarantee furnished by the appellant became an unconditional one.

10. We have carefully considered the rival submissions made during the course of hearing of the appeal.

11. The law relating to invocation of bank guarantees is by now well settled by a catena of decisions of this court. The bank guarantees which provided that they are payable by the guarantor on demand is considered to be an un- conditional bank guarantee. When in the course of commercial dealings, unconditional guarantees have been given or accepted the beneficiary is entitled to realize such a bank guarantee in terms thereof irrespective of any pending disputes. In U.P. State Sugar Corporation vs. Sumac International Ltd. , this court observed that : 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 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 over ride the terms of the guarantee and the adverse effect of such an injunction on commercial dealings in the country. The two grounds are not necessarily connected, though both may coexist in some cases.

12. It is equally well settled in law that bank guarantee is an independent contract between bank and the beneficiary thereof. The bank is always obliged to honour its guarantee as long as it is an unconditional and irrevocable one. The dispute between the beneficiary and the party at whose instance the bank has given the guarantee is immaterial and of no consequence. In BSES Limited (Now Reliance Energy Ltd.) vs. Fenner India Ltd. And anr. this court held :

10. There are, however, two exceptions to this Rule. The first is when there is a clear fraud of which the Bank has notice and a fraud of the beneficiary from which it seeks to benefit. The fraud must be of an egregious nature as to vitiate the entire underlying transaction. The second exception to the general rule of non- intervention is when there are special equities in favour of injunction, such as when irretrievable injury or irretrievable injustice would occur if such an injunction were not granted. The general rule and its exceptions has been reiterated in so many judgments of this court, that in U.P. State Sugar Corpn. V. Sumac International Ltd. (1997) 1 SCC 568 (hereinafter U.P. State Sugar Corpn) this Court, correctly declare that the law was settled.

13. In Himadri Chemicals Industries Ltd. V. Coal Tar Refining Company , this court summarized the principles for grant of refusal to grant of injunction to restrain the enforcement of a bank guarantee or a letter of credit in the following manner :

14.. . . . .

(i) While dealing with an application for injunction in the course of commercial dealings, and when an unconditional bank guarantee or letter of credit is given or accepted, the Beneficiary is entitled to realize such a Bank Guarantee or a Letter of Credit in terms thereof irrespective of any pending disputes relating to the terms of the contract.

(ii) The Bank giving such guarantee is bound to honour it as per its terms irrespective of any dispute raised by its customer.

(iii) The courts should be slow in granting an order of injunction to restrain the realization of a bank guarantee or a Letter of Credit.

(iv) Since a Bank Guarantee or a Letter of Credit is an independent and a separate contract and is absolute in nature, the existence of any dispute between the parties to the contract is not a ground for issuing an order of injunction to restrain enforcement of Bank Guarantees or Letters of Credit.

(v) Fraud of an egregious nature which would vitiate the very foundation of such a Bank Guarantee or Letter of Credit and the beneficiary seeks to take advantage of the situation.

(vi) Allowing encashment of an unconditional Bank Guarantee or a Letter of Credit would result in irretrievable harm or injustice to one of the parties concerned.

14. In Mahatama Gandhi Sahakra Sakkare Karkhane vs. National Heavy Engg. Coop. Ltd and anr. , this court observed :

Para 22. If the bank guarantee furnished is an unconditional and irrevocable one, it is not open to the bank to raise any objection whatsoever to pay the amounts under the guarantee. The person in whose favour the guarantee is furnished by the bank cannot be prevented by way of an injunction from enforcing the guarantee on the pretext that the condition for enforcing the bank guarantee in terms of the agreement entered between the parties has not been fulfilled. Such a course is impermissible. The seller cannot raise the dispute of whatsoever nature and prevent the purchaser from enforcing the bank guarantee by way of injunction except on the ground of fraud and irretrievable injury.

Para 28. What is relevant are the terms incorporated in the guarantee executed by the bank. On careful analysis of the terms and conditions of the guarantee in the present case, it is found that the guarantee is an unconditional one. The respondent, therefore, cannot be allowed to raise any dispute and prevent the appellant from encashing the bank guarantee. The mere fact that the bank guarantee refers to the principle agreement without referring to any specific clause in the preamble of the deed of guarantee does not make the guarantee furnished by the bank to be a conditional one.

[Emphasis supplied]

15. Keeping these principles in mind we shall now proceed to apply the same to the facts of this case.

16. Shorn of all the embellishments the question that really arises for our consideration is as to whether bank guarantee furnished is an unconditional and irrevocable one or a conditional one? It may not be necessary to refer in detail the terms and conditions of the contract except to analyse the original clause of the bank guarantee dated August 10, 2001 and as well as the subsequent amendment of the relevant clause in the said bank guarantee on 20th August, 2001.

17. The relevant clause in the bank guarantee dated 10th August, 2001 furnished by the appellant is to the following effect :

Whereas M/s Vinitec Electronics Pvt. Ltd. H-33, Bali Nagar, New Delhi(hereinafter called the

Supplier) supplied their Vinitec on- line UPS systems of various capacities pursuant to their Agreement dated 10th May, 2000 & P.O.No.4500011730 dated 30.05.00 (hereinafter called the

Company) for the final Purchaser President of India through the Director, National Crime Records Bureau, Ministry of Home Affairs, Government of India, New Delhi(hereinafter called the Purchaser).

Whereas in terms of Clause No.15 of the Agreement for receiving the entire balance payments of Rs.49,99,335/- from the company, the supplier have agreed to provide a Performance Bank Guarantee equivalent to Rs.16,81,238.50 as 10% of the value of the contract to be kept valid till the warranty period during which times the Supplier is required to perform their warranty obligations to the Purchaser; and

Whereas pursuant to the application made by the supplier, we Oriental Bank of Commerce, Kirti Nagar, New Delhi (hereinafter called the Bank) have accordingly agreed to give the supplier a bank guarantee for the aforesaid purpose.

Therefore, we, the bank, hereby affirm that we are guarantors and responsible on behalf of the supplier upto a total of Rs.16,81,238.50(Rupees sixteen lacs eighty one thousand two hundred thirty eight and paise fifty only) and we undertake to pay any sum or sums within the limit of Rs.16,81,238.50(Rupees sixteen lacs eighty one thousand two hundred thirty eight and paise fifty only) as aforesaid upon receipt of written demand from the purchaser and Company within the validity of this Bank Guarantee establishing the supplier to be in default for the performance of their warranty obligations under the contract.

We, the bank, affirm that our liability under this guarantee is limited to the total amount of Rs.16,81,238.50(Rupees sixteen lacs eighty one thousand two hundred thirty eight and paise fifty only) and it shall remain in full force upto and including 31st August,2003 and shall be extended from time to time for such further period(s) as desired by the purchaser, Company and supplier on whose behalf this Guarantee has been given."

18. Thereafter by a letter dated 20th August, 2001, the bank guarantee was amended and Paragraph 4 of the bank guarantee dated 10th August, 2001 was substituted and the same reads as under :

Therefore, we, the Bank, hereby affirm that we are Guarantors and responsible on behalf of the supplier upto a total of Rs.16,81,238.50 (Rupees sixteen lacs eighty one thousand two hundred thirty eight and paise fifty only) and we undertake to pay any sum or sums within the limit of Rs.16,81,238.50 (Rupees sixteen lacs eighty one thousand two hundred thirty eight and paise fifty only) as aforesaid upon receipt of written demand from the Company within the validity of this Bank Guarantee.

19. In the unamended bank guarantee the bank affirmed that they are guarantors and responsible on behalf of the supplier upto a total of Rs. 16,81,238.50 (Rupees sixteen lakhs eighty one thousand two hundred thirty eight and fifty paise only) and had undertaken to pay any sum or sums within that limit upon receipt of written demand from the purchaser within the validity of bank guarantee provided it is established the supplier to be indefault for the performance of their warranty obligations under the contract. This makes it abundantly clear that what was furnished was a conditional bank guarantee and the bankers were liable to pay the amounts only upon establishing the fact that the supplier was in default for the performance of their warranty obligations under the contract. But by the subsequent letter dated 20th August, 2001, the relevant clause in bank guarantee was amended whereunder the banks stood as guarantor and responsible on behalf of the supplier upto a total of Rs.16,81,238.50 (Rupees sixteen lakhs eighty one thousand two hundred thirty eight and fifty paise only) and had undertaken to pay any sum or sums within that limit upon receipt of written demand from the Company within the validity of this bank guarantee. This amended clause

makes it abundantly clear that the bank had undertaken to pay amounts upto a total of Rs.16,81,238.50. The condition that the amounts shall be paid only upon establishing the supplier to be indefault for the performance of their warranty obligation under the contract has been specifically deleted. In our considered opinion, the bank guarantee as amended replacing Paragrah 4 of the original bank guarantee makes the bank guarantee furnished as unconditional one. The bankers are bound to honour and pay the amounts at once upon receipt of written demand from the respondent.

20. The learned senior counsel however relying upon the decision of this court in Hindustan Construction Co. Ltd.and ors. vs. State of Bihar and ors contended that the bank guarantee could not said to be unconditional or unequivocal in terms so that the respondent could claim any unfettered right to invoke the bank guarantee and demand immediate payment thereof from the bank. We find no substance in the submission so made by the learned senior counsel on behalf of the appellant. In Hindustan Construction (supra), the appellant Company was awarded a contract by the State of Bihar for construction of a dam. Clause 9 of the contract between the parties provided that the State would make an advance loan to the Company for the costs of mobilisation in respect of the works on furnishing of a bank guarantee by the appellant for an amount equal to the advance loan. The advance loan was required to be used exclusively for mobilisation expenditure. In case of misappropriation of the advance loan the loan at once shall become due and payable immediately. In terms of this clause bank guarantee was furnished by the bank agreeing unconditionally and irrevocably to guarantee payment on demand without any objection but with the qualification that such payment shall be only in the event the obligations expressed in Clause 9 of the original 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. Clause 9 of the main contract was thus incorporated and made part of the bank guarantee furnished by the banker. It is under those circumstances this court took the view that the bank guarantee furnished was not an unconditional one. Clause 9 in the bank guarantee refers to the terms and conditions of the contract between the parties. The bank guarantee thus could be invoked only in the circumstances referred to in Clause 9 wherein the amount would become payable only if the obligations are not fulfilled or there is misappropriation.

21. In the present case the amended clause does not refer to any of the clauses specifically as such but on the other hand the bank had undertaken responsibility to pay any sum or sums within the guaranteed limit upon receipt of written demand from the Company. The operative portion of the bank guarantee furnished by the bank does not refer to any of the conditions for payment under the bank guarantee. It is true that the bank guarantee furnished makes a reference to the principal agreement between the parties in its preamble. Mere fact that the bank guarantee refers to the principal agreement in the preamble of the deed of guarantee does not make the guarantee furnished by the bank to be a conditional one unless any particular clause of the agreement has been made part of the Deed of Guarantee.

22. The recitals in the preamble in the deed of guarantee do not control the operative part of the deed. After careful analysis of the terms of the guarantee we find the guarantee to be an unconditional one. The appellant, therefore, cannot be allowed to raise any dispute and prevent the respondent from encashing the bank guarantee.

23. The next question that falls for our consideration is as to whether the present case falls under any of or both the exceptions namely whether there is a clear fraud of which the bank has notice and

a fraud of the beneficiary from which it seeks to benefit and another exception whether there are any special equities in favour of granting injunction.

24. This Court in more than one decisions took the view that fraud, if any, must be of an egregious nature as to vitiate the underlying transaction. We have meticulously examined the pleadings in the present case in which no factual foundation is laid in support of the allegation of fraud. There is not even a proper allegation of any fraud as such and in fact the whole case of the appellant centers around the allegation with regard to the alleged breach of contract by the respondent. The plea of fraud in appellants own words is to the following effect:

That despite the respondent, HCL being in default of not making payment as stipulated in the Bank Guarantee, in perpetration of abject dishonesty and fraud, the respondent, HCL fraudulently invoked the Bank Guarantee furnished by the applicant and sought remittance of the sums under the conditional Bank Guarantee from the Oriental Bank of Commerce vide letter of invocation dated 16.12.2003.

25. In our considered opinion such vague and indefinite allegations made do not satisfy the requirement in law constituting any fraud much less the fraud of an egregious nature as to vitiate the entire transaction. The case, therefore does not fall within the first exception.

26. Whether encashment of the bank guarantee would cause any irretrievable injury or irretrievable injustice. There is no plea of any special equities by the appellant in its favour. So far as the plea of irretrievable injustice is concerned the appellant in its petition merely stated:

That should the respondent be successful in implementing its evil design, the same would not only amount to fraud, cause irretrievable injustice to the applicant, and render the

arbitration nugatory and infructuous but would permit the respondent to take an unfair advantage of their own wrong at the cost and extreme prejudice of the applicant.

27. The plea taken as regards irretrievable injustice is again vague and not supported by any evidence.

28. There is no dispute that arbitral proceedings are pending. The appellant can always get the relief provided he makes his case before the Arbitral Tribunal. There is no allegation that it would be difficult to realize the amounts from the respondent in case the appellant succeeds before the Arbitral Tribunal.

29. In this view of the matter, we see no merit in this appeal.

30. We make it clear that this order and as well as the order passed by the Delhi High Court shall have no bearing on the merits of the case pending before the Arbitral Tribunal.

31. The appeal is accordingly dismissed. We make no order as to costs.