CALCUTTA HIGH COURT

Texmaco Ltd

Vs.

State Bank of India

Suit No. 562 of 1977

(Sabyasachi Mukharji, J.)

12.05.1978

ORDER

Sabyasachi Mukharji, J.

1.This is an application in Suit No. 562 of 1972 whereby the petitioner, Textile Machinery Corporation Ltd. hereinafter referred to as Texmaco Ltd. asked for an injunction against the State Bank of India, State Trading Corporation of India and the Projects and Equipment Corporation of India Ltd. restraining the State Bank of India from releasing or making any payments to the State Trading Corporation of India and the Projects and Equipment Corporation of India Ltd. under or in respect of the performance Guarantee issued by the State Bank of India.

2. In order to appreciate the contentions, it may be necessary briefly to refer to certain facts. It appears that on 23rd Oct. 1970, there was an agreement between the Community of the Yugoslav Railways and the State Trading Corporation of India Ltd. briefly referred to hereinafter as S.T.C. for manufacture in India and supply in Yugoslavia for different railways, known as ZTPs 1300 Gas type and 2300 EAS type wagons. Article 10 of the said agreement provided that the technical guarantee was regulated by the provisions stated in Annexure-VI. Annexure-VI to the agreement provided that S.T. C. should give the guarantee for the high quality of the delivered wagons for a period of one year after the acceptance of the wagons in Yugoslavia. RUDNAP, a Yugoslav firm was the agent of the Community and also a confirming party to the agreement. On 4th June 1971 back to back contract between S.T.C. and the plaintiff for manufacture and supply of 434 Gas wagons, 425 EAS wagons on the same terms and conditions of the export contract dated 23rd Oct. 1970 was entered into. The terms and conditions of the export contract including the terms as to the period of guarantee of one year were incorporated in the back to back contract. In the said contract, inter alia, it was stipulated as follows :

> "TEXMACO hereby indemnify and shall keep the S.T.C. indemnified against all actions, claims, proceedings, demand, damages, losses, costs and expenses in respect of or in connection with or in relation to or arising out of any matter under this contract and/or Export Contract relating to the WAGONS due to Texmaco's failure to perform any of its

obligations under the contract."

Thereafter, on or about 18th Sept. 1971 there was an agreement between S.T. C. and the Braithwaite and Co. whereby Braithwaite agreed to manufacture and supply 425 EAS wagons. In Dec. 1972 the wagons to he supplied to ZTP could only be shipped in knocked down condition and contained various parts not available in India. An assembly contract was entered into between Indian manufacturers including the plaintiff and RUDNAP whereby RUDNAP were required to assemble the components of the wagons and to fit into the same the other imported parts. RUDNAP gave necessary undertakings and guarantees to the Indian manufacturers for due performance of its obligations. On 20th Jan. 1973 a tripartite agreement between S.T.C. the plaintiff and Braithwaibe and Co. Ltd., for reallocation between the plaintiff and the Braithwaite for the manufacture and delivery of the Railway wagons was made. Then, pursuant to the back to back contract, the State Bank of India, on or about 26th Feb. 1973 at the instance of the plaintiff gave a Bank guarantee in favor of S.T.C. for a sum of Rs. 49,50,570/- being 5 per cent of the price of the wagons for due performance by the plaintiff in an orderly manner their contractual obligations under the back to back contract. It is now relevant to refer to the said document. The said guarantee after reciting the previous contract mentioned hereinbefore, recited that there was a back to back contract signed by the S.T.C. and Texmaco on 4th June, 1971 and a tripartite agreement had been entered into between the Textile Machinery Corporation Ltd., Braithwaite, and Co. Ltd. and the State Trading Corporation of India Ltd. on the 20th Jan. 1973 and the Texmaco had agreed to manufacture and sell as follows :

> "AND WHEREAS by a Back to Back Contract signed by STC and TEXMACO on 4th June, 1971 and a tripartite agreement into between Textile Machinery Corporation Ltd. Braithwaite and Co. (India) Ltd. and State Trading Corporation of India Ltd. on the 20th Jan, 1973 (hereinafter referred to as Back to Back Contract) TEXMACO have agreed to -
> (a) manufacture and supply 867 GAS wagons (hereinafter referred to as wagons) at the total price of Rs. 9,90,11,400/- (Rupees Nine crores ninety lacs eleven thousand and four hundred only) (hereinafter referred to as the price) and
> (b) perform and observe all the obligations covenants and agreements required to be performed and observed on the part of STC under the Export Contract insofar as these related to the Wagons."

3. Thereafter after reciting the Back to Back Contract, TEXMACO had to provide STC with a performance Bank Guarantee for five per cent of the price guaranteeing orderly performance of TEXMACO'S contractual obligations.

4. Thereafter at the request of TEXMACO the Bank had agreed to give a guarantee and STC had agreed to accept the same. The guarantee was in the following terms :

> "Now This Guarantee Witnesseth That :
> 1. In consideration of the aforesaid premises and at the request of Texmaco we, the Bank, hereby irrevocably and unconditionally guarantee that Texmaco shall perform, in an orderly manner, their contractual obligations under the Back to Back Contract and in the event of Texmaco's failure to do so, the Bank shall pay to STC on its first demand, any

amount up to Rs. 49,50,570/- (Rupees forty nine lacs fifty thousand and five hundred seventy only) being 5% of the price, without any contestation, demur or protest and/or without any reference to Texmaco and,/or without questioning the legal relationship subsisting between STC and Texmaco.

2. Our obligations under this guarantee shall be reduced, automatically in proportion to the value of the wagons for which the guarantee period has expired from time to time in terms of the Back-to-Back contract.

3. The DECISION of the STC as to the liability of the Bank under the guarantee and the amounts payable thereunder shall be final and binding on the Bank. The Bank shall pay forthwith the amount demanded by STC notwithstanding any dispute between STC and TEXMACO.

5. NOTWlTHSANDING anything stated above our liability under the guarantee is restricted to Rs. 49,50,570/- (Rupees forty-nine lacs fifty thousand five hundred and seventy only). Our guarantee shall remain in force until the 31st Dec. 1975. Unless a suit or an action to enforce a claim under the Guarantee is filed against us before that date, all your rights under the guarantee shall be forfeited and we shall be released and discharged from all liability thereunder, provided always that if at the expiry of this guarantee period any wagons remain undelivered or the contractual guarantee period in respect of wagons has not expired, the Bank shall forthwith on demand pay to S.T.C. a sum equal to 5 per cent of the price in respect of such wagons provided further that the statement of S.T.C. with regard to such wagons shall be final and conclusive in this connection."

It appears that on 26th Feb. 1973 in consideration of the guarantee given by State Bank of India to S.T.C. the plaintiff gave a counter guarantee to State Bank of India. In view of the said agreement dated 28th Oct. 1970, on or about 24th Aug. 1973 the back to back contract dated 4th June, 1971 was modified and the plaintiff was required then to manufacture and supply 433 G.A.S. wagons in addition to 434 G.A.S. wagons agreed to be manufactured originally and the plaintiff was discharged from its obligation to manufacture the 425 EAS wagons. On 16th January, 1975 the export contract dated 23rd Oct. 1970 was modified by reducing the total number of EAS type wagons to be supplied by STC to ZTPS to 850 and GAS type to 450. The export contract stood modified by necessary addendum. On the 27th June, 1975 the Bank guarantee given by the State Bank of India was reduced to Rs. 21,51,875/-. In view of the reduction of the number of wagons to be manufactured by the plaintiff to 275, the period of validity was extended till 8th May, 1977. Other conditions of the Bank guarantee remained the same.

5. On the 25th Nov. 1975 the State Bank of India gave a Bank guarantee to the concerned ZTPs guaranteeing the due performance of the obligations under the export contract of STC. On the 10th May, 1978 consequent upon the modification of the export contract, the Back to Back contract of the plaintiff was further modified by an addendum by which the plaintiff was then required to manufacture and supply 275 GAS wagons instead of 867. On the 23rd Nov. 1976 by further endorsement, the period of validity of the Bank guarantee was extended up to 8th February. 1978. On the 11th March 1977, the State Bank of India wrote to the defendant No. 3, the Project and Equipment Corporation of India Ltd. informing that the bank had received a

cable from the foreign bankers of the ZTP claiming full payment of the Bank guarantee on the allegation that STC had failed to perform in orderly manner their obligations under the relevant contract. On the 3rd June, 1977, the validity of the performance guarantee of one year from the date of acceptance of the wagons for 280 wagons had expired, On the 15th June, 1977, two telex were issued on behalf of STC to the State Bank of India and RUDNAP reiterating that an invocation of performance guarantee by the ZTPs was improper and that there was no failure on the part of STC to perform the obligations and that in any event the guarantee automatically stood reduced in proportion to the value of the wagons for which the guarantee period had expired. Thereupon, on the same day, that is, on the 15th June, 1977 the STC wrote to the State Bank of India invoking the guarantee after setting out the performance guarantee as mentioned hereinbefore. The STC wrote to the State Bank of India as follows :

> "The Community of Yogoslav Railway/ZTPs have invoked the STC's Performance guarantee for Rs. 91,95,000.00 furnished in their favor by the State Bank of India, New Delhi at the request of STC by virtue of Clause 55 of the Contract dated 23rd Oct. 1970 between STC and the Community of Yugoslav Railways for the supply of 3600 Railway wagons (hereinafter called "the Export Contract") amended by Addendum dated 16th Jan. 1975 to the Export Contract alleging failure an the part of STC to perform in an orderly manner its obligations under the Export Contract. STC is contesting the Beneficiaries claim for payment under STC's said Performance Guarantees. Notwithstanding the foregoing STC maintains that TEXMACO failed to perform in an orderly manner its obligations under the aforesaid Back to Back contract. In view of the foregoing STC hereby calls upon you to make full payment to it of the whole of the guaranteed amount of Rs. 21,51,875/- (Rupees Twenty one lacs fifty one thousand eight hundred and seventy five only) under your aforesaid performance guarantee."

They have further added the following :

> "as already intimated and stated in our above communication to the State Bank of India, Calcutta Main Branch, 1 - Strand Road, Calcutta, this is once again to place an record that as agreed to by and between you and us STC is contesting the claim of the Community of Yogoslav Railmay/ZTPs for payment to them of the amount guaranteed under our aforesaid Performance Guarantee for Rs. 91,95,000.00 furnished to the Community of Yogoslav Railways/ZTPs by virtue of the Export Contract. But, in the event of the claims of the Community of Yogoslav Railways/Rudnap being upheld or our aforesaid performance guarantee in favor of the Community of Yogoslav Railways/ZTPs being enforced we would enforce payment under your aforesaid performance Guarantee."

6. Thereafter, between 2nd July, 1977 and 22nd July, 1977 there were exchanges of correspondence between STC and the State Bank of India. Again, on the 30th Aug. 1977, STC invoked the Bank guarantee and asked for full payment. Thereafter the suit was filed and interim injunction was obtained in this suit.

7. The question, is, whether the plaintiff petitioner is entitled to the injunction, as asked for restraining the State Bank of India from making any payment pursuant to the performance guarantee. Reliance in this connection was placed heavily on behalf of the petitioner on the observations of the Division Bench of this Court in the case of *State Bank of India v. Economic Trading Corporation*[1], It appears that in the case of *Tarapore and Co. Madras v. V. O. Tractors*[2] the Supreme Court had

[1] AIR 1975 Cal 145 [2] AIR 1970 SC 891

to deal with the nature of letter of credit. Thereafter, the position was reviewed by a Division Bench of this Court in the case of the *Minerals and Metals Trading Corporation of India v. Suryaballav Seth*[3] The distinction between irrevocable letter of credit and bank guarantee was examined by the said Division Bench judgement as well as by the Division Bench judgement of this Court in the case of *State Bank of India v. Economic Trading Corporation.* Both these cases, drew the distinction between the irrevocable letter of credit and the bank guarantee. But both these cases reiterated, the payment under a bank guarantee like payment under letter of credit become due only on compliance with the terms on which the bank was to pay under the respective documents. In the case of the *Minerals and Metals Trading Corporation v. Suryahallav Seth*[4], the Division Bench had to deal with the two Bank guarantees; in respect of one there was no stipulation that the dispute between the parties would be no ground for withholding the payment by the Bank but in respect of the second guarantee there was that express stipulation. The Division Bench in the aforesaid decision, at pp. 997 to 998 of the report noted the said distinction and observed that the absence in the first guarantee of a term similar to the term in the second guarantee, namely the right of the appellant to recover the moneys payable under the guarantee would not be affected by such dispute or any proceedings, and in the end, the Division Bench, therefore, on the construction of the said two Bank guarantees upheld the order of the learned trial judge, who had granted the injunction only in respect of that Bank guarantee which did not contain the term that irrespective of the dispute between the parties, the bank would be obliged to pay but so far as the trial Judge had granted the injunction in respect of other matter which contained this clause, referred to hereinbefore, the injunction was vacated. In the case of *State Bank of India v. Economic Trading Corporation Ltd.* (supra) the facts were significant. There in a prior suit, prior order of injunction had been obtained by an Indian seller against the Egyptian Bank and an Egyptian buyer. That order of injunction, though obtained ex parte, was not the subject matter of consideration before the Division Bench, which had an occasion to consider this question. Thereupon the plaintiff had applied for adding the State Bank of India as a party and issuing an injunction against the State Bank of India from making payment to the Bank of Alexandria at Egypt. The learned trial judge had refused to add the State Bank as a party but had directed the State Bank of India to deposit the money in Court. The propriety of that order was under challenge before the Division Bench. which had to deal with the matter in the decision reported. The Court upheld the order of injunction against the State Bank of India not because the party at whose instance the Bank gave the guarantee had a right to obtain injunction against the Bank, because the dispute between that party and the foreign party was pending but because of the peculiar facts of that case, that is to say, there was a prior pre-existing, order of injunction against the foreign buyer and the foreign banker which order was not the subject matter of dispute before the Appeal Court and which order should not have been circumvented by allowing the State Bank of India to make the payments. It is in this context, the order of injunction against the Bank was sustained. The position would be abundantly clear, if a reference is made to the basis upon which the order was made. There, the Court observed as follows at pp. 149-150 of the report in paras. 4 and 5 :

"4. In the instant cage before us, counsel for the State Bank of India, placed reliance on the use of the expression 'we indemnify you', in the telegram dated the

[3](1970) 74 Cal WN 991

[4](1970) 74 Cal WN 991

29th Aug. 1967, which is at page 63 of the Paper Book. Apart from the aforesaid expression used thereunder we are not aware of the terms and conditions, if any, under which the indemnity, if any, was granted by the State Bank of India to the Bank of Alexandria. The scope and effect of an indemnity is dealt with under the provisions of Section 124 of the Indian Contract Act which provides as follows :

'A contract by which one party promises 'to save the other from the loss caused to him by the conduct of the promisor himself or by the conduct of any other person, is called a Contract of indemnity.'

The Section in its terms is dependent upon the obligation which arises on the loss caused to the party to be indemnified. The loss may, however, be caused not by actual payment but otherwise and that was recognized by several decisions of Calcutta and Bombay. Reference in this connection may be made to the decisions of this Court in the case of *Osman Jamal and Sons Ltd. v. Gopal Purshottam*[5], in the case of *Chand Bibi v. Santoshkumar Pal*[6], and in the case of *Gajanan Moreshwar v. Morehwar Madan*[7], But in ah these cases the cases were decided upon the terms and conditions of the indemnity. In the instant case, as mentioned hereinbefore, we are not aware of the terms and conditions of the indemnity. In this case, therefore, the indemnity, must be for the loss to be caused by the conduct of the other party. In this case, the facts have, again to be viewed in the light that there is already an injunction against the Bank of Alexandria as well as against the foreign buyer restraining them from receiving any money. That injunction was issued by this Court. The order of injunction has not been varied, or vacated. Therefore, lawfully so long as order of this Court stands restraining the Bank of Alexandria from making any payment or the foreign buyer from receiving any payment, any payment to be made or attempted to be made would be in violation of the order of A.N. Sen, J., dated the 28th November 1967 as mentioned hereinbefore and that order is binding on the Bank of Alexandria until it is set aside or lawfully declared not binding. It would, therefore, be not correct to say that so long as that order stands, the Bank of Alexandria would be under an obligation to pay without contestation the amount agreed to be paid under a letter of credit to the foreign buyer. The unilateral assertion of the Bank of Alexandria that under the Egyptian Law they were under an obligation to pay without contestation would not be decisive of the matter. In a case of this nature the question always arises as to what is the proper law of the contract and the unilateral assertion of the party that under the Egyptian law they were under an obligation to pay where there is already a lawful injunction granted by this Court cannot in our opinion be conclusive of the matter. It would not be right to say that any order made in aid and/or in furtherance of that order would be illegal. An order to prevent circumvention of that order by indirect method would not be illegal. Counsel for the appellant stressed a great deal on international credit and reputation. International credit, however, cannot and should not be sought by such dubious process of permitting circumvention of the lawful order passed by this Court. In the aforesaid view of the matter in the facts and circumstances of the case, we are therefore, of the opinion that the same kind of order restraining the State Bank of India from making any payment to the Bank of Alexandria so that the order

made by A.N. Sen, J. an the 28th Nov. 1967 may not be defeated, would not be improper, invalid or illegal, but would be on the contrary quite justified."

[5] AIR 1929 Cal 208
[6] AIR 1933 Cal 641
[7] AIR 1942 Bom 302

8. The position has been recently examined in England by Mr. Justice Kerr in the case of *R.D. Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd*[8]. the learned Judge observed as follows :

> "It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international commerce. Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. Except possibly in clear cases of fraud of which the banks have notice the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration . . . . The courts are not concerned with their difficulties to enforce such claims : these are risks which the merchants take. In this case the plaintiffs took the risk of the unconditional wording of the guarantees. The machinery and commitments of banks are on a different level. They must be allowed to be honoured, free from interference by the courts. Otherwise trust in international commerce could be irreparably damaged."

9. The position was again reviewed by the Court of Appeal in England in the case of *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd*[9]. where speaking for the Court, Lord Denning, M. R. observed that in respect of a bank guarantee which stipulated that payment will be made by the Bank down the line and be made by them on demand and without proof or conditions the Master of Rolls observed that the performance guarantee was virtually a promissory note payable on demand and observed at p. 773 of the report as follows :

> "All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit. A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not. The Bank must pay according to its guarantee, on demand if so stipulated, without proof or conditions. The only exception is when there is a clear fraud of which the Bank has notice."

10. In my opinion, the position in law is as follows, whether the bank is obliged to pay and pay on what terms must depend upon both in the case of bank guarantee and in the case of letter of credit on the terms of the document. With respect to the Court of Appeal, it is not necessary for this Court to go to the extent of saying whether the performance guarantee stands on a similar footing of a letter of credit but so far as the Court of Appeal says the bank must pay according to the guarantee on demand, if so stipulated, without proof or conditions, I respectfully agree. The Court of Appeal has referred to the exception of a clear fraud. I venture to suggest there may be another exception in the form of special equities arising from a particular situation which might

entitle the party to an injunction restraining the performance of bank guarantee. But in the absence of such special equities and in the absence of any clear fraud, the Bank must pay on demand, if so stipulated, and whether the terms are such, must have to be found out from the
[8]1977 (3) WLR 752. At page 761
[9]1977 (3) WLR 764
performance guarantee as such.

11. Keeping the aforesaid principles in mind I must examine the bank guarantee in the instant case. Here though the guarantee was given for the performance by Texmaco in an orderly manner their contractual obligation the obligation was taken by the bank to repay the amount on "first demand" and "without contestation, demur or protest and without reference to Texmaco and without questioning the legal relationship subsisting between STC and Texmaco." It further stipulated, as I have mentioned before, that the decision of STC as to the liability of the bank under the guarantee and the amounts payable thereunder shall be final and binding on the bank. It has further stipulated that the bank should forthwith pay the amount due "notwithstanding any dispute between STC and Texmaco." In that context, in my opinion, the moment a demand is made without protest and contestation, the bank has obliged itself to pay irrespective of any dispute as to whether there has been performance in an orderly manner of the contractual obligation by the party.

12. Then it was contended that there has been no decision of STC as contemplated under Clause 3 referred to hereinbefore and no demand. This position also, in any opinion, cannot be sustained because in the letter dated 15th June 1974 it has been stipulated that "notwithstanding the foregoing" STC Maintains "Texmaco failed to perform in an orderly manner its obligations under the aforesaid contract. In the view of the foregoing, STC hereby asks you to make full payment". Whether STC has acted logically or illogically, rationally or irrationally is not the question relevant but in this case of course there is no evidence that STC has acted illogically or irrationally. They, counsel for the petitioner submitted that with a foreign buyer it was being contended by STC that there has been orderly performance. Therefore, it was urged that there was inconsistent stand or in other words STC could not be allowed to both approbate and reprobate. This position also is not relevant. Under the terms of the bank guarantee it is upon STC's decision to claim the money notwithstanding any dispute between STC and Texmaco that the bank has obliged itself to discharge that liability. Learned Solicitor General appearing for the STC has assured the Court that in case ultimately STC succeeds in reducing or in wiping out the liability payable to the foreign Yugoslav firm in respect of the main contract, proportionate reduction and refund will be given to the petitioner. In that view of the matter, the terms of the guarantee oblige the bank to pay to the STC on demand being made and the existence of the dispute as to due performance or orderly performance is irrelevant on this aspect of the matter. There is no question of any fraud or any equity entitling the plaintiff to an injunction. If that is the position then, in my opinion, the plaintiff is not entitled to an injunction in this application.

13. It is stated on behalf of the respondents that the performance guarantee would be enforced only to the proportion that the STC has paid to the foreign buyer.

14. It is contended on behalf of the petitioners that between 11th March 1977 and 15th June, 1977 certain portions of the validity of the bank guarantee have expired. But it is not necessary for me to go into this aspect of the matter in this application.

15. On behalf of the respondents it is contended on the other hand that it is not a correct statement and it does not affect the recovery of the sum of Rs. 39 lakhs paid by them in respect of which the guarantee has been given. In the view I have taken it is not necessary for me at this stage to go into this aspect of the matter.

16. In the view I have taken the plaintiff is not entitled to an injunction in this application. The application is, therefore, dismissed. Interim orders, if any, are vacated.

17. There will be a stay of operation of this order till 26th May, 1978.

18. Cost of this application will be the costs in the cause.

Application dismissed.