Larsen and Toubro Ltd. Vs Visa Power Ltd.

Court: Calcutta High Court

Date of Decision: July 10, 2012

Acts Referred: Arbitration and Conciliation Act, 1996 â€" Section 9

Citation: (2013) 1 ARBLR 551 : (2012) 4 CALLT 203 : (2013) 1 CHN 129

Hon'ble Judges: Sanjib Banerjee, J

Bench: Single Bench

Advocate: S.N. Mookherjee, Mr. Jishnu Saha, Mr. D. Negi and Mr. N. Mukherjee, for the Appellant;Ranjan Deb Mr. Tilak Bose Mr. Sabyaschi Chowdhury and Mr. Arvind Jhunjhunwala, for the Respondent

Judgement

Sanjib Banerjee, J.
The principal prayer made in this petition u/s 9 of the Arbitration and Conciliation Act, 1996 is for an injunction

restraining the respondent from invoking or receiving payments under three several bank guarantees furnished in connection with a contract for

setting up a power plant in Raigarh. There is an incidental prayer in the nature of attachment before judgment. The arbitration clause is not in

dispute. Upon leave under Clause 12 of the Letters Patent having been granted on July 6, 2012, it was submitted on behalf of the respondent that

it had an objection to the authority of this Court to entertain the petition. The objection has not been elaborated upon today. On July 6, 2012, the

respondent had, however, been gracious enough to not insist on immediate payment from the bank since the matter could not have been

conveniently concluded on that date. The concession recorded in the order dated July 6, 2012, however, did not create any equity in favour of the

petitioner nor did it bind the respondent to abide thereby beyond the time that the matter was due to be taken up in Court. The respondent says

that the bank guarantees have been invoked but the payment has not yet been received. There will be no impediment to the payment under the

three several bank guarantees being received and the bank or banks are left free to make payment thereunder.

2. A letter of award was issued for the design, supply, erection and commission of the two 600 MW units of the proposed power plant. Four

several contracts were entered into by the parties on December 7, 2011 for the supply of machinery, construction of the plant, supply of raw

material and the commissioning of the units. The case made out by the petitioner is that notwithstanding the agreement envisaging regular payments

to be made on 30-day after basis following the running bills being of the petitioner being submitted, the respondent has failed to adhere to the

payment schedule and the respondent has subsequently sought to modify the scope of the work as originally contemplated.

3. The petitioner demonstrates from the correspondence exchanged between the parties that payments in accordance with the agreed terms were

not tendered by the respondent. The petitioner refers to the minutes of several meetings held between the representatives of the parties from which

it is evident that the respondent sought time to make payment and only made part payments of the long overdue amounts. It appears to be fairly

clear on the basis of the documents relied upon, that the petitioner has a substantial claim. The petitioner insists that bills of value in excess of Rs.

141 crore have been certified for payment by the respondent. The respondent disputes such figure but it does not appear that the amount covered

by the bills already raised and not paid for by the respondent is insubstantial.

4. The petitioner refers to the minutes of a meeting held on December 8, 2011, whereat the respondent admitted that a substantial amount

remained due to the petitioner. In letters exchanged thereafter, it is evident that the petitioner claimed by January 14, 2012 that a sum in excess of

Rs. 76 crore was due in respect of the certified bills. The petitioner stresses on a letter dated January 19, 2012 issued by the respondent. It is

evident from such letter that a financial tie-up had been completed by the respondent under which it was to obtain credit facilities from one or more

banks. The petitioner says that in the respondent agreeing to release funds within thirty days of the bills being raised therefor by the petitioner, and

in the respondent not having funds available to honour such commitment, the respondent had perpetrated fraud in inducing the petitioner to enter

into an arrangement without believing that the respondent could honour its part of the bargain therein. The petitioner insists that the conduct of the

respondent would amount to the fraud of the kind that would entitle the petitioner to obtain an order of injunction against the irrevocable bank

guarantees furnished in connection with the transaction.

5. The bank guarantees are as unconditional as they come. The wording of one of the bank guarantees may be taken as a specimen. Under the

bank guarantee of September 23, 2010, the bank promised thus:

We... do hereby guarantee and undertake to pay the Owner, on demand any or all monies payable by the Contractor to the extent of... without

any demur, reservation, contest, recourse or protest and/or without any reference to the Contractor. Any such demand made by the Owner on the

Bank shall be conclusive and binding notwithstanding any difference between the Owner and the Contractor or any dispute between the Owner

and the Contractor pending before any Court, Tribunal, Arbitrator or any other authority. We agree that the guarantee herein contained shall be

irrevocable and shall continue to be enforceable till the Owner discharges this guarantee.

6. The petitioner asserts that following the respondent''s failure to make the payment due to the petitioner, it issued a notice of suspension of the

work on January 30, 2012. Such suspension was to take effect on February 29, 2012 if the money due to the petitioner in terms of the agreement

was not paid by then. The petitioner refers to the minutes of the meeting held between the parties on March 1, 2012 and the promise made by the

respondent to clear the dues and the petitioner revoking the notice of suspension subject to receiving the payment by March 12, 2012. The

petitioner relies on the repeated demands thereafter for release of the money due.

7. The petitioner seeks to demonstrate that the complaints as to the petitioner''s work under the contract began, as an afterthought, only after the

notice of suspension was issued. Though the respondent has carried a set of documents to suggest that such matters as to the pace and quality of

the work had been complained of earlier and several relevant letters in such regard have been suppressed, it is not necessary to dwell at any length

on such aspect of the matter.

8. If the petitioner''s case best arguable case is taken, these are the assertions made: there is an amount in excess of Rs. 140 crore which is due

from the respondent to the petitioner and which has not been paid by the respondent in breach of the terms of the agreement; contrary to the

requirement in the agreement of there being two 600 MW units, the respondent wants to scale it down to one unit and either suspend the work

relating to the second unit or cancel the same altogether; the respondent has resorted to scaling down the operations in view of its inability to

mobilise funds; and, the respondent had a financial tie-up relating to the project as late as in January, 2012 when the work relating thereto had

been commenced several months earlier and it had undertaken the obligation to make payments without having the requisite means.

9. The law as it is on bank guarantees would not permit even such facts and the best arguable case of the petitioner to be rewarded with the

unusual and extraordinary order of payment under an irrevocable bank guarantee being injuncted.

10. The petitioner has first referred to a judgment reported a Hindustan Construction Co. Ltd. and Another Vs. Satluj Jal Vidyut Nigam Ltd.,

where a single Judge noticed several authoritative pronouncements on the legal issue as to when a bank guarantee could be interdicted including the

cases of AIR 1997 1644 (SC); Federal Bank Ltd. Vs. V.M. Jog Engineering Ltd. and Others, Hindustan Steel Works Construction Ltd. Vs.

Tarapore and Co. and another, (1984) 1 All ER 351; and, Itek Corporation v. The First National Bank of Boston, 566 Fed. Supp. 1210, to

conclude that an injunction against the encashment of a bank guarantee was an exception and not the rule. The Court held, at paragraph 20 of the

report, that the exceptional cases should fall within the following categories:

20....

(i) If there is a fraud in connection with the bank guarantee which would vitiate the very foundation of such guarantee and the beneficiary seeks to

take advantage of such fraud.

(ii) The applicant, in the facts and circumstances of the case, clearly establishes a case of irretrievable injustice or irreparable damage.

(iii) The applicant is able to establish exceptional or special equities of the kind which would prick the judicial conscience of the Court.

(iv) When the bank guarantee is not invoked strictly in its terms...

11. In the Satluj Jal Vidyut Nigam matter, the Court found that there was no dispute that the contract had been executed. The performance

guarantee in that case was sought to be invoked a day prior to the expiry of the performance period. The Court noticed that an internal mechanism

set up by the employer in that case found that the contractor was entitled to the extension of the period for completion of the work and held that

since such findings were against the employer, ""it will be more than unfair to permit the respondents to invoke the bank guarantees at this stage of

the proceedings.

12. Such judgment was upheld in an appeal by an order of July 26, 2007 in FAO (OS) 77 of 2006 [Satluj Jal Vidyut Nigam Ltd. v Hindustan

Construction Company Ltd.) on the ground that the facts were covered in a previous Division Bench judgment reported at Satluj Jal Vidyut Nigam

Ltd. Vs. Jai Prakash Hyundai Corsortium, A SLP carried from the Jai Prakash Hyundai Consortium matter was dismissed by the Supreme Court

on April 3, 2006. The Supreme Court order in SLP (Civil) No. 5456 of 2006 reads as follows:

Having heard learned counsel for the parties, we modify the impugned order passed by the High Court directing that the fresh guarantees furnished

by the respondent shall be kept alive and the same shall not be invoked or discharged till a award is made by the arbitrator.

With the aforementioned observations the SLP is dismissed.

13. With respect, the legal basis to the order of injunction granted by the Delhi High Court in either case cannot be appreciated. The High Court

restrained unconditional bank guarantees being encashed upon assessing the merits of the disputes between the parties relating to the underlying

contract. The High Court also did not render a finding in either case that the contractor would not be in a position to claim and obtain the amount

covered by the bank guarantee from the employer. It is also elementary that when a petition for special leave to appeal is dismissed by the

Supreme Court, it does not amount to the Supreme Court affirming the order sought to be appealed against or accepting the legality thereof.

14. In another case cited by the petitioner, one reported at P.D. Alkaram Pvt. Ltd. Vs. Canara Bank and Another, a single Judge granted an

injunction restraining the encashment of a bank guarantee furnished on account of mobilisation advance. The Court found that the contractor in that

case had used the entire mobilisation advance for procuring the material for the construction of the building that was to be built under the contract

and opined, ""I feel that the plaintiff has successfully brought special circumstances which are sufficient to make the present case and exceptional

one justifying interference by restraining defendant No. 2 from enforcing the Bank guarantee in question.

15. In all humility, the legal basis to that order can also not be accepted since it is fundamental to bank guarantees and letters of credit that such

contracts are seen to be independent of the underlying contract. Indeed, bank guarantees are required to be furnished to insulate the matter

covered thereby from the disputes that may arise under the underling contract.

16. Another Single Bench judgment of the Delhi High Court reported at Victor Cables Industries Ltd. Vs. Engineering Projects (I) Ltd. and

Another, has been carried by the petitioner in support of the proposition that where the performance under the contract had been jeopardised by

reason of the unilateral change of conditions of the contract and the terms of payment thereunder by the employer, the bank guarantees pertaining

to the advance payments and security could not be encashed by the recalcitrant employer. The court found that upon the employer causing

financial detriment to the contractor by changing the conditions of the contract, the ""petitioner has made out a prima facie case of special equity in

his favour."" Again, with respect, the law as it is on bank guarantees, does not permit disputes relating to the working of the principal contract to be

made on the grounds for restraining the encashment of an unconditional bank guarantee furnished in connection with the transaction. In the

alternative, the facts in that case were found to be so overwhelmingly in favour of the contractor that an exceptional case was seen to have been

made out.

17. Not every perceived wrong can be exalted to the status of fraud. Irretrievable and unconditional bank guarantees are payable on demand

without demur. That is the law. In Sumac International, the Supreme Court held that the exceptions to the rule of payment under a bank guarantee

would be if a fraud was committed to the notice of the bank which would vitiate the foundation of the bank guarantee or if the encashment of the

bank guarantee would result in irretrievable injustice of the kind which would make it impossible for the person at whose instance the guarantee

was furnished to reimburse itself.

18. None of the grounds canvassed by the petitioner is worthy of consideration when payment under a bank guarantee is sought to be interdicted.

Even if every ground carried by the petitioner in the petition is accepted, it would still not be good enough for the petitioner to be entitled to an

order of injunction restraining payment under a bank guarantee. At the highest, the petitioner makes out a strong prima facie case that the

respondent has committed breach and that it is the petitioner which is to get money from the respondent. Even if such position is accepted, the

order that the petitioner seeks cannot be made. To begin with, bank guarantees and letters of credit are the lifeblood of the commercial world and

cannot be toyed with. Secondly, notwithstanding the underlying contract, there is a separate contract which is embodied in the bank guarantee and

the grounds for the invocation thereof and the entitlement to receive payment thereunder have to be governed by the terms of such independent

contract.

19. That is not to suggest that there can be no injunction against a bank guarantee, but the high case of irretrievable injury and irreparable damage

that has to be made out is not met by this petitioner. The petitioner does not show as to why it should not wait till the arbitral reference to obtain

refund of the money that the respondent may receive upon the encashment of the bank guarantees. There is no credible case made out that the

respondent would be unable to make the payment should an award be made against it. There is no case of special equity which has been made

out. The petitioner has merely cited a strong prima facie case without even suggesting that there was an element of fraud on the part of the

respondent at the inception of the transaction that would entitle the petitioner to an extraordinary order of the kind that has been sought.

20. That a bank guarantee or a letter of credit has to be seen as independent of the underlying contract has prompted American academics to coin

the independence principle in such context. The principle is not absolute; it accommodates the same exceptions that English law - which is the basis

for the law on the subject in India -makes room for: fraud and irretrievable injury. The fraud has to be egregious in nature; such as would shock the

judicial conscience. The irretrievable injury has to be of the kind that would leave the person at whose behest the bank guarantee has been

furnished with almost no chance of recovering the money. Indian judicial pronouncements refer to a third category at times: special equity, without

the expression being definitively explained anywhere. But this third exception has to be seen as ejusdum generis with the two more recognized

exceptions: the conduct of the beneficiary has to be so overwhelmingly shocking that the Court would not require the claimant to await the

outcome of another set of proceedings for recovery of the amount covered by the bank guarantee. It is also possible, as the other judgment relied

upon by the petitioner reported at Hindustan Steel Works Construction Ltd. Vs. Tarapore and Co. and another, instructs, that there could be such

a supervening event that would make the payment under the bank guarantee unconscionable and utterly unjust.

21. None of the exceptions would come into play in the facts of the instant case. The circumstances that would prompt the court to restrain the

invocation or encashment of a bank guarantee may be illustrated with the facts pertaining to the Itek Corporation case. An American exporter was

prevented from honouring the contract with an Iranian buyer following the ban of all US exports to Iran in the wake of the situation that prevailed in

Iran after the Shah was dethroned in course of an Islamic revolution and the hostage crisis in the US embassy in Teheran. If the Iranian party was

allowed to receive the proceeds upon encashing the bank guarantees, the American exporter would have no means to recover the same. It was a

monumental supervening event beyond the control of the exporter that would have resulted in irretrievable injustice if the payments under the bank

guarantees were not stopped. On similar grounds, this High Court had passed several orders in the late 1990s when Indian exporters complained

of their apprehension that the performance guarantees furnished by them would be arbitrarily invoked by the cash-strapped Libyan government

upon international economic sanctions being imposed against that country at the height of Muammar Gaddafi''s conflict with the West.

22. No case of irretrievable injury has been made out by the petitioner. Though the petitioner now brands the respondent''s conduct as fraudulent

on the ground that the respondent awarded the work and induced the petitioner to execute it without having the requisite funds to meet its payment

obligations thereunder, it does not appear that the petitioner cried foul immediately upon receipt of the respondent''s letter of January 19, 2012 that

the respondent had entered into the contract without having the money to sustain it. Even thereafter, the petitioner acceded to the respondent''s

request to withdraw the notice of suspension. If the petitioner had perceived the respondent''s conduct at the inception of the contract to be

fraudulent upon discovering the facts as disclosed in the letter of January 12, 2012, that was the stage to call the entire thing off. There was no

immediate protest by the petitioner that it was not aware that the respondent''s financial tie-up was not in place until January of this year. The

petitioner''s recent cancellation of the contract is upon the respondent''s insistence that the entire basis of the contract be reworked. Such conduct

of the respondent may have been unfair, but it would not amount to fraud.

23. As to the prayer for an order in the nature of attachment before judgment, the petitioner has referred to the latest balance-sheet of the

respondent to suggest that it hardly has any free assets to cover a claim of the kind that the petitioner has against it. The petitioner shows that the

company has a fixed asset by way of a freehold land of value of Rs. 86 crore against and much greater exposure to its banks. On the basis of the

averments in the petition, however, it does not appear that a serious case of the respondent''s impecuniosity has been made out. It is possible that

the focus of the present petition was so overwhelmingly in respect of the bank guarantees that the grounds necessary for the lesser prayer for an

order in the nature of attachment may have been overlooked.

24. Since the best arguable case of the petitioner is not found to be good enough to entitle it to any injunction in respect of the bank guarantee or

any order in the nature of attachment before judgment, affidavits are not called for.

25. A.P. No. 522 of 2012 fails and the same is dismissed without any order as to costs, but with liberty to the petitioner to seek any further order

in support of its money claim.

26. The respondent is discharged from the assurance recorded in the order of July 6, 2012 with immediate effect. A prayer is made on behalf of

the petitioner that the assurance given on July 6, 2012 should continue. Since such assurance was given at the instance of Court, it is not felt

necessary for the tenure of the assurance to be extended.

Urgent certified photocopies of this order, if applied for, be given to the parties subject to compliance with all requisite formalities.