

(1991) 04 CAL CK 0064

Calcutta High Court

Case No: Foreign Exchange Appeal No. 2 of 1990

Star Iron Works Pvt. Ltd.

APPELLANT

Vs

Director of Enforcement

RESPONDENT

Date of Decision: April 25, 1991

Acts Referred:

- Foreign Exchange Regulation Act, 1973 - Section 26, 9(1)

Citation: (1992) 59 ELT 411

Hon'ble Judges: Shyamal Kumar Sen, J; Ajit K. Sengupta, J

Bench: Division Bench

Advocate: Sudipta Sarkar and P.K. Jhunjhunwala, for the Appellant; S.K. Mitra, for the Respondent

Final Decision: Allowed

Judgement

@JUDGMENTTAG-ORDER

Ajit K. Sengupta, J.

This appeal is directed against the order dated September 6, 1990 passed by the Foreign Exchange Regulation Appellate Board rejecting the appeal preferred by the appellant against the order of the Deputy Director, Enforcement Directorate levying a penalty of Rs. 10,000.00 for contravention of Section 9(1)(c) of the Foreign Exchange Regulation Act, 1973. The facts leading to this appeal are stated hereinafter.

2. The appellant was required to export certain electrical materials to Doha, Qatar. In connection with the said export, the appellant had to furnish a bank guarantee in favour of the foreign buyer which the appellant duly did through the Central Bank of India. The said bank guarantee was for a value of US Dollars 7415.75 equivalent to Rs. 96,500/-. According to the appellant the entire matter of furnishing of the bank guarantee was routed through the Central Bank of India, an authorised dealer under the said Act. All Rules and Regulations in the matter were duly complied with

and the matter was reported also to the Reserve Bank of India. The said guarantee was a performance guarantee. By reason of labour unrest and lockout at the appellant's factory, there was some delay in the supply of materials. According to the appellant's foreign buyer, their principal being the Ministry of Electricity and Water, Doha had deducted an amount from their invoice. The foreign buyer, in its turn, invoked the unconditional performance guarantee and obtained payment thereunder through the Hongkong & Shanghai Banking Corporation and the Central Bank of India. In relation to the said matter, the appellant was served with a show cause notice alleging that the appellant had accepted the claim of the foreign buyer and had acknowledged a debt thereby allegedly contravening Section 9(1)(c) of the said Act. At the hearing before the Adjudication Officer it was, inter alia, contended by the appellant that all requirements of the Reserve Bank of India as laid down in the Guidelines and Manual had been complied in relation to the matter. There was no contravention whatsoever of Section 9(1)(c) of the Act as there could not be. The appellant had not acknowledged any debt so that a right to receive payment is created or transferred in favour of any person resident outside India. The guarantee being an unconditional performance guarantee, the appellant according to well settled legal principles was not in a position to prevent payment thereunder, nor was the appellant responsible in any manner for the said amount. The appellant's contentions, however, were rejected by the Deputy Director and the Appellate Board. The Appellate Board, however, while accepting the contentions of the appellant held that the appellant was responsible merely for the furnishing of the guarantee.

3. Two questions call for determination in this appeal are, firstly,

(a) Whether the furnishing of guarantee through authorised dealer in relation to export transaction can amount to an acknowledgment of debt and creation of a right to receive payment within the meaning of Section 9(1)(c) of the Act ?

and secondly,

(b) Whether there can be any contravention of Section 9(1)(c) of the Act where payment is obtained by a foreign buyer against an unconditional performance bank guarantee ?

Section 9(1)(c) of the Act provides as follows :-

"9. Restrictions on payments. - (1) Save as may be provided in and in accordance with any general or special exemption from the provisions of this sub-section which may be granted conditionally or unconditionally by the Reserve Bank, no person, in or resident in, India shall -

(c) draw, issue or negotiate any bill of exchange or promissory note or acknowledge any debt, so that a right (whether actual or contingent) to receive a payment is created or transferred in favour of any person resident outside India." (Emphasis

supplied)

4. The question is whether there was any special or general exemption under the provisions of sub-section (1) of Section 9 granted conditionally or unconditionally by the Reserve Bank of India to the Central Bank of India.

5. As would appear from the order of the Deputy Director, Enforcement, that ♦ on 21st August 1984 the appellant had entered into a contract with M/s. Mars Trading & Contracting Co., Doha, Qatar. Letter of Credit for the total value of US \$ 74,157.52 was opened through Qatar National Bank, Doha for supply of the materials; 50% of the materials was to be supplied by December 1984 and the balance before Mid-February 1985. A bank guarantee of 10% being performance guarantee bond for delivery of the materials according to the above schedule of supply was also furnished. The L/C was Opened with Qatar National Bank through Central Bank of India. The appellant could not fulfil its commitment within the period stipulated in the Contract. This fact was communicated to Mars Trading & Contracting Co., Qatar who had contracted with the Electricity & Water Department, Doha, to whom the contracted materials were to be supplied. On supply of the goods M/s. Mars Trading & Contracting Co., Doha submitted invoice for payment, but the Electricity and Water Department had deducted 10% from the contracted amount. On September 4, 1986 the Central Bank of India by its letter dated September 4, 1986 informed the appellant that the bank guarantee had been invoked and advised the appellant to deposit Rs. 96,500/-. On these facts a show cause notice was issued on the ground that the appellant allegedly accepted the debit claim of US \$ 7,415.75 from their overseas buyers, i.e. M/s. Mars Trading & Contracting Co., Doha, in contravention of Section 9(1)(c) of the Foreign Exchange Regulation Act, 1973 without any general or special exemption of the Reserve Bank of India. The Deputy Director in his order held, inter alia, as follows :-

"In this connection the said exporter company has submitted xerox copy of exchange control manual containing procedure of execution of the performance guarantee on behalf of the exporter. It is observed from the Exchange Control Manual 11A, 17 and 18 that the performance guarantee executed by the authorised dealers on behalf of the exporter should have been reported to the Reserve Bank of India and the whole matter should have been brought to the notice of the Reserve Bank of India long before the situation that had arisen in this case which had forced that said exporter company to make the payment. Had the exporter company informed the Reserve Bank of India about the deduction of the claim in time, the Reserve Bank of India could have given the exporter company the constructive advice the all suggestions of the Reserve Bank of India could have taken up the matter with the Hong Kong and Shanghai Banking Corporation for withdrawal of the claim amount. Therefore, the failure on the part of the exporter company to bring the matter to the notice of the Reserve Bank of India at the appropriate time before the payment of the claim amount was made might have protected the

exporter company from accepting the liability of this payment. The exporter company informed the Reserve Bank of India much later and as such this effort became infructuous".

6. In view of the above position discussed above the contravention on the part of the said exporter company M/s. Star Iron Works (P) Ltd., Calcutta as charged in the Show Cause Notice is clearly established beyond any doubt.

7. The Foreign Exchange Regulation Appellate Board, *inter alia*, observed as follows :-

"It cannot, therefore, be disputed that the encashment of the bank guarantee in the instant case could not have been prevented by the appellant. But it cannot be denied that the bank guarantee was issued by the appellant's banker at the instance of the appellant. A guarantee is a collateral engagement to answer for the debt, default, or miscarriage of another person. A guarantee is a promise to another as creditor to secure the payment of a debt payable by him. (See Stroud's Judicial Dictionary, Fourth Edition, Sweet and Maxwell, Volume II, at page 1198.) A guarantee creates an obligation of the principal debtor to repay the guarantor paying off the debt. Therefore, the learned Adjudicating Officer was correct in holding that the appellant was guilty of the contravention as indicated in the show cause notice."

8. At the hearing before us, Mr. Sunil Mitra, learned counsel appearing for the respondent, contended that in this case there was no special or general exemption granted by the Reserve Bank of India and accordingly although the appellant might have been compelled to make the payment under the bank guarantee, nonetheless it was contravention of the provisions of Section 9(1)(c).

9. Mr. Sudipta Sarkar, learned counsel for the appellant on the other hand, contended that the Reserve Bank Manual has specifically granted the exemption in such cases, otherwise foreign trade could not be carried on by the Indian exporters. We, therefore, by consent of the parties directed the Reserve Bank of India to appear before us and produce the records to ascertain whether any exemption was granted to the Central Bank of India for opening the Letter of Credit and furnishing of the bank guarantee in connection with the export trade. One of the senior officers of the Reserve Bank of India appeared and produced the records before us.

10. Clauses 11A.17 and 11A.18 of the Reserve Bank Manual provided as follows :

"11A.17: Bid Bonds and Other Guarantees against Commodity Exports (ADMA 4/8-3-1989):

(i) Authorised dealers may furnish bid bonds, performance bonds and guarantee (including those in lieu of earnest money) in favour of overseas buyers on account of Indian exporters without prior reference to Reserve Bank in all cases of commodity exports, provided they are satisfied about the bona fides of the applicant and his

ability to perform the export contract, and the terms agreed to between the exporter and foreign buyer are in accordance with Exchange Control regulations. In those cases where exporters find it necessary to furnish bank guarantees for an amount slightly in excess of what is asked for in tender invitation, authorised dealers may execute the guarantee for an amount upto one per cent above the percentage fixed in tender invitation.

Note: Authorised dealers must ensure, while issuing bid bonds and other guarantees that the value for which they are issued as a percentage of the value of the tender or contract is reasonable and according to normal practice in the trade. Any request containing unusual features should be referred to Reserve Bank. Requests for executing performance guarantees on behalf of exporters placed in the Exporters Caution List should also be referred to Reserve Bank for prior approval.

(ii) Authorised dealers should forward to Reserve Bank monthly statement in Form GTE 1 (in duplicate) giving details of bid bonds/tender guarantees and performance, etc. guarantees issued on behalf of Indian exporters in favour of overseas buyers. Certified copies of bonds and guarantees issued should be enclosed to the statements.

(iii) In case any bond/guarantee issued by authorised dealers in favour of nonresidents is invoked, they may make remittance to the non-resident beneficiaries. A special report should, however, be sent to Reserve Bank in all such cases giving full details and citing reference to the monthly statement in which issuance of the relative bond/ guarantee was reported to Reserve Bank and the approval, if any, obtained for furnishing the bond/guarantee. Authorised dealers should confirm in the special report that they have satisfied themselves that the invocation of bond/guarantee by the overseas beneficiary was *prima facie* in order and also enclose copy of the claim received from the latter.

11. Authorised dealers may freely give on behalf of their customers and overseas branches and correspondents, guarantees, in the ordinary course of business in respect of missing or defective documents, authenticity of signatures and for other similar purposes."

12. Subsequently a clarification was also made by the Exchange Control Department of the Reserve Bank of India on March 8, 1989 regarding the counterguarantees in favour of foreign correspondents in respect of commodity exports, as follows :-

"2. Counter-guarantees in favour of foreign correspondents in respect of commodity exports:

In terms of paragraph 11A.17 of the Manual, authorised dealers can furnish bid bonds, performance bonds and guarantees in favour of overseas buyers on behalf of Indian Exporters, without prior reference to Reserve Bank in cases relating to

commodity exports, subject to conditions listed in the paragraph. However, in some foreign countries local laws/regulations stipulate that such guarantees should be only from resident banks. In such cases, authorised dealers have to approach Reserve Bank for permission to furnish counter-guarantees to their branches/respondents abroad to enable the latter to furnish bank guarantees in favour of overseas beneficiaries. In order to avoid such reference to Reserve Bank, it has been decided to permit authorised dealers to furnish counter-guarantees to their foreign branches/respondents in cover of guarantees to be issued by the latter in favour of local beneficiaries on behalf of Indian exporters, in accordance with the local laws/regulations. Accordingly, authorised dealers may in future furnish such counter-guarantees in favour of their branches/respondents abroad without prior reference to Reserve Bank in respect of commonly exports from India, subject to normal precautions. The details of such counter-guarantees may be reported in the monthly statement in form GTE-1."

13. It is not disputed that the Central Bank of India is an authorised dealer.

14. On October 16,1986 the Central Bank of India wrote the following letter to the Reserve Bank of India :

"Invokement of foreign bank guarantee No. FBG/M/84/24 dt. 16-10-1984 for US D. 7415.75 favouring M/s. Mars Trading & Contracting Co., Doha, Qatar on behalf of M/s. Star Iron Works (P). Ltd., Calcutta, a/c. with our Camac St. Branch."

15. At the instruction of our Camac Street Branch we had issued the captioned guarantee as on 16-10-1984 through our correspondent Hongkong & Shanghai Banking Corporation, Calcutta. We have been advised about the invokement of the guarantee by the beneficiary by our correspondent vide their letter dated 25-9-1986 a copy of which is enclosed for your perusal.

16. As per terms of the above letter, we have settled the claim today by TT for US D. 7415.75 to HSBC NY a/c : their Doha office.

The format of the original bond is also enclosed.

The transaction is also reported in form A-2 as usual.

You are, therefore, requested kindly to confirm our action at your earliest convenience.

17. The following notings have been made by the Reserve Bank on the aforesaid letter:

"Central Bank have made a payment of US \$ 7415.75 favouring M/s. Mars Trading & Contracting Co. Doha, Qatar as they have invoked bank guarantee No. FBG/M/ 84/24 dt. 16-10-1984 a photo-copy of which has been submitted. We may enquire -

(i) It appears that the beneficiary cannot claim under this guarantee after 30-4-1986. Then how their demand has been entertained.

(ii) The grounds on which the guarantee has been invoked.

(iii) The facts of the case with the A.D."s comments.

It may be mentioned the A.D."s are allowed to make payment to o/s buyers if the bank guarantee is invoked under 11G 6 of E.C.M."

On October 28, 1986 the Reserve Bank wrote to the Central Bank of India as follows :

"The following particulars/documents required :

(1) It appears that the beneficiary cannot claim under the guarantee No. FBG/M/84/24 dated 16-10-1984 (84) after 30-4-1986. Then how their demand has been entertained.

(2) The grounds on which the guarantee has been invoked.

(3) The facts of the case with the Authorised Dealer"s comments."

18. On November 12, 1986 the Central Bank of India replied to the Reserve Bank"s aforesaid letter of October 28,1986 as follows :-

"As required in your captioned letter, we give below the following particulars for your kind information :

(1) The guarantee was primarily valid upto 30-4-1986. But it was subsequently extended upto 30-4-1987 and our correspondent had served invokement notice of the beneficiary on us vide their letter dated 25-9-1986, a copy of which had already been enclosed to our letter No. FB/LG/86/10/8 dt. 16-10-1986 to you for your perusal.

(2) We have come to know from our correspondent Hongkong and Shanghai Banking Corporation, Calcutta that the beneficiary M/s. Mars Trading & Contracting Co., Doha claimed US D. 7415.75 stating that M/s. Star Iron Works (P) Ltd., Calcutta failed to fulfil the terms of their relative contract.

(3) In view of the above facts we feel that we had no other alternatives than to honour the claim made against our commitment as on 16-10-1986.

We hope that you will accord your confirmation of our action considering the case in light of the above :"

19. The Reserve Bank has made the following notings on the aforesaid letter of the Central Bank of India :-

"Central Bk. clarified that as the guarantee was extended upto 30-4-1987, the validity period of claim was within the stipulation. The Bk. Guarantee was invoked by the o/s buyer as M/s. Star Iron Works (P) Ltd. failed to comply the terms of the

contract and A.D. had no option but to honour their commitment. We may accept their action."

"The bank has not given the reason on which clause of the contract was invoked towards the contract. However, in terms of para 11.G.6 of E.C.M. the a.d's are entitled to make payments on guarantees after ensuring the genuineness and in view of the amount US works out to 10% of the total contract we may not pursue the matter further."

"AC(X) pl. The Central Bank should give a reference to the monthly report in which the guarantee was reported to us."

20. On December 10,1986 the Reserve Bank wrote to the Central Bank of India as follows :-

"Please let us know the reference under which the guarantee was reported to us in the monthly statement of GTE-1."

21. Subsequently, upon a reminder by the Reserve Bank on October 8,1987 the Central Bank of India replied to the aforesaid letter on October 19,1987 as under :-

"With reference to your above memorandum, we have to inform you that we have already furnished the information that were asked by exporter as per their letter ST/75A/26751 dt. 29-8-1987. Our letter covering those information were addressed to Chief Manager of our Camac St. Br. with whom the exporter is maintaining account. Our letter reference is FB/BG/87/09/10 dt. 07-9-1987. Incidentally, we may mention that we do not appear to have received your office memo no. CA. EC. XM. OR. 540/X.236(C)-87 dt. 10-12-1986. You are requested to kindly arrange to send us a copy of the same on receipt of which we shall try to comply with the requirement you have asked for."

22. From the records it further appears that on 25th May 1988 the following letter was addressed by the Reserve Bank to the Central Bank of India :-

We advise to explain the following :-

(1) The circumstances under which the guarantee (No. FBG/M/84/214 dt. 16-10-1984 for US \$ 7415.75) was invoked and whether the authorised dealer was satisfied that the invocation of guarantee was *prima facie* in order.

(2) The allegation made by the exporter in their letter dt. 25-4-1988 addressed to this office that they paid the claim amount and withdraw a court case lodged in City Civil Court, Calcutta regarding the invocation, under pressure of Central Bank of India and the Hongkong and Shanghai Banking Corporation.

(3) How did the invocation of Bank Guarantee affect the Section 9(1)(c) of Foreign Exchange Regulations Act, 1973 as mentioned by the exporters in their letter."

23. By their letter dated 15th June 1988 the Central Bank of India placed on record the following facts :-

"With reference to your captioned letter we like to point out that we are satisfied that the invocation of guarantee was *prima facie* in order as we have received the communication regarding invocation of the guarantee from our correspondent Hongkong Bank, Calcutta (copy of the letter and telex enclosed herewith.)

The allegation made by the exporter that the Bank has pressurised them to pay the claim amount is totally false. Please note that the payment was made as per the delegated authority and in terms of the guarantee. You may further refer to the letter No. ST/75A.1590 dt. 10-10-1986 of M/s. Star Iron Works (P) Ltd. (a copy enclosed) wherein they have requested us to make the payment.

Regarding third point in your above captioned letter, we also do not find any relevancy of the said Section 9(1)(c) of FERA, 1973 in connection with the invocation of guarantee. We do not know how the party has linked up the section with the invocation of guarantee. This clarification may be asked from the party itself.

Hope, the above explanation will satisfy you regarding the queries made by you in this respect."

24. The following endorsements by the Reserve Bank appear on the face of the said letter :-

"As per E.C.O.'s note (enclosed) XT (PX Section) intimated that they are receiving statement from A.D. in terms of para 12.0.15 (11 G. 6 of 1978) and also if any invocation was made under the provision.

Hence we may accept the invocation and advise the A.D. of the acceptance and we need not send any such case of invocation any more to CO."

"As proposed. 13/7"

25. The Reserve Bank of India had issued the following notification with regard to giving of guarantees to or on behalf of non-residents. The said notification is as follows:

SECTION 26

Notification No. F.E.R.A. 16/74-R.B. dated 11th January 1974.

In pursuance of sub-section (6) of section 26 of the Foreign Exchange Regulation Act, 1973 (66 of 1973) and in supersession of the notification of the Reserve Bank of India No. F.E.R.A. 230/65-R.B. dated the 1st April 1965, the Reserve Bank is pleased to permit -

(a) authorised dealers, subject to such instructions as may be issued by the Reserve Bank from time to time,

- (i) to give guarantees in favour of persons resident in India in respect of any debt or other obligation or liability of persons resident outside India;
- (ii) to give performance bonds or guarantees (including those in lieu of earnest money) in favour of overseas buyers on account of bona fide exports made from India;

(b) Firms and companies resident in India to give guarantees to Income Tax Officers and other authorities under the Income Tax Act, 1961 (43 of 1961) in respect of taxes due by nationals of foreign States in employ of such firms or companies."

From the facts and circumstances mentioned hereinabove it will be evident that the Bank is an authorised dealer and as such authorised dealer the Bank can furnish guarantee in connection with the export of commodities from India. Thus, the Bank was enjoying general exemption from the provisions of Section 9(1)(c). The Bank was authorised to draw, issue or negotiate any bill of exchange or acknowledge any debt. The Reserve Bank of India have also accepted the invocation of the Bank guarantee which could not have been done had it not been in conformity with the Exchange Control Regulations of the Reserve Bank of India. It is no doubt true that the bank guarantee was issued by the Bank at the instance of the appellant, but such bank guarantee could not have been issued by the bank even at the instance of the appellant unless as an authorised dealer the bank had the authority to furnish such bank guarantee. The irrevocable obligation assumed by the bank under the bank guarantee in course of international trade and commerce had to be honoured which the bank did in the instant case. The liability, if any, u/s 9(1)(c) was of the bank who furnished the bank guarantee and bond in favour of the foreign buyer. But as we have indicated, the bank acted strictly in accordance with the Regulations of the Reserve Bank of India and the Reserve Bank of India was satisfied that invocation of the bank guarantee was made in accordance with the general exemption granted to the bank.

26. For the reasons aforesaid, the appeal is allowed. The order under appeal is set aside. The proceedings are quashed. It is stated that a sum of Rs. 10,000/- which was imposed by way of penalty was deposited with the Deputy Director, Enforcement Directorate pursuant to the order passed by the Adjudicating Officer. Let the sum of Rs. 10,000/- be refunded to the appellant within two weeks from the date of communication of the operative part of this order and judgment.

27. There will be no order as to costs.