

(1997) 10 DEL CK 0049**Delhi High Court****Case No:** Civil Miscellaneous Appeal No. 8 of 1997

Delkon India Private Limited

APPELLANT

Vs

Bharat Heavy Electrical Limited

RESPONDENT

Date of Decision: Oct. 21, 1997**Acts Referred:**

- Arbitration and Conciliation Act, 1996 - Section 9

Citation: (1997) 6 AD 644 : (1997) 2 ARBLR 628 : (1998) 93 CompCas 106 : (1997) 69 DLT 491 : (1997) 43 DRJ 567**Hon'ble Judges:** D.K. Jain, J**Bench:** Single Bench**Advocate:** Sanjeev Puri, Shankar Ghosh and S.K. Satija, for the Appellant;**Judgement**

D.K. Jain, J.

(1) This is an application u/s 9 of the Arbitration and Conciliation Act, 1996 (hereinafter referred to as the Act), seeking to restrain the respondent M/s. Bharat Heavy Electricals Limited (for short the BHEL), from encashing and receiving any amount under the bank guarantee No. Bom/60/236 dated 24 July 1996 in the sum of Rs. 7,86,750.00 issued on behalf of the petitioner by the Bank of Baroda, India Exchange Place, Calcutta, in favor of the BHEL.

(2) The facts relevant to the controversy involved are as follows;

(3) The respondent Bhel, a Public Sector Undertaking, for the purpose of executing a contract awarded to it by National Thermal Power Corporation Limited (for short the NTPC), awarded a sub-contract to the petitioner for erection, testing, commissioning and trial operation of 2X210 Mw Boilers, Part B at Fgtpp, Unchahar, ST-2, District Rai Bareilly, Uttar Pradesh, and issued a letter of intent dated 21 June 1996, in favor of the petitioner, which was received by the petitioner on 6 July 1996. The value of the work awarded was Rs. 3,13,20,000.00 . It was scheduled to commence from 6 July

1996 and was to be completed by 5 December 1998. Formal contract between the parties was, however, executed on 12 November 1996.

(4) Under the terms of letter of intent, the petitioner was required to furnish a security deposit guarantee for a sum of Rs. 7,86,750.00 for due and faithful performance of the contract, which the petitioner did by furnishing the aforesaid bank guarantee in favor of the respondent. The bank guarantee is stated to be valid up to 31 December 1998. In the bank guarantee the respondent - Bhel is referred to as the company the petitioner as the contractor; and the bank as the guarantor. The relevant portion of the bank guarantee reads as under :-

"THE Guarantor do hereby guarantee to the company the due and faithful performance, observance or discharge of the contract by the contractor and without demur and merely on a demand to the extent of Rs. 7,86,750.00 (Rupees seven lakhs eighty six thousand seven hundred fifty only) against any claim by the company on them for any loss, damage costs, charges and expenses caused to or suffered by the company by reasons of the contractor making any default in the performance, observance or discharge of the terms, conditions, stipulation or undertakings or any of them as contained in the contract. The decision of the company whether any default has occurred or has been committed by the contractor in the performance observance or discharge of any of the terms, conditions, stipulations or undertakings or any one of them as contained in the contract and/or as to the extent of loss, damage, costs, charges and expenses caused to or suffered by the company by reason of the contractor making any default in the performance, observance or discharge of any of the terms, conditions, stipulations or undertakings or any of them shall be conclusive and binding on the guarantor irrespective of the fact whether the contractor admits or denies the default or questions the correctness of any demand made by the company in any Court Tribunal or Arbitration proceedings or before any other Authority".

(5) It appears that not being satisfied with the performance of the petitioner the respondent terminated the contract on 15 January 1997 and on the next date invoked the bank guarantee by addressing letter dated 16 January 1997 to the guarantor bank. It would be expedient to extract here the relevant portion of the letter which reads as follows :-

"AS M/s. Delkon (India Pvt. Ltd., Calcutta have defaulted in the performance, observance and discharge of the terms and conditions stipulated in L.O.I. No. Bhel Nr (BCT) Fgt : Tp : Blr : 42 (59) dated 21.06.96 and Bhel have suffered/would suffer loss - we hereby lodged our claim for encashment of the captioned Bank Guarantee. It is requested that an amount of Rs. 7,86,750.00 (Rupees seven lakhs eighty six thousand seven hundred fifty only) may be remitted to Bhel by means of Demand Draft, payable at NOIDA."

(6) It seems that the bank, instead of straight-away remitting the proceeds under bank guarantee, sought confirmation from the Bhel to the effect that revocation of the bank guarantee was in accordance with the advice of the Ministry of Finance applicable to all PSUs and the person invoking the bank guarantee was higher in rank than the officer who had accepted the guarantee. This was confirmed by the Bhel on 21 January 1997. However, the bank, vide its letter dated 22 January 1997, informed Bhel about its helplessness to honour the bank guarantee on account of the order of injunction passed by this Court. The relevant portion of the said letter having some bearing on the contention of learned counsel for the petitioner reads thus :-

"BE that as it may, honouring our commitment, we had, pending receipt of your confirmation, prepared Demand Draft for Rs. 7,86,750.00 bearing No. 024483 dated 18th January, 1997 in your favour. The said Demand Draft was made out in your favor and payable at our Service Branch at New Delhi. A xerox copy of the said Demand Draft as aforesaid is enclosed. However, on 21st January, 1997 at about 5.30 P.M., we received a Fax transmission from Mr. N. Ganpathy, Advocate, Supreme Court of India, inter alia, informing that the Hon"ble High Court at Delhi passed an interim order restraining you from encashing and/or receiving any amount under the said bank guarantee no Bgp 60/236 dated 24.7.96 for Rs. 7,86,750.00 till 3rd April, 1997. In view of the above, we are unable to remit the amount under the said guarantee as long as the injunction order passed by the Hon"ble High Court at Delhi remains operative. You will appreciate that we had taken prompt action and/or steps forthwith upon receipt of invocation of the said guarantee but are not in a position to remit the amount in view of the order of injunction passed by the Hon"ble High Court at Delhi. Copy of fax message dated 21st January, 1997 sent by Sri Ganapathy, Advocate, referred to above, appears to have been transmitted to you also by the said Advocate."

(7) Being aggrieved by the decision of Bhel to rescind the contract and invoke the bank guarantee, the petitioner claims to have raised the dispute and issued a notice to Bhel u/s 11 of the Act for appointment of Arbitrator (s) and filed the present petition for interim injunction against the invocation of the bank guarantee. It is alleged that the invocation of the bank guarantee is unlawful, fraudulent and contrary to its terms, apart from being inequitable amounting to unjust enrichment on the part of the Bhel because : a) letter of invocation does not specify the/nature of claim and or penalty and or amount there of for which the bank guarantee is sought to be invoked; b) without lodging any claim whatsoever against the petitioner, who has completely discharged its obligation under the contract, the sudden invocation of the bank guarantee, is fraudulent and amounts to illegal and unjust enrichment on the part of the respondent: c) no loss has been suffered by the respondent: d) the signing of the contract after five months of the issue of letter of intent indicates that the respondent had no grievance against the petitioner and e) the respondent had itself agreed to a joint construction programme commencing

from 21 December 1996 to 24 March 1997 and the petitioner had completed the construction work strictly in terms of the revised schedule on unit No. 3. It is pleaded that if the respondent is permitted to encash the bank guarantee ,it would suffer irreparable prejudice and injury.

(8) When the matter came up for hearing on 21 January 1997 while issuing notice, the respondent was restrained from demanding or receiving any amount under the aforesaid bank guarantee. The said ex-parte ad-interim injunction still continues.

(9) The petition is opposed by the respondent inter alia, on the grounds that; the petition for interim relief is not maintainable without asking for substantive relief of appointment of arbitrator; there being a breach of contract, in the absence of any fraud, injunction restraining encashment of bank guarantee cannot be granted in favor of the petitioner.

(10) I have heard learned counsel for the parties at some length.

(11) MR.SANJEEV Puri, learned counsel for the petitioner has submitted that ; i) The invocation of the bank/guarantee is malafide because having watched the performance of the petitioner for five months (from the date of issue of letter of intent to the date of execution of formal agreement), the respondent chose to sign the formal contract and then also agreed to chalk out a joint construction programme for a period of three months commencing from 25 December 1996 and Therefore, there was no compelling circumstance to rescind the contract abruptly on 15 January 1997 ; ii) The invocation is also fraudulent as on the one hand the respondent was not making payments of the running bills and on the other invoked the bank guarantee without preferring any claims against the petitioner. Relying on a letter dated 29 October 1996, addressed by one Texcel Engineers Private Limited (next lowest tender or) to BHEL, offering to undertake the incomplete work, it is alleged that the said letter shows the fraudulent intentions of the respondent from the very beginning, in as much as it was interested in awarding the contract to the said party and was trying to find some excuse to terminate the contract with the petitioner. According to the counsel, the conduct of the respondent in the aforesaid circumstances, clearly establishes a fraud underlying the contract right from its inspection, of which the bank was also made aware vide letter dated 18 January 1997 and thus this Court was justified in restraining the respondent from demanding or receiving any amount under the bank guarantee. In support, reliance is placed on the judgment of the Supreme Court in Dwarikesh Sugar Industries Ltd. Vs. Prem Heavy Engineering Works(P) Ltd. & Anr. Jt 1997 (5) Sc 417 and on a decision of this Court in the case of Ansal Properties and Industries Ltd. Vs. Union of India and others, and; iii) The bank guarantee is conditional one and in order to invoke the same the respondent was required to state as to in what manner the petitioner had committed a default in the performance, observance or discharge of the terms and conditions etc., as contained in the contract and further what was the loss or damage which had occasioned to the respondent on account of default, which has

not been done. Therefore, its invocation is not in terms of the bank guarantee.

(12) On the other hand, Dr. Shanker Ghosh, learned Senior Counsel for Bhel, while inviting attention of the Court to various documents, including some letters from Ntpc to Bhel, complaining about the tardy progress of the project, has contended that the petitioner had been found faulting in due performance of the sub-contract right from the beginning. It is asserted that despite rescheduling of the construction programme from December 1996, the petitioner failed to meet the revised targets. It is pointed out that the total work under the contract awarded to the petitioner was approximately 11600 metric tonnes but from July to December 1996 it had erected only 162.5 metric tonnes which shows that petitioner had failed to mobilise the site or deploy staff members as per the requirement. It is also pointed out that due to the poor performance of the petitioner Ntpc had warned Bhel of an appropriate action as per the contract if no significant improvement was observed. Learned counsel further submitted that despite poor performance of the petitioner, to give one more opportunity to it to expedite the fabrication work, vide minutes of meeting dated 22 November 1996, the petitioner agreed to execute 300 metric tonnes for the month of December 1996 and 500 metric tonnes in each further months starting from January 1997 and ending in June 1997 but the petitioner did not undertake any erection work in the month of December 1996 due to lack of resources and manpower. As regards the alleged fraud it is urged that no such allegation of fraud, as pleaded orally, has been made in the petition, apart from the fact that no particulars of fraud have been spelt out. It is vehemently contended that it is for the guarantor bank to object to the invocation of the bank guarantee if it is not in accordance with the terms of the guarantee but in the present case no such objection having been raised by the bank it could not be interdicted by the Court to not to honour its commitment. Reference is also made to the banks afore-extracted letter to show that infact the bank had not made any grievance that the invocation of the bank guarantee is not in terms thereof. It is maintained that the invocation of the bank guarantee being in order, the bank cannot be restrained from encashing the same. In support, reliance is placed on the decision of the Supreme Court in General Electric Technical Services Company Inc. Vs. M/s. Punj Sons (P) Ltd. and another,

(13) The law relating to the enforcement of a bank guarantee is well settled by a catena of judgments of the Supreme Court and I do not propose to burden this order by referring to all of them except to notice some of the/recent decisions.

(14) One of the decisions, laying general principles governing invocation of bank guarantees, which has been followed in almost all the later judgments is in U.P. Cooperative Federation Ltd. Vs. Singh Consultants and Engineers (P) Ltd., . In that case it was held that in order to restrain the operation of Bank Guarantee, there should be a serious dispute and a good *prima facie* case of fraud and special equities in the form of preventing irretrievable injustice between the parties,

otherwise the very purpose of bank guarantee would be negated and the fabric of trading operation would be jeopardise section. The commitments of banks must be honoured free from interference by the Courts and it is only in exceptional cases, that is, in cases of fraud or in cases of irretrievable injustice be done, that the Court should interfere. It was also observed that the nature of the fraud that the Courts talk about is fraud of an "egregious nature as to vitiate the entire underlying transaction". It is the fraud of the beneficiary, and not the fraud of somebody else.

(15) In the State of Maharashtra and another Vs. M/s. National Construction Company, Bombay and another, it was observed that a bank issuing a guarantee is not concerned with the underlying contract between the parties to the contract because a bank guarantee is a contract quite distinct and independent of the underlying contract, the performance of which it seeks to secure. The duty of the bank under a performance guarantee is created by the document itself. Once the documents are in order, the bank giving the guarantee must honour the same and make the payment. Ordinarily, unless there is an allegation of fraud or the like, the Courts will not interfere, directly or indirectly, to withhold payment, otherwise trust in internal and international trade would be irreparably damaged.

(16) A similar view is expressed in AIR 1997 1644 (SC) . After referring to its various earlier decisions, the Supreme Court held as follows :-

"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 realisation 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."

(17) It was further held that the existence of any dispute between the parties to the contract is not a ground for issuing an injunction to restrain the enforcement of bank guarantees. There must be fraud in connection with the bank guarantee.

(18) In this series of judgments, the latest decision rendered by the Supreme Court is in Dwarikesh Sugar Industries Case (Supra), wherein while adversely commenting on the conduct of the High Court in ignoring Apex Court's authoritative pronouncements on the subject, the Court reiterated the general principles laid down in Up State Sugar Corporation's Case (Supra), and reaffirmed the following observations in Bolivinter Oil S.A. Vs. Chase Manhattan Bank 1984 (1) All E.R. 351, which were earlier approved and followed in Up Cooperative Federation's case

(Supra).

"THE wholly exceptional case where an injunction may be granted is where it is proved that the Bank knows that any demand for payment already made or which may thereafter be made will clearly be fraudulent. But the evidence must be clear both as to the fact of fraud and as to Bank's knowledge. It would certainly not normally be sufficient that this rests on the uncorroborated statement of the customer, for irreparable damage can be done to a Bank's credit in the relatively brief time which must elapse between the granting of such an injunction and an application by the Bank to have it charged".

(19) As regards the question of irretrievable injury, the second exception to be taken into consideration for grant of injunction, the Court observed that it has to be decisively established and must be proved to the satisfaction of the Court that there would be no possibility whatsoever of the recovery of the amount from the beneficiary by way of restitution.

(20) Thus from a conspectus of the aforesaid judgments, it is clear that a bank guarantee is an independent contract whereby the bank undertakes to unconditionally and unequivocally abide by its terms and it cannot be affected by disputes between the parties to the underlying transaction. It creates an irrevocable obligation on the bank to perform the contract in terms thereof and on occurrence of the event mentioned therein, the Bank Guarantee becomes enforceable. Therefore, the Court should be slow in granting an injunction to restrain the realisation of a bank guarantee and it is only in exceptional cases like: i) a case of fraud of egregious nature of which the bank has the knowledge and ii) allowing an encashment would result in irretrievable harm to one of the parties concerned that the encashment of bank guarantee may be interdicted. The two grounds are not necessarily connected, though both may coexist in some cases. In all other cases the bank giving such a guarantee is bound to honour it as per its terms.

(21) Applying the above broad principles on the facts in hand, I find it difficult to hold that the contract between the Bank and Bhel is vitiated by any fraud much less an established fraud either in securing the bank guarantee or its enforcement or even the main contract. Nor is it shown that there are special equities in favor of the petitioner that it would suffer irretrievable harm or injustice if the encashment of bank guarantee is not stayed and the bank is allowed to honour its commitment under the bank guarantee in question.

(22) It is no doubt true that a fresh joint construction programme for a period of three months was chalked out in the month of November 1996 but from the material placed on record by the respondent it appears that the petitioner had failed to meet even the reduced targets fixed for the months of December 1996 and January 1997. The minutes of the joint meetings held between the representatives of the petitioner and respondent on 18 November 1996 and 22 November 1996,

indicate that on account of extremely slow mobilisation and progress at site, the respondent could terminate the contract at that stage itself but it chose to give to the petitioner one more chance to deploy more resources to achieve the desired erection progress as per the revised project schedule but it failed. From respondent's letter dated 17 December 1996, addressed to the petitioner, it appears that the petitioner was asked to increase the manpower strength to achieve the revised output target of 300 Mt for the month of December 1996. In this regard, a reference may be made to the fax message dated 31 December 1996 by the Principals (NTPC) to Bhel, complaining about the poor progress of the work and infact doubting the capability of the petitioner to complete the job. By the same communication, the 'NTPC had infact advised the respondent to withdraw some work from the petitioner and award it to some other agency, preferably a Central Public Sector Enterprise. In the light of the material placed on record by the respondent *prima facie*, the respondent appears to be justified in terminating the contract on 15 January 1997. I say no more lest it may cause some prejudice to either of the parties in proceedings before the arbitrator, who is ultimately to decide the question.

(23) As regards the allegation of fraud, except for bald allegation of fraud in para 16 of the petition on account of sudden invocation of the bank guarantee no facts or particulars have been mentioned by the petitioner in support of its allegation of fraud. It is pertinent to note that even in petitioner's legal notice dated 18 January 1997, demanding arbitration in terms of Clause 33 of Schedule I of the General Instructions to the tender except for complaining that invocation/encashment of the guarantee is fraudulent, there is not even a whisper that the bank guarantee was obtained or issued by playing a fraud by the respondent. In this view of the matter, on a mere bald allegation of fraud that too raised for the first time, after invocation of the bank guarantee, I have no hesitation in holding that the petitioner has failed to make out even a *prima facie* case of fraud - much less a case of established fraud, warranting interference by this Court in the encashment of the bank guarantee. Petitioner's reference to respondent's letter dated 29 October 1996 to M/s. Texcel Engineers Pvt. Ltd., in my view, has no bearing on the question of termination of agreement with the petitioner. Having regard to the consistent poor performance of the petitioner, it appears, *prima facie*, that the respondent was within its rights to explore the alternatives available to it to see that the project awarded by the Ntpc is completed.

(24) Coming to the allegation that the invocation of bank guarantee as sought to be done in respondent's letter dated 16 January 1997, is not in terms of the bank guarantee, from the afore extracted portion of the said letter, it is evident that the bank guarantee is sought to be invoked on the ground that the petitioner has defaulted in the performance etc. of the letter of intent dated 21 June 1996 and as a result thereof the respondent has suffered/would suffer loss. According to the petitioner, a mere parrot like reproduction in the letter of demand of the recitals of

the bank guarantee are not sufficient to invoke the bank guarantee and the letter must disclose as to how and in what manner the respondent has suffered or is likely to suffer loss on account of non performance of the contract by the petitioner, and since the said letter is wanting in these essential particulars, the invocation cannot be said to be in terms of the bank guarantee. The contention is fallacious.

(25) As noted above, it is well settled that a bank guarantee is a distinct and independent contract between the bank and the beneficiary, creating certain obligations and commitments between the two. It is also settled that this independent contract cannot be affected by the disputes between the parties to the underlying transaction. If that be so, can the bank, on being informed about non-performance or non-observance of a particular obligation for which purpose the bank guarantee is furnished and the resultant loss and damage, which has already been suffered or is likely to be suffered by the beneficiary, assume the role of an arbiter and ask the beneficiary to first furnish all the information in that behalf and then to adjudicate, before remitting the amount under the bank guarantee, as to whether the party had in fact suffered loss or not? Obviously, the answer has to be in the negative. Such an enquiry is not within the domain of the contract between the Bank and the beneficiary. The bank cannot adopt the role of an arbitrator. Similarly the bank cannot ask the beneficiary to first supply proof of breach of contract by the party at whose instance it has furnished the bank guarantee.

(26) Interestingly, as is evident from the above extracted portion of the bank's letter dated 22 January 1997, in the present case the bank has not raised any objection to the effect that invocation of the bank guarantee by the respondent is not in accordance with its terms. In fact in the said letter, the bank is at pains to explain its conduct in honouring its commitment under the bank guarantee, for which it had even prepared a bank draft in favor of the respondent but in the meanwhile the respondent was restrained by this Court from demanding or recovering any amount under the bank guarantee by virtue of order dated 21 January 1997. I am of the considered view that the letter of invocation demanding payment of Rs. 7,86,750.00 was in accordance with the terms of the bank guarantee in question. Nothing more was required to be stated therein and the bank was under obligation to make the payment in terms thereof. For the view I have taken it is unnecessary to deal with the decision of this Court in Ansal Properties & Industries Ltd's case (Supra) heavily relied upon by learned counsel for the petitioner, which is otherwise clearly distinguishable on facts. In the said case, the Court, after examining the contents of the letter making bank guarantee, had found that the invocation was not in accordance with the terms of guarantee, which is not the case here. Principle of law laid down in Dwarikesh Sugar Industries' Case (Supra), to which reference was also made by petitioner's counsel, has already been discussed above.

(27) As regards the question of irretrievable injury on account of encashment of bank guarantee, it has neither been seriously urged by learned counsel for the

petitioner nor any thing is placed on record to satisfy the Court that there would be no possibility whatsoever for restitution of the amount so recovered after the disputes between the parties have been adjudicated.

(28) The petitioner having issued notice to the respondent u/s 11 of the Act, demanding arbitration, I do not find substance in the preliminary objection raised by the respondent about the maintainability of this petition/application u/s 9 of the Act and accordingly, reject the same.

(29) For the foregoing reasons, I do not find any merit in the petition. The same is accordingly dismissed with costs, quantified at Rs. 6,000.00 .

(30) Interim order dated 29 January 1997 is hereby vacated.

(31) The view expressed above, is only tentative and *prima facie* for the purpose of the decision of this application for injunction and shall not be construed as expression of opinion on merits of the controversy between the parties.