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Petroleum India International Vs Bank of Baroda and Others

Court: Bombay High Court

Date of Decision: Feb. 4, 2008

Acts Referred: Civil Procedure Code, 1908 (CPC) â€" Order 39 Rule 1

Citation: (2008) 4 BC 259 : (2008) 2 BomCR 674 : (2008) 1 CTLJ 184 : (2008) 6 MhLj 487

Hon'ble Judges: V.C. Daga, J

Bench: Single Bench

Advocate: D.D. Madon and Jyoti Ghag, instructed by Thakore Jariwalla and Associates, for the Appellant; P.K. Dhakephalkar and D.S. Paranjpe, for Defendant No. 1, for the Respondent

Final Decision: Dismissed

Judgement

@JUDGMENTTAG-ORDER

V.C. Daga, J.
This notice of motion is taken out by the plaintiff to claim following relief:

(a) That pending the hearing and final disposal of the above suit, the defendant No. 1 by itself, its servants and agents be restrained by an order

and injunction of this Hon''ble Court from making any payments to Defendant No. 2 or any other person/persons under the said Bank Guarantee

dated 25th February, 2006 annexed as Exh.Q to the plaint.

The Factual Backdrop:

2. The factual backdrop brought on record by the plaintiff is that after having entered into contract with the defendant No. 3, the plaintiff, who is a

customer of the defendant No. 1-bank, vide its letter dated 15th February, 2006 requested its banker-(defendant No. 1) to issue bank guarantee

in favour of the defendant No. 3 (""M/s Abaja Contracting Est. Kingdom of Saudi Arabia"") through defendant No. 2 (""The Saudi British Bank"") as

the plaintiff was awarded contract dismentaling of the refinery at Riyadh by defendant No. 3 and for rebuilding of refinery at AL-Mukala in Yemen

under phase II. for

3. The terms of contract required plaintiff to submit a bank the contract value being milestone against advance to be paid by the defendant No. 3.

the guarantee the for first 10% of payment

4. The value of the aforesaid contract was US $ 4,00,000. As such the similar was the value of the bank guarantee.

5. In pursuance of the aforesaid request of the plaintiff, the Deed of Counter Guarantee bearing No. F2/2006 was executed by defendant No. 1, in

favour of defendant No. 2; guaranteeing an amount not exceeding US $ 4,00,000/-. The bank guarantee issued is unconditional and irrevocable

undertaking on the part of the first defendant to pay to the defendant No. 2 forthwith on demand in writing or by cable. The liability of defendant

No. 1 was limited to maximum of US $ 4,00,000/-. The bank guarantee contains a clause that the said guarantee shall be subject to the laws of

Saudi Arabia.

6. After execution of the above deed of counter guarantee dated 3.3.2006 by first defendant in favour of second defendant, the second defendant

in turn issued bank guarantee dated 8.3.2006 in favour of the third defendant. Thus, the terms and conditions of the bank guarantee issued by the

first defendant were accepted by defendant No. 2 and the same were acted upon by it by guaranting irrevocably and unconditionally, payment of

US $ 4,00,000/-, to the defendant No. 3 on demand.

7. The terms of the aforesaid bank guarantee, inter-alia, provided that the guarantee was to remain in full force upto 17.8.2006.(inclusive) The

said guarantee also provided that it shall not be necessary for defendant No. 3 to proceed against plaintiff before proceeding to invoke bank

guarantee. The said guarantee further provided that the liability of bank to the defendant No. 3 shall remain in force notwithstanding the existence

of any difference or disputes between plaintiff and defendant No. 3.

8. Plaintiff vide itÃ¯Â¿Â½s letter dated 13.9.2006 requested defendant No. 1 not to make payment under the aforesaid bank guarantee if any request is

received from the second defendant. In reply, defendant No. 1 through its Branch Manager vide its letter dated 1.8.2006 informed the plaintiff that

as per terms of the aforesaid bank guarantee defendant No. 1 was bound to make payment of guarantee amount as and when demanded by the

beneficiary i.e. defendant No. 3.

9. It appears that the plaintiff requested the defendant No. 1 to extend the validity of the bank guarantee furnished by the plaintiff in favour of the

defendant No. 3 and, accordingly, the plaintiff got the bank guarantee validated and extended till 30.9.2006.

10. It appears that the first defendant received swift message from defendant No. 2 that they had received official claim from beneficiary under the

above guarantee demanding US $ 4,00,000 and further called upon them to make payment forthwith. As such defendant No. 2 requested the first

defendant to immediately credit full amount of the bank guarantee to the account of their head office. In view of this, according to the first

defendant, it was their obligation and responsibility to pay the said amount to the defendant No. 2.

11. It appears that plaintiff again got the bank guarantee validated and extended upto 31.10.2006, that too, after receipt of the above demand by

defendant No. 1 from defendant No. 2.

12. It further appears that on 6.11.2006 again another swift message was received by the first defendant from the defendant No. 2, inter alia;

calling upon them to pay proceeds of the bank guarantee with interest thereon @ 15% p.a. from the date of lodgment of claim with first defendant

till payment in full and final.

13. Faced with the aforesaid situation and imminent danger of remittance of the proceeds of the bank guarantee, the plaintiff has invoked

jurisdiction of this Court on 10th October, 2006 through the present suit praying for declaratory relief that the invocation of bank guarantee is bad,

illegal and not binding on plaintiff and also sought permanent injunction restraining the first defendant from paying amount of bank guarantee to the

defendant No. 2. In the aforesaid suit, present notice of motion is moved for interim relief as stated in opening part of this order.

14. The aforesaid prayer is opposed by defendant No. 1-bank by filing its written statement and also counter-affidavit opposing interim prayer.

15. During the course of hearing, it is brought to my notice that by an order dated 16.10.2006, learned Single Judge (S.J. Vazifdar, J) was pleased

to grant ad-interim relief restraining payment under the subject bank guarantee. The said order was extended from time to time and is in operation

as on date.

Submissions:

16. With the aforesaid rival pleadings, notice of motion was heard. The learned Senior Counsel appearing for both sides canvassed their respective

contentions.

17. Mr. Madon, learned Senior Counsel, appearing for the plaintiff urged that the extension of validity of the bank guarantee by the plaintiff in

favour of defendant No. 3 on two occasions was purely by way of good gesture with a view to point out to the defendant No. 3 that the contract

was terminated for no fault of the plaintiff. He further submits that entire termination of the contract was an outcome of fraud played upon the

plaintiff by defendant No. 3 in collusion and conspiracy with Regional Petroleum Products Corporation (R.P.P.C), who have, immediately

thereafter, entered into a fresh contract with defendant No. 3 on the false representation that defendant No. 3 was authorised to represent the

plaintiff. He, thus, submits that if the fraud is committed by the beneficiary then the bank can be restrained from making payment of the proceeds of

the bank guarantee by issuing order of injunction.

18. Mr. Madon in support of his submissions relied upon judgment of the Apex Court in the case of Federal Bank Ltd. v. V.M. Jog Engineering

Ltd. and Ors. (2001) 1 S.C.C. 663 and heavily relied upon paras 55 and 56 of the said judgment.

19. Per contra, Mr. Dhakephalkar, Learned Senior Counsel, appearing for the defendant No. 1-bank strongly opposed the prayer for grant of

injunction and also prayed for vacation of the order of ad-interim injunction which is in operation since 16.10.2006 contending that the bank

guarantee is unconditional and irrevocable and that bank had no prior notice of fraud at any point of time till service of the copy of the plaint. He,

thus, submits that the judgment of the Apex Court in the case of Federal Bank Limited v. V.M. Jog Engineering Ltd. and Ors.(supra) is not

applicable to the facts of the present case.

20. Learned Counsel for the defendant No. 1-bank went a step ahead and urged that the bank was never given any notice of fraud before receipt

of the letter of the defendant No. 2 invoking bank guarantee. No documents in support of alleged story of fraud were given to the bank. He further

submits that bank, itself, is desirous of making payment and discharging its obligation in order to maintain its reputation in the field of international

banking.

21. Mr. Dhakephalkar placed reliance on another judgment of the Apex Court in the case of BSES Ltd. (Now Reliance Energy Ltd.) Vs. Fenner

India Ltd. and Another, to urge that it is an absolute obligation of the guarantor bank to honour the bank guarantee issued by it free from

interference by the Court. Otherwise, internal as well as international trade and commerce would be irreparably damaged.

22. In the submission of Mr. Dhakephalkar, the courts have carved out only two exceptions. A fraud in connection with such a bank guarantee

would vitiate the very foundation of such bank guarantee. Hence, if there is such a fraud of which the beneficiary seems to take advantage, he can

be restrained from doing so. The second exception relates to cases where allowing enforcement of an unconditional bank guarantee would result in

irretrievable harm or injuries to one of the parties concerned. He further submits that the nature of fraud of a core nature has to vitiate underlined

transaction.

23. Mr Dhakephalkar took me through the letter dated 15th September, 2006 addressed by the plaintiff to the defendant No. 1; wherein, the

plaintiff has mentioned only one ground to prevent payment of bank guarantee, which was reading as under:

In view of the above, the entire underlying consideration for which the Bank Guarantee has been given does not survive and is now nonexistent. In

view of the above, the Bank Guarantee given by you in favour of M/s Abaja Cont. Est. now stands discharged and you are not liable to make any

payment under the same.

In view of the above we request you not to take cognizance of any letter of invocation if at all received by you in respect of the said Bank

Guarantee. If in spite of the above, you chose to make any payment under the Bank Guarantee, the same shall be at your own risk and you shall

not be entitled to debit our account in respect of the said amount nor recover the said amount from us.

Yours truly

24. Mr. Dhakephalkar submits that reading of the aforesaid letter, unequivocally, shows absence of theory of fraud. He further submits that bank

had no prior knowledge of alleged fraud alleged to have been played on the plaintiff. He further submits that, not only no prima facie; case is made

out by the plaintiff but the plaintiff has also failed to establish any irretrievable damage or loss or irreparable injury, much less balance of

convenience is its favour. He went on to submit that even if payment is made by the bank, the plaintiff can always be compensated in terms of

money if the action of bank is found to be bad and illegal. He, thus, submits that this is not a fit case for grant of interim relief.

Consideration:

25. Having heard rival parties, the submissions advanced by Mr. Dhakephalkar need acceptance. The judgment of the Apex Court in the case of

Federal Bank Ltd (supra) is not at all applicable to the facts of the present case. At no point of time, prior to filing of the suit, plaintiff had given any

notice or intimation of the alleged fraud to the defendant No. 1-bank much less before receipt of the request from defendant No. 2 to remit the

amount guaranteed by it.

26. The bank itself is not willing to withhold amount pending any adjudication of the rights and obligations of the parties. At this juncture, it will be

relevant to note that plaintiff has not raised any dispute with respect to the termination of the contract or alleged fraud played by defendant No. 3 in

termination of contract. Thus, as on date, there is no dispute with regard to the underlying contract between the plaintiff and defendant No. 3.

27. The Apex Court in the case of AIR 1997 1644 (SC) ; wherein it is observed

Clearly, therefore, 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 a fraud in connection with the bank guarantee.

28. The Apex Court has also referred to the judgment of V.M. Jog Engineering Ltd. and Ors. 2001 1 S.C.C. 663 of the said judgment makes a

reference to the several judgments of the Apex Court; wherein, it has been held that courts ought not to grant injunction to restrain encashment of

bank guarantees or letters of credit. However, two exceptions have been carved out: (i) fraud, and (ii) irretrievable damage. The settled legal

position emerging from the said judgment of the Apex Court is that if the plaintiff is able to establish that the case comes within these two

exceptions, temporary injunction under Order XXXIX Rule 1 C.P.C. should follow.

29. Paras 56 and 57 of the said judgment read as under:

Decided cases hold that in order to obtain an injunction against the issuing bank, it is necessary to prove that the bank had knowledge of the fraud.

Kerr, J. said in R.D. Harbottle (Mercantile) Ltd. v. National Westminister Bank Ltd. (QB at p.155) that irrevocable Letters of Credit are ""the

lifeblood of international commerce"". He said:

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.... Otherwise, trust in international commerce could be irreparably damaged.

Denning M.R. stated in Edward and Owen Engg. Ltd. v. Barclays Bank International Ltd that ""the only exception is where there is a clear fraud of

which the bank had notice"". Browne, L.J. said in the same case; ""but it is certainly not enough to allege fraud, it must be established and in such

circumstances, I should say, very clearly established"". In Bolivinter Oil S.A. v. Chase Manhattan Bank ALL ER 352, it was said:

Where it is proved that the bank knows that any demand for payment already made or which may thereafter clearly be evidence must to the fact

the bankÃ¯Â¿Â½s certainly not be fraudulent. be of fraud knowledge. made will But the clear, both as and as to It would normally be sufficient that this

rests on the uncorroborated statement of the customer, for irreparable damage can be done to bank''s credit in the relatively brief time ''before the

injunction is vacated''.

Thus, not only must ""fraud"" be clearly proved but so far as the bank is concerned, it must prove that it had knowledge of the fraud. In S.A. v. was

stated proof of the part of United Trading Corpn. Allied Arab Bank it that there must be knowledge of fraud on the bank at any time before

payment. It was also observed that,

It would be sufficient if the corroborated evidence of the plaintiff usually in the form of contemporary documents and the unexplained failure of a

beneficiary to respond to the attack, lead to the conclusion that the only realistic inference to draw was ''fraud''.

In Guaranty Trust York v. Hannay accepted the documents any knowledge of falsification and it that the defendants counter-claim from However,

it would bankerÃ¯Â¿Â½s duty to refuse the documents which on their face bear signs of having been altered (See Saloman and Naudus, Re. That was

contract. The Supreme Court in I.T.C. Ltd. v. Debts Recovery Appellate Tribunal also held that knowledge a Co. of New the banker without

fraud or was held could not the bank be the C.I.F. of the bank as to the fraud or forgery had to be prima facie established.

30. Reading of the aforesaid paras would go to show that in order to obtain an injunction against the issuing bank, it is necessary to prove that the

bank had knowledge of fraud. How knowledge is to be imputed to the bank is also spelt out in para 58 of the said judgment.

31. When Mr. Madon, was called upon to show the prior knowledge of fraud to the bank, he categorically, made a statement that except plaint

allegations, no prior intimation of the alleged fraud was given to the defendant No. 1 bank. He tried to fasten knowledge to the bank for the first

time through the plaint allegations only.

32. In the aforesaid view of the matter, in my considered view, none of the conditions warranting grant of injunction in favour of the plaintiff are

satisfied. There must be clear and cogent evidence to establish fraud and its prior knowledge to the bank. It is not a case that fraud was committed

by the defendant No. 3 while entering in the contract with plaintiff. Nor is there any fraud into formation of the contract of bank guarantee.

33. No plea of irretrievable injury has been made out or any attempt was made in that behalf. No submissions were advanced that the plaintiff is

likely to suffer irreparable loss on account of enforcement of the bank guarantee.

34. In the concurring judgment in U.P. Co-operative Federation, (supra), Hon''ble Shri Jagannatha Shetty, J, (as he then was) while dealing with

the above general principles quoted with approval the following observations of Shri A.P. Sen, J. (as he then was) in United Commercial Bank Vs.

Bank of India and Others, :

The rule is well established that a Bank issuing or confirming a letter of credit is not concerned with the underlying contract between the buyer and

seller. Duties of a Bank under a letter of credit are created by the document itself, but in any case it has the power and is subject to the limitations

which are given or imposed by it, in the absence of the appropriate provisions in the letter of credit.

35. The Courts usually refrain from granting injunction to restrain the performance of the contractual obligations arising out of a letter of credit or a

Bank guarantee between the Bank and another. If such temporary injunctions were to be granted in a transaction between a Banker and a Banker,

restraining a Bank from recalling the amount due when payment is made under reserve to another Bank or in terms of the letter of guarantee or

credit executed by it, the whole Banking system in the country would fail. In view of the BankerÃ¯Â¿Â½s obligation under an irrevocable guarantee or

letter of credit to pay, buyer-customer cannot instruct him not to pay.

36. Shetty, J. has approved the following observations of Lord Denning M.R. in Edward Owen Engineering Ltd. v. Barclay"s Bank International

Ltd. 1978 (1) ALL E.R. 976:

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 question whether the supplier has performed his contractual obligation or not: nor with the

question whether supplier is in default or not. The Bank must pay according to its guarantees, on demand if so stipulated, without proof or

conditions. The only exception is when there is a clear fraud of which the Bank has noticed.

37. The nature of fraud, which could be one of the grounds for refusing to honour the Bank guarantee was described by Shetty, J. in the following

words:

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 fraud of the

beneficiary, not the fraud of somebody else.

38. It is, however, settled by catena of decisions that the Court should not lightly interfere with in the operation of the irrevocable guarantee or

documentary credit and that in order to restrain the operation of irrevocable letter of credit, performance bond or guarantee, there should be

serious dispute to be tried and there should be a good prima facie case of fraud.

39. The above decision in U.P. Co-operative Federation Ltd (supra), was followed by a three-Judge Bench of the Supreme Court in General

Electric Technical Services Company Inc. Vs. M/s. Punj Sons (P) Ltd. and another, . In the above case, the Supreme Court set aside the order of

the Delhi High Court staying the encashment of Bank guarantee. While doing so, the Supreme Court observed:

The demand by GETSCO is under the Bank guarantee and as per the terms thereof. The Bank has to pay and the Bank was willing to pay as per

the undertaking. The Bank cannot be interdicted by the Court at the instance of respondent No. 1 in the absence of fraud or special equities in the

form of preventing irretrievable injustice between the parties. The High Court in the absence of prima facie case on such matters has committed an

error in restraining the Bank from honouring its commitment under the Bank guarantee.

40. The Supreme Court had occasion to consider the very same controversy once again in Svenska Handelsbanken Vs. M/s. Indian Charge

Chrome and others, . A three-Judge Bench of the Supreme Court, on consideration of the facts and circumstances of that case, observed:

It appears to us that High Court totally misdirected itself in assuming that the present application for interim relief against the enforcement of Bank

guarantee is not to be decided strictly on principles of injunction in relation to Bank guarantee but general principles of injunction on tenders would

be applicable and on that basis proceeded to decide the matter.

It was further observed:

The High Court totally ignored the irretrievable injury which will be caused to defendant No. 12 (Industrial and Development Bank of India) in not

honouring the Bank guarantee in international market which may cause grievous and irretrievable damage to the interest of the country as opposed

to the loss of money to the borrower plaintiff. There was no question of defendant No. 4 not making any demand. The installments for repayment

of the loans had already been fixed and liable to be paid without demand by defendant No. 4. Defendant No. 12 is under a duty to pay the

installments regularly on a fixed date without any demand to defendant No. 4.

It was reiterated:

In law relating to Bank guarantees a party seeking injunction from encashing of Bank guarantee by the suppliers has to show prima facie case of

established fraud and an irretrievable injury.

41. Taking the over all view of the matter, I am of the considered view that no out for grant of interim relief. motion is, thus, dismissed with costs

quantified in the sum of Rs. 25,000/-. case is Notice made of.

42. At this stage, learned Counsel for the plaintiffs prayed for ad-interim order. Learned Counsel appearing for the defendant bank has opposed

grant of such order. However, considering the fact that ad-interim order operated right from October, 2006 till today, I deem it fit to extend it for

another two weeks. continuation of

43. Plaintiffs are put on notice that no further extension would be granted. With the expiry of two weeks'' time, automatically ad-interim order

would lapse.