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ANSAL ENGINEERING PROJECTS LTD.

v.

TEHRI HYDRO DEVELOPMENT CORPORATION
LTD. AND ANR.

JULY 31, 1996

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[K. RAMASWAMY, S. SAGHIR AHMAD AND
G.B. PATTANAIK, JJ.]

Arbitration Act, 1940 :

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Ss. 20. and 41 read with Schedule II—Bank guarantee—Letter of invocation—Application by contractor for injunction to restrain the respondent Corporation from invoking the bank guarantee contending that amount due and payable should be determined—Held bank guarantee is an independent and distinct contract between bank and beneficiary and is not qualified by the

D *underlying transaction and validity of primary contract between the parties—Unless fraud or special equity is pleaded and *prima facie* established by strong evidence as a triable issue, beneficiary cannot be restrained from encashing bank guarantee even if a dispute had arisen in performance of contract or execution of work undertaken—In terms of bank guarantee the*

E *beneficiary is entitled to invoke bank guarantee and seek encashment of the amount specified in bank guarantee—Final adjudication is not a pre-condition to invoke bank guarantee and that is not a ground to issue injunction restraining the beneficiary to enforce bank guarantee—Liability of bank is absolute and unequivocal; it is not concerned with ultimate decision of a court or a tribunal as to the amount due and payable to the beneficiary—Any payment by bank would be subject to the final decision by the court or tribunal—No case of fraud or special injury is made out for interference by way of injunction—High Court was right in refusing injunction.*

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Hindustan Steel Workers Construction Ltd. v. G.S. Atwal & Co. (Engineers) Pvt. Ltd., [1995] 6 SCC 76 and Hindustan Steel Works Construction Ltd. v. Tarapore & Co. & Anr., JT (1996) 6 SC 295, relied on.

Bank guarantee—Invocation of—Discussed.

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Hindustan Steel Workers Construction Ltd. v. G.S. Atwal & Co. (Engineers) Pvt. Ltd., [1995] 6 SCC 76 and Hindustan Steel Works Construction Ltd. v. Tarapore & Co. & Anr., JT (1996) 6 SC 295, relied on.

CIVIL APPELLATE JURISDICTION : Special Leave Petition (C)

H No. 15878 of 1996.

From the Judgment and Order dated 17.1.96 of the Delhi High Court A in Suit No. 990 of 1995.

Nageswar Rao, Makarand D. Adkar, S.D. Singh and Sudhanshu Atreya for the petitioner.

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The following Order of the Court was delivered :

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This Special Leave Petition arises from the order of the learned Single Judge of the Delhi High Court dated January 17, 1996 made in Suit No. 990/95. The petitioner had sought for injunction under Section 41 read with Schedule II of the Arbitration Act, 1940 (for short, the 'Act') to restrain the respondent from invoking the bank guarantee No. 33/1991 dated February 13, 1991 to encash Rs. 57,57,970 pursuant to the letter of invocation dated April 5, 1995. The facts mentioned therein are that petitioner had entered into contract on March 30, 1991 pursuant to a tender submitted by him to construct 108 residential quarters at Katharia, Bhagirath Puram, Tehri. The construction was to be completed within stipulated period but was not completed. In terms of the contract, the first respondent had terminated it. The petitioner availed of the remedy under Section 20 of the Act for appointment of an arbitrator for reference of the dispute in terms of the contract. Pending consideration thereof, he filed an application to restrain the respondent to encash the bank guarantee. The respondent after termination of the contract had issued a letter of invocation dated April 5, 1995 calling upon the UCO Bank to pay the aforesaid amount in terms of the bank guarantee. It was contended in the High Court that the amount due and payable by the petitioner should be determined in the suit. The bank guarantee could not be invoked till then and the payment thereof could not be made. The respondent had played fraud on the petitioner in entering into the contract and seeking extension of the time. There are exceptional circumstances which necessitated the petitioner to seek relief of injunction pending determination of the amount due and payable by the petitioner. The High Court rejected the contentions and dismissed the petition. Thus, this special leave petition.

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Admittedly, the bank guarantee given by the UCO Bank on behalf of the petitioner reads as under :

"On production of a Bank Guarantee for the above principal amount and interest due thereon, we, UCO Bank, 5, Parliament

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A Street, New Delhi (hereinafter referred to as "the Bank") at the request of Ansal Engineering Projects Limited Contractor (s) do hereby undertake to pay to the Corporation an amount not exceeding Rs. 57,57,970 plus interest as aforesaid against any loss or damage caused to suffered or would be caused to or suffered by the Corporation by reason of any breach by the said Contractor (s) of any of the terms or conditions contained in the said Agreement.

B We, UCO Bank, 5, Parliament Street, New Delhi do hereby undertake to pay the amount due and payable under this guarantee without any demur, merely on a demand from the Corporation stating that the amount claimed is due by way of loss of damage caused to or would be caused to or suffered by the Corporation by reason of breach by the said contractor (s) of any of terms or conditions contained in the said Agreement or by reason of the Contractor (s) failure to perform the said Agreement. Any such demand made on the bank shall be conclusive as regards the amount due and payable by the bank under this guarantee. However, our liability under this guarantee shall be restricted to an amount not exceeding Rs. 57,57,970 plus interest due on the outstanding balance of mobilisation advance @ 18% p.a.

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E We undertake to pay to the Corporation money so demanded notwithstanding any dispute or disputes raised by the Contractor (s)/Supplier (s) in any suit or proceeding pending before any Court or Tribunal relating thereto. Our Liability under this present being absolute and unequivocal."

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The letter of invocation of the respondent is thus :

G "We hereby invoke subject Bank Guarantee and demand the amount detailed herein after as the amount claimed is due by way of loss and damage caused to or would be caused to or suffered by THDC/ourselves by reason of breach by Your customer of the terms and conditions contained in the said agreement and also by reason of your Customer's failure to perform the said agreement.

H THDC/We are limiting our claim against you to the extent of the principal amount of mobilisation advance lying outstanding

against your customer plus interest due on the outstanding balance A
of mobilisation advance @ 18% per annum. You are as such,
requested to pay the following amounts :

(a) Outstanding amount of mobilisation advance due and payable B
by M/s. Ansal Engineering Project Limited, in terms of the Bank
Guarantee in question. Rs. 51,02,658.

(b) Balance interest @ 18% per annum calculated on the outstanding B
mobilisation advance upto 30th October, 1994, Rs. 13,89,625.

(c) Interest @ 18% per annum on the outstanding mobilisation C
advance of Rs. 51,02,658 w.e.f. 31.10.1994 till the date of payment
by you.

This notice of demand may be treated as fresh a demand to pay D
the above noted amounts in terms of order dated 1.9.1994 passed
by the Hon. High Court of Delhi at New Delhi in O.M.P. No.
39/1994 titled as M/s. Ansal Engineering Projects Ltd. versus Tehri
Hydro Development Corporation Ltd. & Yourself. Photo copy of
the said order is enclosed herewith for ready reference."

It is settled law that bank guarantee is an independent and distinct E
contract between the bank and the beneficiary and is not qualified by the
underlying transaction and the validity of the primary contract between the
person at whose instance the bank guarantee was given and the beneficiary.
Unless fraud or special equity exists, is pleaded and *prima facie* established F
by strong evidence as a triable issue, the beneficiary cannot be restrained
from encashing the bank guarantee even if dispute between the beneficiary
and the person at whose instance the bank guarantee was given by the
Bank, had arisen in performance of the contract or execution of the works
undertaken in furtherance thereof. The Bank unconditionally and ir- G
revocably promised to pay, on demand, the amount of liability undertaken
in the guarantee without any demur or dispute in terms of the bank
guarantee. The object behind is to inculcate respect for free flow of
commerce and trade and faith in the commercial banking transactions
unhedged by pending disputes between the beneficiary and the contractor.

It is equally settled law that in terms of the bank guarantee the H
beneficiary is entitled to invoke the bank guarantee and seek encashment

- A of the amount specified in the bank guarantee. It does not depend upon the result of the decision in the dispute between the parties, in case of the breach. The underlying object is that an irrevocable commitment either in the form of bank guarantee or letters of credit solemnly given by the bank must be honoured. The Court exercising its power cannot interfere with
- B enforcement of bank guarantee/letters of credit except only in cases where fraud or special equity is *prima facie* made out in the case as triable issue by strong evidence so as to prevent irretrievable injustice to the parties. The trading operation would not be jettisoned and faith of the people in the efficacy of banking transactions would not be eroded or brought to disbelief. The question therefore, is : whether the petitioner had made out
- C any case of irreparable injury by proof of special equity or fraud so as to invoke the jurisdiction of the Court by way of injunction to restrain the first respondent from encashing the bank guarantee. The High Court held that the petitioner has not made out either. We have carefully scanned the reasons given by the High Court as well as the contentions raised by the
- D parties. On the facts, we do not find that any case of fraud has been made out. The contention is that after promise to extend time for constructing the buildings and allotment of extra houses and the term of bank guarantees was extended, the contract was terminated. It is not a case of fraud but one of acting in terms of contract. It is next contended by Shri G.
- E Nageshwara Rao, learned counsel for the petitioner that unless the amount due and payable is determined by a competent court or tribunal *by mere invocation of bank guarantee or letter of credit pleading that the amount is due and payable by the petitioner, which was disputed, cannot be held to be due and payable in a case*. The Court has yet to go into the question and
- F until a finding after trial, or decision is given by a court or tribunal that amount is due and payable by the petitioner, it cannot be held to be due and payable. Therefore, the High Court committed manifest error of law in refusing to grant injunction as the petitioner has made out a *prima facie* strong case. We find no force in the contention. All the clauses of the contract of the bank guarantee are to be read together. Bank guarantee/letters of credit is an independent contract between the bank and the beneficiary. It does not depend on the result of the dispute between the person on whose behalf the bank guarantee was given by the bank and the beneficiary. Though the question was not elaborately discussed, it was in sum answered by this Court in *Hindustan Steel Workers Construction Ltd. v. G.S. Atwal & Co. (Engineers) Pvt. Ltd.*, [1995] 6 SCC 76 at 79. This Court

had held in para 6 that the entire dispute was pending before the arbitrator. Whether, and if so, what is the amount due to the appellant was to be adjudicated in the arbitration proceedings. The order of the learned Single Judge proceeds on the basis that the amounts claimed were not and cannot be said to be due and the bank has violated the understanding between the respondent and the Bank in giving unconditional guarantee to the appellant. The learned Judge held that the bank had issued a guarantee in a standard form, covering a wider spectrum than agreed to between the respondent and the bank and it cannot be a reason to hold that the appellant is in any way fettered in invoking the unconditional bank guarantee. Similarly, the reasoning of the learned Single Judge that before invoking the performance guarantee the appellant should assess the quantum of loss and damages and mention the ascertained figure, cannot be put forward to restrain the appellant from invoking the unconditional guarantee. This reasoning would clearly indicate that the final adjudication is not a pre-condition to invoke the bank guarantee and that is not a ground to issue injunction restraining the beneficiary to enforce the bank guarantee. In *Hindustan Steel Works Construction Ltd. v. Tarapore & Co. & Anr.*, JT (1996) 6 SC 295, it was contended that a contractor had a counter-claim against the appellant; that disputes had been referred to the arbitrator and no amount was said to be due and payable by the contractor to the appellant till the arbitrator declared the award. It was contended therein that those were exceptional circumstances justifying interference by restraining the appellant from enforcing the bank guarantee. The High Court had issued interim injunction from enforcing the bank guarantee. Interfering with and reversing the order of the High Court, this has held in para 23 that a bank must honour its commitment free interference by the courts. The special circumstances or special equity pleaded in the case that there was a serious dispute on the question as to who has committed the breach of the contract and that whether the amount is due and payable by the contractor to the appellant till the arbitrator declares the award, was not sufficient to make the case an exceptional one justifying interference by restraining the appellant from enforcing the bank guarantee. The order of injunction, therefore, was reserved with certain directions with which we are not concerned in this case.

A conjoint reading of the bank guarantee and the letter of invocation demanding payment of amount due and payable by the petitioner would

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- A show that the first respondent had specified and quantified in terms of the bank guarantee a total sum with interest due thereon in a sum of Rs. 57,57,970 as on April 5, 1995. A demand in terms of clause (i) of the bank guarantee was made. The bank had irrevocably promised and undertaken to pay to the Corporation without any demur or damage an amount not exceeding Rs. 57,57,970 plus interest as per terms and conditions contained in the bank guarantee untrammelled by the bi-lateral agreement between the petitioner and the first respondent-Corporation stating the amount claimed was due and payable on account of loss or damage caused to or likely to be caused to or by the Corporation by reason of any breach by the said contract or any of the terms and conditions contained in the said
- B agreement notwithstanding any dispute or disputes raised under the contract in any suit or proceedings pending before any court or tribunal relating thereto. The liability of the bank is absolute and unequivocal; it would thereby be clear that the bank is not concerned with the ultimate decision of a court and a tribunal in its finding after adjudication as to the amount due and payable by the petitioner to the first respondent. What would be material is the quantification of the liability in the letter of revocation. The bank should verify whether the amount claimed is within the terms of the bank guarantee or letter of credit. It is axiomatic that any payment by the bank, obviously be subject to the final decision of the court or the tribunal. At the stage of invocation of bank guarantee, the need for final adjudication and decision on the amount due and payable by the petitioner, would run contrary to the terms of the special contract in which the bank had undertaken to pay the amount due and payable by the contractor. Thus we hold that there is no question of making out any *prima facie* cause much less strong evidence or special equity or exceptional circumstances for interference by way of injunction.
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The special leave petition is accordingly dismissed.

R.P.

Petition dismissed.