M/S Bses Ltd. (Now Reliance Energy Ltd.) vs M/S Fenner India Ltd. & Anr on 3 February, 2006

Equivalent citations: AIR 2006 SUPREME COURT 1148, 2006 (2) SCC 728, 2006 AIR SCW 721, 2006 (2) AIR JHAR R 157, 2006 (2) AIR KANT HCR 633, 2006 (2) SCALE 186, 2006 (3) SRJ 389, 2006 (1) ARBI LR 388, 2006 (1) UPLBEC 711, 2006 (2) COM LJ 430 SC, (2006) 2 ALLMR 85 (SC), (2006) 2 CTC 137 (SC), (2006) 2 COMLJ 430, (2006) 1 CURCC 218, (2006) 3 CAL HN 38, (2007) WRITLR 70, (2006) 2 PAT LJR 160, (2006) 3 SCJ 9, (2006) 1 RECCIVR 638, (2006) 1 UPLBEC 711, (2006) 2 SUPREME 106, (2006) 2 SCALE 186, (2006) 1 WLC(SC)CVL 416, (2006) 2 JLJR 207, (2006) 1 KCCR 565, (2006) 2 ALL WC 1155, (2006) 4 CIVLJ 25, (2006) 2 MAD LJ 304, (2006) 130 COMCAS 8, (2006) 1 ARBILR 388, MANU/SC/741/2006, (2006) 2 MAD LW 788, (2006) 3 BANKJ 17, (2006) 2 PUN LR 227, (2006) 2 BANKCAS 20, (2006) 2 CIVILCOURTC 186, (2006) 1 BANKCLR 419, (2006) 2 CTC 794 (MAD)

Bench: H. K. Sema, B. N. Srikrishna

CASE NO.:
Appeal (civil) 955 of 2006

PETITIONER:
M/s BSES Ltd. (Now Reliance Energy Ltd.)

RESPONDENT:
M/s Fenner India Ltd. & Anr.

DATE OF JUDGMENT: 03/02/2006

BENCH:
H. K. Sema & B. N. Srikrishna

JUDGMENT:

J U D G M E N T (arising out of S.L.P. (C) No. 20062/2004) SRIKRISHNA, J.

Leave granted.

This is one more instance of an injunction being sought against a beneficiary seeking to enforce his/her rights under a bank guarantee, albeit with a novel averment that "lack of good faith" or "enforcing with an oblique purpose" constituted further exceptions to the general rule against intervention.

The Facts M/s Godavari Sugars Ltd. awarded a contract for a captive power plant to M/s BSES Ltd. (now Reliance Energy Ltd.) (hereinafter "the Appellant"). The Appellant, in turn, awarded a part of that work to M/s Fenner India Ltd. (hereinafter "the First Respondent"). In connection with this, the Appellant issued to the First Respondent, four work orders/ purchase orders, as follows:

> "(i) Work Order No. 2245 dated 15.3.2000/ 4.5.2000 for a sum of Rs.70,00,000/-
>
> (ii) Work Order No. 2246 dated 15.3.2000/ 4.5.2000 for a sum of Rs.5,57,00,000/-
>
> (iii) Work Order No. 2247 dated 15.3.2000/ 4.5.2000 for a sum of Rs.90,00,000/-
>
> (iv) Work Order No. 2248 dated 15.3.2000/ 4.5.2000 for a sum of Rs.50,00,000/- "

As required by the terms and conditions of the said work/ purchase orders, the First Respondent submitted four bank guarantees from the State Bank of India (hereinafter "the Second Respondent-Bank"), dated 23.3.2000 bearing Nos. 288/99, 289/99, 290/99 and 291/99 in sums of Rs. 7,00,000/-, Rs. 9,00,000/-, Rs. 55,70,000/- and Rs. 38,35,000 respectively. They were unconditional irrevocable bank guarantees, under which the Second Respondent-Bank agreed to pay to the Appellant the amount claimed or demanded by the Appellant. The amounts guaranteed thereunder were payable with or without any reason in writing from the Appellant, without protest or demur or proof of satisfaction, and without reference to the First Respondent, upon being called by the Appellant, irrespective of any dispute between the Appellant and the First Respondent with regard to or touching any of the contractual terms between them. They were, of course, subject to the aggregate limits stipulated in each of the bank guarantees.

On 10.5.2000, the Appellant and the First Respondent entered into a "wrap-around agreement", under which it was agreed that the First Respondent would perform its contractual obligations on a turnkey basis viz. as a composite one. This principle was also made applicable to the bank guarantees. Thus, Clause (4) of this agreement in terms says:

> "In case of any material breach of any or all the Contracts, BSES shall have the right to embark upon the retentions and encashment of Bank Guarantees of all the contracts."

On 4.12.2003, the Appellant invoked the four bank guarantees. On 7.12.2003, the First Respondent invoked the arbitration clause, as provided in the work/ purchase orders. On 8.12.2003, the First Respondent moved a petition under Section 9 of the Arbitration and Conciliation Act, 1996 (hereinafter "the Arbitration Act") before the District Court, Madurai, seeking a declaration that the Appellant was not entitled to invoke the four bank guarantees. The First Respondent also sought an interim injunction against the Appellant restraining them from encashing or receiving any amount under the bank guarantees, pending disposal of the arbitration proceedings.

On 22.3.2004, the learned Principal District Judge, Madurai, dismissed the First Respondent's petition by holding that this was not a case where "irretrievable injustice" would be done by

enforcement of the bank guarantees, nor was it a case where a strong prima facie case of fraud had been made out. Despite this finding, the learned District Judge took the view that, although the Appellant was not entitled to an order of injunction, the Appellant's rights would have to be safeguarded till the matter was disposed of in the arbitration proceedings. Accordingly, the learned District Judge directed the Appellant to maintain status quo for a period of one month (from the date of the order), within which the arbitral proceedings were to be disposed of. The parties were directed to seek their remedies before the arbitrator.

Sometime in April 2004, an application was made under Section 17 of the Arbitration Act before the Arbitral Tribunal. The First Respondent preferred an appeal before the High Court of Madras challenging the order and judgment dated 22.3.2004 of the learned District Judge. On 24.5.2004, even while the arbitral proceedings were pending, the High Court made an interim order. Further, by the impugned judgment dated 30.7.2004, the High Court allowed the appeal preferred by the First Respondent and granted the injunction as prayed for, and set aside the order of the learned District Judge.

The Rule and its Exceptions Mr. Rohtagi, learned Senior Counsel for the Appellant, urged that the settled law in this country is that a bank guarantee is an independent contract between the bank and the beneficiary thereof. Accordingly, irrespective of any dispute between the beneficiary and the party at whose instance the bank has given the guarantee, the bank is obliged to honour its guarantee, as long as the guarantee is unconditional and irrevocable. Our attention was drawn to the judgment of this Court in U.P. Cooperative Federation Ltd. v. Singh Consultants and Engineers (P) Ltd. (hereinafter "U.P. Cooperative Federation"). It was pointed out in that case that a bank guarantee must be honoured in accordance with its terms as the bank, which gives the guarantee, is not concerned with the relations between the supplier and the customer. Neither is the bank concerned with the question whether any of them have failed in their contractual obligations or not. In other words, the bank must pay according to the tenor of its guarantee, on demand, without proof or condition.

There are, however, two exceptions to this rule. The first is when there is a clear fraud of which the bank has notice and a fraud of the beneficiary from which it seeks to benefit. The fraud must be of an egregious nature as to vitiate the entire underlying transaction. The second exception to the general rule of non-intervention is when there are "special equities" in favour of injunction, such as when "irretrievable injury" or "irretrievable injustice" would occur if such an injunction were not granted. The general rule and its exceptions has been reiterated in so many judgments of this Court, that in U.P. State Sugar Corporation v. Sumac International Ltd., (hereinafter "U.P. State Sugar Corporation") this Court, correctly declared that the law was "settled" .

Mr. Sorabjee, however, tried to expand upon the settled exceptions to the rule by first, relying on an order of this Court in State of Haryana v. Continental Construction Ltd. (hereinafter "Continental Construction Ltd."). We are afraid that the short order in Continental Construction Ltd. (supra) appears to have been made on the narrow facts of that case and does not constitute a precedent binding us. Moreover, as mentioned earlier, a line of judgments of this Court have long settled the law relating to the invocation of bank guarantees.

Second, Mr. Sorabjee placed reliance on a number of foreign judgments, especially that of the Queen's Bench Division in TTI Team Telecom Ltd. v. Hutchison 3G UK Ltd., wherein, the rule and its exceptions in England have been elegantly summarized. Mr. Sorabjee placed special emphasis on the following propositions:

> " (3) The basis for a contention of a breach of faith must be established by clear evidence even for the purposes of interim relief. A breach of faith can arise in such situations as: a failure by the beneficiary to provide an essential element of the underlying contract on which the bond depends; a misuse by the beneficiary of the guarantee by failing to act in accordance with the purpose for which it was given; a total failure of consideration in the underlying contract; a threatened call by the beneficiary for an unconscionable ulterior motive; or a lack of an honest or bona fide belief by the beneficiary that the circumstances, such as poor performance, against which a performance bond had been provided, actually exist.
>
> (4) In addition, where it appears that the call would be a nullity, a court will intervene to restrain that invalid call.

Examples are where a condition precedent to a call has not yet been fulfilled; where the bond is a 'see to it' bond necessitating prior proof of loss by the beneficiary or poor performance by the third party which has not yet been established; or where the demand or the supporting documents show that the demand does not conform to the requirements imposed by the bond for a valid demand.

(5) Otherwise, a threatened call will not be restrained. In particular an allegedly incorrect calling of a performance bond will not be restrained merely because the factual basis of the call arising out of the underlying contract is disputed. Thus disputes as to whether a breach of contract, a determination of a contract for cause, a repudiation of a contract or the incurring of loss have occurred, where these are events covered by the performance guarantee, will not be allowed to found an application to restrain a call unless these disputes reveal a breach of faith by the beneficiary. Any consequent payment under the bond to the beneficiary which over-compensates the beneficiary may be recouped in the 'accounting' exercise that the third party may claim in subsequent litigation against the beneficiary under the underlying contract "

> Mr. Sorabjee, finally contended that in Singapore, where commercial cases are expeditiously disposed of, the Court of Appeal in Samwoh Asphalt Premix Pte. Ltd. v. Sum Cheong Piling Pte. Ltd. has held that calling a performance guarantee for an oblique purpose was not permissible. Specifically, using it as a "bargaining chip", as a "deterrent" or in an "abusive" manner, would invite an injunction from the court. He submitted that the Singapore court has gone so far as to say that the unconscionable calling of a bank guarantee was an exception independent of fraud.
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> We are afraid that in the face of the law succinctly laid down in U.P. Cooperative Federation (supra) and reiterated in numerous judgments of this Court referred to earlier, we are unable to accept the wide proposition of law laid down in the foreign

judgments cited by Mr. Sorabjee. Whatever may be the law, as to the encashment of bank guarantees in other jurisdictions, when the law in India is clear, settled and without any deviation whatsoever, there is no occasion to rely upon foreign case law.

Contentions of the First Respondent A reading of the impugned judgment of the High Court shows that the learned Judge was cognizant of the settled rule relating to bank guarantees, but came to the conclusion that the encashment of the bank guarantees by the Appellant would present a case under one of the exceptions to the rule viz. would cause "irretrievable injustice" to the First Respondent.

Learned counsel for the First Respondent strongly supported this line of argument of the High Court. He contended that the bank guarantees were for different purposes, either to: (i) secure the payment of advances or (ii) secure performance. As far as the bank guarantees to secure advance payments were concerned, he contends that there is a provision in the contract that the amount of advance was to be recovered by deduction from the gross accepted amount of any running bill. The contract stipulates two modes of recoveries: (i) By deduction from the gross amount from the running bill, and (ii) By invocation of the bank guarantee. Mr. Sorabjee further urged that it had been found by the District Court and the High Court concurrently that the entire amount of the bank guarantee had been recovered from the running bills of the First Respondent. Accordingly, he argued that, encashing the bank guarantee after having recovered the full amount of advances from the running bills was an "egregious fraud" or at any rate, created a situation of "special equities" in favour of the First Respondent. The High Court, he submits, was fully justified in granting an injunction since these facts were prima facie established as triable issues.

Further, Mr. Sorabjee submitted that the fourth bank guarantee (No. 291/99 dated 23.3.2000) was further qualified by "due and faithful performance of the contract", and that the contract had been admittedly performed. In the circumstances, he submits that, the encashment of this guarantee was fraudulent or created a situation of special equities, which was covered by U.P. Cooperative Federation Ltd. (supra). Mr. Sorabjee's assertions, however, need closer scrutiny through examining the contractual clauses, as well as through examining the conduct of the First Respondent.

The Contractual Clauses Mr. Sorabjee is correct in that both the District Court and the High Court have concurrently held that the documents placed on record do bear out that the entire guarantee amount had been recovered. We are, however, unable to accept Mr. Sorabjee's contention that the bank guarantees were given only for the purpose of security as against the advance paid to the First Respondent. Indeed, Mr. Rohtagi is justified in his submission that the final contract was a "wrap-around agreement". The terms of the agreement signed on 10.5.2000 make it clear, after referring to the four contract agreements for work/ purchase orders, that:

> " It is specifically agreed between the parties that CONTRACTOR is not only responsible and liable for its scope of supplies in Contract No. I and for its scope of services in the Contract Nos. II, III and IV, but also to perform and take care of all such works which though are not specifically mentioned in these four contracts, but are essential to complete the "BAGASSE HANDLING SYSTEM PACKAGE" as a whole in its true intent and requirement unless the exclusion(s) are specifically agreed by BSES. Contract-III shall also include unloading of plant and equipment supplied under Contract-I consequent to receipt at site, movement within site to stores and/or to intermediate location and/or to final location, co- ordination with Owner for entry in their store documents, issue of Store Issue Voucher, etc."

The agreement further provides vide Clause (2):

> "The successful and timely completion of the 'BAGASSE HANDLING SYSTEM PACKAGE' by CONTRACTOR and its performance thereof under Contract-I, Contract-II, Contract- III and Contract-IV shall be jointly and severally bound by the terms of the "Contract" and shall be jointly and severally liable to BSES for the performance of all obligations under the "Contract".

Clause (3) of the agreement declares:

> "CONTRACTOR agrees that if liquidated damages for delay and/or performance guarantees, claim on warranty/workmanship, punch lists and any breach of contract by CONTRACTOR are applied under the provisions of any of the four "Contracts", it automatically shall be construed that the same provision can be applied on all the four contracts as read together. BSES shall have the right to treat the contracts jointly as turnkey contract and money can be recovered by BSES including but not limited to liquidated damages, fines or penalties of whatever nature as per the "Contract" and any excess costs and expenses associated with the completion of the job by BSES for the "BAGASSE HANDLING SYSTEM PACKAGE"."

Clauses (4) and (5) in express terms respectively state:

> "In case of any material breach of any or all the Contracts, BSES shall have the right to embark upon the retentions and encashment of Bank Guarantees of all the contracts."

> "Notwithstanding the works undertaken by the designated sub- contractor(s) of the Contractor subject to provisions of the contract, the Contractor shall remain wholly liable to perform, fulfill and discharge all the obligations and responsibilities under this contract on a turnkey basis and the same shall in no way be reduced or diminished for any reasons whatsoever."

Upon a careful reading of this agreement, we are satisfied that the contract though, for the sake of convenience, was split up into four sub- contracts (viz. the four work/ purchase orders), was a composite contract executable on a turnkey basis. The terms of this turnkey contract were reduced into writing by the "wrap-around agreement" of 10.5.2000. We are of the definite view that under the "wrap-around agreement", the Appellant had the right to encash any or all of the guarantees for any breach in any of the terms of the four contracts. Hence, we are unable to accept the submission of Mr. Sorabjee that the first three bank guarantees were only for securing the advances paid and that it was only the fourth bank guarantee (No. 291/99 dated 23.3.2000) that was liable to be called for failure to perform the contract. In fact, an appraisal of the terms of the contract leads us to the conclusion that the bank guarantees were intended for both purposes: for securing the advances paid to the First Respondent and also for securing due performance of the contract.

Renewal of the Guarantees Our conclusions as to the real purpose of the bank guarantees are fortified by our examination of the conduct of the First Respondent. Indeed, we repeatedly asked Mr. Sorabjee as to why and under what circumstances the First Respondent continued the first three guarantees, purportedly pertaining to advances, even after the First Respondent knew that the advance amount had been fully recovered. Mr. Sorabjee claimed sometime to put an Additional Affidavit to deal with this query, which according to him, had been raised by this Court for the first time. In the Additional Affidavit (dated 11.11.2005) filed on behalf of the First Respondent, the explanation given for the continuation of bank guarantees even after full recovery of the advances is that:

> " the petitioner (the Appellant) has been insisting on extension of bank guarantees and threatened to encash them if they were not extended, Thus under petitioner's threat of encashment of the bank guarantees, and in the hope of amicably settling the issue with the petitioner, the first respondent (sic) felt compelled to extend the bank guarantees."

In our view, this is an unsatisfactory explanation in the circumstances of the case and in any event, this explanation neither establishes "egregious fraud" by the Appellant nor creates a situation of "irretrievable injury".

The Fourth Bank Guarantee Finally, Mr. Sorabjee tried to intervene in the fourth bank guarantee (No.291/99 dated 23.3.2000) and contended that this was the only bank guarantee intended to secure "due and faithful performance of the contract". He further urged that the performance had been duly satisfied and, therefore, there was no warrant for calling this bank guarantee. Mr. Sorabjee turned to a certificate issued by M/s Godavari Sugar Mills Ltd. (dated 18.3.2003) to contend that there had been due and satisfactory performance of the contract. We are, however, not impressed with Mr. Sorabjee's argument because the evidence on record is precisely to the contrary. In fact, the certificate, in terms, says that there was a technical defect found:

> " for which correction will be done by Fenner representative (sic) as assured by him. After completion of all those points further tests can be carried out."

Accordingly, we are prima facie not satisfied that performance had been duly and satisfactorily certified. Under the terms of the "wrap-around agreement", the Appellant was entitled to encash all or any of the bank guarantees for breach of the First Respondent's obligations under any one of the contracts. In our view, it is the case of the Appellant that there was no satisfactory performance of the contract, as a result of which, the Appellant was justified in encashing the concerned bank guarantee. Indeed, as per the terms of the bank guarantee itself, the Appellant is the best judge to decide as to when and for what reason the bank guarantees should be encashed. Further, it is no function of the Second Respondent-Bank, nor of this Court, to enquire as to whether due performance had actually happened when, under the terms of the guarantee, the Second Respondent-Bank was obliged to make payment when the guarantee was called in, irrespective of any contractual dispute between the Appellant and the First Respondent. Indeed, in similar circumstances, this Court in General Electric Technical Services Company Inc. v. Punj Sons (P) Ltd., held:

> " the Bank must honour the bank guarantee free from interference by the courts. Otherwise, trust in commerce internal and international would be irreparably damaged. It is only in exceptional cases that is to say in case of fraud or in case of irretrievable injustice, the court should interfere. 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."

This was also a case where, after having recovered certain amount from the running bills, a call was made on the bank guarantee in respect of the full guaranteed amount. In an observation with direct relevance for the present case, this Court pointed out that the bank was not concerned with the outstanding amount payable under the running bills:

> "The right to recover the amount under the running bills has no relevance to the liability of the Bank under the guarantee. The liability of the Bank remained intact irrespective of the recovery of mobilisation advance or the non-payment under the running bills. The failure on the part of (the Beneficiary) to specify the remaining mobilisation advance in the letter for encashment of bank guarantee is of little consequence to the liability of the bank under the guarantee."

Irretrievable Injury As we have stated repeatedly, the First Respondent can succeed only if the case can be brought under the two accepted exceptions to the general rule against intervention. Evidently, there is no "egregious fraud" so as to fall within the first exception. Hence, only one more point remains: whether encashment of the guarantees will create special equities (in particular, "irretrievable injury") in favour of the First Respondent? We are not satisfied on facts that such is the present situation.

There is no dispute that arbitral proceedings are pending. In fact, we were shown that one of the disputes referred to arbitration is whether the bank guarantees are null and void. Further, one of the substantive prayers in the arbitration made on behalf of the First Respondent, is to make an award declaring the four bank guarantees unenforceable, illegal, void and liable to be discharged. Further,

there is also a prayer for permanent injunction to restrain the Appellant from encashing the bank guarantees. Therefore, since this prayer is already pending before the Arbitral Tribunal, we see no situation of "irretrievable injustice" if, at the present moment, the Appellant is allowed to encash the bank guarantees. For justice can always be rendered to the First Respondent, if he succeeds before the Arbitrators. Nor do we see any special equity in favour of the First Respondent, when there is in fact a dispute that performance was prima facie not satisfactory, which enabled the Appellant to encash all or any of the four bank guarantees.

The Final Findings In this view of the matter, we see no merit in the stand taken by the First Respondent. In our judgment, the Madras High Court erred in interfering with the bank guarantees and in granting injunction as sought for. In the result, the impugned judgment of the High Court is set aside and the judgment of the learned District Judge, Madurai is affirmed, except with regard to the maintenance of status quo directed on the encashment of guarantees. It is made clear that the Appellant is entitled to encash the bank guarantees and the Second Respondent-Bank shall be free to honour its guarantees, subject to adjustment in the arbitral proceedings.

The appeal is accordingly allowed with costs quantified at Rupees Twenty Thousand.