

Supreme Court of India

State Trading Corpn.Of India Ltd vs Jainsons Clothing Corpn on 14 September, 1994

Equivalent citations: 1994 AIR 2778, 1994 SCC (6) 597

Author: K Ramaswamy

Bench: Ramaswamy, K.

PETITIONER:

STATE TRADING CORPN.OF INDIA LTD

Vs.

RESPONDENT:

JAINSONS CLOTHING CORPN.

DATE OF JUDGMENT 14/09/1994

BENCH:

RAMASWAMY, K.

BENCH:

RAMASWAMY, K.

VENKATACHALA N. (J)

CITATION:

1994 AIR 2778

1994 SCC (6) 597

JT 1995 (5) 403

1994 SCALE (4) 332

ACT:

HEADNOTE:

JUDGMENT:

ORDER

1. The appellant had entered into a contract with Abu Dhabi Municipality, Abu Dhabi for supply of 7500 MT of 'B' Grade Basmati Rice. It in turn had entered into an agreement with the respondent on 20-4-1985 for supply of 3000 MT and in case of necessity another 1500 MT at the option of the STC, for shipment, of the B Grade Basmati Rice to foreign buyer M/s Abu Dhabi Municipality, Abu Dhabi. Clause 17 of this contract envisages execution of a bank guarantee by the respondent for due performance of the contract and reads thus:

"17. Bank Guarantee.- The supplier shall within three days of the signing of this contract furnish to the STC a bank guarantee from a scheduled bank for an amount of Rs 11,70,000 (Rupees Eleven lakhs Seventy thousand only) which is equivalent to 5% value of the contract as per the pro forma attached hereto as Annexure III for the

performance of its obligations under this contract and the export contract. The bank guarantee should be made valid up to 22-7-1985. In the event of supplier's failure to perform any of its obligations under the back-to-back contract and/or the export contract, STC shall without prejudice have the right to claim eventual damages, be entitled to invoke the bank guarantees and forfeit the amount realised thereunder. Supplier's liability and on account of their failure to fulfil their obligations will not be restricted up to the value of the bank guarantee to be furnished by supplier."

In furtherance thereof, the respondent had executed the contract of guarantee of even date, namely, 20-4-1985 in the following manner:

"That the Bank hereby irrevocably and unconditionally guarantee to the Corporation that in the event of any failure/default for whatever reason on the part of M/s Jainsons Clothing Corporation in performing all or any of its obligations under the said contract and/or the export contract and the L/C established thereunder and as may be amended from time to time, the Bank shall pay to the Corporation forthwith on Corporation's first demand an amount of Rs 11,70,000 (Rupees Eleven lakhs Seventy thousand only) being approximately 5% of the contract value of the export. The payment shall be made by the Bank to the Corporation without any demur, protest or contestation and without any reference to supplier notwithstanding any dispute(s) whatsoever pending between the Corporation and the buyer. A certificate of the Corporation that supplier has defaulted in the fulfilment of its obligations shall be sufficient for the purpose of filing claim on the Bank under the guarantee and the same shall be final, conclusive and binding on the Bank. The bank shall forthwith pay to the Corporation the amount claimed by the Corporation up to the amount guaranteed herein. In case Bank fails to pay the amount claimed by the Corporation within 15 days of the date of demand of the Corporation, then the bank shall also be liable to pay to the Corporation interest @ 22.75% per annum from the date of Corporation demand up to the date of actual payment and the guarantee amount shall stand enhanced to the extent of the interest thus due and payable by the Bank."

2. On 15-6-1986 the Officer of the STC in terms of the guarantee had issued a certificate that the respondent had committed default in the performance of the contract and called upon the bank to pay the sum of Rs 11,70,000 contracted under the bank guarantee. The respondent filed Suit No. 1086 of 1985 in the High Court, Delhi for perpetual injunction restraining the appellant from enforcing the bank guarantee. IA No. 3455 of 1985 was filed for temporary injunction, pending suit. By order dated 11-3-1986, the learned Single Judge of the High Court refused to grant injunction under Order 39, Rules 1 and 2, CPC. On appeal, the Division Bench in FAO (OS) No. 97 of 1986 by order dated 4-8-1986 issued the injunction as prayed for. Thus, this appeal by special leave.

3. Shri Arun Jaitley, the learned Senior Counsel for the respondent contended that the High Court was justified in issuing the injunction. In support thereof, he placed before us two contentions, namely, that the foreign buyer and the STC had by their agreement dated 15-5-1985 cancelled the contract of supply under which the respondent had to act as an agent of the appellant for the supply

of 3000 MT of Basmati B Grade rice and that having got the contract cancelled with the foreign buyer and intimation in that behalf having duly been given to the respondent on 22-5-1985, the appellant committed fraud in invoking the bank guarantee. The Analyst's Report, dated 15-5-1985 was sought to be relied upon to show that the respondent had sought to supply shipment of substandard B Grade Basmati rice contrary to the contract had been procured to show that the respondent has committed breach of the contract. He also contended that having done these fraudulent acts, the appellant is not entitled to invoke the bank guarantee and the Division Bench, therefore, was right in issuing the injunction pending the respondent's suit for permanent injunction. We find no substance in the contentions.

4. It is seen that the appellant in terms of clause 17 of the contract, extracted herein before, had clearly agreed to execute an unconditional and irrevocable bank guarantee for the performance of the contract to supply 3000 MT in terms of the contract dated 20-4-1985. The contract of guarantee is independent of and unconditional one. Its enforcement is not hedged with or conditional upon the performance of or frustration of the contract which either the appellant had with the foreign buyer or of the respondent. Only precondition for enforcement of the contract of guarantee is a certificate by the named officer to the bank of the default committed by the respondent in the performance of the contract. The grounds for the breach of contract are irrelevant. Bank guarantee clearly mentions that the bank guarantee, thereby, given by the respondent is "irrevocable and unconditional". In the event of the respondent committing default or failure for whatever reason on its part to perform all or any of its obligations under the said contract or the export contract or letters of credit established thereunder, the appellant is entitled to make a demand from the bank and the bank shall pay to the appellant on first demand, a sum of Rs 11,70,000 and interest at contracted rate for delayed payment. It is only hedged with a condition that the STC shall give a certificate that the respondent had committed default or failed to perform the contract. The certificate given by the officer is "conclusive, final and binds the bank". Admittedly, the officer had given the certificate and on its basis the appellant called upon the bank to pay a sum of Rs 11,70,000 in terms of the contract.

5. The question, therefore, is whether there is any fraud committed by the respondent (sic appellant) as regards the contract of guarantee which the appellant was entitled to invoke. Under Section 126 of the Indian Contract Act, 1872 a contract of guarantee is a distinct separate contract to discharge the liability of a third person in case of his default. Section 17 of the Contract Act postulates fraud that:

"17. 'Fraud' defined.- 'Fraud' means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract- (1) the suggestion, as a fact, of that which is not true, by one who does not believe it to be true;

(2) the active concealment of a fact by one having knowledge or belief of the fact; (3) a promise made without any intention of performing it;

(4) any other act fitted to deceive; (5) any such act or omission as the law specially declares to be fraudulent."

6. None of the conditions are satisfied or applicable to the facts in this case. It is not the case that there is any fraud committed by the appellant in entering into contract with the respondent in particular with reference to clause 17 of the contract dated 20-4-1985. Nor is there any fraud in formation or execution of bank guarantee. From the contention of the appellant it would appear that on account of negotiations between the appellant and the principal foreign buyer Abu Dhabi Municipality, the supply of 7000 MT of B Grade Basmati Rice was not made in terms of the principal contract entered into by the appellant with the foreign buyer. But there is no clause in the contract dated 20-4-1985 entered between the appellant and the respondents that the contract with the respondents is note ominous with non-performance or frustration of the contract with the foreign buyer. In the absence of such recital the necessary consequences is that irrespective of the frustration of the contract or cancellation of the contract between the principal supplier, namely, the appellant and the foreign buyer, namely, Abu Dhabi Municipality, the respondent was under the contract obligated to make supply of 3000 MT of B Grade Basmati Rice in terms thereof. The certificate issued by the officer clearly shows that there was a failure or default committed by the respondent in supplying the rice as contracted for. Under those circumstances, it is not a case of any fraud, but at best, it is a case of cancellation of the contract by the appellant-principal supplier to the foreign buyer. But that does not have the effect of frustrating or cancelling the contract which the respondent had entered into with the appellant. Therefore, even from the affidavit evidence given in support of the application for injunction, not only no plea of fraud was made out but also there was no plea of irretrievable injustice that the respondent was likely to suffer on account of the enforcement of the bank guarantee an exception carved out by this Court in U.P Coop. Federation Ltd. v. Singh Consultants and Engineers (P) Ltd.¹ Therein this Court after elaborate consideration of all the decisions, held in para 34 that on the basis of these principles the commitments of bank guarantee must be honoured 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 would interfere.

7. While elaborating the plea of fraud, in the concurrent judgment, Jagannatha Shetty, J. had it elaborately dealt with it and quoting Sir John Donaldson, M.R., In *Bolivinter Oil SA v. Chase Manhattan Bank*² he stated that:

"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 the 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 discharged."

Under those circumstances, it was also held that the plea of fraud must be of an egregious nature as to vitiate the entire underlying transaction of the bank guarantee. It is fraud of that beneficiary and not the fraud of somebody else that would make the court to grant the order of injunction as asked for. If the bank detects with the minimal investigation the fraudulent action of the seller, the payment could be refused is not a fraud as contemplated under the guarantee. We respectfully agree with the above ratio. This view was reiterated in General Electric Technical Services Co. Inc. v. Punj Sons (P) Ltd.³ This Court has held in paragraph 9 thus: (SCC p. 237) "The question is whether the court was justified in restraining the bank from paying to GETSCO under the bank guarantee at the instance of Respondent 1. The law as to the contractual obligations under the bank guarantee has been well settled in a catenate of cases. Almost all such cases have been considered in a recent judgment of this Court in U. P Coop. Federation Ltd. v. Singh Consultants and Engineers (P) Ltd.

Following that ratio it was observed that:

- (SCC p. 237, para 9)
- 1 (1988) 1 SCC 174
- 2 (1984) 1 All ER 351, 352
- 3 (1991) 4 SCC 230

"[T]he 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. In the concurring opinion one of us (K. Jagannatha Shetty, J.) has observed that whether it is a traditional bond or performance guarantee, the obligation of the Bank appears to be the same. If the documentary credits are irrevocable and independent, the Bank must pay when demand is made. Since the Bank pledges its own credit involving its reputation, it has no defence except in the case of fraud. The Bank's obligations of course should not be extended to protect the unscrupulous party, that is, the party who is responsible for the fraud. But the banker must be sure of his ground before declining to pay. 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." To the same effect is the decision of this Court in Maharashtra State Electricity Board, Bombay v. Official Liquidator, High Court, Emakulam⁴, where this Court has reiterated that the injunction shall not be issued in honoring the bank guarantees which jeopardizes the sanctity attached to the commercial transactions and such a payment, if made, is open to the bank to have recourse to the securities given by the company on whose behalf the bank guarantee was given. It was also further reiterated in Syndicate Bank v. Vijay Kumar⁵.

8.The grant of injunction is a discretionary power in equity jurisdiction. The contract of guarantee is a trilateral contract which the bank has undertaken to unconditionally and unequivocally abide by the terms of the contract. It is an act of trust with full faith to facilitate free flow of trade and commerce in internal or international trade or business. It creates an irrevocable obligation to perform the contract in terms thereof. On the occurrence of the events mentioned therein the bank guarantee becomes enforceable. The subsequent disputes in the performance of the contract does

not give rise to a cause nor is the court justified on that basis, to issue an injunction from enforcing the contract, i.e., bank guarantee. The parties are not left with no remedy. In the event of the dispute in the main contract ends in the party's favour, he/it is entitled to damages or other consequential reliefs.

9. It is settled law that the court, before issuing the injunction under Order 39, Rules 1 and 2, CPC should prima facie be satisfied that there is triable issue strong prima facie case of fraud or irretrievable injury and balance of convenience is in favour of issuing injunction to prevent irremediable injury. The court should normally insist upon enforcement of the bank guarantee and the court should not interfere with the enforcement of the 4 (1982) 3 SCC 358 5 (1992) 2 SCC 330 contract of guarantee unless there is a specific plea of fraud or special equities in favour of the plaintiff. He must necessarily plead and produce all the necessary evidence in proof of the fraud in execution-of the contract of the guarantee, but not the contract either of the original contract or any of the subsequent events that may happen as a ground for fraud.

10. Under these circumstances, the High Court was wholly wrong in its conclusion that the respondent has proved prima facie case for granting injunction in favour of enforcement of the bank guarantee, admittedly entered into by the respondent with the appellant. The learned Single Judge was quite right in refusing to issue the injunction in terms of clause 17 of the contract and the bank guarantee given by the respondent.

11. Pending appeal, this Court directed the respondent to deposit the amount in the Registry and the Registry was directed to keep the amount in fixed deposit which would earn interest. Since the amount has already been deposited and it is earning interest, it is open to the appellant to withdraw the same from the Registry.

12. The appeal is accordingly allowed. It is made clear that it shall not be taken that we have expressed any final opinion on the merits of the contract entered into between the appellant and the respondent. However, we award costs quantified at Rs 20,000 and the same shall be payable by the respondent to the appellant.