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Supreme Court of India

JUDGES J.S Verma, Yogeshwar Dayal, B.P Jeevan Reddy,

Svenska Handelsbanken v. M/S Indian Charge Chrome And Others

Civil Appeal No. 5433 of 1993

15.10.1993

bank guarantee – "… in case of confirmed bank guarantees/irrevocable letters of credit, it cannot be interfered with unless there is fraud and irretrievable injustice involved in the case and fraud has to be an established fraud….

… irretrievable injustice which was made the basis for grant of injunction really was on the ground that the guarantee was not encashable on its terms….

… there should be prima facie case of fraud and special equities in the form of preventing irretrievable injustice between the parties. Mere irretrievable injustice without prima facie case of established fraud is of no consequence in restraining the encashment of bank guarantee."

K. Parasaran and V.A BobdeSenior Advocates (R.F Nariman and K. J JohnAdvocates, with them) for the Appellant; Deepankar GuptaSolicitor GeneralKK Venugopal, Senior Advocate (Jaydeep Gupta, A. K SilG. Joshi and G. Kandpal, Advocates, with them) for the Respondents.

judgment

Yogeshwar Dayal, J.— Special leave granted. Heard.

2. This is an appeal by M/s Svenska Handelsbanken (defendant 4) against the judgment and order dated October 11, 1991 of the High Court of Orissa in Misc. Appeal No. 370 of 1991 whereby the Single Judge of the High Court accepted the appeal filed on behalf of the plaintiff while injuncting defendants 4 to 12 from encashing the bank guarantee furnished by Industrial Development Bank of India (defendant 12) in favour of defendants 4 to 11 for a period of 2 years or till the disposal of the suit whichever is earlier and set aside an order passed by the Subordinate Judge, Cuttack dated August 14, 1991 vacating an order of ad interim injunction dated April 25, 1991 and dismissing the application for ad interim injunction (Misc. Case No. 143 of 1991) against defendants 4 to 12.

3. We find it convenient to refer to the parties as they were described in the suit.

4. The suit out of which the present appeal arises was filed by the plaintiff (hereinafter referred to as the 'borrower') before the Subordinate Judge, Cuttack, inter alia for a declaration that the guarantees executed by Industrial Development Bank of India, defendant 12 (hereinafter referred to as the 'guarantor') in favour of defendants 4 and 5 to 11 (hereinafter referred to as the 'lenders') are void and for an order of injunction restraining the guarantor from making payments under the guarantees to the 'lenders'.

5. For appreciating the submissions made on behalf of the parties the facts shortly stated, leading to the filing of the present appeals are as follows.

6. Sometime in 1982 M/s Indian Metals & Ferro Alloys Ltd., (in short 'IMFA' — defendant 13) issued a global tender for setting up a captive power plant, viz. a coal-fired steam power plant in Choudwar, Orissa. The

tender indicated that credit by the suppliers will be preferred. Defendants 1 to 3 (hereinafter referred to as the 'suppliers' submitted their tenders in this regard. Since the tender indicated that suppliers' credit for the entire project is preferred, the suppliers approached defendant 4 (one of the lenders) to finance the project. Inquiries were made to find out the possibilities for financial assistance by the Swedish Government in the form of interest at subsidised rates.

7. Since 85 per cent of the foreign exchange portion of the total price of the project was to be financed, discussions were held between the borrower and defendant 4 (one of the lenders) for finalising the terms and conditions of the loans. Discussions were also held between the borrower and the suppliers in regard to the terms and conditions of the loans so as to ensure that the credit agreements would be in accordance with the Swedish Law and regulations for subsidised export credit facilities.

8. The borrower made extensive investigation itself over a period of about two years into the details of the proposed plant. On or about September 28, 1984 contracts were entered into between the borrower (plaintiff) and the suppliers for setting up the power plant and for supplying the machinery and other equipments for the plant to the borrower.

9. Defendant 4 (one of the lenders) formed a consortium of banks i.e defendants 5 to 11 (Swedish Banks) (lenders) and an American Bank for financing the project. The American Bank subsequently assigned its interest in favour of one of the defendant Bank (lender). The lenders entered into two credit agreements dated October 30, 1984 with the borrower. The credit agreements were entered into by defendant 4 for itself and on behalf of defendants 5 to 11 under which the lenders agreed to lend 85 per cent of the foreign exchange portion of the cost of the project to the borrower by way of certain credit facilities. A third credit agreement dated November 15, 1984 between the borrower and defendant 4 (lender) in its individual capacity was entered into. The first two credit agreements were for the loans of US Dollars equivalent of Swedish Kroner 370,855,000 and 239,700,000 and the third was for the loan of the sum of US Dollars 1,754,000. Two additional credit agreements were also entered into between the borrower and the lenders supplemental to the first and second credit agreements on December 23, 1987 providing for additional loans of 10 per cent of the original loans which the borrower required to finance cost escalations caused by delay. These two additional credit agreements were for US Dollars equivalent of Swedish Kroner 37,085,500 and 23,970,000. All the credit agreements inter alia purported to provide payments by the lenders to the suppliers on various documents, as provided in the credit agreements, being presented to the lenders and also against a notice of drawdown by the borrower. In relation to the third credit agreement the disbursements were to be made directly to the lenders in respect of the financial cost payable by the borrower upon notice of drawdown by the borrower.

10. The loans were required to be repaid by twenty (subsequently amended to eighteen) equal semi-annual (six monthly) consecutive instalments, the number of instalments and date of commencement of the instalments being separately provided for under each credit agreement. Repayments were required by the borrower to be made without demand or notice. It was specifically provided in the credit agreements that:

"Any amounts payable by the borrower shall be paid without set-off or counter-claim. The liability of the borrower to effect any payment under this Agreement is thus unconditional and shall not in any way be dependent upon the performance of the contracts i.e the agreements between the borrower and the suppliers-exporters or be affected by any other claim which the borrower may have against the exporters or against any other party (natural or legal) collaborating with the exporters.

(These are the actual words of the relevant clause in each credit agreement.)"

The credit agreements also provided:

"All disputes arising from the provisions of this Agreement or its performance shall be finally settled by arbitration under the Rules of Conciliation and Arbitration of the International Chamber of Commerce by three arbitrators appointed in accordance with these rules. Arbitration shall take place in Stockholm and be conducted in the English language. The award of the arbitral tribunal is final and obligatory for the parties without any right for a further appeal or contestation of its fulfilment. The borrower hereby expressly submits to the jurisdiction of the above mentioned arbitration tribunal.

(These are the actual words of the relevant clause in each Credit Agreement.)"

11. The credit agreements also provided that the borrower shall furnish guarantees in favour of the lenders as security for the loans covering 100 per cent of each of the loans plus interest, costs and fees payable under the credit agreements. As quoted above, the agreements also contained an arbitration clause which contemplates disputes arising from the agreements to be finally settled by arbitration under the Rules of Conciliation and Arbitration of the International Chamber of Commerce by three arbitrators appointed in accordance with these rules. The arbitration is provided to take place at Stockholm.

12. It is thus prima facie clear from the aforesaid terms of the credit agreements with the borrower that the lenders are, as a matter of law and express agreement, in no way connected or related to or dependent upon the contracts entered into between the borrower and the suppliers. At the instance of defendant 4, defendant 12 provided the bank guarantee for the payments to be made by lenders to the suppliers. In order to ensure that the guarantor would be liable in all circumstances in the event of the borrower failing to carry out its obligations, the lenders insisted that the guarantees very clearly made express provision to be unconditional first demand guarantees which were insulated from any possible dispute between the borrower and the suppliers and even the borrower and the lenders. In fact the form of guarantee was itself enclosed as an appendix to each credit agreement.

13. The terms of payment contained in the contracts between the borrower and defendants 1 and 2 (suppliers) which deals with disbursement of last 5 per cent of the respective contract price reads thus:

"5 per cent of the contract price at the date of the purchasers' taking over of the Power Plant against presentation of a taking over certificate, issued by the purchaser, however, not later than 35 months after the date this contract has come into force unless the date of taking over is delayed due to reasons for which the supplier is responsible."

Defendant 4 (lender) was to disburse the balance 5 per cent payment to defendants 1 and 2.

14. On June 24, 1989 the plaintiff (borrower) took over the plant and on June 25, 1989 issued a taking over certificate. On July 28, 1989 the plaintiff authorised defendant 4 to disburse the balance 5 per cent of the payment to defendant 3 as well.

15. It is common case that the amounts due to the suppliers were paid by the lenders on instructions from the borrower, plaintiff and the suppliers have been paid in full by the lenders. After the issuance of the take over certificate by the plaintiff, three instalments of payments were made by the guarantor on behalf of the plaintiff as per their instructions vide payments dated October 31, 1989; April 30, 1990 and October 31, 1990 under the first two credit agreements of the sum of US Dollars 9,033,324.47; 8,810,563.87 and 8,681,062.40 towards principal plus interest.

16. Again the three instalments were paid by the IDBI/guarantor under the third agreement on October 15, 1989; May 15, 1990 and November 15, 1990 amounting to US Dollars 301,339.99; 278,468.14 and 270,778.54 towards principal plus interest.

17. It was on or about April 28, 1991 that the present suit was filed by the plaintiff for : (a) a declaration that

the taking over certificate dated June 25, 1989 is void/voidable instrument and the same may be delivered and cancelled; (b) it be further declared that the plaintiff is entitled to diminution/extinction of price towards the power plant as mentioned in Annexure 'A' to the plaint, in the alternative, if the court finds, that any amount is payable to defendants 1 to 11 jointly or severally, the same be directed to be paid as per reschedule of payment to be calculated on a cash-flow basis on actual generation as determined on inquiry; (c) a decree of declaration that the guarantees obtained from defendants 12 and 13 by defendants 1 to 11 are void/voidable instruments and ought to be delivered and cancelled; (d) a decree of perpetual injunction restraining defendants 12 and 13 from making payments dated April 30, 1991 and payments falling due on subsequent dates under any guarantee to defendant 4 and/or defendants 4 to 11; and (e) a decree of perpetual injunction restraining defendants 4 to 11 from recalling the loan and/or taking any steps from recovering the said loan either in full or in part, etc. etc.

18. The basis of the plaintiff's claim against defendants 1 to 12 was that defendants 1 to 3 had promised to supply the captive power plant of the capacity of 108 MW worked with talcher coal whereas on working, the plant was found to be of the capacity of 60 MW. The case of the plaintiff further was that all the agreements between the borrower and the suppliers and borrower and lenders are interconnected and constituted one transaction and are vitiated by fraud committed by defendants 1 to 4. It was pleaded that the plaintiff was fraudulently led into entering of contracts with the suppliers by fraud of the suppliers and defendant 4, the lender. The suppliers were not competent enough to manufacture 108 MW plant. They fraudulently persuaded the plaintiff to go in for a 'stoker fired' boiler instead of a 'pulverised fuel' boiler in spite of the recommendations of the Central Electricity Authority to the contrary. The representatives of the consortium/suppliers visited Bhubaneshwar and Choudwar in the second week of March 1983 and during discussions represented to the plaintiff that the recommendations of the Central Electricity Authority were not correct and that their vast experience in this field had shown that 'stoker fired' boilers were preferable over 'pulverised fuel' boilers in the instant case, with talcher coal as the basic raw material. The defendants 1 to 3 further represented that they had arranged credit facility for the proposed captive power plant through defendant 4 at a very low interest rate and specifically indicated that their offer was limited to the setting up of only 'stoker fired' boilers. It was further alleged in the plaint that the plaintiff relying on the judgment, representation and advice given by the suppliers decided to go ahead with setting up of the power plant although Central Electricity Authority and other advisors had expressed reservations that the boilers of the size as suggested by the suppliers would be less effective. Since the plaintiff had never undertaken and were unaware of the technology/expertise required for the setting up of the captive power plant they had no other option/alternative but to rely totally upon the skill of the suppliers in this regard. It was further pleaded that subsequently in August 1983 with a view to further induce the plaintiff to act on the representations made by consortium that the suppliers were capable of setting up a 108 MW plant with 'stoker fired' boiler, defendant 4 on behalf of itself and defendants 5 to 11 approached the plaintiff directly and represented that the said defendant 4 would finance the project of setting up the captive power plant at a very low interest rate if the plaintiff accepted the offer of suppliers for supply, erection and commission of the said plant with 'stoker fired' boilers. It was alleged that defendant 4 further represented to the plaintiff that the suppliers are the valued clients of defendant 4 and that defendant 4 was aware of the background and experience of the suppliers.

19. It was pleaded that defendant 4 along with defendants 1 to 3 prepared a feasibility report for setting up 108 MW plant. The feasibility report was prepared on the assumptions — (a) a 108 MW plant shall be established guaranteeing a minimum generation of 700 million units of electricity per year and (b) raw material used will be talcher coal. The feasibility report specifically enumerated and set out a cash-flow statement which was based on an assumption that 700 million units would be generated each year. Based on this assumption a cash-flow statement was prepared on the basis of generation of a minimum of 700 million units per year which was with the knowledge of defendants 1 to 4 and the plaintiff was informed that generation at 700 million units per annum would be the basis of the repayment schedule to be adopted for defraying the proposed loans to be given by defendant 4 on behalf of defendants 4 to 11 in twenty (which was

later on reduced to eighteen) half-yearly instalments.

20. It was further pleaded that defendant 4, in fact, acted as a representative or an agent of defendants 1 to 3. It was also pleaded that in fact the supply of the plant and financing thereof through deferred credit was one composite transaction in which defendant 4 was integrally involved and interconnected as defendants 1 to 3. It was pleaded that the plaintiff relying upon the representations made by defendants 1 to 3 and 4 entered into three separate contracts with the suppliers on September 28, 1984 for erection and commissioning of the captive power plant.

21. It is not necessary at this stage to elaborately refer to the terms and conditions of the suppliers' agreements with the borrower except to mention that — under the first contract, defendant 1 had agreed to supply turbine and other accessories for a total consideration of Swedish Kroner 432 million; under the second contract between the borrower and defendant 2, defendant 2 had agreed to supply 4 ‘chain grate stoker fired' boilers with other accessories and under the third contract defendant 3 agreed to erect and commission the captive power plant. The third agreement in clauses 12.1, 12.2, 12.7 and 13.1 provided as under:

“12.1 Taking over.— The plant shall be deemed to have been taken over by the purchaser at the time when the Tests on Completion have shown that the Plant has the operational characteristics which, in accordance with the Agreement, it should have at the time of taking over, and when the Contractor has fulfilled all other obligations to be performed by him under the terms of the Agreement before taking over the Plant.

12.2 Taking over Certificate.— The purchaser shall issue a certificate to confirm taking over in accordance with clause 12.1

12.7 Performance Testing.— Taking over of Plant as above does not relieve the Contractor from carrying out Performance Testing in accordance with Section 13.

13.1 Time point for determination of performance.— Determina-tion of whether the Plant has the performance and other characteristics as guaranteed in the agreement shall be done when the Plant undergoes Performance Testing.”

22. That an agreement was also signed on September 28, 1984 between the plaintiff and defendant 3 wherein it was specifically guaranteed that the said plant would be 108 MW plant and capable of producing a minimum of 1400 million units of electricity over a period of 2 years. The loan was required to be repaid as per the agreement by 20 equal semi-annual consecutive instalments, the first six months after the taking over date, but in no case later than February 1, 1988. (Later on changed to October 1988 and instalments reduced to 18 half-yearly instalments.)

23. The borrower also undertook to furnish to defendant 4 the guarantee in favour of the lenders as security for the loan covering 100 per cent of the loan. As mentioned earlier the plaintiff furnished the guarantee of defendant 12 to defendant 4 (defendant 4 acting for itself and on behalf of defendants 5 to 11) to guarantee repayment of loans given by defendants 4 to 11. Defendant 12 in turn was provided a guarantee by defendant 13.

24. We may mention that defendant 12 furnished the guarantees as per directions of this Court on a writ petition being filed by the plaintiff to direct defendant 12 to furnish the guarantees in relation to the aforesaid contracts. The guarantor made payment of 15 per cent of the contract price immediately and as stated earlier made some payments to the lenders before and after the taking over certificate.

25. It was further pleaded in the plaint that defendants 1 to 3 on May 29, 1989 conducted a test on completion of the captive plant using Australian coal. Defendants 1 to 3 wrongfully, fraudulently and illegally began to insist that the said test on completion was in terms of the contract and that the plaintiff should give a ‘take

over certificate' of the captive power plant to enable defendant 3 to receive the final 5 per cent payment from defendant 4. It was pleaded that the attempt of the consortium was to deceive the plaintiff that they had supplied, erected and commissioned a plant having 108 MW capacity which would run with talcher coal. It was pleaded that the plaintiff was not satisfied with the plant and expressed its unwillingness to give a take over certificate. The plaintiff pointed out to defendants 1 to 3 that talcher coal was going to be used and the plant should be made ready to accept the same. It was pleaded that defendants 1 to 3.suppliers threatened the plaintiff that if it did not take over the plant immediately, they would shut down 50 per cent of the plant as they had by then already received 100 per cent of the payment. Further to induce the plaintiff to issue take over certificate, the suppliers offered a 'package deal' if the plaintiff gave a taking over certificate to the suppliers. Under the 'package deal' defendants 1 to 3 offered that if the take over certificate was given by the plaintiff the suppliers would rectify all the defects of the plant and increase the defect liability period. Although the plaintiff was not satisfied by the test which on completion was specifically communicated to the suppliers but in view of the threat of the suppliers and on the basis of the offer of 'package deal' which was accepted by the plaintiff, the plaintiff gave a conditional taking over certificate on June 25, 1989 with effect from June 24, 1989. The said take over certificate was a part of the 'package deal', it was pleaded. It was also pleaded that when the plant was operated on talcher coal the plaintiff came to know that the defendants had not supplied the plant as per the specifications envisaged under the contracts and that the plant was not of 108 MW. It was pleaded that defendants 1 to 3 have committed a fundamental breach of the contracts.

26. It was on these allegations that the plaintiff pleaded that the conduct of defendants 1 to 4 clearly shows that they made fraudulent representations to the plaintiff which were false to the knowledge of defendants 1 to 4 to induce the plaintiff to enter into agreements with the suppliers and defendants 4 to 11 when the defendants 1 to 4 knew that the plaintiff would suffer because of an under-capacity overrated plant. It was pleaded that defendants 1 to 4 were aware that the captive power plant is not of the specifications as contracted for and the suppliers by their letters dated July 3, 1989 and August 23, 1989 intentionally terminated the 'package deal' with a view to perpetuate the fraud.

27. In paragraph 52 of the plaint it was specifically pleaded thus:

"52. That the cause of action arose in favour of the plaintiff on June 25, 1989 when the defendants 1 to 4 fraudulently misrepresented to the plaintiff regarding their intention to supply the goods as per the description and requirement of the plaintiff. The cause of action again arose on the various dates when the representatives of defendants 1 to 4 met the representatives of plaintiff and induced the plaintiff by their fraudulent misrepresentations to enter into an agreement with the plaintiff. The cause of action also arose on May 29 and 31, 1990 when the plaintiff for the first time became aware of the fraud perpetuated by the defendants on the plaintiff. The cause of action also arose when in March 1990 the plaintiff discovered the fundamental breach committed by the consortium. The cause of action for this suit also arose when the defendant 4 as agent, on behalf of defendants 4 to 11 called upon the plaintiff by telex dated March 4, 1991 to pay the sum of US $ 8.40 million by April 30, 1991. Furthermore defendant 12 has also called upon the plaintiff to make a sum of US $ 8.40 million payable by April 30, 1991. The cause of action is continuous and no part of it is barred by law of limitation."

28. We have already noticed that defendant 12, on instructions from the plaintiff, made payments to the lenders on October 31, 1989 and again on November 15, 1990.

29. On receipt of summons in the suit and notice on the application for interim injunction filed by the plaintiff, defendants 1 to 3 did not enter appearance. Defendant 4 entered appearance specifically in Misc. Case No. 143 of 1991 i.e in relation to the application for ad interim injunction and specifically denied the case of fraud against the lenders. It also challenged the jurisdiction of the trial court to entertain the suit as well as the miscellaneous application in view of the provision for arbitration under the Rules of Conciliation and Arbitration of the International Chamber of Commerce. It was pleaded that separate loan agreements were

executed between the plaintiff and the lenders. All the loan agreements were governed by Swedish Law. All three loan agreements were separately guaranteed by defendant 12 as primary obliger and not as a surety and the amount was payable by defendant 12 upon first demand. It was pleaded that the liability of the borrower is unconditional and shall not in any way be dependent upon the performance of the contracts for supply of power plant and the payment to the lenders is not in any way affected by any other claim which the borrower may have against the suppliers. It was also pleaded that all disbursements and payments under the loan agreements were made by defendant 4 to defendants 1 to 3 in Sweden and they have been paid in full and it is only the lenders, who had to be paid by the borrower and in view of such express provision in the loan agreements the Indian Courts have no jurisdiction to entertain the suit or the miscellaneous case as against the lenders. It was pleaded that if the order for injunction is vacated no irreparable loss would be caused to the plaintiff because the amount could always be recovered from the banks, if any amount is declared repayable by them. It was pleaded that the lenders are large and reputed banks, and that the plaintiff has no prima facie case nor the balance of convenience is in its favour. The loan agreements provided a complete answer to the claim of the plaintiff. It was pleaded that the plaintiff attempted to allege fraud but the lenders had nothing to do with the negotiations or agreements or subsequent performance of the project and there is no question of fraud as alleged against the lenders. It was pleaded that there might have been some misrepresentations or fraud on the part of the suppliers which is not to their knowledge. The lenders have no concern with the suppliers with regard to the alleged fraud. It was pleaded that the plaintiff had waited for nearly seven years since the signing of the loan agreements and three years for commissioning of the plant before raising such spurious assertions and this would show that there is no prima facie case in favour of the plaintiff.

30. Defendant 12, the guarantor, also filed objections to the application for interim injunction with regard to the guarantee executed by defendant 12 in favour of defendants 4 to 11. It was pleaded that the plaintiff itself had filed Writ Petition Nos. 5218 and 5219 and this Court (Supreme Court) by order dated June 5, 1985 directed defendant 12 to make disbursements prior to June 15, 1985 of the first down payment of 15 per cent of the loan amount and to issue guarantee as per the letter of intent dated October 27, 1984. Even on application filed before the Supreme Court by defendant 12 for modification of the order the Supreme Court directed by order dated June 17, 1985 that the earlier order directing down payment of 15 per cent of the loan amount and issue of guarantee are to be carried out by defendant 12 on or before June 25, 1985. In pursuance of the aforesaid direction the plaintiff executed necessary documents in favour of defendants 4 to 11 and in turn defendant 12 executed the necessary guarantee in favour of defendants 4 to 11 and defendant 4 as agent of defendants 5 to 11. It was pleaded that under clause 5.2 action or proceedings against the guarantor in respect of the loan agreements or loans may be brought in the High Court of Justice in England or in some other Court in United States or in the Court of Sweden or Indian Court as the lenders or any of them may determine. It was pleaded that in view of the aforesaid provisions under the guarantee executed by defendant 12 no proceeding arising out of the loan guarantees or the loans can be brought in any court in India and the jurisdiction of the Indian Courts is expressly ousted. It was also pleaded that under clause 1.2 of the payment-guarantee, the guarantee shall not be impaired by any dispute or claim with regard to the borrower and the sellers or between the borrower and the lenders. Under clause 2.1 if the borrower does not pay any amount when due, the guarantor shall forthwith without any protest of any kind pay the full amount due and payable under the agreements on first demand. It was pleaded that the alleged dispute of the plaintiff with the suppliers does not affect the liability or obligation of defendant 12. It was also pleaded that in case defendant 12 is restrained from honouring its obligation under the payment-guarantee executed by it, this will seriously affect its image and financial reputation in the international market and the objects of defendant 12 for development of industries in the country shall be frustrated and that defendant 12 may be dragged into litigation in Swedish Courts in view of the guarantee executed by it. It was also pleaded that defendant 12 is neither aware nor concerned with any fraud.

31. On these averments, the trial court held:

(1) that defendant 12 has not committed any fraud nor has it any knowledge of it on the material produced;

(2) that the project report was not prepared by defendant 4;

(3) that the defendant 4 made the payments to the suppliers only on instructions and notice issued by the plaintiff/borrower as per the credit agreements;

(4) that there is no direct allegation of fraud against defendants 4 to 11 and the allegations of fraud are based on suspicion;

(5) that the allegation of fraud against defendants 4 to 11 "is practically without substance";

(6) that after the execution of the agreements only the agreements are to be looked into and there is no allegation of the plaintiff that defendants 4 to 11 have breached any terms and conditions of agreements executed between the plaintiff and defendants 4 to 11;

(7) that the agreements executed by defendants 4 to 11 are not incidental to the designing, manufacturing, erection and fabrication of the project and defendant 4 being a banker has no concern with the agreements executed between the plaintiff and suppliers;

(8) that the rights and obligations of the parties flow from the agreements and therefore the agreements should be based for deciding the issue; and

(9) that the dues of the lenders as per clause 10.07 of the agreements between the plaintiff and the lenders provide that all amounts payable by the borrower under the agreements shall be paid without set off or counter-claim and liability of the borrower to effect any payment under these agreements is unconditional and is not in any way dependent on the performance of the contracts or be affected by any other claim which the borrower may have against the suppliers or against any other party collaborating with the suppliers. This being so no adjustments can be made so far as the repayment of the loans with that of the claim of the plaintiff against defendants 1 to 3 which is yet to be adjudicated and defendants 4 to 11 are entitled to the repayment of the loans advanced by them notwithstanding any claim of the plaintiff against the suppliers that is defendants 1 to 3;

(10) that the bank guarantee had been issued by defendant 12 in favour of the lenders on the writ petitions filed by the plaintiff itself and defendant 13 and a direction issued by the Supreme Court and, therefore, no fraud has been played in execution of the bank guarantee;

(11) that the breach of terms between the plaintiff and defendants 1 to 3 does not prima facie give rise to any cause of action against defendants 4 to 11 and for breach of contracts by defendants 1 to 3 remedies are available to the plaintiff;

(12) that the bank guarantee in question is independent of the contracts between the plaintiff and the suppliers and the same can be enforced without reference to any claim or counter-claim arising from the main contracts between the plaintiff and defendants 1 to 3;

(13) that the plaintiff has failed to establish prima facie case of established fraud, therefore, in the absence of clear and established fraud against defendants 4 to 11 there is no prima facie case in favour of the plaintiff; and

(14) that the plaintiff will not suffer any irreparable loss and the balance of convenience is also against the plaintiff and in favour of defendants 4 to 11.

32. On these findings, as stated earlier, the trial court vacated the ad interim injunction and dismissed the application for interim relief.

33. The plaintiff being dissatisfied went up in appeal to the High Court (Miscellaneous Appeal No. 370 of 1991). It appears that when the appeal was listed for admission before the High Court defendants 4 and 12 entered appearance and since the matter was urgent in nature, it was heard finally without issue of notice to defendants 1 to 3 and 5 to 11 who had not entered appearance in the trial court.

34. The High Court noticed that defendant 4 had already paid the suppliers. Defendants 5 to 11 are not directly connected with the captive power plant and defendant 4 is their agent. Since defendants 5 to 11 are not concerned and defendants 1 to 3 have already received payments, there is no question of any restraint on them. It was noticed by the High Court that defendant 4 is the lender and the plaintiff is the borrower. The High Court observed that principles of guarantee would not be strictly applicable to it. General principles of injuction on lender would alone be applicable. The High Court examined the terms of clause 2.1 of the guarantee given by defendant 12 in favour of defendants 4 to 11 and took the view that this clause under the guarantee agreement creates an obligation on defendant 12 to pay to defendant 4 upon first demand if the plaintiff does not pay any amount when due or the loan is declared default. There is neither any demand nor a declaration of default. Much before the same the suit had been filed alleging fraud in the transaction. On the receipt of the plaint the defendant 12 was required to make investigation whether there was a fraud and how defendant 4 is connected therewith. Defendant 12 without making any inquiry ought not to have entered appearance to contest the claim of the plaintiff and ought to have waited till the order of the court. Instead it has contested the claim which may give rise to suspicion that it is anxious to pay to defendant 4 in terms of US Dollars which is now precious for our republic. If defendant 12 which gave the guarantee by direction of the Supreme Court was not happy about the filing of the suit by the plaintiff it could have approached the Supreme Court, which gave the direction, to get an order to discharge its obligation to defendant 4 and ought to have acted upon such direction. The High Court also noticed that the fraud is alleged against defendants 1 to 4 and, therefore, it thought it fit to examine whether the prima facie allegation of fraud against defendants 1 to 4 has been made out by the plaintiff.

35. The High Court in paragraph 14 of its order took the view as under:

"14. Defendant 13 issued a global tender for execution of work of captive power plant. Defendant 2 on basis of such global tender offered to defendant 1 by telex on October 5, 1982. On January 19, 1983 defendant 4 addressed a letter by defendant 13 offering financial assistance referring to defendant 2's arrangement for easy terms. On March 31, 1983 defendant 4 described the credit facilities which can be given by defendant 4. In spite of the fact that each party entered into separate agreements, the facts contained therein give a clear idea that defendant 4 had knowledge of the nature of work to be executed by defendants 1 to 3. Thus, there was collaboration with such links that agreement of defendant 4 cannot be separately read at this stage while considering the question of injunction."

Though no notice was issued to defendants 1 to 3 in the appeal, the High Court observed:

"It shall be sufficient to shortly state that I carry an impression on reading the documents filed that defendants 1 to 3 had no capacity to execute the work of 108 MW captive power plant. Even if they had capacity, the execution was not perfect. They had knowledge that the power plant is to be commissioned based on Talcher Coal. They, however, commissioned the same on Australian Coal. All these were within their knowledge. Defendant 4 was linked with them in such manner that for the purpose of considering the question of injunction, defendant 4 ought not to be delinked and treated separately."

36. The High Court also held that it is true that the plaintiff failed to bring to the notice of defendant 4 about its grievances and about the nature of work executed by defendants 1 to 3. If the same would have been

brought to the notice of defendant 4 and in spite of it defendant 4 would have paid to defendants 1 to 3 basing upon clearance given by the plaintiff, a strong prima facie case of fraud by defendant 4 could have been made out. However, on the facts as presented at this stage it cannot be said that defendant 4 is as innocent as it claims to be. The High Court took the view that the inference of fraud is to be drawn not from individual event and such event by itself may not be sufficient for drawing inference of fraud. Totality of the events cumulatively have the effect of fraud and in this case, if the facts and circumstances from the stage of global tender till the suit is filed are considered together, a clear impression of fraud in the transaction of captive power plant by defendants 1 to 3 is created and defendant 4 cannot be fully disassociated from it. On balance of convenience the High Court took the view that if the injunction is granted, payment to defendant 4 would be delayed and if no injunction is granted, defendant 12 would pay to defendant 4 periodically on demand and fall back on the plaintiff to pay the dues. The plaintiff is to pay on cash-flow basis as per the project and feasibility report. On account of generation of electrical energy which is far less than the assured units, there is no scope for payment on cash-flow basis. It has to divert its capital for payment of loans and in that process becomes owner of a sick industry. While on account of delayed payment defendant 4 may have some effect on its goodwill whereas the plaintiff will have to sacrifice its entire goodwill. Therefore, the balance of convenience is in favour of the plaintiff. The High Court then considered the nature of injunction that would be granted by it. For this it issued a direction to defendant 4 not to insist on defendant 12 for payment for two years till the end of 1993 and a direction to defendant 12 not to pay defendant 4 till that period on the basis of guarantee or till the disposal of the suit whichever is earlier and for this period of deferred payment the plaintiff shall pay interest at the rate of 18 per cent instead of subsidised interest for amount due during this period.

37. Before we examine the respective contentions of learned counsel for the parties we very much regret the observation made by the High Court against IDBI, defendant 12. It is true that the guarantee was given as per the order of this Court. In the order of this Court the guarantee culminated into the accepted agreements between the lenders and IDBI. There was no question of defendant 12 approaching this Court for taking direction as to what it should do while meeting its own contractual obligations as an apex organisation of the Government in helping the industrialisation of the country. The remarks against defendant 12 are wholly uncalled for. Defendant 12 is a party to the suit. It is entitled to enter appearance on its behalf and to take the pleas open to it on facts and in law. It has to maintain its credibility and not merely be guided by the loss to our citizens. It has also to maintain its international credibility. Credibility is the most important thing for any banking institution. If the credibility goes the bank cannot survive. The bank in its working has to be most upright and honest in dealing with its customers.

38. Coming to the merits of the case itself it appears to us that the 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 lenders would be applicable and on that basis proceeded to decide the matter.

39. Whenever an appeal is heard it is the duty of the appellate court to examine the findings of the trial court and if the findings of the trial court are not correct, to deal with it. What we find in the present case is that the High Court did not even appear to have noticed the findings of the trial court much less any attempt being made to meet them. We have noticed earlier the findings which were recorded by the trial court. One of the basic findings of the trial court was that there is no material of established fraud against defendant 4 nor defendant 4 has any knowledge of any fraud having been committed by defendants 1 to 3. The allegation of fraud against defendant 4 has been made on suspicion. Another important finding given by the trial court was that one has to look at the actual agreements executed between the parties and defendants 4 to 11 have not committed any breach of agreements with the plaintiff. Another finding given by the trial court was that the agreements executed by defendants 4 to 11 are not incidental to the designing, manufacturing, erection and fabrication of the project and defendant 4 being a banker has no concern with the agreements executed between the plaintiff and the suppliers. The other finding recorded by the trial court was that the rights and obligations of the parties flow from the agreements and, therefore, the agreements should be the basis for

deciding the issue. Again the trial court had very specifically held that in view of the agreements between the lenders and borrower, breach, if any, of the agreements by defendants 1 to 3 and claim, if any, of the plaintiff against defendants 1 to 3 would be of no effect on the agreements between the borrower and lenders. None of these findings are either noticed or met by the High Court. On the other hand the High Court after noticing that the agreements between the borrower and suppliers are separate from the agreements between the lenders and borrower it jumped to the conclusion that "the facts contained therein give a clear idea that defendant 4 had knowledge of the nature of the work to be executed by defendants 1 to 3. Thus there was collaboration with such links that agreement of defendant 4 cannot be separately read at this stage while considering the question of injunction."

40. With all due respect to the learned Judge, we fail to understand this reasoning. Section 92 of the evidence Act debars the court from looking into oral evidence once the contract is executed in writing except as provided for in six provisos thereof.

41. Again it appears that the High Court found a strong prima facie case against defendant 4 merely on reading the plaint. Pleadings make only allegations or averments of facts. Mere pleadings do not make a strong case of prima facie fraud. The material and evidence has to show it. No material whatsoever is referred to by the High Court.

42. In A.L.N Narayanan Chettyar v. Official Assignee, High Court Rangoon [196 IC 404 = 1941 OWN 1392] the Privy Council held that:

"Fraud like any other charge of a criminal offence whether made in civil or criminal proceedings, must be established beyond reasonable doubt. A finding as to fraud cannot be based on suspicion and conjecture."

43. Mr Venugopal, learned counsel for the plaintiff, took us through the entire correspondence exchanged between the supplier (defendant 2) and the holding company of the plaintiff (defendant 13) including the letters dated October 5, 1982, January 7, 1983, March 31, 1983, April 14, 1983, project report dated August 12, 1983, the financial pattern as well as various proposals made by defendants 1 to 3 to defendant 13, draft agreements and other documents till the culmination of contracts with defendants 1 to 3. Learned counsel also took us through the various letters dated April 7, 1989; April 20, 1989, May 22-24, 1989 from the plaintiff to defendants 1 to 3 and other documents including letter dated October 6, 1989 from the plaintiff to defendant 3 and a mass of other documents.

44. We are prima facie debarred from looking at various proposals, drafts, project reports, if any, before the contracts between the borrower and defendants 1 to 3 on one hand and the credit agreements between the borrower and the lenders having been executed later. Facts which come within provisos 1 to 6 to Section 92 of the Evidence Act can be proved. The plaintiff could have resorted to proviso 1 to Section 92 of the Evidence Act. Section 92 with proviso (1) of the Evidence Act reads as follows:

"92. Exclusion of evidence of oral agreement.— When the terms of any such contract, grant or other disposition of property, or any matter required by law to be reduced to the form of a document, have been proved according to the last section, no evidence of any oral agreement or statement shall be admitted, as between the parties to any such instrument or their representatives in interest, for the purpose of contradicting, varying, adding to, or substracting from, its terms:

Proviso (1).— Any fact may be proved which would invalidate any document, or which would entitle any person to any decree or order relating thereto; such as fraud, intimidation, illegality, want of due execution, want of capacity in any contracting party, want or failure of consideration, or mistake in fact or law."

45. It is clear from the averments in the plaint that the plaintiff was not seeking cancellation of any of the agreements either with the suppliers or the lenders. We have already reproduced the substance of the prayers

made in the plaint. In fact the plaintiff prayed for diminution of the price towards the power plant by way of breach of contracts, goods being not of the specifications. The plaintiff prayed for avoidance of the take over certificate. Vis-a-vis taking over certificate there is no allegation of coercion or fraud against defendant 4 at all.

46. The plea that the lenders were to be paid from the cash flow by sale of surplus electricity in the market is nowhere mentioned in any of the contracts between the borrower and the suppliers and the High Court without any prima facie admissible material went on to rely on the bald averment in the pleadings. Again it is not known on what material the High Court got “the clear impression of fraud in the transaction of captive power plant by defendants 1 to 3 is created and defendant 4 cannot be fully disassociated from it”. Neither the trial court nor the High Court was required to go into the question of fraud on behalf of defendants 1 to 3 as there was no interim relief being claimed against them. Even if we assume fraud by defendants 1 to 3 where was the material to associate defendant 4 with defendants 1 to 3.

47. Mr Venugopal again stressed the fact that defendant 4, the lender was the agent of defendants 1 to 3, the suppliers. For this submission there is no material whatsoever except the suppliers' introducing defendant 4 as the formal channel for making the credit available. The communication of defendant 4 to the plaintiff mentioning the suppliers as valuable clients of defendant 4 is again of no consequence. A banker has to deal with its customers every day. If the bank calls its customer a valuable client it only means the credit worthiness of the client. Nothing more nothing less. It made no mention of the professional capability of the suppliers.

48. United Commercial Bank v. Bank of India 1981 3 SCR 300 as it appears from its title, was a case between two bankers i.e United Commercial Bank and Bank of India. In that case appellant bank was a bank for the buyer whereas the respondent bank was a bank for the seller. The facts were that Respondent 2 entered into a contract to sell to Respondent 3 the goods valued at approximately Rs 86 lakhs pursuant to which the buyer opened a letter of credit with the appellant bank. After despatching the goods to various destinations to which they were instructed to send, the seller presented 20 sets of documents in the first lot and 27 sets of documents in the second, the aggregate value of which was equivalent to the amount of the letter of credit. The appellant, who was the buyer's bank refused to make payment “except under reserve” pointing to a discrepancy in the railway receipts as regards the description of goods. On instructions from the seller the respondent bank received the money in respect of the first lot of 20 documents “under reserve” and credited the amount to their account with a specific notation that the amount was paid “under reserve” as a result of discrepancies between the railway receipts and the instructions in the letter of credit.

49. In respect of the second lot, the appellant bank refused payment on the ground of discrepancies in the railway receipts as before as also on the ground that some of the railway receipts were “stale”. In the meantime the appellant bank asked the respondent to refund the amount paid in respect of the first lot of documents under reserve because the bills were not acceptable to the buyer due to discrepancies. Some correspondence ensued between the parties and the bank; eventually on the faith of an undertaking given by the seller the appellant bank paid the remainder amount in respect of the 27 bills as well “under reserve” so that the value in respect of both the sets of bills paid to the seller in two instalments was made “under reserve”.

50. The seller filed the suit in the High Court. A few days thereafter the appellant bank served a letter of demand on the respondent bank for refund of the entire amount paid to it in respect of two sets of bills together with interest thereon because, according to it, the bills of exchange had not been retired by the buyer for the reasons that the railway receipts were stale; that the goods had not been supplied according to the terms of the agreement and that chemical analysis of the oil showed that it was not fit for human consumption.

51. The respondent bank in turn wrote to the seller to refund the whole amount whereupon the seller moved

the High Court for the grant of an ex parte ad interim injunction restraining the appellant from recalling or receiving the amount due from the respondent bank which was granted. A Single Judge of the High Court made a temporary injunction till the disposal of the suit filed by the seller on the view that the appellant was not entitled under the terms of the letter of credit to unilaterally impose a condition of the payment "under reserve" or refuse to pay to the seller merely because of the alleged discrepancies.

52. On an appeal the Division Bench summarily dismissed the appellant bank's appeal with the result that the seller received the whole of the amount of the letter of credit as well as bought the whole lot of goods for Rs 18.53 lakhs.

53. On the question whether the High Court should, in a transaction between a banker and a banker, grant an injunction at the instance of the beneficiary of an irrevocable letter of credit restraining the issuing bank from recalling the amount paid under reserve from the negotiating bank acting on behalf of the beneficiary against a document of guarantee at the instance of the beneficiary this Court held that: (SCR headnote) (SCC p. 784, para 41)

"[T]he High Court was wrong in granting the temporary injunction restraining the appellant bank from recalling the amount paid to the respondent bank. 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 one 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."

54. In U.P Cooperative Federation Ltd. v. Singh Consultants & Engineers (P) Ltd. 1988 1 SCR 1124 the facts were: The appellant, a State Government enterprise, on or about May 17, 1983, entered into a contract with the respondent, a private limited company, for the supply and installation of a vanaspati manufacturing plant at a place in the district of Nainital. The contract bond contemplated guaranteed performance of the work at various stages in accordance with the time schedule prescribed and provided for completion and commissioning of the plant after trial run by May 15, 1984. According to the appellant, the time was essentially and indisputably the essence of the contract.

55. As per the terms and conditions of the contract bond, according to the appellant, the respondent was to furnish a performance bank guarantee for Rs 16.5 lakhs and yet another bank guarantee for Rs 33 lakhs as security for the monies advanced by the appellant to the respondent for undertaking the work. Both these guarantees as also the contract bond entitled the appellant to invoke them and call for their realisation and encashment on the failure of the respondent to perform the obligations for which the appellant was made the sole judge.

56. It was alleged that the respondent defaulted at various stages and finally failed to complete the work within the stipulated time. The appellant invoked the two guarantees one after the other, and thereafter proceeded to have the plant completed, etc. According to the appellant, the plant could actually be commissioned for commercial production in July/August 1985.

57. The respondent, on August 4, 1986, filed an application under Section 41 of the Arbitration Act, 1940 (The Act) in the Court of the Civil Judge, praying for an injunction restraining the appellant from realising and encashing the bank guarantees. The Civil Judge dismissed the application. The respondent filed a revision petition before the High Court, which allowed the same, holding that the invocation of the performance guarantees was illegal, and the contentions of the appellant that the performance guarantees constituted independent and separate contracts between the guarantor bank and the beneficiary and created independent rights, liabilities and obligations under the guarantee bonds themselves, as being "technical pleas". The High

Court, however, directed the respondent to keep alive the bank guarantee during the pendency of the arbitration proceedings.

58. The appellant then moved this Court and this Court through Sabyasachi Mukharji and Shetty, JJ. allowed the appeal; at page 1138 of the report Mukharji, J. observed as under: (SCR headnote)

"Under the terms agreed to between the parties, there is no scope of injunction. The High Court proceeded on the basis that this was not an injunction sought against the bank but against the appellant. But the net effect of the injunction is to restrain the bank from performing the bank guarantee. That cannot be done. One cannot do indirectly what one is not free to do directly. The respondent was not to suffer any injustice which was irretrievable. The respondent can sue the appellant for damages. There cannot be any basis in the case for apprehension that irretrievable damage would be caused, if any. His Lordship was of the opinion that this was not a case in which injunction should be granted. An irrevocable commitment either in the form of confirmed bank guarantee or irrevocable letter of credit cannot be interfered with except if a case of fraud or a case of a question of apprehension of irretrievable injustice has been made out. This is the well-settled principle of the law in England. This is also the well-settled principle of law in India. No fraud and no question of irretrievable injustice was involved in the case."

(emphasis supplied)

The learned Judge at pages 1141 and 1142 held as under: (SCR headnote)

"In order to restrain the operation either of irrevocable letter of credit or of confirmed letter of credit or 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 guarantees would be negatived and the fabric of trading operation would be jeopardised. The commitments of the banks 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, in cases of fraud or in cases of irretrievable injustice that the court should interfere. This is not a case where irretrievable injustice would be done by enforcement of the bank guarantee. This is also not a case where a strong prima facie case of fraud in entering into a transaction was made out. The High Court should not have interfered with the bank guarantee. The judgment and order of the High Court set aside. The order of the Civil Judge restored."

(emphasis in original)

59. Shetty, J. concurring with Mukharji, J. noticed the question involved at page 1143 of the report as under: (SCR headnote)

"Whether the obligation is similar to the one arising under a letter of credit? Whether the Court could interfere in regard to such obligation, and if so, under what circumstances? These are the questions raised in the appeal."

The learned Judge at pages 1144 to 1145 observed: (SCR headnote)

"The primary question for consideration is whether the High Court was justified in restraining the appellant from invoking the bank guarantees. The basic nature of the case relates to the obligations assumed by the bank under the guarantees given to the appellant. If under the law, the bank cannot be prevented by the respondent from honouring the credit guarantees, the appellant also cannot be restrained from invoking the guarantees. What applies to the bank must equally apply to the appellant. Therefore, the frame of the suit by not impleading the bank cannot make any difference in the position of law. Equally, it would be futile to contend that the court was justified in granting the injunction since it has found a prima facie case in favour of the respondent. The question of examining the prima facie case or balance of convenience does not arise if the

court cannot interfere with the unconditional commitment made by the bank in the guarantees in question."

(emphasis in original)

The learned Judge further at pages 1145, 1146 and 1148 observed: (SCR headnote)

"The modern documentary credit had its origin from letters of credit. The letter of credit has developed over hundreds of years of international trade. It was intended to facilitate the transfer of goods between distant and unfamiliar buyer and seller. It was found difficult for a buyer to pay for goods prior to their delivery. The bank's letter of credit came to bridge this gap. In such transactions, the seller (beneficiary) receives payment from the issuing bank when he presents a demand as per the terms of the documents. The bank must pay if the documents are in order and the terms of credit are satisfied. The bank, however, was not allowed to determine whether the seller had actually shipped the goods or whether the goods conformed to the requirements of the contract. Any dispute between the seller and the buyer must be settled between themselves. The Courts, however, in carving out an exception to this rule of absolute independence, held that if there has been a 'fraud in the transaction', the bank could dishonour beneficiary's demand for payment. The Courts have generally permitted dishonour only on the fraud of the beneficiary, not the fraud of somebody else.

In modern commercial transactions, various devices are used to ensure performance by the contracting parties. The traditional letter of credit has taken a new meaning. Stand-by letters of credit are also used in business circles. Performance bond and guarantee bond are also devices increasingly adopted in transactions. The Courts have treated such documents as analogous to letter of credit."

(emphasis supplied)

Learned Judge at pages 1149 and 1150 again observed as under: (SCR headnote)

"Whether it is a traditional letter of credit or a new device, like performance bond or performance guarantee, the obligation of the bank appears to be the same. Since the bank pledges its own credit, involving its reputation, it has no defence except in the case of fraud. The nature of the fraud that the courts talk about is the fraud of an 'egregious nature as to vitiate the entire underlying transaction'. It is the fraud of the beneficiary, not fraud of somebody else. The bank cannot be compelled to honour the credit in such cases. In such cases, it would be proper for the bank to ask the buyer to approach the court for an injunction. The court, however, should not lightly interfere with the operation of irrevocable documentary credit. In order to restrain the operation of irrevocable letter of credit, performance bond or guarantee, there should be a serious dispute to be tried and there should be a good prima facie act of fraud."

(emphasis supplied)

Learned Judge at page 1150 observed: (SCR headnote)

"The sound banking system may, however, require more caution in the issuance of irrevocable documentary credits. It would be for the banks to safeguard themselves by other means, and, generally, not for the courts to come to their rescue with injunctions unless there is established fraud. The appeal must be allowed, and the order of the Civil Judge, restored."

(emphasis supplied)

60. We have referred to the observations of both Sabyasachi Mukharji as well as Shetty, JJ. in extenso to emphasise that in case of confirmed bank guarantees/irrevocable letters of credit, it cannot be interfered with unless there is fraud and irretrievable injustice involved in the case and fraud has to be an established fraud. The expression "to prevent irretrievable injustice" appears to have been taken from the decision of the Court

of Appeal in England in the case of Elian and Rabbath (Trading as Elian & Rabbath) v. Matsas and Matsas 1966 2 Lloyd's Rep 495. The facts of that case were peculiar. The first defendant, a vessel, was chartered by Lebanese charterers for carriage of plaintiffs' cargo (consigned to Hungary) from Beirut to Rijeka. Discharge of the cargo was delayed at Rijeka and the shipowners exercised their lien on cargo in respect of demurrage due to delay in discharge of cargo. The third defendant-bank put up a guarantee in London in favour of the second defendants, who were first defendants' London agents, to secure release of cargo. There was a claim by Yugoslavians to distrain upon goods, involving the ship in further delay and master of the ship, on lifting original lien, immediately exercised another lien, in respect of extra delay. Original lien was raised when Hungarian buyers put up 2000 Pounds. Two years later the shipowners claimed arbitration with charterers to assess demurrage for which the first lien was exercised and claimed to enforce guarantee. Plaintiff claimed declaration that guarantee was not valid (as the original lien had been lifted) and an injunction to restrain shipowners or their agents from enforcing guarantee. The shipowners and their London agents as first and second defendants appealed against granting of injunction by Blain, J. It was held by the Court of Appeal that it was a special case in which court should grant injunction to prevent what might be irretrievable injustice. Lord Denning observed that although the shippers were not parties to the bank guarantee, nevertheless they had a most important interest in it. If the Midland Bank Ltd., paid under this guarantee, they would claim against the Lebanese Bank, who in turn would claim against the shippers. The shippers would certainly be debited with the account. On being so debited, they would have to sue the shipowners for breach of their promise express or implied to release the goods. Lord Denning posed the question: “Were the shippers to be forced to take that course?” Or can they short-circuit the dispute by suing the shipowners at once for an injunction? Lord Denning observed that it was a special case in which injunction should be granted and went on to observe that there was a prima facie ground for saying that the shipowners promised that, if the bank guarantee was given, they would release the goods. He further went on to observe that the only lien they had in mind at that time was the lien for demurrage. But would anyone suppose that the goods would be held for another lien in respect of extra delay. His Lordship observed that “it can well be argued that the guarantee was given on the understanding that the lien was raised and no further lien imposed, and that when the shipowners, in breach of that understanding imposed a further lien, they were disabled from acting on the guarantee”. If we closely analyse the facts of that case, irretrievable injustice which was made the basis for grant of injunction really was on the ground that the guarantee was not encashable on its terms when the buyers had paid 2000 Pounds to lift the original lien.

61. Another matter came before this Hon'ble Court in General Electric Technical Services Company Inc. v. Punj Sons (P) Ltd. 1991 4 SCC 230 The facts of the case are as follows.

62. The appellant's contract with Indian Airlines included the construction and fabrication of aircraft testing centre/engine repair centre in Delhi. For getting that work done, the appellant entered into a contract with Respondent 1.

63. As per the contract, Respondent 1 was required to provide performance bond equal to 30 per cent of the total value of contract price, which was to be split up into two performance bonds partly to be released on completion of the project, and the balance upon the expiration of the warranty, and to furnish a bank guarantee to secure the mobilisation advance of 25 per cent of contract value.

64. Respondent 1, instead of furnishing the two performance bonds, wrote a letter for a revised proposal, which was accepted by the appellant.

65. As the Respondent 1 failed to complete the project within the stipulated time, as per contractual specifications, despite repeated opportunities, the appellant terminated Respondent 1's right to continue the project and sought for encashment of the bank guarantee for Rs 1,06,12,500, which was issued to the appellant by the bank.

66. Respondent 1 filed a suit for injunction against the appellant and the bank in the High Court and obtained an ex parte injunction from the Single Judge, restraining the bank and the appellant from encashing the bank guarantee.

67. When the ex parte injunction was vacated, Respondent 1 preferred an appeal to the Division Bench of the High Court. The Division Bench allowed the appeal, staying the encashment of the bank guarantee till the disposal of the respondent's suit.

68. On the question, whether the court was justified in restraining the bank from paying the appellant under the bank guarantee at the instance of Respondent 1, allowing the appeal of the appellant-company, this Court held as under:

"In the instant case, the High Court has misconstrued the terms of the bank guarantee and the nature of the inter-se rights of the parties under the contract. The mobilisation advance is required to be recovered by the appellant from the running bills submitted by the respondent. If the full mobilisation advance has not been recovered, it would be to the advantage of the respondent. Secondly, the Bank is not concerned with the outstanding amount payable by the appellant 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 appellant 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. The demand by the appellant 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 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."

69. One of the arguments in that case was that as per the terms of bank guarantee it could not be encashed at that stage. This Court at pages 416 to 418 noticed the terms and conditions of the first bank guarantee which was towards the performance of the project and to secure mobilisation advance of 25 per cent of the contract value. Again at page 418 the Court noticed the replaced second composite bank guarantee dated January 25, 1988 keeping the other terms of the original bank guarantee dated October 28, 1986 unchanged. The case of the plaintiff was that there was no proper demand for payment of balance of the mobilisation advance nor was it mentioned in the letter of demand to the bank. It was also the case of the respondent that on terms of the bank guarantee the stage had not reached to encash it. This Court noticed at pages 419-420 of the report as follows: (SCC p. 236, para 8)

"The second bank guarantee with which we are concerned makes a reference to the first guarantee. It states that the guarantee is a composite bank guarantee for mobilisation of advance and performance bond. It further states that all the other terms and conditions of the original guarantee will remain unchanged."

70. The Court first decided that all the terms of the first bank guarantee were there except that earlier guarantee was towards the mobilisation advance whereas the later guarantee was a composite bank guarantee for both — performance of the contract as well as for recovery of mobilisation advance. The Court noticed how the liability under the guarantee will get reduced from stage to stage by realisation from running bills towards mobilisation advance and under the first guarantee itself the bank had undertaken to pay to the appellant the amount guaranteed without any demur merely on demand stating that the amount is due by way of loss or damage caused to or would be caused to or suffered by any breach committed by the respondent on any of the terms or conditions contained in the agreement or by reason of respondent's failure to perform the agreement and that such demand shall be conclusive as regards the amount due and payable by the bank under the guarantee. The appellant had only sought to enforce the bank guarantee for the balance amount of the

mobilisation advance on a complaint that Respondent 1 had failed to perform the contract as per terms and conditions. As mobilisation advance could be recovered earlier only from the running bills and since the contract had been terminated, the balance of mobilisation advance was sought to be recovered from the bank guarantee. The bank had undertaken to pay this amount and in fact the bank was prepared by pay the same. It was in these circumstances that the Court accepted the appeal and observed that the law has been settled in the aforesaid case of U.P Cooperative Federation Ltd. and again noticed the observations of Mukharji, J. in that case and observed at page 421 that the High Court has misconstrued the terms of the bank guarantee and the nature of the inter-se rights of the parties under the contract. It was on the question whether the amount was due under the terms and conditions of the bank guarantee that the learned Judge speaking for the Court observed that in the absence of prima facie case on such matters the High Court committed error in restraining the bank from honouring its commitment under the bank guarantee.

71. Shetty, J. speaking for the Bench noticed the earlier observations of Mukharji, J. in the case of U.P Cooperative Federation Ltd. and stated 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 fraud of the beneficiary, not the fraud of somebody else.

72. Again in this very judgment Shetty, J. referred to the observations of Mukharji, J. that there should be prima facie case of fraud and special equities in the form of preventing irretrievable injustice between the parties. Mere irretrievable injustice without prima facie case of established fraud is of no consequence in restraining the encashment of bank guarantee.

73. Mr Venugopal, learned counsel for the borrower referred us to the decision in Itek Corpn. v. The First National Bank of Boston etc.6 by the United States District Court, Massachusetts reported in 566 Federal Supplement 1210, particularly observations at page 1217, which read thus:

“Because I find that Itek has demonstrated that it has no adequate remedy at law, and because I find that the allegations of irreparable harm are not speculative, but genuine and immediate, I am satisfied that Itek will suffer irreparable harm if the requested relief is not granted.”

74. The facts in that case were that the exporter in USA entered into an agreement with Imperial Government of Iran and brought action seeking order terminating its liability on stand-by letters of credit issued by American Bank in favour of Iranian Bank as part of the contract. The learned District Court held that the contractor was entitled to issuance of preliminary injunction.

75. It will be noticed that this judgment is on peculiar facts of its own and the situation created after the Iranian Revolution when the American Government cancelled the export licence in relation to Iran as it related to high technology. As the American Government had cancelled the export licence in view of revolution in Iran and the Iranian Government had forcibly taken 52 American citizens as hostages and President Carter by executive order blocked all Iranian assets subject to the jurisdiction of the United States and also cancelled the export contracts, the plaintiff informed the importer in Iran invoking force majeure but the Iranian importer in spite of it resorted to encashment of the bank guarantee. The court was of the view that even if claim for damages is decreed by the American courts situation in Iran was such that the decree will not be executable in Iran. It was on these facts that the court felt that it was a case where the plaintiff had demonstrated that it has no adequate remedy at law and the allegations of irreparable harm are not speculative but genuine and immediate and the plaintiff would suffer irreparable harm if the requested relief is not granted. The court also found as a fact on page 1217 itself that “the uncontested facts in the record, if proved at trial, appear to make out a prima facie case of fraud within the meaning of Section 5-114(2)(b) and held that under these circumstances, any demand on the guarantees or letters of credit by Iranian importer in March 1980 would necessarily have been fraudulent”.

76. It is thus clear that this judgment is based on peculiar facts, particularly of situation in the Government of Iran which came into power after the revolution in Iran and its relations with the United States of America and in any case on the prima facie finding of fraud being given by the learned court read with the finding of irreparable harm which could not be avoided by adequate remedy at law due to peculiar situation in Iran.

77. It will be noticed that the plea of the plaintiff was that the contract will get frustrated due to restrictions imposed for import and export by the American Government. Along with it the plea was of irretrievable injury which was explained in the judgment also as to what it meant.

78. Mr Venugopal then referred us to the decision of Berger, J. in Handerson v. Canadian Imperial Bank of Commerce and Peat Marwick Ltd. 40 British Columbia LR 318 Here again the facts were peculiar. The plaintiff arranged an irrevocable letter of credit to fulfil his obligation to purchase 20 episodes of two television shows from a production company. Although the shows were never produced and the production company went into bankruptcy, the receiver of the seller made demand upon the bank for payment under the letter of credit and the plaintiff brought an application for an interlocutory injunction to stop the bank from making payment. The court granted the interim injunction and held that the letter of credit is independent of the primary contract of sale between the buyer and the seller. The issuing bank agreed to pay upon presentation of documents, not goods. There is an exception to this rule; the bank should not pay under the credit where it knows that the request for payment is made fraudulently in circumstances when there is no right to payment. The case fell within this exception. The bank had been put in knowledge of the fact that the shows had not been produced and, therefore, the receiver was not entitled to the proceeds. It will be noticed that this decision is based on obvious fraud and this view was given by Berger, J. after considering the case of Sztejn v. J. Henry Schroder Banking Corpn. 1941 31 NY Supp 2d 631, 633

79. A decision of New York Supreme Court in NMC Enterprises, Inc. v. Columbia Broadcasting System, Inc.9 was also referred to by Mr Venugopal. Here again Fein, J. observed that preliminary injunctive relief will be granted, restraining bank from honouring a letter of credit, where a prima facie showing has been made of fraud in the underlying transaction and the plaintiff has further shown that it may be irreparably injured if the relief is not granted.

80. On the facts the Court had taken the view that the plaintiff had made a sufficient showing of fraud to justify an injunction against the honouring of the letter of credit covering the sale of stereo receivers and related equipment where it appeared by affidavit that at the time the contract was negotiated, the plaintiff was provided with brochures containing technical performance specifications for the receivers including their continuous power-output ratings; that the receivers did not comply with the representation as to continuous power output thereby reducing their value; that an officer of the defendant had allegedly admitted that defendant was aware of the non-conformity prior to the execution of the contract and failed to disclose it to the plaintiff; and that if the letter of credit was drawn up or negotiated plaintiff might be forced into bankruptcy.

81. It will again be noticed that in this case the dispute was between the supplier and the purchaser and the decision is based on the facts found by the court for grant of preliminary injunction.

82. Halsbury Fourth Edn., Volume 9, para 542 observes as follows:

"542. Conditions and warranties.— The predominant modern approach is to consider the nature of the terms of the contract in order to decide whether those terms are conditions or warranties. Prima facie a breach of condition entitles the innocent party to rescind the contract and claim damages for any loss he may have suffered, whereas a breach of warranty only entitles him to damages."

83. Section 12 of the Sale of Goods Act, 1930 provides the difference between 'condition' and 'warranty' and reads as follows:

"12. Condition and warranty.— (1) A stipulation in a contract of sale with reference to goods which are the subject thereof may be a condition or a warranty.

(2) A condition is a stipulation essential to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated.

(3) A warranty is a stipulation collateral to the main purpose of the contract, the breach of which gives rise to a right to treat the contract as repudiated.

(4) Whether a stipulation in a contract of sale is a condition or a warranty depends in each case on the construction of the contract. A stipulation may be a condition, though called a warranty in the contract."

Again Section 13 of the Sale of Goods Act provides when 'condition' is to be treated as 'warranty', relevant part of sub-sections (1) and (2) thereof reads as under:

"13. When condition to be treated as warranty.— (1) Where a contract of sale is subject to any condition to be fulfilled by the seller, the buyer may waive the condition or elect to treat the breach of the condition as a breach of warranty and not as a ground for treating the contract as repudiated.

(2) Where a contract of sale is not severable and the buyer has accepted the goods or part thereof, the breach of any condition to be fulfilled by the seller can only be treated as a breach of warranty and not as a ground for rejecting the goods and treating the contract as repudiated, unless there is a term of the contract, express or implied, to that effect."

84. It will be noticed that in the present case prima facie the provision for capacity of the power plant being of 108 MW was a condition. Therefore, the plaintiff could have repudiated the contract as provided in Section 12(2) of the Sale of Goods Act or treated as a warranty by waiving the condition or elect to treat the breach of the condition as a breach of warranty and not as a ground for treating the contract as repudiated.

85. In the present case the plaintiff has not repudiated the contract. In fact it is working with the power plant and, therefore, the breach of condition has been treated by the plaintiff as a breach of warranty and in view of Section 12(3) of the Sale of Goods Act, the breach of warranty gives a right to claim for damages but not to a right to reject the goods and treat the contract as repudiated. Even the prayer in the plaint is for diminution of the price of the power plant and the relief is based on Section 59 of the Sale of Goods Act.

86. We have already held that the contracts between the lenders and the borrower are not vitiated by any fraud much less established fraud and there is no question of irretrievable injury. Therefore, there was no reason for the High Court to set aside the order of the trial court. Again there is no case of any irretrievable injury either of the type as held in the case of Itek Corpn. as there is no difficulty in the judgment of this country being executable in the courts in Sweden.

87. The High Court was not right in working on mere suspicion of fraud or merely going by the allegations in the plaint without prima facie case of fraud being spelt out from the material on record.

88. The High Court was also in error in considering the question of balance of convenience. 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. Irretrievable injury is of the nature as noticed in the case of Itek Corpn. Here there is no such problem. Once the plaintiff is able to establish fraud against the suppliers or suppliers-cum-lenders and obtains any decree for damages or diminution in price, there is no problem for effecting recoveries in a friendly country where the bankers and the suppliers are located. Nothing has been pointed out to show that the decree passed by the Indian Courts could not be executable in Sweden.

89. The High Court totally ignored the irretrievable injury which will be caused to defendant 12 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 4 not making any demand. The instalments for repayment of the loans had already been fixed and liable to be paid without demand by defendant 4. Defendant 12 is under a duty to pay the instalments regularly on a fixed date without any demand to defendant 4.

90. We may make it clear that our views are only tentative and prima facie for the purpose of the decision of the application for injunction and should not be construed as expression of opinion at all on the merits of the controversy between the plaintiff and the defendants.

91. For the reasons stated above the appeal is accepted; the judgment and order of the High Court dated October 11, 1991 is set aside and that of the trial court dated August 14, 1991 is restored and the application of the borrower/plaintiff for interim injunction against the lenders is dismissed with costs.

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