A GENERAL ELECTRIC TECHNICAL SERVICES COMPANY INC.

v.

PUNJ SONS (P) LTD. AND ANOTHER

AUGUST 7, 1991

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[K. JAGANNATHA SHETTY, V. RAMASWAMY AND YOGESHWAR DAYAL, JJ.]

Contract—Termination due to failure to comply specifications—Bank guarantee—Claim for encashment—Liability of Bank—Order restraining Bank from making payment—Legality of.

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

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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 E **mobilisation advance of 25 per cent of contract value.**

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

F **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.**

G **The 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.**

When the ex-parte injunction was vacated, respondent-1 preferred H **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. A

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, B

HELD: 1. In the instant case, the High Court has misconstrued the terms of the Bank guarantee and the nature of the inter-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. [421E-422A] C D E

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***U.P. Cooperative Federation Ltd.* v. *Singh Consultants and Engineers (P) Ltd.*, [1988] 1 SCC 174, Followed.**

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 3087 of 1991. G

From the Judgment and Order dated 23.11.1990 of the Delhi High Court in F.A.O. (O.S.) 123 of 1989.

Kapil Sibal, D.D. Thakur, Ms. Lira Goswamy, A.K. Mahajan, A.S. Chandhoik, Ms. Meera Chibber and Dinesh Agnani for the appearing parties. H

A The Judgment of the Court was delivered by

K. JAGANNATHA SHETTY, J. We grant special leave and proceed to dispose of the appeal.

B The General Electric Technical Services Company ('GETSCO') had entered into a contract with Indian Airlines which included, *inter alia,* the construction and fabrication of air craft testing centre/engine repair centre in Delhi. The GETSCO in turn entered into a contract with M/s Punj Sons (P) Ltd. respondent-1 for getting that work done for Indian Airlines. As per the contract respondent-1 was required to provide performance bond equal to 30 per cent of the total value of C 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. The respondent-1 was also required to furnish a bank guarantee to secure the mobilisation advance of 25 per cent of the contract value. On 28 October, 1986 D respondent-1 furnished the bank guarantee to secure the mobilisation advance of Rs.1,86,00,000. The guarantee was furnished by Hongkong & Shanghai Bank ('the Bank') respondent-2.

Respondent-1 instead of furnishing the two performance bonds, as agreed upon, wrote a letter dated 3 September, 1987, as follows:

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Sub: *Jet Engine Test & Repair Centre at Palam*

Finance September 3, 1987

F Dear Sir,

In terms of above contract we have to submit two separate Bonds for Mobilisation advance & performance guarantee & 25% and 30% of the Contract value. Bank G Guarantee for mobilisation advance has already been submitted and we have not to submit the Performance Bonds for 30% of the Contract value. Since the amount of Performance Bond shall be progressively utilised over the contract period, in order to reduce Bank charges and marginal money, we would like to suggest alternative proposals to H meet with your requirements:

AA. We propose to submit performance guarantees for 30% of the contract value duly signed by two directors in their personal capacity and countersigned by Punj Sons (Pvt) Ltd. This Performance bond shall include identical terms & conditions, as desired in your format. Similar Bond has already been accepted by M/s Hindustan Petroleum Corporation Ltd. Bombay for their Bombay-Pune Pipeline Project valued at Rs.7.05 crores.

BB. Alternatively, we would suggest submission of a Composite Bank Guaratee where amount vacated by Mobilisation advance shall be utilised by Performance Bank Guarantee amount. This Guarantee shall at any time be valid for equivalent to 30% of the contract value, to cover unrecovered mobilisation advance and Performance Guarantee amount of the work certified.

We have submitted similar Bonds to a number of our customers to their entire satisfaction. May we request you to look into the above arrangement and allow us to submit the above Bond or Composite Bank Guarantee under this Contract.

Thanking you and assuring you of our best services at all times ...."

GETSCO has accepted the revised proposal contained in the aforesaid letter. Consequently, on 25 January 1988, the Bank furnished a composite bank guarantee for Rs.2,12,25,000. Out of this composite bank guarantee 15 per cent being Rs.1,06,12,500 would remain in force until 30 June, 1988 and the balance 15 per cent would remain valid till final acceptance certificate i.e. till 30 June 1989.

It seems respondent-1 failed to complete the project within the stipulated time as per contractual specifications despite repeated opportunities to rectify defects and deficiencies prior to August 1988 and thereafter. GETSCO terminated respondent-1's right to continue the project and wrote a letter dated 17 April 1989 to the Bank seeking encashment of the bank guarantee dated 25 January 1988 for Rs.1,06,12,500. On the same day the bank issued a cashier's order No. 2605 for Rs.1,06,12,500 in favour of GETSCO. On 18 April 1989 the respondent-1 filed a suit for injunction against GETSCO and the Bank in the High Court and obtained an ex-parte injunction at the residence

of learned Single Judge restraining the Bank and GETSCO from encashing the bank guarantee. On 11 July 1989 the ex-parte injunction was vacated. On the same day respondent-1 preferred an appeal to the Division Bench of the High Court and obtained stay of encashment of the bank guarantee. On 23 November 1990, the Division Bench allowed the appeal, set aside the order of learned Single Judge and stayed the encashment of the bank guarantee till the disposal of the respondent's suit.

It seems to us that the Division Bench of the High Court has misconstrued the terms of the bank guarantee and the rights and liabilities of the parties thereunder. The first bank guarantee dated 28 October, 1986 is in these terms:

> "1. In consideration of General Electric Technical Services co. Inc. Cincinnati, Ohio, U.S.A. C/o M/s P.L. Jaitly & co. 1E/12, Jhandewalan Extension, New Delhi (hereinafter called the owner) having agreed to grant mobilisation advance of Rs.18,600,000 [Rs. Eighteen million six hundred thousand only] to M/s Punj Sons Pvt. Ltd., Industrial Area, Kalkaji, New Delhi 110019 (hereinafter called Contractor) under the terms and conditions of Tender No. HB-040-1 made by and between owner and Contractor for Indian Airlines Jet Engine Repair and Test Facilities Phase II Construction being undertaken at the Indira Gandhi International Airport, New Delhi (hereincalled the Agreement) on the production of Bank Guarantee for Rs.18,600,000 [Rupees eighteen million six hundred thousan only] we, Hongkong & Shanghai Banking Corporation, 28 Kasturba Gandhi Marg, New Delhi-110001 (hereinafter called Bank) do hereby undertake to pay to the Owner an amount not exceeding Rs.18,600,000 [Rs. eighteen million six hundred thousand only], against any loss or damage caused to or suffered or would be caused to or suffered by the owner by reason of any breach by the Contractor of the terms and conditions contained in the Agreement.
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> 2. We, the Bank do hereby undertake to pay the amount due and payable under this Guarantee with demur, merely on demand from the owner stating that the amount claimed is due by way of loss or damage caused to or would be caused to or suffered by the owner by reason of any breach

by the Contractor of any of the terms or conditions contained in the Agreement or by reason of the Contractor's failure to perform the Agreement. Any such demand made on the Bank shall be conclusive, as regards the amount due and payable by the Bank under this Guarantee. However, our liability under this Guarantee shall be restricted to an amount not exceeding Rs. 18,600,000 [Rupees eighteen million six hundred thousand only].

3. We, the Bank further agree that the Guarantee herein contained shall remain in force and effect during the period that would be taken for the performance of the Agreement and that it shall continue to be enforceable till all the due of the owner under or by virtue of the Agreement have been fully paid and its claims satisfied or discharged or till the owner certifies that the terms and conditions of the Agreement have been fully and properly carried out by the Contractor and accordingly discharges the Guarantee. Unless a demand or claim under this Guarantee is made on us in writing on or before the date (named in the Agreement as the end of the warrant/maintenance period) we shall be discharged from all liability under this Guarantee thereafter.

4. We, the Bank further agree with the Owner that the owner shall have the fullest liberty without our consent and without affecting in any manner our obligations hereunder to vary any of the terms and conditions of the Agreement or to extend time of performance by the Contractor from time to time or to postpone for any time or from time to time any of the powers exercisable by the owner against the Contractor and to forbear or enforce any of the terms and conditions relating to the Agreement and we shall not be relieved from our liability by reason of any such variation, or extension being granted by the owner or any indulgence by the owner to the Contractor or by any such matter or thing whatsoever which under the law relating to sureties would but for this provision have effect of so relieving us.

5. We, the Bank lastly undertake not to revoke this Guarantee during its currency except with the previous consent of the owner in writing.

A Notwithstanding anything stated above, our liability under this Guarantee is restricted to a sum of Rs.18,600,000 [Rs. eighteen million six hundred thousand only]. Our Guarantee shall remain in force untill the (date named in the Agreement as the end of the warrant/maintenance period). Unless a demand is lodged with us on or before that date 13 B day of February 1988, all your rights under the said guarantee shall be forfeited and we shall be relieved and discharged from all liabilities thereafter."

The relevant terms of the second composite bank guarantee dated 25 January 1988 are as follows:

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"Bank Guarantee No. 86 NDH 918 dt. 28.10.1986 for Rs.1,86,00,000 favouring M/s General Electric & Technical Services Co. Inc.

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Under the instructions from our clients M/s Punj Sons (Pvt) Ltd. M-13, Connaught Place, New Delhi 110001, we hereby enhance the value of the above Bank Guarantee upto Rs.21,225,000 [Rupees twenty one million two hundred twenty five thousand only] being 30% of the revised E Lumpsum Contract value of Rs.70,750,000 [Rupees seventy million seven hundred fifty thousand only].

This Bank Guarantee shall act 'Composite Bank Guarantee' for Mobilisation Advance and Performance Bond where in Bank Guarantee, to the extent of amounts of F Mobilisation Advance so recovered, shall be utilised towards Two Performance Bonds of 15% of the Contract value each valid upto 30th June, 1988 and 30th June, 1989, respectively.

G All the other terms and conditions of the original Guarantee will remain unchanged.

We, the Hongkong & Shanghai Banking Corporation, 28, Kastruba Gandhi Marg, New Delhi-110001, hereby undertakes not to revoke the Guarantee during the currency H except with the previous consent of the General Electric

and Technical Services Company Inc.

Notwithstanding, anything contained herein before our liability under this Guarantee is restricted to Rs.21,225,000 [Rupees Twenty One Million Two Hundred Twenty five thousand only] and the recovery of Mobilisation advance from Running Bills Account will be in accordance with the contract, the Guarantee against such amounts of Mobilisation Advance as so recovered shall be treated towards performance Guarantee with the intent that after recovery of Mobilisation Advance in full, the Guarantee shall operate against the full value of Performance Bond. Out of the said guarantee amount, the Bank Guarantee amount of Rs.10,612,500 [Rupees ten million six hundred twelve thousand & five hundred only] being the 15% of lumpsum value of the contract shall remain in force till the completion of the Project i.e. upto 30th June 1988 and the Bank Guarantee for the balance amount i.e. Rs.10,612,500 [Rupees ten million six hundred twelve thousand five hundred only] being 15% amount shall remain in force till final acceptance certificate till 30th June, 1989.

NOTWITHSTANDING anything contained hereinbefore our liability under this Guarantee will be restricted to Rs.21,225,000 [Rupees twenty one million two hundred twenty five thousands only] until 30th June 1988 and will automatically stand reduced from Rs.21,225,000 to Rs.10,612,500 (Rupees ten million six hundred twelve thousand and five hundred only) on 30th June, 1988 without further reference to you. Our liability will continue only to the extent of the balance amount of Rs.10,612,500 [Rupees ten million six hundred twelve thousand and five hundred only] after 30th June, 1988 and will be conditional upon a claim being filed with us in writing on or before 30th June 1989. Thereafter our liability under this guarantee shall stand extinguished and we shall be relieved and discharged from all liabilities thereunder."

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

A the original Guarantee will remain unchanged. The liability of the Bank shall automatically reduce from Rs.2,12,25,000 to Rs. 1,06,12,500 on 30 June 1988, which will continue even after 30 June, 1988 and will be conditional upon a claim being filed with the Bank in writing on or before 30 June 1989. In the first guarantee, the Bank has undertaken to pay to GETSCO the amount guaranteed without any B 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 GETSCO by reason of 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. It is also provided that any such demand by GETSCO made on the Bank shall be conclusive as regards C the amount due and payable by the Bank under the guarantee. The GETSCO has only sought to enforce the bank guarantee for the balance amount of Rs. 1,06,12,500 on a complaint that respondent-1, has failed to perform the contract as per the terms and conditions. The Bank has undertaken to pay this sum of money and it is a commitment of the Bank. The Bank must honour its commitment when demand is D made. Indeed, the Bank was prepared to pay and has in fact issued the Cashier's order as per demand from GETSCO, but the Court has directed the Bank not to pay under the guarantee.

The question is whether the Court was justified in restraining the E 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 catenae of cases. Almost all such cases have been considered in a recent judgment of this Court in *U.P. Cooperative Federation Ltd.* v. *Singh Consultants and Engineers (P) Ltd.*, [1988] 1 SCC 174 wherein Sabyasachi F Mukherji, J., as he then was, observed (at 189) 'that 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 serious dispute and there should be 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 operations will get jeopardised'. It was G further observed that the Bank must honour the bank guarantee free from interference by the Courts. Otherwise, trust in commerce internal and international would be irreparably damaged. It is only in exceptional cases that is to say in case of fraud or in case of irretrievable injustice, the Court should interfere. In the concurring opinion H 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.

The High Court has observed that failure on the part of GETSCO to make a reference to mobilisation advance in the letter seeking encashment of the bank guarantee would be tantamount to suppression of material facts, in the sense that the mobilisation advance was, under the contract to be recovered from the running bills. It was further observed that disclosure of such facts would have put the bank to further inquiry as to what was the amount covered by those bills and what was the corresponding amount of the mobilisation advance and to what extent the amount coverd by the bank guarantee remained payable. In any event, the High Court said, that GETSCO could not demand full amount of the bank guarantee on 17 April 1989. It seems to us 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. The mobilisation advance is required to be recovered by GETSCO 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 GETSCO 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 GETSCO 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 GETSCO is under the Bank guarantee and as per the terms thereof. The Bank has to pay and the Bank was willing to pay as per the undertaking. The Bank cannot be interdicted by the Court at the instance of respondent-1 in the absence of fraud or special equities in the form of preventing irretrievable injustice between the parties.

A 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.

In the result, we allow the appeal, set aside the impugned judgB ment and order of the High Court. The appellant is entitled to costs in this Court.

S.L.P. (Civil) No.—of 1991

(In CC-13153/91)

C Since we have set aside the order of the Division Bench of the High Court this Special Leave Petition does not survive and is accordingly dismissed.

No costs.

V.P.R. Appeal allowed.