

The State of Bihar and Others Vs. Hindustan Construction Co. Ltd. and Others

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Court : Mumbai

Decided On : Mar-20-1998

Reported in : 1998(3)ALLMR236; 1998(3)BomCR495;
[1999]97CompCas528(Bom)

Judge : M.B. Shah and; A.Y. Sakhare, JJ.

Acts : [Contract Act, 1872](#) - Sections 126; [Code of Civil Procedure \(CPC\), 1908](#) - Order 39, Rules 1 and 2

Appeal No. : Appeal No. 1346 of 1996 in Notice of Motion No. 2475 of 1992 in Suit No. 3295 of 1992

Appellant : The State of Bihar and Others

Respondent : Hindustan Construction Co. Ltd. and Others

Advocate for Def. : Subramaniam and ;Pradeep Sancheti, Advs., ;Mulla & ;Mulla

Advocate for Pet/Ap. : R.A. Dada, Addl. Solicitor General and ;K.R. Belosey, Adv.

Judgement :

ORDER

A.Y. Sakhare, J.

1. This appeal is filed by the original defendant Nos. 4, 5 and 6 in Suit No. 3295 of 1992, challenging the order dated 9th February 1996 passed by the learned Single Judge in Notice of Motion No. 2475 of 1992. By the impugned order the learned Single Judge has restrained the defendant Nos. 1 to 3 viz., the State Bank of India, State Bank of Patiala and Indian Bank from making the payment, under the bank guarantees and the defendant Nos. 4 to 6 viz., State of Bihar, Superintending Engineer and Executive Engineer, are restrained from invoking the bank guarantees.

2. On 25th April 1989, the plaintiffs were awarded a contract for construction of Icha dam across river Khadkai at village Kuju, Bihar for an amount of Rs. 39,71,31,019. The duration of the contract was for a period of 42 months, i.e. upto 24th April 1992. Clause 5 of the said contract provides for obligation on the part of the plaintiffs to furnish bank guarantee for 10% of the contract price as performance guarantee. Clause 9 of the contract casts obligation upon the plaintiffs to furnish bank guarantees against mobilisation advance given by the defendant Nos. 4 to 6. As per the plaintiffs the bank guarantee as performance guarantee was duly executed by them so also the bank guarantees were executed to the tune of Rs. 596 lakhs from time to time against receipt of mobilisation advance. On 21st October 1992, the present suit has been filed by the plaintiffs seeking reliefs for permanent injunction against the defendant Nos. 1 to 3 from making payment against the bank guarantees so also permanent injunction against the defendant Nos. 4 to 6 from invoking bank guarantees. As per the plaintiffs, the defendant No. 4 cannot invoke the bank guarantee furnished as performance of guarantee as the decision was taken by the defendant Nos. 4 to 6, themselves to stop the construction work on account of non availability of funds for the said project. As far as the bank guarantee issued against the mobilisation advances received by the plaintiffs, it is contended that the plaintiffs have purchased machinery after receipt of the said advances and that the plaintiffs have spent the amount on the work, the plaintiffs are not at fault, and as the decision was taken to stop the work by the defendant Nos. 4 to 6 themselves, the plaintiffs could not execute/complete the work, consequently, the defendant Nos. 4 to 6

cannot invoke bank guarantees.

3. On 22nd October 1992, the plaintiffs took out a Notice of Motion No. 2475 of 1992 for the reliefs as stated above. On the same date the learned Single Judge granted ad-interim orders in terms of prayer Clause (a)(ii) of the Notice of Motion. On 5th February 1992, the ad-interim order was continued till the disposal of the Notice of Motion. It appears that the defendant Nos. 4 to 6 did not remain present on both these dates. On behalf of the defendant Nos. 4 to 6 Shri Gorakhnath Singh, Executive Engineer, Khadkai Dam Icha Chalia District Singhbnum, Bihar has filed an affidavit in reply opposing the Notice of Motion. The case of the defendant Nos. 4 to 6 is that the plaintiffs cannot pray for injunction against them for invoking the bank guarantees issued under the caption of performance security and mobilisation advances. As per these defendants, the plaintiffs did not adhere to the schedule of work and have abandoned the work after receipt of the mobilisation advance of Rs. 532 lakhs. These defendants have contended that inspite of receiving mobilisation advances, the plaintiffs were not in a position to proceed with or complete the construction work and fulfill its contractual obligations. These defendants have further alleged that slight delay in making payment of the mobilisation advance was due to the act of the plaintiffs themselves, therefore, the plaintiffs are not entitled for reliefs sought for. These defendants have further stated that the performance of the plaintiffs was poor and unsatisfactory and during the span of 24 months, the plaintiffs could complete only 3 to 4% of the work which resulted in creating sufficient doubts in the minds of these defendants about the capability of the plaintiffs in executing the work. Thus, these defendants stated that their act of invoking the bank guarantees is legal and proper.

4. The contract between the parties is dated 25th April 1988. Clause 5 of the said contract relates to guarantee for performance and retention money, while Clause No. 9 relates to guarantees to be executed by the plaintiffs against mobilisation advance. The plaintiffs have executed the bank guarantee as the guarantee for performance so also against mobilisation advance received from time to time to the tune of Rs. 596 lakhs.

5. The learned Single Judge while granting the plaintiffs prayer for injunction has come to the conclusion that after stoppage of work on the grounds that the funds were not available, the defendant No. 4 cannot invoke the performance guarantee. As per the learned Single Judge, the bank guarantee could have been invoked only if there was some failure on the part of the plaintiffs to carry out its obligation under the contract.

6. As per the contract dated 24th April 1989, the plaintiffs have furnished two types of guarantees, (i) a guarantee for performance and retention money, and (ii) guarantee for repayment of mobilisation advance. While considering the submissions advanced on behalf of the plaintiffs and the defendant Nos. 4 to 6, we will have to consider the submissions of the parties separately for both these guarantees. Both these guarantees contemplate separate situation under which they can be invoked. Guarantee for performance and retention money contemplates that the plaintiffs will carry out their obligation and comply with the terms and conditions of the contract, while the guarantees issued against the mobilisation advance contemplate that the said bank guarantees will remain effective till mobilisation advances are repaid by the plaintiffs. Clause 10 of the contract provides for recovery of mobilisation advances by the defendant No. 4. As per these clause the defendant No. 4 was authorised to make recoveries in suitable percentage of the gross value of each bill in addition to the interest accrued thereon. The recovery against the principal amount was to be made after first 25% of the value of the work at the contract price is executed by the plaintiffs. However, for interest accrued on the mobilisation advance the defendant No. 4 was authorised to make deduction from 1st bill itself. The agreed interest rate was 15% per annum. An option was given to the plaintiffs to prepone the recoveries.

7. While considering the case of the plaintiffs as well as of the defendant Nos. 4 to 6, the learned Single Judge has not considered the case of the parties separately on each guarantee. From the impugned order it is clear that the learned Single Judge has come to the conclusion that as the defendant Nos. 4 to 6 have stopped the work on the ground that funds were not available for the project, therefore, the defendant No. 4 cannot be permitted to enforce the performance guarantee. About the guarantees executed against the mobilisation advances, the learned Single

Judge has not discussed the case of the defendant Nos. 4 to 6 nor has recorded specific findings.

8. On behalf of the defendant Nos. 4 to 6, it was contended that the defendant No. 4 have advanced a sum of Rs. 526 lakhs as mobilisation advance, the same amount has been received by the plaintiffs by executing the bank guarantees from time to time. As far as the invocation of these bank guarantees are concerned, these defendants have submitted that the plaintiffs have not utilised the mobilisation advance for which they were paid. It was submitted on behalf of these defendants that inspite of these defendants advancing substantial amounts they found that the plaintiffs performance in implementation of the project was poor and unsatisfactory and that the plaintiffs have completed only 3 to 4% of the work during the stipulated total period. As per these defendants the plaintiffs are under legal obligation to refund monies received by them as mobilisation advance and the plaintiff cannot withheld these amounts on any pretext or ground. It was further pointed out that the plaintiffs have abandoned the work without any sufficient cause and that these defendants will be justified in invoking bank guarantees. In support of this plea, these defendants have placed reliance upon the decision of the Supreme Court in the case of Dwarikesh Sugar Industries Ltd. v. Prem Heavy Engineering Works (P.) Ltd. & another, reported in : AIR 1997 SC2477 and the decision in the case of State of Maharashtra and another v. National Construction Company, reported in : [1996]1SCR293 .

9. On behalf of the plaintiffs, it was submitted that the defendant Nos. 4 to 6 will not be legally entitled to enforce the bank guarantees executed against the mobilisation advances as they have invested this amount in machineries which are lying at the site and repayment was to be made by making adjustment from the running bills. The plaintiffs stated that as the work was slopped by the defendant Nos. 4 to 6 without any sufficient cause, the plaintiffs could not complete the work. Consequently, the defendants cannot be permitted to invoke the bank guarantee. As per the plaintiffs, the mobilisation advances are utilised by them and the defendant No. 4 State of Bihar, the beneficiary should not be allowed to invoked the bank guarantees when the defendants No. 4 was to make deduction from the running bills. In support of these submissions, the plaintiffs have placed reliance

upon the decision of the Supreme Court in the case of Svenska Handelsbanken v. M/s. Indian Charge Chrome and others, reported in : AIR 1994 SC626 and the decision in the case of Larsen and Toubro v. Maharashtra State Electricity Board, reported in : AIR 1996 SC334 .

10. There is serious dispute between the parties as to whether the mobilisation advances are utilised by the plaintiffs as claimed by them. There is also serious dispute as to how much amount is spent by the plaintiffs on the machineries etc. from the mobilisation advance. Our attention was invited by the defendant Nos. 4 to 6 to one statement prepared by the plaintiffs officers which is at Exh. ! at page 89 to show that an amount of Rs. 195 lakhs and odd was spent on purchases while on the rest of the items mentioned therein the plaintiffs have incurred expenses of Rs. 467 lakhs and odd. In view of the bona fide dispute between the parties no finding can be recorded at this stage in favour of the plaintiffs that the plaintiffs have spent mobilisation advances for which it was advanced. Suffice to say that there is serious bona fide dispute about the spending of the mobilisation advances. In the case of State of Maharashtra, (cited supra) the Supreme Court has observed that a bank issuing guarantee is not concerned with the underlying contract between the parties to the contract. The duty of the bank under the guarantee is created by the document itself. The bank giving the guarantee must honour the same and make payment. Unless there is an allegation of fraud or the like the Court will not interfere directly or indirectly to withhold the payment. The Supreme Court has further observed that the bank guarantee is ordinarily a contract quite distinct and independent of the underlying contract.

11. In Dwarikesh Sugar Industries case (cited supra) the Supreme Court has observed that the courts have carved out two exceptions to the aforesaid rule.

i) Fraud in connection with such guarantee which would vitiate the very foundation of such bank guarantee.

ii) Where allowing encashment of an unconditional bank guarantee would result in irretrievable harm and injustice.

The Supreme Court while dealing with the powers of the Courts to grant injunction has observed in paras 21, 22, 23 and 24 as under:-

PARA 21: 'Numerous decisions of this Court rendered over span of nearly two decades have laid down and reiterated the principles which the courts must apply while considering the question whether to grant an injunction which has the effect of restraining the encashment of a bank guarantee. We do not think it necessary to burden this judgment by referring to all of them. Some of the more recent pronouncements on this point where the earlier decisions have been considered and reiterated are Svenska Handelsbanken v. M/s. Indian Charge and Chrome and other, : AIR 1994 SC626 , Larsen & Toubro Ltd. v. Maharashtra State Electricity Board and other, : AIR 1996 SC334 Hindustan Steel Workers Construction Ltd. v. G.S. Atwal & Co., (Engineers) Pvt. Ltd. J.T. : AIR 1996 SC131 and U.P. State Sugar Corporation v. Sumac International Ltd. : AIR 1997 SC1644 . The general principle which has been laid down by this Court has been summarised in the case of U.P. State Sugar Corporation case as follows:-

The law relating to invocation of such bank guarantees is by now well settled. When in the course of commercial dealings an unconditional bank guarantee is given or accepted , the beneficiary is entitled to realise such a bank guarantee in terms thereof irrespective of any pending disputes. The bank giving such a guarantee is bound to honour, it as per its terms irrespective of any dispute raised by its customer. The very purpose of giving such a bank guarantee would otherwise be defeated. The Courts should, therefore, be slow in granting an injunction to restrain the realisation of such a bank guarantee. The courts have carved out only two exceptions. A fraud in connection with such a bank guarantee would vitiate the very foundation of such a bank guarantee. Hence if there is such a fraud of which the beneficiary seeks to take the advantage, he can be restrained from doing so. The second exception relates to cases where allowing the encashment of an unconditional bank guarantee would result in irretrievable harm or injustice to one of the parties concerned. Since in most cases payment of money under such a bank guarantee would adversely affect the bank and its customer at whose instance the guarantee is given, the harm or injustice contemplated under this head must be of such an exceptional and irretrievable

nature as would override the terms of the guarantee and the adverse effect of such an injunction on commercial dealings in the country.'

22. 'Dealing with the question of fraud it has been held that fraud has to be an established fraud. The following observations of Sir John Donaldson, M.R. in *Bolivinter Oil SA v. Chase Manhattan Bank* 1984(1) All E.R. 351 are apposite:

'The wholly exceptional case where an injunction may be granted is where it is proved that the bank knows that any demand for payment already made or which may thereafter be made will clearly be fraudulent. But the evidence must be clear both as to the fact of fraud and as to bank's knowledge. It would certainly not normally be sufficient that this rests on the uncorroborated statement of the customer, for irreparable damage can be done to a bank's credit in the relatively brief time which must elapse between the granting of such an injunction and an application by the bank to have it charged.'

23. 'The aforesaid passage was approved and followed by this Court in *U.P. Cooperative Federation Ltd. v. Singh Consultants and Engineers (p) Ltd.* : [1988]1SCR1124 .

24. 'The second exception to the rule of granting injunction, i.e. the resulting of irretrievable injury, has to be such a circumstance which would make it impossible for the guarantor to reimburse himself, if he ultimately succeeds. This will have to be decisively established and it must be proved to the satisfaction of the Court that there would be no possibility whatsoever of the recovery of the amount from the beneficiary, by way of restitution.'

12. The learned Counsel for the appellant relied upon the decision rendered by the Supreme Court in the case of *Larsen and Toubro Ltd. v. Maharashtra State Electricity Board* : AIR 1996 SC334 . In that case the question of invocation of bank guarantee was involved. On the facts of that case it was held that the work was successfully completed, plant was taken over by the M.S.E.B. and in view of the execution of the contract the M.S.E.B. cannot be permitted to invoke the bank guarantee. The Supreme Court further observed that the M.S.E.B. must be restrained from invoking the bank guarantee to prevent the irretrievable injustice.

In the aforesaid case, the Supreme Court has relied upon its decision and has not differed therefrom.

Similar test is applied by the Supreme Court in the case of Svenska Handelsbanken, : AIR 1994 SC626 .

13. In the present case the plaintiffs have received mobilisation advance from the defendant No. 4. For repayment of this amount adjustment was to be made from running bills. This was only to facilitate the plaintiffs in making repayment. For withholding repayment of this amount, no condition is put in the contract nor our attention is invited to any other letter/correspondence between the parties, which could permit the plaintiffs to withhold repayment. Thus the defendant No. 4 will be entitled to recover the mobilisation advance even though the work is stopped. The mobilisation advance is nothing but loan advance to the plaintiffs to execute work. Therefore the defendant No. 4 will be legally entitled to claim its repayment. On failure on the part of the plaintiffs to repay mobilisation advance, the defendant Nos. 4 to 6 will be competent to invoke Bank guarantees executed under caption of mobilisation advance. On these guarantees, the plaintiffs case do not fall within any exception carved out by the Supreme Court in Dwarikesh Sugar Industries case : AIR 1997 SC2477 . Considering the decisions of the Supreme Court Dwarikesh Sugar Industries Ltd. and State of Maharashtra : [1996]1SCR293 , the defendant Nos. 4 to 6 cannot be prevented from invoking the bank guarantees executed against mobilisation advance. Consequently the order passed by the learned Single Judge preventing the defendant Nos. 1 to 3 in making payment and preventing the defendant Nos. 4 to 6 from invoking the bank guarantees executed against mobilisation advance will have to be set aside.

14. The plaintiffs case of bank guarantee for performance and retention money stands on different footing and will have to be upheld. By applying the test laid down by the Supreme Court in the aforesaid cases, on present facts it will have to be held that the defendant Nos. 4 to 6 themselves have stopped the work for want of funds, therefore, they are not entitled to invoke the performance guarantee. The relevant letter dated 27th November 1997 was issued by the Chief Engineer and was addressed to all the administrator, Superintending Engineer and all concerned

Executive Engineers. The relevant portion of the said letter reads as under :-

'Executive Engineers of the above mentioned Icha Dam Works at Icha Chaliama have intimated that some work has been executed in their Division as a result payment is due to the contractors. Division wise payment due to contractors is as under:-

Kharkai Dam Div.No. 1. Icha, Chaliama.

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'Considering the above matter, it will be seen that a sum of Rs. 57,93,000.00 is immediately due to the Contractor and its payment is felt necessary.'

'Therefore , it is requested that funds be made available for making payments to the Contractors.'

'It is suggested that in case funds are not available for disbursement immediately with Bihar Government then the same could be considered from the amount available out of contribution from Orissa Government.'

'Along with this all Executive Engineers are also being instructed to stop work due to non availability of funds. Which may please be approved.'

Copy to Superintending Engineer, Kharkai Dam Circle, Icha Chaliama, and all concerned Executive Engineers, for their information. They have been directed that without actual allotment of funds to them no work will be commenced under any circumstances, failing which, entire responsibility will rest with them.'

The defendants Nos. 4 to 6 contended that the plaintiffs themselves have abandoned the work therefore, these defendants' act of invoking the bank guarantees under this head was proper. By reading the letter referred to above, it is clear that the construction work was stopped due to non availability of funds. The learned Single Judge had rightly found that having stopped the work on the ground that the defendant Nos. 4 to 6 have no funds, these defendants cannot be permitted to enforce the performance guarantee as there was no failure on the part of the plaintiffs to carry out its obligation under the contract. The material on record,

prima facie, indicates that it was the defendant Nos. 4 to 6 who prevented the plaintiffs from executing the work and no funds were made available to the project in question. Prima facie at this stage it appears that the plaintiffs have not committed any breach of any of the terms of the contract which will enable the defendant No. 4 to invoke guarantees. Hence, in order to prevent irretrievable harm and injustice, injunction as prayed for by the plaintiffs, so far as it relates to invocation of the performance guarantee is granted. We, therefore, uphold the order passed by the learned Single Judge so far as it relates to the performance guarantee. We make it clear that these observations are only for a limited purpose and the question would be required to be decided at the time of trial.

15. In the result the appeal is partly allowed. The order dated 9th February 1996 so far as it relates to the invocation of the bank guarantee executed as the performance and retention money is hereby confirmed. Injunction order preventing the defendant Nos. 1 to 3 from making payment to the defendant Nos. 4 to 6 and further preventing the defendant Nos. 4 to 6 from invoking the bank guarantees executed by the plaintiffs against the mobilisation advance is hereby vacated.

16. However it is agreed by both the parties that the defendant Nos. 4 to 6 will not be entitled to invoke the bank guarantee No. MP/04/091 dated 2nd July 1991 issued by the Indian Bank, Bombay for Rs. 40 lakhs (against mobilisation advance), as, against the said bank guarantee the defendant No. 4 has not released the mobilisation advance to the plaintiffs.

17. Appeal to stand disposed of accordingly with no orders as to costs.

18. At the request of the respondent No. 1 operation of our order whereby injunction order is vacated is stayed for a period of 2 weeks from today.

19. Appeal partly allowed.