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**Court : Karnataka**

**Decided On : Feb-26-2003**

**Reported in : [2005]124CompCas144(Kar)**

**Judge : S.R. Nayak and ;K. Ramanna, JJ.**

**Acts : [Arbitration and Conciliation Act, 1996](#) - Sections 9**

**Appeal No. : M.F.A. Nos. 7679 and 7704 of 2002**

**Appellant : P.S. Measurements and Controls Pvt. Ltd.**

**Respondent : Technicom Systems (i) Pvt. Ltd. and anr.**

**Advocate for Def. : K.S. Shivasubramanyan, Adv. for respondent No. 1 and ;A. Venkatachalaiah, Adv. for respondent No. 2**

**Advocate for Pet/Ap. : K.G. Raghavan Dua Associates**

**Disposition : Appeal dismissed**

**Judgement :**

**S.R. Nayak, J.**

1. Both the above miscellaneous first appeals are directed against the same judgment dated November 22, 2002, passed in A. C. No. 45 of 1999 on the file of the VI Addl. City Civil Judge, Bangalore City (CCH No. 11). By the order under appeals, the court below has dismissed the petition filed by the appellant under Section 9 of the [Arbitration and Conciliation Act, 1996](#), for short 'the Act' and refused to grant a measure of interim protection under Section 9 of the Act and thereby vacating the order of injunction restraining the respondents from encashment of bank guarantee bearing Nos. 97/444 and 97/445.

2. The case of the appellant is as follows :

3. The appellant is engaged in the manufacture of telecom equipment. The first respondent and another company by the name of National Telecom of India Ltd. are engaged in a similar line of business. The appellant-company manufactures products which are indigenously developed by M/s. Measurements and Controls, a sister concern of the appellant. The telecom equipment manufactured by the appellant are used by the Department of Telecommunications (DoT). The DoT had floated tenders in respect of certain terminals. The first respondent bid for the said tenders and received orders for the supply of the following products. (A) 2/34 MB Skip Mux, (B) 2/34 MB Optimux and (C) 2/140 MB Optimux

4. The first respondent after securing the said order, approached the appellant for supply of the said products of DoT on January 12, 1998. The appellant entered into the memorandum of understanding with the first respondent and M/s. Measurements and Controls, Bangalore (technology provider) for the supply of the above noted products. As per the agreement, the purchase order received from the first respondent will be sent to M/s. Measurements and Controls as and when received from the DoT. The purchaser shall place purchase orders on the contract supplier indicating the description of the items, quantity and price. The letter of credit shall be opened within seven days from the date of purchase order and intimation given to the contract supplier. Further, they agreed for performance guarantee. The contract supplier has to submit 5 per cent, of the value of the the DoT's purchase for each purchase order, valid for a period of two years and three years in the case of any non-performance of any of the products for which the DoT

extends the period of bank guarantee shall be furnished within ten days from the date of placement of purchase order on the contract supplier. The first respondent was to place purchase orders as prescribed by the DoT on the appellant for the supply of products after receipt of the orders from the DoT. Within seven days of the date on which the purchase order was placed, the first respondent was obliged to open a letter of credit and intimate the same to the appellant. The appellant thereafter was obliged to furnish a performance bank guarantee for 5 per cent, of the value of the order of the DoT within ten days after the date of placement of the purchase order which included opening a letter of credit by the first respondent. The letter of credit formed the basis of any supply to be effected to the first respondent. The letter of credit in the said memorandum of understanding acted as a condition precedent, the fulfilment of which was essential for any supply to commence. The first respondent was required to first perform the promise of opening the letter of credit which would then make it incumbent on the appellant to perform its promise of providing a performance guarantee. Respondent No. 1 placed three purchase orders dated February 3, 1998. As per the agreement, the respondent was obliged to furnish letter of credit within seven days. In several oral conversations with the appellant, the first respondent requested the appellant to give the bank guarantees even prior to opening of the letter of credit. The appellant with the bona fide belief, agreed to furnish the said bank guarantee.

5. The first respondent is the sister concern of a company called National Telecom of India Ltd., referred to as NATELCO. NATELCO requested the appellant by its letter dated February 4, 1998, to furnish the bank guarantee by February 9, 1998, in respect of its purchase orders and the orders placed by the first respondent even though it had not furnished the letter of credit. The appellant being persuaded by the first respondent that bank guarantees would be beneficial to the first respondent to obtain letter of credit as the NATELCO has requested the appellant to furnish the bank guarantees, the appellant by its letter dated February 26, 1998, indicated that it would be getting the necessary guarantee from the bank and requested that the letter of credit be submitted by March 1, 1998. Thereafter, the State Bank of India, the second respondent herein issued bank guarantees against all the three purchase orders. The appellant has already supplied all goods after letter of credit was opened under the first and second purchase orders. For

the first purchase order, the second respondent issued a performance bank guarantee bearing No. 97/444 dated March 12, 1999, for a sum of Rs. 10,67,000 and performance bank guarantee bearing No. 97/445 dated March 12, 1999, for a sum of Rs. 22,18,000. To begin with the second respondent issued conditional bank guarantees. The first respondent wanted the conditional bank guarantees converted into unconditional bank guarantees and called upon the appellant to amend the bank guarantees. The appellant informed respondent No. 1 that the letter of credit had not yet been opened and supply could not be commenced without them. The respondent, however, by his letter dated March 25, 1998, requested the appellant to amend the bank guarantees. Accordingly, the appellant instructed the bank for amendment of bank guarantees. Thereafter, the second respondent-bank carried out amendments and converted the conditional bank guarantees into unconditional bank guarantees. The first respondent had not given its letter of credit. The appellant withheld the amendment and did not send the same to the first respondent as it was not agreeable to an unconditional bank guarantee. NATELCO for its and on behalf of the first respondent by its letter dated May 7, 1998, requested the appellant to send originals of the amendment to the bank guarantees. The appellant requested the first respondent to open the letter of credit. The first respondent thereafter, opened a letter of credit on July 22, 1998, only for the part of purchase order. But not opened letter of credit for the other purchase orders. Therefore, the appellant supplied the goods only for the amount of TLC. The appellant received the communication from the second respondent stating that the first respondent has invoked the bank guarantees bearing Nos. 97/444 and 97/445 which were issued for second and third purchase orders bearing Nos. PDH/TECH/98-99/002 and PDH/TECH/98-99/003.

6. At that stage, the appellant filed an application under Section 9 of the Act in the court below for an interim measure of protection thereby restraining the second respondent from making any payment in respect of the bank guarantee Nos. 97/444 and 97/445 and also restraining the first respondent from receiving payments. The court below issued ex parte order of injunction. Subsequently, the arbitration proceedings has been set in motion and the application of the appellant was contested by the first respondent and that application was finally disposed of on November 22, 2002, whereby the court below rejected the said application for

injunction on the ground that : (i) The clauses relating to the opening of the letter of credit and the furnishing of bank guarantee are independent clauses as per the memorandum of understanding, (ii) the furnishing of bank guarantee is not conditional on the opening of the letter of credit, (iii) The bank guarantee furnished is an unconditional bank guarantee, (iv) The appellant had not pleaded fraud or misrepresentation on the part of respondent No. 1 in seeking to invoke the bank guarantee.

7. We have heard learned counsel for the parties, perused the pleadings of the parties and the order of the court below impugned in these appeals. Learned counsel for the appellants contended that the opening of letter of credit and furnishing bank guarantee were in the nature of reciprocal promises and one could not take place without the performance of the other. According to learned counsel, the letter of credit by the first respondent would enable the appellant to open the letters of credit on its suppliers for procurement of raw material and enable the appellant to commence the manufacture of the said products. Learned counsel for the appellant next contended that the court below acted illegally in holding that there exists unconditional bank guarantees and in fact the amended unconditional bank guarantees are still with the appellant and they are not handed over to the first respondent and therefore, there is no question of the first respondent encashing those unconditional bank guarantees. Learned counsel would maintain that, in the context of the memo of understanding between the parties, it is clear that the opening of letter of credit acted as a condition precedent for supply of goods to the first respondent and also for furnishing bank guarantee. Learned counsel, further, contended that the learned trial judge completely erred in coming to the conclusion that the appellant had not pleaded fraud or misrepresentation on the part of the first respondent in securing the bank guarantees. Learned counsel would maintain that the appellant had, in explicit terms, in the petition filed before the court below submitted that the first respondent has committed fraud right from the inception of the contract and has continued to act fraudulently thereafter. Learned counsel would contend that since the bank guarantees were obtained by the first respondent by playing fraud, encashment of the same could be prevented by an order of injunction. Learned counsel submitted that the first respondent without performing its obligation under the contract of opening the necessary

letters of credit, is estopped by law from acting upon the bank guarantees which the appellant had executed bona fide, by diligently performing its obligations as envisaged under the contract.

8. Sri K. C. Shivasubramanyan, learned counsel for the first respondent, on the other hand, fully supported the judgment of the court below and would maintain that there is absolutely no substance in any of the contentions advanced by learned counsel for the appellant. Sri K. C. Shivasubramanyan, particularly would draw our attention to what is stated in paras. 9 and 14 of the counter affidavit filed by the first respondent by way of objection to I. A. No. I filed by the appellant in the court below and contend that under the agreement, the appellant was to supply products of all types against three orders but for the reasons best known to them they supplied products only against order 001 and no products were supplied against orders 002 and 003 and this has totally affected the commitment of supply to the DoT by the first respondent. According to him, the required supplies were not done by the appellant because the appellant did not have the type approval certificate for 2/140 Mb/S optimux equipment ordered by the first respondent. Learned counsel would also highlight that no rejoinder was filed by the appellant to the counter affidavit. Learned counsel further contended that neither there is any satisfactory pleading nor any proof to sustain the plea of fraud raised by the appellant's counsel. Learned counsel would contend that in order to prevent the encashment of bank guarantees on the ground of fraud, not only the fraud on the part of the beneficiaries of the bank guarantees should be established but it is also necessary to prove that the concerned bank has had the knowledge of fraud. We have also heard learned standing counsel for the second respondent-bank.

9. The law relating to encashment of the bank guarantees and the circumstances under which a court can issue injunction against encashment of bank guarantees has been crystalised by a catena of decisions of the Supreme Court and High Courts. It is well settled that, the courts ought not to grant injunction restraining the encashment of bank guarantees or letter of credits except on two grounds-(i) fraud and (ii) irretrievable damage. The Supreme Court in the case of Federal Bank Ltd. v. V. M. Jog Engineering Ltd. [2001] 106 Comp Cas 267, 287; [2001] 1 SCC 663 has held as follows :

'55. In several judgments of this court, it has been held that courts ought not to grant injunction to restrain encashment of bank guarantees or letters of credit. Two exceptions have been mentioned-(i) fraud, and (ii) irretrievable damage. If the plaintiff is prima facie able to establish that the case comes within these two exceptions, temporary injunction under Order 39, Rule 1 of the Civil Procedure Code can be issued. It has also been held that the contract of the bank guarantee or the letter of credit is independent of the main contract between the seller and the buyer. This is also clear from articles 3 and 4 of UCP (1983 Revision). In the case of an irrevocable bank guarantee or letter of credit the buyer cannot obtain injunction against the banker on the ground that there was a breach of the contract by the seller. The bank is to honour the demand for encashment if the seller prima facie complies with the terms of the bank guarantee or the letter of credit, namely, if the seller produces the documents enumerated in the bank guarantee or the letter of credit. If the bank is satisfied on the face of the documents that they are in conformity with the list of documents mentioned in the bank guarantee or the letter of credit and there is no discrepancy, it is bound to honour the demand of the seller for encashment. While doing so it must take reasonable care. It is not permissible for the bank to refuse payment on the ground that the buyer is claiming that there is a breach of contract. Nor can the bank try to decide this question of breach at that stage and refuse payment to the seller. Its obligation under the document having nothing to do with any dispute as to breach of contract between the seller and the buyer. As to its knowledge of fraud or forgery, we shall presently deal with it.'

10. It is also well settled that in order to obtain an injunction against encashment of bank guarantees, it is necessary to prove that the bank had the knowledge of fraud. The Supreme Court dealing with the above requirement in the same case in para. 57 held as follows (page 287) :

'57. Kerr ),, said in R. D. Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd. [1977] 2 All ER 862, 870 (QB); [1977] 3 WLR 752; [1978] QB 146, (QB at page 155) that irrevocable letters of credit are 'the lifeblood of international commerce'. He said :

'Except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration . . . Otherwise, trust in international commerce could be irreparably damaged.'

Denning M. R. stated in *Edward and Owen Engineering Ltd. v. Barclays Bank International Ltd.* [1977] 3 WLR 764 (CA); [1978] QB 159; [1978] 1A11 ER 976, 983, 984, that 'the only exception is when there is a clear fraud of which the bank has notice'. Browne L. J., said in the same case : 'but it is certainly not enough to allege fraud; it must be established and in such circumstances, I should say, very clearly established'.'

11. In *Bolivinter Oil SA v. Chase Manhattan Bank* [1984] 1 All ER 351; [1984] WLR 392 (CA), All ER at page 352, it was said :

'Where it is proved that the bank knows that any demand for payment already made or which may thereafter be made will clearly be fraudulent. But the evidence must be clear, both as to the fact of fraud and as to the bank's knowledge. It would certainly not normally be sufficient that this rests on the uncorroborated statement of the customer, for irreparable damage can be done to a bank's credit in the relatively brief time 'before the injunction is vacated'.'

12. Thus, not only must 'fraud' be clearly proved but so far as the bank is concerned, it must prove that it had knowledge of the fraud. In *United Trading Corporation S. A. v. Alied Arab Bank Ltd.* [1985] 2 Lloyd's Rep 554 (CA), it was stated that there must be proof of knowledge of fraud on the part of the bank at any time before payment. It was too also observed that it:

'would be sufficient if the corroborated evidence of the plaintiff usually in the form of contemporary documents and the unexplained failure of a beneficiary to respond to the attach, lead to the conclusion that the only realistic inference to draw was fraud.'

13. The judgment of the Supreme Court in the case of *Hindustan Steelworks Construction Ltd. v. Tarapore and Co.* : AIR 1996 SC2268 , is a binding authority

to state that the bank guarantee is an independent and distinct contract between the bank and the beneficiary and is not qualified by the underlying transaction and the primary contract between the person at whose instance the bank guarantee is given and the beneficiary. In other words, in the case of unconditional bank guarantee, the nature of obligation of the bank is absolute and not dependent upon any dispute or proceeding between the party at whose instance the bank guarantee is given and the beneficiary. The Supreme Court in the above case, in paras. 14 and 23 held as follows (pages 354 and 360) :

'14. The High Court also committed a grave error in restraining the appellant from invoking the bank guarantees on the ground that in India only a reasonable amount can be awarded by way of damages even when the parties to the contract have provided for liquidated damages and that a term in a bank guarantee making the beneficiary the sole judge on the question of breach of contract and the extent of loss or damages would be invalid and that no amount can be said to be due till an adjudication in that behalf is made either by a court or an arbitrator, as the case may be. In taking that view the High Court has overlooked the correct position that a bank guarantee is an independent and distinct contract between the bank and the beneficiary and is not qualified by the underlying transaction and the primary contract between the person at whose instance the bank guarantee is given and the beneficiary. What the High Court has observed would be applicable only to the parties to the underlying transaction or the primary contract but can have no relevance to the bank guarantee given by the bank, as the transaction between the bank and the beneficiary is independent and of a different nature. In the case of an unconditional bank guarantee the nature of obligation of the bank is absolute and not dependent upon any dispute or proceeding between the party at whose instance the bank guarantee is given and the beneficiary. The High Court thus failed to appreciate the real object and nature of a bank guarantee. The distinction which the High Court has drawn between a guarantee for due performance of a works contract and a guarantee given towards security deposit for that contract is also unwarranted. The said distinction appears to be the result of the same fallacy, committed by the High Court of not appreciating the distinction between the primary contract between the parties and a bank guarantee and also the real object of a bank guarantee and the nature of bank's obligation thereunder.

Whether the bank guarantee is towards security deposit or mobilisation advance or working funds or for due performance of the contract if the same is unconditional and if there is a stipulation in the bank guarantee that the bank should pay on demand without a demur and that the beneficiary shall be the sole judge not only on the question of breach of contract but also with respect to the amount of loss or damages, the obligation of the bank would remain the same and that obligation has to be discharged in the manner provided in the bank guarantee.

23. We are, therefore, of the opinion that the correct position of law is that commitment of banks must be honoured free from interference by the courts and it is only in exceptional cases, that is to say, in case of fraud or in a case where irretrievable injustice would be done if bank guarantee is allowed to be encashed, that the court should interfere.'

14. To the same effect is the judgment of the Supreme Court in the case of General Electric Technical Services Company Inc. v. Punj Sons (P) Ltd., : [1991]3SCR412 .

15. Further this court in the case of HVS Technologies Inc., United States of America v. Aeronautical Development Agency (ADA), Bangalore [2001] 4 Karn LJ 211 has held that the right of beneficiary of guarantee to recover guaranteed amount cannot be stayed pending arbitration and bank cannot be restrained from honouring its obligation.

16. In the case of Association Corporation and Apex Societies of Handlooms v. State of Bihar, : AIR2000 Delhi106 , the terms and conditions for invocation of bank guarantee are mentioned only in the main contract and not in the bank guarantee. The Delhi High Court has held that the guarantee amount was to be paid by the bank without any demur or protest.

17. In the instant case, though the bank guarantees were conditional initially, at the request of the first respondent, admittedly, the appellant amended the bank guarantees and converted them as unconditional. In bank guarantees paras. 2 to 4 read as follows :

'In clause No. 5, page No. 3, line No. 4, add (after the words 'any amount that') 'may become without any demur, merely on a demand from the purchaser stating that the amount claimed is due'.

In clause No. 5, page No. 3, line No. 8, add (after the words 'to perform the said agreement') 'Any such demand made on the bank shall be conclusive as regards the amount due and payable by the bank under this guarantee where the decision of the purchaser in these counts shall be final and binding on the bank'.

Add the following clause after clause No. 5 in page No. 3, 'We undertake to pay the purchaser any money so demanded notwithstanding any dispute or disputes raised by the contractor(s)/supplier(s) in any suit or proceeding pending before any court or tribunal relating thereto our liability under this present being absolute and unequivocal. The payment so made by us under this bond shall be valid discharge or our liability for payment thereunder and the contractor(s)/supplier(s) shall have no claim against us for making such payment'.'

18. It is the case of the first respondent that after the conversion of the bank guarantees into unconditional ones, copies of the amended bank guarantees were sent to the first respondent. Therefore, the court below has rightly held that merely because the unconditional bank guarantees are kept with the appellant, that fact itself would not come in the way of the first respondent invoking and encashing the bank guarantees. As could be seen from the above extracted clauses of the bank guarantee, the bank guarantee is given as unconditional bank guarantee. Therefore, the bank is under an obligation to pay the amount on demand from the purchaser. The decision of the purchaser is final and binding on the bank. It needs to be emphasised that clause IV of the guarantee specifically states that the bank undertakes to pay the purchaser any money so demanded 'notwithstanding any dispute or disputes raised by the contractor(s)/supplier(s) in any suit or proceeding pending before any court or tribunal relating thereto'. The underlined phrase occurring in clause IV in unequivocal terms shows that the liability of the bank to honour and pay is absolute and unequivocal.

19. We also do not find any flaw in the finding recorded by the court below in regard to the allegations of the appellant that the bank guarantees were secured

by the first respondent by playing fraud. The bald observations of fraud pleaded by the appellant without any proof could not be a justifiable ground for the court to issue injunction. In this case, admittedly, initially the conditional bank guarantee was furnished but later, the appellant himself requested the second respondent-bank to convert it into unconditional bank guarantee. It is well settled that where an applicant seeks injunction against the invocation of the bank guarantee on ground of fraud, not only such applicant should lay necessary factual matrix in the pleading but also produce prima facie substantive evidence to bring home the charge of fraud to the satisfaction of the court. In the instant case, the appellant has utterly failed on both counts.

20. The bank guarantee is an independent and distinct contract between the beneficiaries and the bank and the rights and obligations therein are to be determined on its own terms. The commitments of the bank must be honoured as free from interference.

21. We also do not find any merit in the contention of learned counsel for the appellant that the appellant has made out special equities in its favour and therefore, it is entitled for injunction. It needs to be noticed that in order to prove the case within the ambit of special equities in the form of preventing irretrievable injustice, it must be proved to the satisfaction of the court that there is no possibility whatsoever of the recovery of the amount. The appellant has not placed any material before the court to discharge that burden cast upon it.

22. The decisions cited by learned counsel for the appellant, in the case of U.P. Co-operative Federation Ltd. v. Singh Consultants and Engineers (P.) Ltd. : [1988]1SCR1124 , General Electric Technical Services Company Inc. v. Punj Sons (P) Ltd. (supra) and Ansal Engineering Projects Ltd. v. Tehri Hydro Development Corporation Ltd. : (1996)5SCC450 , in support of his contentions are of no help in the context of the present case. It is true, as already stated supra, the courts have made an exception in the matter of issuing injunction against encashing unconditional bank guarantee in the case where fraud is established or at least prima facie fraud is shown. Since the appellant has failed to establish fraud, its case will not fall in one of the two excepted categories.

23. In the result and for the foregoing reasons, we dismiss both the appeals with no order as to costs.

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