

D.S. Constructions Limited Vs. Rites Limited and anr.

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Court : Delhi

Decided On : Jan-17-2006

Reported in : AIR2006Delhi98; III(2006)BC82; 2006(1)CTLJ123(Del);
127(2006)DLT1

Judge : Badar Durrez Ahmed, J.

Acts : [Indian Contract Act, 1872](#) - Sections 6(2), 7, 126, 128 and 130 to 141; ;
[Code of Civil Procedure \(CPC\) , 1908](#) - Sections 151

Appeal No. : IA No. 11121/2003 and CS (OS) No. 2030/2003

Appellant : D.S. Constructions Limited

Respondent : Rites Limited and anr.

Advocate for Def. : Anil Airi, Adv. for the Defendant No. 1, ; Neeraj Sachdeva,
Adv. for the Defendant No. 2

Advocate for Pet/Ap. : R.S. Endlaw, Adv

Judgement :

Badar Durrez Ahmed, J.

1. Initially, the application [IA No. 11121/2003] under Order 39 Rules 1 & 2 of CPC was argued on 30.11.2005 and orders were reserved. The counsel also sought

time to take instructions as to whether the suit itself could be disposed of at this stage. On 05.12.2005 the counsel responded by saying that it could. The following issues were framed:-

1. Whether any contract/agreement came into existence between the plaintiff and the defendant No. 1?
2. Whether the defendant No. 1 is entitled to invoke the Bank Guarantee?
3. Relief.

And, it was submitted that the arguments advanced at the hearing of the said application be treated as arguments in the suit and the same be disposed of. It is so being disposed of by this judgment.

2. The plaintiff has filed the present suit seeking a declaratory decree as well as a decree for permanent injunction. The declaration that is sought by the plaintiff is that no agreement / contract has come into being between the plaintiff and the defendant No. 1 for the construction of Semi-Merry Go Round System for Tenughat Thermal Power Station, Lalpania, Jharkhand pursuant to the letter inviting tenders dated 17.02.2003 issued by the defendant No. 1. The relief of permanent injunction that is sought by the plaintiff is for restraining the defendant No. 1 from invoking / negotiating the bank guarantee No. LKB/4692/22050 of 22.03.2003 for a sum of Rs. 15.00 lakhs issued by the defendant No. 2 (bank) at the request of the plaintiff to the defendant No. 1. An injunction is also sought against the defendant No. 2, restraining it from making any payment under the said bank guarantee to the defendant No. 1. The application [IA No. 11121/2003] under Order 39 Rules 1 and 2 read with Section 151 of the Code of Civil Procedure, 1908 (hereinafter referred to as the 'CPC') was filed by the plaintiff seeking the interim relief of restraining the defendant No. 1 from invoking / negotiating the said bank guarantee as also restraining the defendant No. 2 from making payment to the defendant No. 1 under the said guarantee.

3. On 25.11.2003, the plaint was registered as a suit and this court directed the issuance of summons to the defendants. Notice was also issued to the defendants

in the said application (IA No. 11121/2003) and ex parte interim orders were passed restraining the defendant No. 1 from invoking the said bank guarantee subject to the condition that the validity of the bank guarantee was extended for a further period of three months from the date of its expiration. The defendant No. 2 was also restrained from releasing the bank guarantee and from making payment till further orders from this court. This ex parte order has continued till date. The bank guarantee has, however, been kept alive by extending its validity from time to time.

4. The admitted facts in brief are that the defendant No. 1 issued a letter inviting tender (hereinafter referred to as the 'LIT') on 17.02.2003 (Annexure-'A' to the plaint), inter alia, to the plaintiff in respect of the construction of Semi-Merry Go Round System for Tenughat Thermal Power Station, Lalpania, Jharkhand. It was a condition of the LIT that the bids must be accompanied by Earnest Money Deposit of Rs. 15.00 lakhs. Clause 7.0 of the Instructions to Tenderers related to Earnest Money. While the said clause specifically provided for the deposit of Earnest Money of Rs. 15.00 lakhs by crossed bank draft or pay order, it is an admitted position between the parties that subsequently instead of the requirement of depositing the Earnest Money by crossed bank draft or pay order, the tenderers could give a bank guarantee for the said amount in favor of the defendant No. 1. Clause 7.5 of the Instructions to Tenderers prescribed that the Earnest Money of the unsuccessful tenderers would be discharged / returned on the award of contract to the successful tenderer. It was also provided that in the case of the successful tenderer, the Earnest Money would be retained by the defendant No. 1 as part of the security deposit in accordance with clause 16.0 of the General Conditions of the Contract. Clauses 8.0, 8.1, 8.2 are crucial for determination of the issues at hand and, therefore, the same are reproduced in their entirety:-

8.0 Validity

8.1 Tenders shall remain valid and open for acceptance / award for a period of 6 months from the date of opening of tenders. Should the tenderer fail to keep the tender open for acceptance / award as stated above or if the tenderer withdraws his tender before the expiry of the said period or makes any modifications in the

terms and conditions of the tender which are not acceptable then RITES without prejudice to any other right or remedy shall be at liberty to forfeit his Earnest Money.

8.2 In exceptional circumstances, prior to expiry of the original validity period, RITES may request the tenderers for a specified extension in the period validity. The request and the responses thereto shall be made in writing or by cable or telex. A tenderer may refuse the request without forfeiting his Earnest Money. A tenderer agreeing to the request will not be required nor be permitted to modify his tender but will be required to extend the validity of his Earnest Money correspondingly.

5. It is in the background of these provisions that the factual position has to be understood. The tender was submitted by the plaintiff on 24.03.2003. The bids were opened on the same day, i.e., on 24.03.2003. By virtue of clause 8.1 referred to above, the tenders were to remain valid and open for acceptance / award for a period of six months from 24.03.2003, i.e., up to 23.09.2003. On 09.09.2003, the defendant No. 1 sent a letter to the plaintiff informing the plaintiff that the finalisation of the subject tender would take some more time and, therefore, requested the plaintiff to extend the validity of the same unconditionally up to 30.11.2003 . The plaintiff by a letter dated 22.09.2003 responded to the aforesaid request of the defendant No. 1 by indicating that in the quotation submitted by it on 24.03.2003, the plaintiff had offered a rebate of 18%, but in the intervening period, the prices specially of steel had seen a steep rise and therefore, the rates quoted in the original bid were no longer workable. The plaintiff, however, to maintain its relations with the defendant No. 1 and the Tenughat Thermal Power Project, agreed to extend the validity of the offer up to 30.11.2003 in the following words:-

However to maintain our relations with RITES and Tenughat Thermal Power Project, we extend the validity of our offer up to 30th November, 2003 subject to rebate in our bid being reduced from 18% offered on 24/03/2003 to 5%.

5. By a letter dated 28.10.2003 (Annexure-'G' to the plaint), the defendant, with reference to the plaintiff's said letter of 22.09.2003, informed the plaintiff, inter alia, as under:-

Please refer your letter No. DSC/2K3/1329 dated 22.09.2003. Your conditional extension of validity of the subject tender is unacceptable under Clause No. 8.2 of Instructions to Tenderer Vol.-I. However, your offer of extension of validity has been accepted unconditionally.

It also informed the plaintiff that the defendant No. 1 was pleased to issue this letter of award for the said work on acceptance of the plaintiffs bid at a total contract price of Rs. 15,13,67,385.35. The defendant No. 1 by the same letter also informed the plaintiff that the Earnest Money submitted by it in the form of a bank guarantee for Rs. 15.00 lakhs would be retained as part of the total security deposit and would be adjusted against the security deposit as per clause 16.1 of the General Conditions of Contract. Since the plaintiff did not respond to this letter awarding the contract, the defendant No. 1 sent another letter dated 18.11.2003 (Annexure-'H' to the plaint) asking the plaintiff to expedite the return of two copies of the Letter of Award signed by it as a token of its unconditional acceptance. The defendant No. 1, by the same letter also indicated that failure to do so would constitute a breach of the agreement effected by the acceptance / award of the tender and that the Earnest Money accompanying the tender would be forfeited by the defendant No. 1 as liquidated damages for such default. Immediately thereupon, the plaintiff instituted the present suit on 24.11.2003 and on 25.11.2003 when the matter came up for hearing before this court, the aforesaid ex parte interim orders were passed. The position has continued to remain the same since then.

Plaintiff's Arguments

6. It was argued by Mr Endlaw, who appeared for the plaintiff, that there was no enforceable contract between the plaintiff and the defendant No. 1 and, therefore, the defendant No. 1 was not entitled to invoke the bank guarantee and thereby forfeit the Earnest Money. He submitted that the offer that was made by the plaintiff by submission of its bid on 24.03.2003 was valid up to 23.09.2003. Till that date, the defendant No. 1 had not awarded the contract to anybody. It is, no doubt, true he contended, that the defendant No. 1 by its letter of 09.09.2003 requested the plaintiff to extend the validity of its original bid of 24.03.2003 unconditionally up

to 30.11.2003. But, it is also true that the plaintiff agreed to extend the validity up to 30.11.2003 only conditionally, i.e., subject to the rebate of 18% being reduced to 5%. According to him, this was a conditional extension of validity and unless the condition was accepted by the defendant No. 1, the offer made could not be deemed to have been extended beyond the period of 23.09.2003. He further contended that since the defendant No. 1 by its letter dated 28.10.2003 had indicated that the plaintiff's conditional offer was unacceptable under clause 8.2 of the Instructions to Tenderers, the defendant No. 1 was not entitled to accept the extension of validity unconditionally. The defendant No. 1, according to the learned counsel, could either accept the conditional extension of validity or reject it. It could not convert the conditional extension of validity of the tender made by the plaintiff into an extension of validity unconditionally. therefore, according to the learned counsel for the plaintiff, there was no contract which emerged between the plaintiff and the defendant No. 1 as there was no consensus ad idem between them. This being the case, he submitted that the position of the plaintiff would be that of an unsuccessful tenderer and, therefore, by virtue of clause 7.5 of the Instructions to Tenderers, the Earnest Money was liable to be returned to the plaintiff. Mr Endlaw referred to the decision of the Supreme Court in the case of Zodiac Electricals Pvt Ltd v. Union of India 1986 SC 1918 and India Meters Ltd., Madras v. Punjab State Electricity Board and Ors. : (1993)1SCC230 .

Defendants' Arguments

7. On the other hand, Mr Anil Airi, the learned counsel for the defendant No. 1, submitted that the defendant No. 1 was entitled to forfeit the Earnest Money and was entitled to invoke the bank guarantee in view of clauses 8.1 and 8.2 of the Instructions to Tenderers. He submitted that upon a reading of clause 8.2, it would be apparent that this clause does not permit a conditional acceptance. If a tenderer accepts the request for extension of the period of validity, then that acceptance must be without any modifications. The tenderer had every right to refuse the request of the defendant No. 1 to extend the validity of the offer, but if the tenderer accepts the request for extending the validity period, then it must be unconditional. According to him, since the plaintiff had accepted the request of extending the validity period, in terms of clause 8.2, it must be deemed to be an

unconditional acceptance and the conditions sought to be imposed by the plaintiff would have to be ignored. It was further argued by the learned counsel for the defendant No. 1 that the encashment of a bank guarantee can be injuncted only under two exceptional circumstances-

1) where there is a fraud in connection with the bank guarantee which would vitiate the very foundation of such guarantee and this fraud must be an established fraud; and

2) where allowing the encashment of an unconditional bank guarantee would result in irretrievable harm or injustice to one of the parties concerned and the irretrievable injury must be of such an extent as would make it impossible for the guarantor to reimburse himself if he ultimately succeeds.

He also submitted that in cases of bank guarantees, it is only the bank guarantee which must be looked into and not the underlying contract. The two are separate contracts in which different parties are involved. In support of this proposition, the learned counsel for the defendant No. 1 relied upon the decisions of the Supreme Court in the case of National Highways Authority of India v. Ganga Enterprises and Anr. : AIR 2003 SC3823 and Dwarikesh Sugar Industries Ltd. v. Prem Heavy Engineering Works (P) Ltd and Anr. : AIR 1997 SC2477 . The learned counsel for the defendant No. 2 (bank) supported the arguments raised by the counsel for the defendant No. 1.

General Discussion

8. After having heard the arguments advanced by the counsel for the parties, it appears to me that the most vital issue in the present matter is the interpretation which has to be put to clause 8.2 of the Instructions to Tenderers in the light of the two letters dated 09.09.2003 and 22.09.2003 exchanged between the plaintiff and the defendant No. 1.

9. Before I examine the meaning of the said clause 8.2, I would like to clear the ground insofar as the scope of the present suit is concerned. Issue No. 1 pertains to the formation of a contract. And, Issue No. 2 relates to the right of the parties

under the Bank Guarantee. What makes this case interesting are the special circumstances: (1) the question of existence of a contract between the plaintiff and the defendant No. 1; and (2) the absence of an invocation letter insofar as the Bank Guarantee is concerned. What has to be seen is to what extent the existence or otherwise of an 'underlying contract' between the plaintiff and the Defendant No. 1 affects the enforceability of the Bank Guarantee extended by the Defendant No. 2 to the Defendant No. 1 at the instance of the Plaintiff. Insofar as the question of injunctioning a bank from encashing the bank guarantee is concerned, there is ample authority that such a course is only open in the exceptional cases of fraud (and that too an established fraud) or where, because of special equities, the non-grant of an injunction would lead to irretrievable injustice to the party seeking the injunction. In this case, although fraud in the classical sense has not been pleaded some elements of fraud would arise. The argument being, if in the absence of the Defendant No. 1 being entitled to forfeit the earnest money deposit, the Defendant No. 1 still went ahead and invoked the Bank Guarantee,--Would it not be a fraudulent invocation Moreover, if the plaintiff were to succeed in Issue No. 1, would it not result in a situation of special equities ?

Issue No. 1:

10. The entire dispute between the plaintiff and the defendant No. 1 falls within the narrow compass of the interpretation that is to be placed on clause 8.2 of the Instructions to Tenderers. Upon a reading of the said clause, it becomes clear that if the defendant No. 1 wanted to have the validity of the tender extended beyond the original period of six months as prescribed under clause 8.1, it was up to the defendant No. 1 to request the tenderers for a specified extension and this request had to be made prior to the expiry of the original validity. There is no dispute with regard to this. The request was made by the defendant No. 1, inter alia, to the plaintiff prior to the expiry of the original validity period. There is no dispute that the request was made in writing and that the response thereto by the plaintiff was also in writing. In the event the tenderer refused the request, his Earnest Money would not be forfeited. Where a tenderer agreed to the request, it was specifically indicated in clause 8.2 that neither could the defendant No. 1 require the tenderer to modify his tender nor was it permissible for the tenderer to modify his tender. To

my mind, the correct interpretation of clause 8.2, therefore, entails that either the tenderer acceded to the request for extending the period of validity unconditionally or his response would be treated as a refusal. The tenderer was not permitted to agree to the request of keeping his offer valid and also modify his offer. If he did so, then it would amount to a refusal. And, if it amounted to a refusal, then he did not incur the liability of forfeiture of his Earnest Money. The case cited by the learned counsel for the plaintiff [Zodiac Electricals (supra)] would certainly help the plaintiff's cause. In that case, under similar circumstances, a conditional offer was made. However, the other party did not unconditionally accept such offer and insisted on another condition which was contrary to the stipulation made in the offer by the first party. In these circumstances, the Supreme Court was of the view that the addition of the condition by the second party did not amount to an unconditional acceptance of the offer made by the first party and, therefore, it could not possibly be contended that a concluded contract had been arrived at between the parties. The court held that the additional condition imposed by the second party was really in the nature of a counter-offer. It appears that a similar logic would be applicable in the facts of the present case. The request for extension made by the defendant No. 1 was an offer or a proposal extended by it to the plaintiff. This offer or proposal was not met by the plaintiff in the shape of an acceptance simplicities but by a counter-offer. This counter-offer which specified a condition of reduction in rebate from 18% to 5% was not accepted in its entirety by the defendant No. 1. therefore, it cannot be said that an offer was met with an acceptance of that offer resulting in a concluded contract. The counter-offer or counter-proposal made by the plaintiff was with a condition. The defendant No. 1 rejected the condition and purported to accept the proposal thereby claiming that a concluded contract had been struck and since the plaintiff thought otherwise, the defendant No. 1 was entitled to forfeit the Earnest Money by invoking the Bank Guarantee. I am unable to subscribe to this view. The offer or proposal had to be accepted in its entirety with the condition or not at all and, if the offer was not accepted in its entirety, then it would be a deemed refusal on the part of the plaintiff and, therefore, the defendant No. 1 would not be entitled to forfeit the Earnest Money. There is no other clause which has been pointed out under which the defendant No. 1 could forfeit the Earnest Money in the circumstances

obtaining in this case.

11. To elucidate, let me refer to the first principles as set out in The [Indian Contract Act, 1872](#) (hereinafter referred to as the Contract Act). When one person signifies to another his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal¹. When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted, becomes a promise². The person making the proposal is called the Promisor, and the person accepting the proposal is called the promisee³. When, at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing something, such act or abstinence or promise is called a consideration for the promise⁴. Every promise and every set of promises, forming the consideration for each other, is an agreement⁵. An agreement not enforceable by law is said to be void⁶. An agreement enforceable by law is a contract⁷.

12. In this context, the question that arises is whether the relationship between the plaintiff and the Defendant No. 1 can be said to be governed by an agreement enforceable by law?' viz. a contract It must be made clear that the matter involves two stages. The first stage commencing with the defendant's LIT (which was merely an invitation for proposals) and culminating upon the expiration of the initial validity period of the plaintiff offer or proposal (i.e., the tender). The second stage commenced upon the defendant No. 1's request to the plaintiff to extend the validity of its tender and relates to the events subsequent thereto. Insofar as the first stage is concerned there does not seem to be any difficulty. The defendant No. 1 invited proposals / offers by virtue of its LIT of 17.02.2003. The plaintiff, amongst others responded to this invitation and submitted its proposal / offer (the tender) on 24.03.2003 Along with the earnest money deposit (in the shape of the said Bank Guarantee). The defendant No. 1 did not accept this proposal / offer throughout the validity period of six months, i.e., up to 23.09.2003. therefore, if the events of the second stage are kept aside for the time being, the proposal / offer made by the plaintiff on 24.03.2003 lapsed on 23.09.2003 by virtue of clause 8.1 read with Section 6 of the Contract Act⁸. Obviously, no agreement came into

being, much less a contract.

13. Now, do the events of stage two indicated above change the position To examine this aspect it must be kept in mind that before an agreement is said to result from the communications of parties there must be a meeting of minds, there must be consensus ad idem. This principle is codified in India in Section 7 of the Contract Act which, inter alia, provides that in order to convert a proposal into a promise, the acceptance must be absolute and unqualified. The defendant No. 1, by its letter of 09.09.2003 proposed to the plaintiff to extend the validity of the original offer of the plaintiff up to 31.11.2003 unconditionally . The plaintiff did not agree to extend the validity up to 31.11.2003 unconditionally . The plaintiff made a counter-proposal. It agreed to extend the validity of its offer but only upon different terms ?' viz. the rebate of 18 % be reduced to 5%. But, the defendant No. 1 did not accept this counter-proposal absolutely or unconditionally. What it did was to split up the plaintiff's counter-proposal into two components--(a) agreement to extend the validity and (b) the condition of reduction in rebate from 18% to 5%. Having done so, the defendant No. 1 accepted Part (a) and discarded Part (b) of the plaintiff's counter-proposal. Thereby claiming to bind the plaintiff down to accepting the extension of validity of the initial offer unconditionally up to 30.11.2003. Keeping in mind the express provisions of the Contract Act, it is clear that what the defendant No. 1 purports to do is impermissible in law. The proposal made by the defendant No. 1 to the plaintiff to extend the validity up to 30.11.2003 unconditionally was not accepted by the plaintiff. The counter-proposal made by the plaintiff was also not accepted by the defendant No. 1. As such, no agreement was reached by and between the plaintiff and the defendant No. 1 to extend the validity of the initial offer of 24.03.2003 up to 30.11.2003 unconditionally .

14. In the case of the General Assurance Society Ltd v. The Life Insurance Corporation of India : [1964]5SCR125 , the Supreme Court in the context of a question as to the extent of the dispute which was referred to arbitration in the backdrop of an offer of settlement made in that case observed:-

When one party makes a composite offer, each part thereof being dependent on the other, the other party cannot by accepting a part of the offer compel the other

to confine its disputes only to that part not accepted, unless the party offering the composite offer agrees to that course.

It follows, therefore, that a composite offer such as the one made by the plaintiff in response to the defendant No. 1's request of 09.09.2003 cannot be accepted in part unless the plaintiff agrees to that course. No such agreement is discernible from the conduct of the plaintiff. It was, therefore, not open to the defendant No. 1 to accept only a part of the plaintiff's counter-proposal and unilaterally style it as an 'unconditional' acceptance. The only course open was to reject the plaintiff's conditional counter-proposal. Which would amount to the plaintiff having refused to accede to the defendant No. 1's request for extending the validity of the original offer of 24.03.2003. In such a situation, in view of the said clause 8.2 itself, the earnest money was not liable to forfeiture at the hands of the defendant No. 1. Issue No. 1 is decided accordingly in favor of the plaintiff.

Issue No. 2

15. Is the defendant No. 1 entitled to invoke the Bank Guarantee even though there is no contract between the plaintiff and the defendant No. 1 and even though the defendant No. 1 is not entitled to forfeit the earnest money? The plaintiff's counsel submitted that the defendant No. 1 would not be so entitled. And, as mentioned above, the counsel for the defendant No. 1 urged that the bank guarantee was an entirely separate contract, independent of the underlying contract. The bank guarantee was unconditional and, therefore, neither its invocation nor its encashment could be enjoined except in cases of fraud or irretrievable injustice.

16. To appreciate the arguments of counsel, it would be necessary to state the law on the subject. One must keep this in mind that while the law of contracts in England is largely uncodified and it is court made law based upon established commercial practices and principles of contract law which are essentially common law principles except in modern times where some specialised laws have been enacted. The same is the position with American law. In India, however, much of the principles of contract as was then a part of the common law of England has been codified in the form of the [Indian Contract Act, 1872](#). Contracts, and that

includes bank guarantees, would, therefore, be governed by the statutory provisions. The common law principles as applicable in England or in the USA which have been imported into the Indian legal system after the [Indian Contract Act, 1872](#) would only supplement it and not supplant it. This, I am afraid, is often lost sight of when considering the question of injunction of Bank Guarantees.

17. I shall now examine the relevant provisions of the Contract Act. Section 126 of the said Act, which defines the terms 'contract of guarantee', 'surety', 'principal-debtor' and 'creditor,' provides that a 'contract of guarantee' is a contract to perform the promise, or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the 'surety'. The person in respect of whose default the guarantee is given is called the 'principal-debtor' and the person to whom the guarantee is given is called the 'creditor'. A guarantee may be either oral or written. In the context of the present case, the bank guarantee is a contract of guarantee. The bank (defendant No. 2) is the surety inasmuch as it has extended the guarantee and the plaintiff and the defendant No. 1 are the principal-debtor and creditor respectively. The transaction between the aforesaid three parties is essentially a matter of three separate contracts. The first and main being the underlying contract between the principal-debtor and the creditor, i.e., between the plaintiff and the defendant No. 1. The second being the contract of guarantee or the bank guarantee which is between the surety and the creditor, i.e., the defendant No. 2 and the defendant No. 1. The third is the contract between the principal-debtor and the surety, i.e., between the plaintiff and the defendant No. 2. Although, the three contracts are independent in one sense, they are also inter-related in another sense and are founded upon the underlying contract. Section 128 of the Contract Act stipulates that the liability of the surety is co-extensive with that of the principal-debtor, unless it is otherwise provided by the contract. Section 133 makes it clear that any variance made without the surety's consent in the terms of the contract between the principal-debtor and the creditor, discharges the surety as to transactions subsequent to the variance. Section 134 stipulates that the surety is discharged by any contract between the creditor and the principal-debtor, by which the principal-debtor is released, or by any act or omission of the creditor, the legal consequence of which is the discharge of the principal-debtor. However, certain kinds of discharge of the principal-debtor which

may operate by operation of law may not ensure to the benefit of the Surety. Such instances being the bankruptcy of the principal-debtor or liquidation in the case the principal-debtor is a company¹⁰. Construing the aforesaid provisions, it is apparent that although there are three separate relationships and contracts between the three parties, the contract of guarantee does, to a large extent, depend upon the relationship between the creditor and the principal-debtor under the underlying contract. This is so because firstly, the liability of the surety under a contract of guarantee is co-extensive with that of the principal-debtor unless, of course, otherwise provided by the contract. Secondly, any variation brought about by the principal-debtor and the creditor in the terms of the contract between them, without the surety's consent, would discharge the surety as regards all transactions subsequent to the variance. Thirdly, if the principal-debtor and the creditor enter into an arrangement whereby the principal-debtor is released or because of any act or omission on the part of the creditor the legal consequence of which is the discharge of the principal-debtor, the surety is also automatically discharged. thereforee, under the scheme of the provisions under the Contract Act itself, the contract of guarantee is not entirely independent of the underlying contract between the principal-debtor and the creditor and/or of their acts of omission or commission resulting in any variation or modification or discharge of the principal-debtor. Going strictly by these provisions, it would be seen that when a principal-debtor is discharged or released of its liability, then, the surety is also so discharged. In the context of the present case, it would mean that if the plaintiff is discharged of its liability, then, the surety (defendant No. 2) would also stand discharged under the contract of guarantee. As I have held while discussing Issue No. 1 that there was no contract between the plaintiff and the defendant No. 1 and the period of validity of the offer had also expired on 23.09.2003, the defendant No. 1 (creditor) could not forfeit the earnest money amount and, thereforee, could not insist upon the defendant No. 2 (surety) to discharge its liability under the bank guarantee. Clearly, thereforee, the defendant No. 1 would not be entitled to invoke the bank guarantee and seek payment there under when by its own act and omission the principal-debtor has been discharged.

18. Coming now to the aspect of injuncting the invocation or encashment of a bank guarantee, it is seen that the Common law principles with regard to this appears to

be quite well-settled inasmuch as the invocation / encashment of a bank guarantee ought not to be injuncted except where there is fraud or special equities or where the non-grant of an injunction would lead to irretrievable injustice to the parties seeking injunction. Courts have also stressed the aspect of a bank guarantee being independent from the underlying contract. The case law in this regard is plentiful. A survey of the same would be instructive.

19. In *Elian v. Matsas* (1966) 53 LR 495 Lord Denning, M.R., while refusing to grant an injunction observed:- a bank guarantee is very much like a letter of credit. The courts will do their utmost to enforce it according to its terms. They will not, in the ordinary course of things, interfere by way of injunction to prevent its due implementation. Thus they refused in *Malas v. British Imex Industries Ltd.* (1958) 2 QB 127. But that is not an absolute rule. Circumstances may arise such as to warrant interference by injunction.

In *R.D. Harbottle (Mercantile) Ltd v. National Westminster Bank Ltd.* 1977 (3) WLR 752, Kerr, J. observed as under (at page 761):-

It is only in exceptional cases that the courts will interfere with the machinery of irrevocable obligations assumed by banks. They are the life-blood of international commerce. Such obligations are regarded as collateral to the underlying rights and obligations between the merchants at either end of the banking chain. 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 as available to them or stipulated in the contracts. The courts are not concerned with their difficulties to enforce such claims; these are risks which the merchants take. In this case the plaintiffs took the risk of the unconditional wording of the guarantees. The machinery and commitments of banks are on a different level. They must be allowed to be honoured, free from interference by the courts. Otherwise, trust in international commerce could be irreparably damaged.

20. In *United City Merchants (Investments) Ltd. and Ors. v. Royal Bank of Canada*: 1983 A.C.168 , the court was considering the question of fraud and as to whether the do were fraudulent although accurate would still have to be accepted by the bank and the bank was thus obliged to make payment under a letter of

credit. The court observed as under:-

A large number of English and American authorities were considered by the Court of Appeal. But, as all three members of the Court of Appeal concluded, there is no English or American authority directly deciding the point now being considered, since it was never an issue. It is very important to bear this in mind since dicta in certain cases state the fraud exception in terms of the fraud of the beneficiary, commonly the seller, and the buyers placed much reliance upon them: see, for example, *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.* [1978] Q.B. 159 and *Sztejn v. J. Henry Schroder Banking Corporation* (1941) 31 N.Y.S. 2D 631. But Stephenson L.J. observed [1982] Q.B. 208, fraud on the part of the beneficiary was all that the court was concerned with in both of those cases; it never directed its mind in either case to the question of the effect of fraud of a third party.

It further held as under:-

As to the authorities, *Hamzeh Malas & Sons v. British Imex Industries Ltd.* [1958] 2 Q.B. 127 merely emphasises the separate nature of the contract. It is nowhere concerned with the issues raised in the present case, *R.D. Harbottle (Mercantile) Ltd v. National Westminster Bank Ltd.* [1978] Q.B. 146; *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.* [1975] 1 W.L.R. 315 all relate to the granting of interlocutory relief. In the above cases, the bank was desirous of paying, but the courts held to the contrary. It would, therefore, be surprising that where there is fraud and the bank does not wish to pay, the court in those circumstances should compel it to pay. Neither *Power Curber International Ltd. v. National Bank of Kuwait S.A.K.* [1981] 1 W.L.R. 1233 nor *Gian Singh & Co. Ltd. v. Banque de l'Indochine* [1974] 1 W.L.R. 1234 assist on the present point.

The appellants contend that it is axiomatic that an issuing or confirming bank deals in documents not in goods and that the letter of credit contract is, and must remain, independent of any dispute under the primary contract of sale. It follows, therefore, they contend, that with two possible exceptions, the bank is bound to pay if the documents are in order on their face and entitled to refuse to pay only if the documents do not support the appellants proposition.

21. In *Bolivinter Oil SA v. Chase Manhattan Bank and Others*: [1984] 1 All ELR 351, Sir John Donaldson MR and Griffiths LJ, speaking for the court of appeal said as under:-.we should like to add a word about the circumstances in which an *ex parte* injunction should be issued which prohibits a bank from paying under an irrevocable letter of credit or a performance bond or guarantee. The unique value of such a letter, bond or guarantee is that the beneficiary can be completely satisfied that, whatever disputes may thereafter arise between him and the bank's customer in relation to the performance or indeed existence of the underlying contract, the bank is personally undertaking to pay him provided that the specified conditions are met. In requesting his bank to issue such a letter, bond or guarantee, the customer is seeking to take advantage of this unique characteristic. If, save in the most exceptional cases, he is to be allowed to derogate from the bank's personal and irrevocable undertaking, given be it again noted at his request, by obtaining an injunction restraining the bank from honouring that undertaking, he will undermine what is the bank's greatest asset, however large and rich it may be, namely its reputation for financial and contractual probity. Furthermore, if this happens at all frequently, the value of all irrevocable letters of credit and performance bonds and guarantees will be undermined.

He further cautioned the judges who deal with cases where such injunctions are sought in the following words:-

Judges who are asked, often at short notice and *ex parte*, to issue an injunction restraining payment by a bank under an irrevocable letter of credit or performance bond or guarantee should ask whether there is any challenge to the validity of the letter, bond or guarantee itself. If there is not or if the challenge is not substantial, *prima facie* no injunction should be granted and the bank should be left free to honour its contractual obligation, although restrictions may well be imposed on the freedom of the beneficiary to deal with the money after he has received it. The wholly exceptional case where an injunction may be granted is where it is proved that the bank knows that any demand for payment already made or which may thereafter be made will clearly be fraudulent. But the evidence must be clear, both as to the fact of fraud and as to the bank's knowledge. It would certainly not normally be sufficient that this rests on the uncorroborated statement of the

customer, for irreparable damage can be done to a bank's credit in the relatively brief time which must elapse between the granting of such an injunction and an application by the bank to have it discharged.

22. In *U.P. Cooperative Federation Ltd v. Singh Consultants and Engineers (P) Ltd*: : [1988]1SCR1124 , the Supreme Court (Per Sabyasachi Mukherjee, J) held as under:-

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 negated and the fabric of trading operation will get jeopardised.

23. In *General Electric Services Company Inc v. Punj Sons (P) Ltd and Anr.* : [1991]3SCR412 , the Supreme Court held:-

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 defense 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. 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.

24. In *Syndicate Bank v. Vijay Kumar and Others*: 1992 (2) SCC 330 in paragraph 14 thereof, the Supreme Court held as under:-

14. From the above discussion it can be gathered that the Bank guarantees are on different level and they must be allowed to be honoured free from interference by the courts and a Bank which gives a guarantee must honour the same according to its terms and it is only in exceptional cases that the court will interfere with the machinery of irrevocable obligations assumed by the banks. A fortiori the same principle applies in respect of Bank guarantees which are discharged. When once

the Bank guarantee is discharged the obligation of the Bank ends and there is no question of going behind such discharged Bank guarantee. The courts should refrain from probing into the nature of the transactions between the Bank and the customer which led to the furnishing of the Bank guarantee.

25. In *Svenska Handelsbanken v. M/s Indian Charge Chrome and Others*: : AIR 1994 SC626 , the Supreme Court emphasised that (see paragraph 60):-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.

In the said case, while considering the decision in *Handerson v. Canadian Imperial Bank of Commerce and Peat Marwick Ltd*: 40 B C LR 318, the Supreme Court observed that that was a case where the facts were peculiar. The plaintiff had arranged an irrevocable letter of credit to fulfill his obligation to purchase 20 episodes of two television shows from a production company. The shows were never produced and the production company went into bankruptcy, yet the receiver of the seller made a demand upon the bank for payment under the letter of credit. Upon an application brought about by the plaintiff, the court granted interim injunction and held that the letter of credit is independent of the contract of sale between the buyer and the seller. The issuing bank agreed to pay upon presentation of documents, not goods. It was held that there is an exception to this rule which is that 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 in *Handerson* (supra) fell within that exception inasmuch as 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. After discussing the entire case law on the subject and upon examination of the facts before it, the Supreme Court in *Svenska Handelsbanken* (supra) refused to grant injunction in view of the finding that the contracts between the lender and the borrower were not vitiated by any fraud and there was no question of irrevocable injury. It was again reiterated that:-

In law relating to bank guarantees, a party seeking injunction from encashing of bank guarantees by the suppliers has to show prima facie case of established fraud and an irrevocable injury.

26. In *State Trading Corporation of India Ltd v. Jainsons Clothing Corporation and Another*: : AIR 1994 SC2778 , the Supreme Court was of the view that in case of bank guarantees:-

it is only in exceptional case, that is to say, in case of fraud or in case of irretrievable injustice, the court would interfere.

In *State Trading Corporation (supra)*, the Supreme Court further held as under:-

8. The grant of injunction is a discretionary power in equity jurisdiction. The contract of guarantee is a trilateral contract which the bank has undertaken to unconditionally and unequivocally abide by the terms of the contract. It is an act of trust with full faith to facilitate free flow of trade and commerce in internal or international trade or business. It creates an irrevocable obligation to perform the contract in terms thereof. On the occurrence of the events mentioned therein the bank guarantee becomes enforceable. The subsequent disputes in the performance of the contract does not give rise to a cause nor is the court justified on that basis, to issue an injunction from enforcing the contract, i.e., bank guarantee. The parties are not left with no remedy. In the event of the dispute in the main contract ends in the party's favor, he/it is entitled to damages or other consequential reliefs.

9. It is settled law that the court, before issuing the injunction under Order 39, Rules 1 and 2, CPC should prima facie be satisfied that there is triable issue strong prima facie case of fraud or irretrievable injury and balance of convenience is in favor of issuing injunction to prevent remedial injury. The court should normally insist upon enforcement of the bank guarantee and the court should not interfere with the enforcement of the contract of guarantee unless there is a specific plea of fraud or special equities in favor of the plaintiff. He must necessarily plead and produce all the necessary evidence in proof of the fraud in execution of the contract of the guarantee, but not the contract either of the

original contract or any of the subsequent events that may happen as a ground for fraud.

27. In *Ansal Engineering Project Ltd v. Tehri Hydro Development Corporation Ltd and Another*: : (1996)5SCC450 , the Supreme Court held as under:-

4. It is settled law that bank guarantee is an independent and distinct contract between the bank and the beneficiary and is not qualified by the underlying transaction and the validity of the primary contract between the person at whose instance the bank guarantee was given and the beneficiary. Unless fraud or special equity exists, is pleaded and prima facie established by strong evidence as a triable issue, the beneficiary cannot be restrained from encashing the bank guarantee even if dispute between the beneficiary and the person at whose instance the bank guarantee was given by the bank, had arisen in performance of the contract or execution of the works undertaken in furtherance thereof. ...

It further held as under:-

5. It is equally settled law that in terms of the bank guarantee the beneficiary is entitled to invoke the bank guarantee and seek encashment of the amount specified in the bank guarantee. It does not depend upon the result of the decision in the dispute between the parties, in case of the breach. The underlying object is that an irrevocable commitment either in the form of bank guarantee or letters of credit solemnly given by the bank must be honoured. The court exercising its power cannot interfere with enforcement of bank guarantee / letters of credit except only in cases where fraud or special equity is prima facie made out in the case as triable issue by strong evidence so as to prevent irretrievable injustice to the parties. The trading operation would not be jettisoned and faith of the people in the efficacy of banking transactions would not be eroded or brought to disbelief. The question, therefore, is whether the petitioner had made out any case of irreparable injury by proof of special equity or fraud so as to invoke the jurisdiction of the Court by way of injunction to restrain the first respondent from encashing the bank guarantee. ...

28. In *Dwarikesh Sugar Industries Ltd v. Prem Heavy Engineering Works (P) Ltd and Another*: : AIR 1997 SC2477 , the Supreme Court observed that numerous decisions had been rendered by the court over a span of nearly two decades with regard to the principles which the courts must apply while considering the question whether to grant an injunction which has the effect of restraining the effect of bank guarantees. The court mentioned its earlier decisions in *Svenska (supra)*, *Larsen & Toubro Ltd v. Maharashtra SEB*: : AIR 1996 SC334 , *Hindustan Steel Workers Construction Ltd v. G.S. Atwal & Co. (Engineers) (P) Ltd*: : AIR 1996 SC131 and *U.P. State Sugar Corporation v. Sumac International Ltd*: : AIR 1997 SC1644 and reiterated the principles set down in those cases. The Supreme Court pointed out that one exception to the rule of non-interference with a bank guarantee is fraud and that too established fraud. It further pointed out that the second exception to the rule of granting injunction is the result of irretrievable injury which has to be such a circumstance which would make it impossible for the guarantor to reimburse himself if he ultimately succeeds. While considering the question of fraud, the Supreme Court mentioned that the observations of Sir John Donaldson MR and Griffiths LJ in *Bolivinter Oil SA (supra)*, were apposite and had also been approved by the Supreme Court in *U.P. Cooperative Federation Ltd v. Singh Consultants and Engineers (supra)*. It must be remembered that in *Bolivinter Oil SA (supra)*, it was inter alia held that an injunction may be granted as an exceptional case where it is proved that the bank knows that any demand for payment already made or which may be made thereafter will be clearly fraudulent. The evidence must be clear both as to the fact of the fraud and as to the bank's knowledge.

29. In *Hindustan Construction Company Ltd v. State of Bihar and Others*: : AIR 1999 SC3710 , the Supreme Court reiterated the principle that courts are reluctant in granting an injunction against the invocation of a bank guarantee except in the case of fraud, which should be an established fraud or where irretrievable injury was likely to be caused to the guarantor. In *Hindustan Construction Company (supra)*, however, the court passed an injunction against encashment of a bank guarantee but on the ground that the invocation itself was bad. It was held that in that case, the bank guarantee could be invoked by none except the Chief Engineer and as the invocation had not been done by the Chief Engineer, the

same was wholly wrong and the bank was under no obligation to pay the amount covered by the performance guarantee to the Executive Engineer. This case added another dimension in the question of injunctions of a bank guarantee. It provided that where the bank guarantee had been improperly invoked, then, an injunction could be granted from encashment of the same.

30. In *Federal Bank Ltd v. V.M. Jog Engineering Ltd and Others*: 2001 (1) SCC 663, the Supreme Court held as under:-

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.

31. In *Industrial Finance Corporation of India Ltd v. Cannanore Spinning and Weaving Mills Ltd and Others*: : [2002]2SCR1093 , the Supreme Court noted that a contract of guarantee, though it is not a contract regarding a primary transaction, but is an independent transaction containing independent and reciprocal obligations. It is on principal-to-principal basis and by reason wherefore the statute has provided both the creditor and the guarantor some relief as specified in Section 130 to 141 of the Indian Contract Act.

32. The principles deducible from the aforesaid decisions is that courts ought not to grant injunction to restrain encashment / invocation of bank guarantees or letters of credit except in cases of fraud and irretrievable damage. The fraud must be an established fraud of an egregious nature so as to vitiate the underlying transaction and it is fraud of the beneficiary, not fraud of somebody else. The bank can refuse to pay under a bank guarantee or a letter of credit where it is proved that the bank knows that any demand for payment already made or which may be made thereafter will be clearly fraudulent.

33. Now, in the factual background of the present case, I find that the offer of the plaintiff lapsed on 23.09.2003 and there was no underlying contract between the plaintiff and the defendant No. 1. When the plaintiff's offer lapsed on 23.09.2003 it became entitled to the return of the earnest money amount and the defendant No. 1 could not, in law, forfeit the same. Knowing that it is not entitled to forfeit the

amount, if the defendant No. 1 still goes ahead and invokes the bank guarantee it would be doing so despite the knowledge that it has no right to forfeit the amount. Such an invocation would be clearly fraudulent. Since the defendant No. 1 is the beneficiary, such fraudulent action on its part would be liable to be enjoined in view of the well settled legal principles.

34. Thus, whichever way one looks at the problem the answer is the same. If the statutory provisions of the Indian Contract Act and in particular Section 134 are considered, the Surety (the Bank) stands discharged because the principal-debtor (the plaintiff) is discharged / released of its liability inasmuch as I have held that the creditor (defendant No. 1) has no right to forfeit the earnest money deposit. That being the case, the defendant No. 1 cannot ask the defendant No. 2 (the bank) to pay under the bank guarantee. If the common law principles as per various decisions of the courts are considered, then, too, the defendant No. 1 cannot insist on payment under the bank guarantee. This is so because, such an insistence would be fraudulent in the wake of its knowledge that it has no right in law to forfeit the earnest money deposit. Hence, this issue also is decided in favor of the plaintiff and against the defendants.

Issue No. 3.

35. Now comes the question of relief. Both issues 1 & 2 have been decided in favor of the plaintiff. This being the case, the plaintiff is entitled to a declaration that upon the expiry of validity of the initial offer there subsisted no contractual relationship between the plaintiff and the defendant No. 1 and, therefore, the defendant No. 1 is not entitled to forfeit the earnest money. The plaintiff is also entitled to the relief of permanent injunction restraining the defendant No. 1 from invoking the bank guarantee No. LKB/4692/22050 of 22.03.2003 for a sum of Rs. 15.00 lakhs issued by the defendant No. 2. The plaintiff is also entitled to an injunction restraining the defendant No. 2 from making any payment under the said bank guarantee to the defendant No. 1. The plaintiff is also entitled to costs. It is so decreed.

36. The suit and all pending applications including is No. 11121/2003 stand disposed of.

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