

PETITIONER:
OIL & NATURAL GAS CORPORATION LTD.

Vs.

RESPONDENT:
STATE BANK OF INDIA, OVERSEAS BRANCH, BOMBAY

DATE OF JUDGMENT: 21/07/2000

BENCH:
S. Rajendra Babu, J. & S.N. Phukan, J.

JUDGMENT:

J U D G M E N T
RAJENDRA BABU, J. :

Leave granted.

This appeal arises out of a suit filed to enforce a Bank Guarantee against the respondent under Order XXXVII CPC. The respondent filed an application seeking leave to defend the suit unconditionally. That application having been allowed this appeal is filed by special leave. Facts leading to this appeal are as follows:

The appellant entered into a contract with a consortium of M/s Saipem SPA/Snamprogetti of Italy for construction of a system of undersea pipelines known as the Gas Lift Pipelines. The work comprised of pre-engineering survey, design and engineering, procurement, wrap and coat, fabrication, transportation, laying, installation, testing and pre-commissioning of forty sub-marine pipeline segments of approximately total length of 181.8 kms. The contract price was to the tune of US \$63,875,000 plus Indian Rs. 8,06,00,000/-. The scheduled completion date of the entire works subject to any requirements in the contract specifications as to the time of completion of any part of the work before completion of the whole, the whole of the work was to be completed by April 30, 1991. The contract also provided for levy of liquidated damages if the contractor failed to complete the entire works or any part thereof comprising the total turn key project before the respective scheduled completion date fixed for the entire works or part thereof at a rate equal to 3% of the total contract price for each months delay subject to a maximum of 10% of the contract price. The contractor was obliged to furnish a bank guarantee to cover liquidated damages for an amount equivalent to 10% of the contract price not later than 4 months prior to the scheduled completion date. However, if the projects completion date slips beyond the scheduled completion date, the contractor shall get validity of said guarantee suitably extended. In case, the contractor fails to provide the guarantee for liquidated damages within the time stipulated therein, the appellants shall be entitled to encash the performance guarantee. All disputes arising out or in connection with the contract shall be settled in accordance with the laws of India and the exclusive jurisdiction of the courts in India. In compliance with this requirement, the contractor had furnished a bank guarantee from the State Bank of India, Overseas Branch, Bombay, to cover liquidated damages claim. That guarantee was for a sum of US \$6,387,500 plus Indian Rs. 8,060,000/-. Through

the said guarantee, the respondent Bank had unconditionally undertaken as under :- Now therefore, in consideration of the premises aforesaid and at the request of the contractor, we, State Bank of India, Overseas Branch, Bombay, Bank organised under the laws of India and having its registered/head office at Calcutta (hereinafter called the Bank) so as to bind ourselves and our successors and assignees, do hereby irrevocably and unconditionally undertake to pay to you, the Company, on demand in writing without demur or protest and irrespective of any contest or dispute between your goodselves and the contractor and without reference to the contractor, any sum of money at any time or from time to time demanded by the Company upto an aggregate limit of USD. 6,387,500/- (US Dollars six million three hundred eighty seven thousand and five hundred only) plus INR 8,060,000/- (Indian Rupees eight million sixty thousand only) on account of any liquidated damages due from the contractor to the company.

We further agree that as between us and the company for the purpose of this guarantee/undertaking, any notice of demand by the company towards liquidated damages and any amount claimed on account thereof, shall be final and binding as to the factum of the L.D. and the amount payable by us to the company hereunder relative thereto.

We further agree that this guarantee shall be governed by and construed in accordance with Indian laws.

We further agreed that if the project completion date slips beyond schedule completion date because of whatsoever reason we shall extend validity of this guarantee suitably so as to keep it valid for 180 days beyond actual completion date.

We further confirm that this guarantee has been issued with the approval of Exchange Control Authorities in India and that the issuance of the guarantee is in order and in accordance with the laws and regulations in force in India

As a result of protracted correspondence and extension or increase or decrease in value of Bank Guarantee the same was kept alive from time to time. On March 17, 1993 after taking into account the total delay of 306 days in completing the work, the appellant assessed the liquidated damages as US \$ 4,320,432 plus Indian Rs. 55,15,959.00. Accordingly by letter dated March 17, 1993 the appellant advised the contractor to extend the bank guarantee for a further period of six months. The contractor was given certain options. The respondent Bank furnished an enhanced value of US \$ 4,320,432 plus Indian Rs. 5,515,959/- with validity upto October 4, 1993 under a covering letter of the same date. The appellant by its letter dated September 13, 1993 advised the contractor to extend the validity of the bank guarantee and on September 23, 1993 the contractor got issued a notice through a lawyer for referring the dispute to arbitration and also appointed its arbitrator. Again the appellant on September 27, 1993 informed the respondent Bank that the contractor was separately advised vide its letter date September 13, 1993 to extend the validity of the bank guarantee and in case the validity of the same is not extended on or before October 1, 1993, the said letter be treated as its notice invoking the said bank guarantee. The contractor as well as the bank not having honoured the terms of the bank guarantee, the appellant once again asked the respondent bank to credit the said guarantee along with interest from October 4, 1993. On December 3, 1993 the respondent Bank stated that (a) they have issued the guarantee in question in favour of ONGC against the counter guarantee of the Italian Bank Credito Italiano, Milan and the

contractor obtained an order of injunction from an Italian Court restraining Credito Italiano from making any payment to the respondent Bank under the counter guarantee; (b) they are also considering the question of validity or otherwise of the appellants demand for the guaranteed sum under the liquidated guarantee vide its letter dated September 27, 1993; (c) in terms of exchange control regulations, the rupee payment under the guarantee shall be made only on receipt of re-imburement from the foreign bank in an approved manner, (d) since the matter is subjudice, the appellant should wait until the issue is resolved. In the meanwhile, apart from engaging in correspondence both the appellant and respondent appeared through counsel before the Italian Court. It was contended that the bank guarantee is autonomous, unconditional and they are bound to honour the same irrespective of any counter guarantee they have from the Credito Italiano and that any proceeding with regard to enforcement of any such counter guarantee should not obstruct payment under the guarantee given by the respondent bank. The respondent Bank fearing that if the Italian Court order continuation of the restraint order, it would be difficult for them to get reimbursement from the Credito Italiano. In the alternative, they invited the court to restrain them so that they can avoid payment to the appellant under such guarantee and also an order directing the appellant not to request for payment from the respondent bank under the said bank guarantee. The Italian Court on March 2, 1994 made an order which is as under :- Credito Italiano, Milan branch, in the person of its legal representative and the State Bank of India overseas Branch, Bombay, to abstain from payment of any sum in execution of the agreement of guarantee/counter guarantee arising between the parties originating from relationship between Snam Progetti SPA and Saipem SPA on the one side and Oil & Natural Gas Commission on the other side arising from the Contract of the 6th March, 1990.

In the circumstances, aggrieved by the refusal to honour the bank guarantee, the appellant filed a summary suit under Order XXXVII of the Code of Civil Procedure before the High Court of Judicature at Mumbai praying for a decree in a sum of US \$ 43,204,32 plus Indian Rs. 55,159,59 and interest on the said amount at the rate of 18% per annum and pendente lite interest till payment of realisation.

The High Court by order dated April 27, 1998 granted unconditional leave to defend the suit on the following terms (i) while invoking the bank guarantee, vide letter dated September 27, 1993 the amount of liquidated damage was not stated; (ii) according to bank guarantee, a clear notice of demand towards liquidated damage was to be given; (iii) the notice dated September 27, 1993 was not a legal notice to communicate the liquidated damages, and (iv) arbitration proceedings is pending and the Italian Court is also seized of the matter. Aggrieved by that order, the appellant has filed this appeal by special leave. Shri Ashok H. Desai, the learned senior advocate appearing for the appellant, submitted that none of the grounds stated by the High Court could provide enough basis for granting an unconditional leave to defend. He strongly placed reliance upon the decision of this Court in Hindustan Steelworks Construction Ltd. v. Tarapore & Co. & Anr., 1996 (5) SCC 34, and Larsen & Toubro Limited v. Maharashtra State Electricity Board & Ors., 1995 (6) SCC 68. After a survey of the decisions of this Court in United Commercial Bank v. Bank of India, 1981 (2) SCC 766; U.P. Coop. Federation Ltd. v. Singh Consultants & Engineers (P) Ltd., 1988 (1) SCC 174; General Electric Technical Services Co. Inc. v. Punj Sons (P) Ltd., 1991 (4) SCC 230, law as applied in England in Eljan and Rabbath v. Matsas and Matsas,

(1966) 2 Lloyds Rep 495, CA. and a few American decisions, this Court in Svenska Handelsbanken v. Indian Charge Chrome, 1994 (1) SCC 502, declared the law that in case of confirmed bank guarantee/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 as established fraud. There should be prima facie case of fraud and special equities in the form of preventing irretrievable injustice between the parties. Mere irretrievable injustice without prima facie case of established fraud is of no consequence in restraining the encashment of bank guarantee. Only in the event of fraud or irretrievable injustice the court would be entitled to interfere in a transaction involving a bank guarantee and under no other circumstances. In that case, the contention put forth before the court was regarding liquidated damages. The respondent had to prove that liquidated damages quantified the same before invoking the guarantee. It was also contended that the invocation of the guarantee relating to advance and liquidated damages was after the expiry of the period. In the absence of an averment relating to fraud or irretrievable injustice, the court held that the appellant will be able to claim relief before arbitration by way of damages or amounts wrongly recovered and irretrievable injustice can be said to exist. The learned single Judge also held that the first respondent by separate letter dated September 14, 1994 and May 10, 1994 addressed to the Bank while requesting to extend the bank guarantee specifically stated that if it was not so done, the communication should be treated as notice for encashment of the bank guarantee and these communications addressed to the respective banks prior to the guarantee would serve the purpose of notice to the banks and so it cannot be held that the invocation was after the date of expiry of the said guarantees. The same is the principle stated by this Court in Hindustan Steelworks Construction Ltd. v. Tarapore & Co. & Anr. (supra). It is held therein that encashment of an unconditional bank guarantee does not depend upon the adjudication of disputes. No distinction can also be made between bank guarantee for due performance of a work contract and a guarantee given towards security deposit for a contract or any other kind of guarantee. Where the beneficiary shall be the sole judge on the question of breach of primary contract the bank shall pay the amount covered by the guarantee on demand without a demur. In the absence of a plea of fraud, guarantee had to be given effect to. Though these two decisions pertain to grant of injunction for enforcement of bank guarantee, the principle stated therein could be extended to understand the nature of defence raised by the respondent Bank in the present case. Whether the respondent Bank could at all raise such a defence which is totally untenable. In the light of what is stated above, in the absence of a plea relating to fraud, much less of a finding thereto, we find that the court could not have stated that the defence raised by the respondent Bank on the grounds set forth earlier is sufficient to hold that unconditional leave should be granted to defend the suit. In the arbitration proceedings that were pending it was certainly open to the parties concerned to adduce proper evidence and establish as to what are the liquidated damages that are payable and if any excess amount had been paid, the same would be recovered. So far as the order made by the Italian Court for not enforcing the bank guarantee is concerned, it must be stated that the said order arose out of the counter guarantee with which the appellant had nothing to do. In this context, it is brought to our notice that the Foreign Exchange Manual, 1999 provided as under :- Reserve Bank has likewise granted general permission to authorised dealers vide the above Notification to give guarantees in favour of persons resident in India in respect of any debt or other

obligation or liability of a person resident outside India subject to such instructions as may be issued by Reserve Bank from time to time. Authorised dealers may accordingly give, on behalf of their overseas Head Offices/branches/correspondents or a bank of international repute guarantees/performance bonds in favour of residents of India in connection with genuine transactions involving debt liability or obligation of non-residents provided the bond/guarantee is covered by a counter guarantee of the overseas Head Office/ branch/correspondent or a bank of international repute. Authorised dealers may make rupee payments to the resident beneficiaries immediately when the guarantee is invoked and simultaneously arrange to obtain the reimbursement from the overseas bank concerned which had issued the counter guarantee. Authorised dealers are well advised that they should ensure that counter guarantees are properly evaluated and their own guarantees against such guarantees are not issued in routine manner. Before issuing a guarantee against the counter guarantee from an overseas Head Office/branch/correspondent or a bank of international repute, authorised dealers should satisfy themselves that the obligations under the counter guarantee when invoked, would be honoured by the overseas bank promptly. If the authorised dealer desires to issue guarantee with the condition that payment will be made provided reimbursement has been received from the overseas bank which has issued the counter guarantee, this fact should be made clearly known to the beneficiary in the guarantee documents itself. Cases whose payments are not received by the authorised dealers when the guarantees of overseas banks are invoked; should be reported to Reserve Bank indicating the steps taken by the bank to recover the amount due under the guarantee.

Till the new Exchange Control Manual was introduced the position was as follows :-

Reserve Bank has likewise granted general permission to authorised dealers vide the above Notification to give guarantees in favour of persons resident in India in respect of any debt or other obligation or liability of a person resident outside India subject to such instructions as may be issued from time to time. Authorised dealers may accordingly give, on behalf of their overseas Head Offices/branches/correspondents, performance bonds or guarantees in favour of residents of India, in support of tenders to be submitted for due performance of contracts or for refund, in the event of contracts not being fulfilled, of advance payments received, provided the bond or guarantee is covered by counter guarantee of the Head Office/branch/correspondent. Authorised dealers may make rupee payments to residents in implementation of invoked bonds/guarantees issued in favour of residents of India without, prior reference to Reserve Bank, provided reimbursement has been received from the Head Office/branch/correspondent abroad in an approved manner.

When, in fact, there is no defence for suit filed merely to rely upon an injunction granted or obtained in their favour does no carry the case of the respondent Bank any further. The only basis upon which the respondent Bank sought for and obtained the injunction is that in event the counter guarantee cannot be honoured by reason of the injunction granted by the Italian court the respondent Bank should be extended the similar benefit. But a perusal of the Foreign Exchange Manual makes it clear that none of the claims would be an impediment to make payment under the Bank Guarantee in question. Therefore, in our view, the High Court plainly erred in having granted leave to defend unconditionally. We vacate that order and dismiss the application filed by respondent Bank for leave to defend by

allowing this appeal. Considering the nature of the case, we order no costs.

JUDIS