

A HINDUSTAN STEELWORKS CONSTRUCTION LTD.

v.

TARAPORE AND CO. AND ANR.

JULY 9, 1996

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[S.C. AGRAWAL AND G.T. NANAVATI, JJ.]

Bank Guarantee—Enforcement of—Commitments of banks must be honoured free from interference by courts—Powers of courts to interfere—Limitations.

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The appellant awarded a contract to the contractor for construction of civil works. Some disputes arose between the appellant and the contractor. Two arbitrators were appointed by the parties for deciding those disputes. The appellant rescinded the contract as the contractor did not complete the work. Bank of India has given 14 guarantees on different dates in favour of the appellant at the instance of the contractor. By these bank guarantees, bank had undertaken to indemnify the appellant against any loss or damage caused to or suffered by it by reason of any breach by the contractor, stating that appellant shall be the sole Judge on the question as to whether the contractor had committed any breach of the contract and also regarding the extent of loss and damage. The bank had undertaken to pay the appellant any amount payable by the contractor without any demur and protest and such demand by the appellant had to be required as conclusive and binding on the bank notwithstanding any difference between the appellant and the contractor. On the day on which the appellant rescinded the contract, the appellant called upon the bank to pay to it the amount of loss/damage it has suffered as the contractor had failed to fulfil its obligations under the contract and had committed breach of its terms and conditions. The contractor prayed for an injunction restraining the appellant from encashing the bank guarantees alleging that there were genuine disputes between the parties and those disputes had been referred to the Arbitrators for adjudication. Both the petitions were dismissed as the court refused to grant injunction holding that the bank guarantees were unconditional. The contractor filed revision petitions against the judgment contending that the bank guarantees were given by way of security for due performance of the contract and for the purposes connected therewith and therefore they would be encashable only when the

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arbitrators decide that the contractor had committed a breach of the contract and the amount of loss or damage caused to or suffered by the appellant was quantified and that as the dispute in this behalf were pending before the arbitrators the demand for encashment of the bank guarantees was premature. Allowing the revisions, the High Court held that in absence of any determination by the Court or the arbitrator no amount could be said to be payable by the contractor to the appellant by way of damages. Therefore, it will be just and proper to restrain the appellant from enforcing the bank guarantees; that any term in the agreement that one of the parties shall be the sole judge to quantify the same has to be held as invalid and that it is for the Court or the arbitrator to decide as to who had committed the breach and till the liability was ascertained, it could not be said that there was a 'debt due or debt owing' and that the interest of the appellant could be safeguarded by directing the contractor to go on extending the bank guarantees till the matter was settled by the arbitrators. This appeal had been filed against the judgment of the High Court.

The appellant submitted that in the matter of encashment of a bank guarantee the Court should not as a rule interfere unless it is a clear case of fraud and is likely to result in irretrievable injustice. The respondent contended that though fraud is an established exception to the general rule regarding interference with the autonomy of irrevocable letter of credit or a bank guarantee that is not the only exception and the Court can and should interfere where special circumstances or special equities exist and they are likely to result in irretrievable injustice.

Allowing the appeals, this Court

HELD 1.1. An irrevocable letter of credit is a contract between the banker and the beneficiary and is independent of and unqualified by the contract of sale or other underlying transaction and that obligation of a bank in such a case is absolute, as a letter of credit constitutes the sole contract with the bank and the bank issuing the letter of credit has no concern with any question that may arise between the seller and the purchaser of the goods. The Courts usually refrain from granting injunction to restrain the performance of the contractual obligations arising out of a letter of credit or a bank guarantee between the bank and another. In case of an unconditional bank guarantee the nature of obligation of the

- A bank is absolute and not dependent upon any dispute or proceedings between the party at whose instance the bank guarantee is given and the beneficiary. Whether the bank guarantee is towards security deposit 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. [404-A-E, 405-C, 406-C-D, F-G]
- 1.2. Commitments 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 case of irretrievable injustice would be done the courts should interfere. Fraud cannot be said to be the only exception. In a case where the party approaching the Court is able to establish that in view of special equities in his favour if injunction as restricted is not granted then he would suffer irretrievable injustice, the Court can and would interfere. Fraud which is recognised as an exception is the fraud by one of the parties to the underlying contract and which has the effect of vitiating the entire underlying transaction. A demand by the beneficiary under the bank guarantee may become fraudulent not because of any fraud committed by the beneficiary while executing the underlying contract but it may become so because of subsequent events or circumstances. The Courts should restrain a person making such a fraudulent demand from enforcing a bank guarantee. [409-C-E]
- 1.3. In this case fraud has not been pleaded and the relief for injunction was sought by the contractor/Respondent 1 on the ground that special equities or the special circumstances of the case required it. The special circumstances and/or special equities which have been pleaded in this case were that there was a serious dispute on the question as to who had committed breach of the contract, that the contractor had a counter claim against the appellant, that the disputes between the parties had been referred to the arbitrators and that no amount could be said to be due and payable by the contractor to the appellant till the arbitrators declared their award. These factors were not sufficient to make this case an exceptional case justifying interference by restraining the appellant from enforcing the bank guarantees. [411-F-H, 412-A]

Tarapore & Co. v. Tractor Export, Moscow, [1969] 2 SCR 920; *United Commercial Bank v. Bank of India*, [1981] 3 SCR 300; *Centax (India) Ltd. v. Vinmar Impex Inc.*, [1986] 4 SCC 136; *U.P. Cooperative Federation Ltd. v. Singh Consultants and Engineers (P) Ltd.*, [1988] 1 SCC 174; *General Electric Technical Services Co. Inc. v. Punj Sons (P) Ltd.*, [1991] 4 SCC 230; *Larsen & Toubro Ltd. v. Maharashtra State Electricity Board*, [1995] 6 SCC 68; *Hindustan Steel Workers Construction Ltd. v. G.S. Atwal & Co. (Engineers) Pvt. Ltd.*, [1995] 6 SCC 76 and *Svenska Handelsbanken v. M/s. Indian Charge Chrome*, [1994] 1 SCC 502, relied on.

Elian and Rabbath v. Matsas and Matsas, [1966] 2 Lloyd's Rep 495; *Handerson v. Canadian Imperial Bank of Commerce and Peat Marwick Ltd.*, 40 British Columbia LR 318 and *Itek Corporation v. The First National Bank of Boston*, 566 FED Supp 1210, referred.

CIVIL APPELLATE JURISDICTION : Civil Appeal Nos. 4713-14 of 1990.

From the Judgment and Order dated 28.12.89 of the Andhra Pradesh High Court in C.R.P. Nos. 3865 and 3866 of 1989.

Dr. Shankar Ghosh, Badar Durrez Ahmed, for the Appellant.

G.L. Sanghi, K.R. Nambiar and R. Murari for the Respondents.

The Judgment of the Court was delivered by

NANAVATI, J. These two appeals, by special leave, are directed against the Judgment and Order passed by the Andhra Pradesh High Court in Civil Revision Petition No. 3865 and 3866 of 1989. The High Court allowed the revision petitions, set aside the common order passed by the subordinate Judge, Visakhapatnam in O.P. No. 456 and 457 of 1988 and passed an order of injunction restraining Hindustan Steelwork Construction Ltd. (the appellant and for short referred to as HSCL) from encashing the bank guarantees given by Bank of India in its favour at the instance of M/s. Tarapore & Co. (Respondent No. 1 and hereinafter referred to as the contractor).

The HSCL awarded a contract to the contractor for construction of civil works in its Visakhapatnam Steel Plant. On 16.3.84 a letter of intent

- A was issued and the formal contract was signed on 25.10.84. It was a lumpsum contract for Rs. 19,21,36,804 and was to be completed on or before 15.11.1985. The contractor was not able to complete the work within the stipulated time and at its request the time for completion of the work was extended till 31.3.87. Even during this extended period the contractor could not complete the work. It appears that some disputes arose between
- B the appellant and the contractor and on 28.8.1986 the contractor appointed an arbitrator and called upon the appellant to appoint its arbitrator for deciding those disputes. Now those disputes are pending before the two arbitrators appointed by the parties. In August, 1988 by mutual agreement the contract work was reduced and the contract price was fixed at Rs. 4.5
- C crores. This reduced work also was not completed within the extended time and at the request of the contractor the time for completing the work was extended till 30.9.1988. As the contractor did not complete the work by that time the HSCL rescinded the contract on 17.10.1988.
- D In between 30.1.84 and 8.12.87, Bank of India gave 14 guarantees in favour of HSCL at the instance of the Contractor. Bank guarantee No. 3/21 was furnished on 28.1.84 and 3/39 on 21.2.84 for Rs. 10 lacs and 40 lacs respectively towards mobilisation advances. Bank guarantee No. 3/58 dated 28.3.84 for Rs. 17,04,580 was towards security deposit. Bank guarantee No.
- E 6/175 given on 31.7.87, initially for Rs. 45 lacs and subsequently reduced to 36,25,000, was to secure the working funds provided by HSCL to the contractor and also for due performance of the contract. Rest of the bank guarantees were furnished on different dates as and when security deposits were released by HSCL. By these bank guarantees, except bank guarantee
- F No. 6/175, bank has undertaken to indemnify HSCL against any loss or damage caused to or suffered by it by reason of any breach by the contractor of any term and condition of the contract. It is also stipulated in the bank guarantees that HSCL shall be the sole Judge on the question as to whether the contractor has committed any breach of the contract and what is the extent of loss or damage. It is further stipulated therein that the decision of HSCL in this behalf shall be treated as final and binding
- G on the bank. By furnishing bank guarantee 6/175 the bank has undertaken to pay HSCL on demand any amount payable by the contractor without any demur and protest, without any reference to the contractor and such demand by HSCL has to be regarded as conclusive and binding on the bank notwithstanding any difference between the HSCL and the contrac-
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On the very day on which the appellant rescinded the contract, that is on 17.10.88, HSCL by three separate demand letters informed the bank that the contractor has failed to fulfil its obligations under the contract and has committed breach of its terms and conditions and by reasons thereof it has suffered loss/damage far exceeding the amount guaranteed by the bank, but for the purpose of invoking the bank guarantees it has assessed such loss/damage at Rs. 1,49,76,580. By those letters it also called upon the bank to pay to the appellant the said sum without any demur or protest.

The contractor on coming to know of this demand filed O.P. No. 456/88 and 457/88 under Section 41(b) read with Schedule II of the Arbitration Act in the Court of Principal Subordinate Judge at Visakhapatnam and prayed for an injunction restraining HSCL from encashing the bank guarantees. O.P. No. 457/88 was in respect of bank guarantees No. 3/21 and 3/39 and O.P. No. 456/88 for the other bank guarantees. The ground urged for granting the injunction was that there are genuine disputes between the parties and those disputes have been referred to the Arbitrators for adjudication. The court finding that the bank guarantees are unconditional refused to grant injunction and dismissed both the petitions by a common judgment.

The contractor thereupon filed two revision petitions before the Andhra Pradesh High Court. CRP No. 3865/89 was filed against the Judgment and order passed in O.P. 456/88 CRP No. 3866/89 was filed against the judgment and order passed in O.P. No. 457/88. It was contended on behalf of the contractor that the bank guarantees were given by way of security for due performance of the contract and for the purposes connected therewith and therefore they would be encashable only when the arbitrators decide that the contractor has committed a breach of the contract and the amount of loss or damage caused to or suffered by HSCL is quantified. It was submitted that as the disputes in this behalf are pending before the arbitrators the demand for encashment of the bank guarantees was premature. After referring to this contention the High Court observed as under :

"It is now well established that unless there is fraud or special circumstances or equities exist, the beneficiary cannot be restrained from encashing the letter of credit, even if there are disputes between the beneficiary and the person at whose instance

- A the letter of credit was given by the Bank. The same principle is extended in regard to the performance guarantees or performance bonds executed by the banks in favour of the beneficiaries. So injunctions have to be refused restraining the beneficiary from encashing the letter of credit or performance guarantee or bond and the only exceptions are in cases of fraud or where special equities exist or where special circumstances warrant issued of injunction to prevent irretrievable injustice being caused."
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- C The High Court after taking a note of the fact that fraud is not pleaded in this case, went on to examine whether there were special equities or special circumstances justifying granting of an injunction. It then considered the reasons why the courts refuse to grant injunction against encashment of confirmed letter of credit and the case law on the point. Thereafter it referred to *Edward Owen v. Barclays Bank International*, (1978) 1 A.E.R. 976 wherein it is held that performance guarantee stands on the same footing as a confirmed letter of credit and then observed that principles underlying the letters of credit are made applicable in England even in regard to performance guarantees or bonds. It distinguished the decision of this Court in *U.P.C.F. Ltd. v. Singh Consultants and Engineers (P) Ltd.*, [1988] 1 SCC 174 on the ground that "it is not a case where it was observed that in our country also the performance guarantee should be treated which is like confirmed letter of credit in order to consider whether injunction has to be refused or granted." After noticing that bank guarantees in this case except bank guarantee Nos. 3/21, 3/39 and 6/175 were given towards security deposits only it observed that "Neither of the learned counsels had drawn attention of this court to any decision granting or refusing injunction in regard to a bank guarantee given by way of security deposit to indemnify against any loss or damage caused by breach of the terms and conditions of the contract." It then considered the position of law with respect to liquidated damages in our country and observed that "Hence there cannot be any agreement in regard to the amount that has to be allowed except the upper limit that can be fixed, in case of breach". Relying upon the decision of this Court in *Union of India v. Raman Iron Factory*, AIR (1974) SC 1265 the High Court held that any term in the agreement that one of the parties shall be the sole judge to quantify the same has to be held as invalid." According to the High Court liability to pay damages would arise only after it is established that there is a breach of the contract and it is
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- H for the court or the arbitrator to decide as to who has committed the

breach. Till the liability is ascertained, it cannot be said that there is a "debt due or debt owing". On these grounds the High Court rejected the contention raised on behalf of HSCL that it was the sole judge to decide as to whether the contractor has committed a breach of the contract and what is the extent of damage caused to it. It also held that in absence of any determination by the Court or the arbitrator no amount can be said to be payable by the contractor to HSCL by way of damages and, therefore, it will be just and proper to restrain HSCL from enforcing the bank guarantees. It also held that no irretrievable injustice would be caused to HSCL as it can recover damages from the bank and the contractor in case it succeeds in the case and that the interest of HSCL can be safeguarded by directing the contractor to go on extending the bank guarantees till the matter is settled by the arbitrators. The High Court therefore allowed both the revision petitions and by an order of injunction has restrained HSCL from enforcing the bank guarantees, except bank guarantee no. 6/175, till the arbitrators pass an award in its favour. As regards bank guarantee no. 6/175 also it has restrained HSCL from encashing the said guarantee till the balance of the amounts advanced together with interest and the value of the material supplied is ascertained. For ascertaining the amount due, the High Court has remanded O.P. 456/88 to the lower court.

What was contended by Dr. Shankar Ghosh, learned senior counsel for the appellant, was that the High Court has not stated nor applied the law correctly. He submitted that in the matter of encashment of a bank guarantee the Court should not as a rule interfere unless it is a clear case of fraud and is likely to result in irretrievable injustice. The law is so declared, according to him, by the decisions of this Court in *United Commercial Bank v. Bank of India*, [1981] 3 SCR 300, *Centax (India) Ltd. v. Vinmar Impex Inc.*, [1986] 4 SCC 136, *U.P. Cooperative federation Ltd. v. Singh Consultants and Engineers (P) Ltd.*, [1988] SCC 174. The learned counsel for the respondents, on the other hand, contended that though fraud is an established exception to the general rule regarding interference with the autonomy of irrevocable letter of credit or a bank guarantee that is not the only exception and the Court can and should interfere where special circumstances or special equities exist and they are likely to result in irretrievable injustice.

With respect to an irrevocable letter of credit this Court in the case

A of *Tarapore & Co. v. Tractors Export, Moscow*, [1969] 2 SCR 920 pointed out that such a contract between the banker and the beneficiary is independent of and unqualified by the contract of sale or other underlying transaction and quoted with approval the following observations made by Jenkins L.J. in *Hamzeh Malas and Sons v. British Imex Industries Ltd.*, [1958] 2 Q.B. 127:

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"We have been referred to a number of authorities, and it seems to be plain enough that the opening of a confirmed letter of credit constitutes a bargain between the banker and the vendor of the goods, which imposes upon the banker an absolute obligation to pay, irrespective of any dispute there may be between the parties as to whether the goods are up to contract or not. An elaborate commercial system has been built up on the footing that bankers' confirmed credits are of that character, and in my judgment, it would be wrong for this Court in the present case to interfere with that established practice"

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In *United Commercial Bank v. Bank of India*, [1981] 3 SCR 300 this Court again emphasised that obligation of a bank in such a case is absolute, as a letter of credit constitutes the sole contract with the banker and the bank issuing the letter of credit has no concern with any question that may arise between the seller and the purchaser of the goods. Therein the following passage from the judgment of Kerr, J. in *R.D. Horbottle (Mercantile) Ltd. v. National Westminster Bank Ltd.*, (1977) 3 W.L.R. 752 was quoted as a correct statement of law on the point :

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"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 these merchants take. In this case the plaintiffs took the risk of the unconditional wording of the guarantees. The machinery and com-

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mitments 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."

In *United Commercial Bank's* case (supra) the High Court had granted a temporary injunction restraining the United commercial Bank from making a recall of the amount paid by it under reserve against the relative bills of exchange drawn against the letter of credit issued by it, from the Bank of India, and in terms of the letter of guarantee or indemnity executed by that Bank. While allowing the appeal this Court observed that the courts usually refrain from granting injunction to restrain the performance of the contractual obligations arising out of a letter of credit or a bank guarantee between one bank and another.

In *Centax (India) Ltd.* (supra) it has been held in clear terms that a bank guarantee resembles and is analogous to a letter of credit and the same considerations which apply to a letter of credit in the matter of interference by the court should apply to a bank guarantee.

In *U.P. Cooperative Federation Ltd.* (supra) also Mukherji, J. in paragraph 21 of his judgment has observed as under :

"..... An irrevocable commitment either in the form of confirmed bank guarantee or irrevocable letter of credit cannot be interfered with except in case of fraud or in case of question of apprehension of irretrievable injustice has been made out. This is the well settled principle of the law in England. This is also a well settled principle of law in India,....."

It is, therefore, difficult to appreciate the attempt of the High Court to distinguish that decision and to raise a doubt whether in India also the same principles apply in case of a performance guarantee issued by a bank. In our opinion, the High Court was not right either in its attempt to distinguish that decision or to raise a doubt regarding the correct position of law.

The High Court also committed a grave error in restraining the appellant from invoking 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

- 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
- B 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
- C 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 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
- D 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
- E 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
- F 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. In *General Electric Technical Services Company Inc. v. Punj Sons (P) Ltd.*, [1991] 4 SCC 230 while dealing with a case of bank
- G guarantee given for securing mobilisation advance it has been held that the right of a contractor to recover certain amounts under running bills would have not relevance to the liability of the bank under the guarantee given by it. In that case also the stipulations in the bank guarantee were that the
- H bank had to pay on demand without a demur and that the beneficiary was

to be the sole judge as regards the loss or damage caused to it. This Court held that notwithstanding the dispute between the contractor and the party giving the contract, the bank was under an obligation to discharge its liability as per the terms of the bank guarantee. *Larsen and Toubro Limited v. Maharashtra State Electricity Board*, [1995] 6 SCC 68 and *Hindustan Steel Workers Construction Ltd. v. G.S. Atwal & Co. (Engineers) Pvt. Ltd.*, [1995] 6 SCC 76 were also cases of work contracts wherein bank guarantees were given either towards advances or release of security deposits or for due performance of the contract. In both those cases this Court held that the bank guarantees being irrevocable and unconditional and as the beneficiary was made the sole judge on the question of breach of performance of the contract and the extent of loss or damages an injunction restraining the beneficiary from invoking the bank guarantees could not have been granted. The above referred three subsequent decisions of this Court also go to show that the view taken by the High Court is clearly wrong.

In view of the settled legal position and unsustainable view taken by the High Court, the learned counsel for the contractor has rightly not attempted to defend the judgment of the High Court except on the ground that in view of the exceptional circumstances and special equities of this case, it was justified in granting the injunction. He submitted that fraud is not the only ground requiring interference by courts and if it is made out that exceptional circumstances creating special equities exist then the court can and should restrain the beneficiary from encashing the bank guarantee. On the other hand the learned counsel for the appellant contended that interference by courts is permissible only when fraud is pleaded and *prima facie* established and it is further shown that irretrievable injustice would otherwise be caused. In support of his contention, the learned counsel for the appellant has heavily relied upon the following observations, made by Mukherji, J. in paragraph 28 and by Shetty, J. in paragraph 53 of the judgment in *U.P. Cooperative Federation Ltd.* (supra) :

"28. 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." (Emphasis supplied)

A "53. Since the bank pledges its own credit involving its reputation, *it has no defence except in the case of fraud*. The bank's obligations of course should not be extended to protect the unscrupulous seller, that is, the seller who is responsible for the fraud..... . The nature of the fraud that the courts talk about is
 B fraud of an "egregious nature as to vitiate the entire underlying transaction". It is fraud of the beneficiary, not the fraud of somebody else..... "

(Emphasis supplied)

C On the basis of these observations the learned counsel submitted that the law laid down by this Court is that except in case of fraud and that too when it creates special equities in the form of irretrievable injustice, the courts should not interfere by restraining the beneficiary from encashing the bank guarantee. We have carefully gone through the judgments delivered by Mukherji and Shetty, JJ. and in our opinion that is not the
 D ratio of the judgment. In that case the court was not called upon to decide whether apart from fraud there can be any other valid ground for interference. Moreover, the said observations cannot be read like a text of a statute or out of context. Observations made by Mukherji, J. in other parts of his judgment (See paragraphs 24 and 34) and his opinion stated in
 E paragraph 21, with which Shetty, J. also agreed, do not support that submission. Mukherji, J. in paragraph has stated his opinion as under :

"21. An irrevocable commitment either in the form of confirmed bank guarantee or irrevocable letter of credit cannot be interfered with *except in case of fraud or in case of question of apprehension of irretrievable injustice* has been made out." (Emphasis supplied)
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Mukherji, J. referred to the following paragraph from the judgment in *R.D. Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd.*,
 G [1977] 2 All ER 862 and then stated that in his view the said view represents the correct state of law :

"*Only in exceptional cases* would the courts interfere with the machinery of irrevocable obligations assumed by banks. In the case of a confirmed performance guarantee, just as in the case of a confirmed letter of credit, the bank was only concerned to ensure
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that the terms of its mandate and confirmation had been complied with and was in no way concerned with any contractual disputes which might have arisen between the buyers and sellers. Accordingly, since demands for payment had been made by the buyers under the guarantees and *the plaintiffs had not established that the demands were fraudulent or other special circumstances*, there were no grounds for continuing the injunctions....." A
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(Emphasis supplied)

What Mukherji, J. has stated in paragraph 34 of his judgment, namely, that "It is only in exceptional cases that is to say in case of fraud or in case irretrievable injustice be done the courts should interfere" is really the ratio of the decision of this Court in *U.P. Cooperative Federation Ltd.* (supra). Therefore, fraud cannot be said to be the only exception. In a case where the party approaching the court is able to establish that in view of special equities in his favour if injunction as requested is not granted then he would suffer irretrievable injustice, the court can and would interfere. It may be pointed out that fraud which is recognised as an exception is the fraud by one of the parties to the underlying contract and which has the effect of vitiating the entire underlying transaction. A demand by the beneficiary under the bank guarantee may become fraudulent not because of any fraud committed by the beneficiary while executing the underlying contract but it may become so because of subsequent events or circumstances. We see no good reason why the courts should not restrain a person making such a fraudulent demand from enforcing a bank guarantee. C
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The learned counsel for the appellant also drew our attention to a 3-Judge bench decision of this Court in *General Electric Technical Services Company Inc.* (supra) to which Shetty, J. was also a party. The learned counsel submitted that after referring to the observations of Mukherji, J. in paragraph 28 and that of Shetty, J. in paragraph 53 of the judgment in *U.P. Cooperative Federation Ltd.* (supra) this Court in para 9 of that judgment has observed that what is stated therein is the settled position of law. What is overlooked by the learned counsel is that in that very paragraph the opinion of Mukherji, J. that "It is only in exceptional cases that is to say in face of fraud or in case irretrievable injustice be done the courts should interfere" is also quoted. (Emphasis supplied) Moreover, while F
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A dealing with the facts of the case this Court in paragraph 10 of the judgment has stated that "The bank cannot be interdicted by the court at the instance of Respondent 1 in the absence of fraud *or* special equities in the form of irretrievable injustice between the parties". (Emphasis supplied) This observation would clearly go to show that the 3-Judge Bench has approved the view that fraud and other exceptional circumstances leading to irretrievable injustice are exceptions to the rule.

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Lastly, the learned counsel for the appellant relied upon the following observations made in paragraph 60 of the 3-Judge Bench decision of this Court in *Svenska Handelsbanken v. M/s. Indian Charge Chrome*, (1994) 1 SCC 502:

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"60. We have referred to the observations of both Sabyasachi Mukherji as well as Shetty, JJ. in extenso to emphasise 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 an established fraud."

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In that case the question which fell for consideration was whether the High Court was right in taking the view that while deciding an application for interim relief against enforcement of a bank guarantee general principles of injunction on lenders should be applicable and not the principles of injunction in relation to bank guarantee. This Court was not called upon to decide whether apart from the case of fraud there can be any other exceptional case wherein the court can interfere in the matter of encashment of a bank guarantee. It is also significant to note that the said observation in paragraph 60 has been made after quoting the following observation made by Mukherji, J. in paragraph 21 of his judgment in *U.P. Cooperative Federation Ltd.* (supra) :

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"..... An irrevocable commitment either in the form of confirmed bank guarantee or irrevocable letter of credit cannot be interfered with except if a case of fraud or a case of a question of apprehension of irretrievable injustice has been made out. This is the well-settled principle of law in England. This is also the well-settled principle of law in India. No fraud and no question of irretrievable injustice was involved in the case."

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H Therefore, we cannot attach much importance to the use of the word

"and" in the observation that "it cannot be interfered with unless there is fraud and irretrievable injustice involved in the case.....". It is also significant to note that in that case this Court referred to the decision of Court of Appeal in England in the case of *Elian and Rabbath v. Matsas and Matsas*, [1966] 2 Lloyd's Rep 495 and distinguished it by stating that the facts of that case were peculiar but did not state that the view taken in that case is not correct. The decision in *Handerson v. Candian Imperial Bank of Commerce and Peat Marwick Ltd.*, 40 British Columbia LR 318 was also referred to and distinguished on the ground that the facts of that case were peculiar but with respect to the decision in that case also it has not been stated that it does not represent the correct position of law. That was not a case of that type of fraud which has been recognised as an exception to the rule though the request by the beneficiary for payment was considered fraudulent in the circumstances because there was no right to payment. This Court also referred to the case of *Itek Corpn. v. The First National Bank of Boston*, 566 Fed Supp 1210. In that case the underlying contract had become impossible of performance, because of 'force majeure'. It was an event subsequent to the execution of the contract. Yet injunction was granted by the court on the ground that the plaintiff had no adequate remedy at law and the allegations of irreparable harm were not speculative but genuine and immediate and the plaintiff would have suffered irreparable harm if the request for relief was not granted. Though this Court observed that "this judgment is based on peculiar facts" has not disapproved the view taken in that case.

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, the court should interfere. In this case fraud has not been pleaded and the relief for injunction was sought by the contractor/Respondent No. 1 on the ground that special equities or the special circumstances of the case required it. The special circumstances and/or special equities which have been pleaded in this case are that there is a serious dispute on the question as to who has committed breach of the contract, that the contractor has a counter claim against the appellant, that the disputes between the parties have been referred to the arbitrators and that no amount can be said to be due and payable by the contractor to the appellant till the arbitrators declare their award. In our opinion, these

A factors are not sufficient to make this case an exceptional case justifying interference by restraining the appellant from enforcing the bank guarantees. The High Court was, therefore, not right in restraining the appellant from enforcing the bank guarantees.

B These appeals are, therefore, allowed. The judgment and order passed by the High Court are set aside. However, in view of the fact that no stay was granted by this Court during the pendency of these appeals and in view of the statement made by learned counsel for Respondent No. 1 that the arbitrators are likely to declare the award within a short time, we direct that the appellant shall not call upon the bank, Respondent No. 2 to discharge its obligations under the bank guarantees till 31st July, 1996. C If by that time, the arbitrators declare the award then obviously the parties will have to reconsider their position in the light of the correct legal position and the observations made in this judgment. The respondent No. 1 shall pay the cost of these appeals to the appellant.

R.A.

Appeals allowed.