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M/S. RELIANCE SALT LTD.

v.

M/S. COSMOS ENTERPRISES AND ANR.

NOVEMBER 22, 2006

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[S.B. SINHA AND DALVEER BHANDARI, JJ.]

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Contract Act, 1872—ss. 126 and 17—Agreement of consignment—Bank Guarantee—Invocation of, by Principal company on non-settlement of bills by consignment agent within stipulated period—Suit for injunction restraining Principal Company from invoking Bank Guarantee by consignment agent, pleading case of fraud—Courts below holding invocation of Bank Guarantee vitiated by fraud—Correctness of—Held: Bank Guarantee constitutes agreement between Banker and Principal, though, at instance of promisor—On invocation of bank guarantee, bank is to plead case of fraud and not the promisor-consignment agent—In terms of the agreement, Bank could not refuse invocation—Further, bank did not dispute claim of Principal Company nor contested the suit nor supported the case of consignment agent—Thus, order of courts below set aside.

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Respondent No. 1 and the appellant company entered into a sale agreement and respondent was appointed as consignment agent. Respondent No. 1 furnished a Bank Guarantee of Rs. 5 lakhs as required. The appellant could invoke the Bank Guarantee for any loss or damage suffered by it in case of breach of contract on non-payment of bills within 30 days. The bills were not settled within the time stipulated. Appellant invoked the Bank Guarantee. Respondent No. 1 filed suit for declaration that the appellant was not entitled to invoke the Bank Guarantee and injunction restraining respondent No. 2 from encashing Bank Guarantee at instance of appellant. Trial court decreed the suit in favour of respondent no. 1 holding that the invocation of Bank guarantee was vitiated by fraud. Hence the present appeal.

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Allowing the appeal, the Court

HELD: 1.1. A bare perusal of the contents of the Bank Guarantee, shows that there is no escape from arriving at a conclusion that the guarantee furnished was an unconditional one. It not only provided for loss or damage

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in case of breach of contract, but also loss or damage by reason of non-settlement of bills. Such bills under the agreement of consignment were to be settled within a period of 30 days. In the event the bills are not settled within the period stipulated in the agreement, the parties intended, as it appears from the tenor of the Bank Guarantee, that the same would constitute a breach of contract. It is not in dispute that some amount was due to the appellant from the Respondent. The suit was not a suit for settlement of accounts. The suit was, *inter alia*, only for a decree for injunction restraining appellant from invoking the Bank Guarantee. Respondent No. 2-Bank, did not controvert allegations contained in the demand of the appellant. It did not contest the suit. It even did not support respondent No. 1 before the trial judge or before the High Court. [288-G-H; 289-A-B]

1.2. A claim which is denied or disputed, in the event of necessity for determination of the *lis*, may not be found to be correct. If appellant was to allege a breach of contract in a properly framed suit, Respondent No. 1 could also allege the breach of contract on the part of appellant. Breach of contract by reason of supply of inferior quality of tea or salt or delay in supply or a short supply may render a party responsible for damages for commission of breach of contract, but, breach of contract alone does not lead to the conclusion that a fraud had been committed thereby. It is contended that commission of fraud would include any act to deceive but then such act must be confined to acts committed by a party to a contract with intention to deceive another party or his agent or to induce him to enter into a contract. Fraud, which vitiates the contract, must have a nexus with the acts of the parties prior to entering into the contract. Subsequent breach of contract on the part of a party would not vitiate the contract itself. [289-B-E]

1.3. Bank Guarantee constitutes an agreement between the Banker and the Principal, *albeit*, at the instance of the promisor. When a contract of guarantee is sought to be invoked, it was primarily for the bank to plead a case of fraud and not for a promisor to set up a case of breach of contract.

1.4. The discrepancies in the bills or non-submission of the detailed account in respect of business cannot be a ground for denial of encashment of Bank Guarantee if it is otherwise invokable. [290-A]

1.5. Although, the Trial Judge as also the High Court observed that the Bank Guarantee was invokable after lapse of 30 days from date of the bill, as stipulated therein, on its own terms the Bank was bound to pay the amount in

A question on its invocation, subject of course to the fulfillment of the other conditions laid down therein. It could not have refused to honour its commitment only because the purported accounts were not settled between the parties or the accounts furnished to the Court were wrong ones. The other reasons assigned by the Trial Judge as also the High Court that the conduct of Appellant was not clean or it had tried to defraud other customers in other parts of the State, are of not much significance in view of the nature of the guarantee furnished by the Bank. Submission of respondent that after the judgment of the High Court, Respondent no. 1 has got all documents released, cannot be a ground to refuse invocation of Bank Guarantee by appellant, if it was otherwise entitled thereto. [290-B-E]

C CIVIL APPELLATE JURISDICTION : Civil Appeal No. 5151 of 2006.

From the Judgments and Orders dated 31.7.2000 and 28-10-2003 of the High Court of Judicature at Patna in F.A. No. 28/1997 and L.P.A. No. 1632 of 2000 respectively.

D Ranjan Mukherjee for the Appellant.

Sunil Kumar, Ranjit Kumar, Rajiv Shankar Dvivedi, Manish Mohan, Ashish Thakur, Ajay Choudhary, S.S. Ray and Rakhi Ray for the Respondents.

E The Judgment of the Court was delivered by

S.B. SINHA, J. Leave granted.

F The 1st Respondent herein was appointed as a Consignment Agent by an agreement dated 23.12.1993 in regard to the sale of products of the Appellant Company-plaintiff, namely, Salt and Tea in South and Central Bihar. In terms of the said agreement it was required to furnish a Bank Guarantee for a sum of Rs.5 lakhs. The transactions between the parties started in January, 1994. Some of the clauses in the said Bank Guarantee are as under :

G “.....We.....(hereinafter referred to as the Bank) do hereby agree to pay the Principal Co. an amount not exceeding Rs.6,00,000/- (Rupees Six Lacs only) against any loss or damage caused to or suffered or would be caused to or suffered by the Principal Co. *by reason or any breach of contract by the consignment agent as their due performance of their duties as consignment agent for the Principal Co., the major term being settlement of the Principal Co.'s bills by the consignment agent within 30 days from the date of*

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receipt of material.

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(2) We.....(Bank) do hereby undertake to pay the amounts due and payable under this guarantee *without any demur merely on a demand from the Managing Director or any other director of the Principal Co.* stating that the amount claimed is due by way of loss or damage caused to suffered by the Principal Co. by reason of any breach of contract for non payment of the Principal Company's bills within 30 days from the date of receipts of materials by the consignment agent of any of the terms and conditions agreed upon/to be agreed in performance of their duties of consignment agent on behalf of the Principal Co. Any such demand made on the (Bank) shall be conclusive as regard the amount due and payable by the Bank under this guarantee.

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(3) We (Bank) further agree that the guarantee shall remain in full force and effect for a period of 12 (Twelve) months from the date of issue of this guarantee or till the period that would be taken by the consignment agent for the due performance of their duties as consignment agent on behalf of the Principal Company on the terms and conditions mutually agreed upon/to be agreed upon shall continue to be enforceable till all the dues of the Principal Company have been fully paid and its claims satisfied or discharged or till the Managing Director or any other director of the Principal Company certified that the due performance of their duties as consignment agent have been fully and properly carried by the consignment agent and accordingly discharge the Guarantee, which ever date is earlier.

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(4) We (Bank), further agree with the Principal Company that the Principal Company have been fullest liberty without our consent and without AFFECTING IN ANY MANNER. Our OBLIGATIONS HEREUNDER to vary any of the terms and conditions agreed/to be agreed with the consignment agent in the due performance of their duties as consignment agent or to extent time of performance by the consignment agent from time to time any of the power exercisable by the Principal Company against the consignment agent and to forbear or enforce any of the terms and conditions agreed upon and we shall not be relieved from our liabilities by the reason for any such variation or extension being granted to the consignment or any forbearance act or omission on the part of the Principal Company or

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A any indulgence by the Principal Company or any indulgence by the Principal Company to the Consignment Agent by any such manner or thing whatsoever which under the law relating to sureties would but for this provision have effect of so relieving us.”

B Pursuant to or in furtherance of the agreement entered into by and between the parties herein, the 1st Respondent furnished a Bank Guarantee of Rs.5 lakhs issued by Respondent No. 2, Bank of India, Muradpur, Chouhatta Branch, Patna on 12.1.1994.

C Indisputably, the business dealings between the parties continued upto July, 1994. Appellant’s bills allegedly remained unpaid for more than 30 days after the same had been raised amounting to Rs.5,04,739.92p. The said Bank Guarantee was invoked by letter dated 4.8.1994 whereabouts Respondent No. 2 intimated to 1st Respondent. A Title Suit No. 316/94 was filed by 1st Respondent herein in the Court of Subordinate Judge at Patna, *inter alia*, for the following reliefs :

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- “(a) declaration that the petitioner is not entitled to invoke the Bank Guarantee for Rs.5 lakhs.
 - (b) order of injunction restraining the respondent No. 2 from encashing the Bank Guarantee at the instance of the petitioner”

E In the said suit, whereas Appellant filed a written statement, the Bank did not choose to file any. The suit was decreed on contest against Appellant and *ex parte* against Respondent No. 2. An appeal taken therefrom by Appellant before the Patna High Court being First Appeal No. 28/1997 was dismissed by a learned Single Judge by an order dated 31.7.2000. An intra-court appeal was filed as against by Appellant, which was found to be not maintainable, purported to be in view of the amended provisions of Section 100-A of the Code of Civil Procedure.

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The learned Trial Judge framed several issues, the issue No. 7 being :

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- “VII. Is the defendant no. 1 is entitled to invoke the bank guarantee in question?”

The learned Trial Judge, *inter alia*, found that (i) the invocation of Bank guarantee was vitiated by fraud; and (ii) the 1st Respondent would suffer irreparable injury in regard to the issue of fraud.

H It was held :

“So, I find that plaintiff has made a specific plea of the case of fraud and irreparable harm in his pleading and therefore, the plaintiff is entitled to establish the fact of fraud and irreparable harm, the exceptions for granting injunction in case of invoking bank guarantee.”

In the very nature of the things fraud is secret in its origin or inception and in the means adopted for its success. Each circumstances of by itself may not mean much, but taking all of them together they may reveal a fraudulent and dishonest plea.

So, the plaintiff is able to establish that the dealing of the plaintiff was sincere for the business whereas the defendant No. 1 has not made sincere dealing which caused irregularity in supply and other difficulties for which the plaintiff made complaint to the defendant No. 1 time to time.

Now from the perusal of the Ext. E, the original bank guarantee, it is clear that the bank guarantee was revocable on the ground of any loss and damage caused to the defendant No. 1 due to breach of the contract by the plaintiff or due to non-settlement of the bills of the defendant No. 1 within 30 days from the date of those bills.

From the perusal of the letter dated 4.8.94 of Defendant No. 1 to the Bank of India, Muradpur, Chouhatta Branch, Patna, it is clear that the ground for invoking the Bank Guarantee as stated in the letter dated 4.8.94 is only non payment of the bills within the stipulated period. Therefore there is no ground of loss or damage caused to the Defendant No. 1 due to non performance of work in business by the plaintiff or due to any breach of contract by the plaintiff.”

The learned Trial Judge further opined that the evidence of the plaintiff corroborated in the form of contemporary documents as well as the unexplained failure of the beneficiary to respond thereto would lead to the conclusion that the only realistic inference to draw would be fraud, holding :

“The defendant No. 1 has not submitted any document in support of the balance amount as given in the written statement whereas the plaintiff has filed all the relevant documents regarding his accounting in order to prove that actually up to 31.7.94 only Rs.32,864.35 paise was due.”

“Besides, the defendant had filed objection petition of the injunction

A petition of the plaintiff on 23.8.94 and there has been annexure given as Annexure A in which detailed account of the dealing of business has been also given. In this, bill dated 16.7.94 is given as the last bill amounting to Rs.28,000/-."

B "So it appears that up to 16.7.94 the defendant No. 1 has sent goods to the plaintiff and in that case the bill dated 16.7.94 is liable to be paid up to 16.8.94 i.e. within 30 days as per the terms of the agreement vide Ext. (1) and defendant No. 1 is entitled to invoke the bank guarantee only after the lapse of 30 days from the date of bill as stipulated in the deed of bank guarantee Ext. E."

C "In this view of the fact the amount given in Ext. D does not seem to be correct and the account given in the written statement vide para 9 also does not seem to be correct."

D "The absence of these things indicate that the action of defendant no. 1 was not clean and honest rather it was fraudulent one and therefore, the invocation of bank guarantee was made by way of fraud."

E "Therefore, the defendant No. 1 had difference with the consigning agent in the State of Uttar Pradesh and Andhra Pradesh. This circumstance also leads to show that the action of the defendant No. 1 was of a fraudulent nature."

In regard to the issue of irreparable injury, it was held :

F "In the instant case, as discussed above, on the basis of oral and documentary evidence, I find that the defendant No. 1 had played fraud for withdrawing the amount of bank guarantee and it will also cause irreparable harm to the plaintiff. Therefore this case comes in purview of the exception given in the settled law and accordingly, injunction can be granted and defendant No. 1 can be prevented from invoking the bank guarantee. Thus, this issue is also decided in favour of the plaintiff and against the defendant."

G The High Court in its judgment opined that although the bank cannot be prevented from honouring the Bank Guarantee as and when demanded by the beneficiaries except in the case of fraud which would vitiate the entire transaction. It was further opined that the plaintiff in paragraph 11, 16 and 19 of the plaint, specifically and clearly pleaded about the fraud played on the part of Appellant herein. It was furthermore stated that Appellant ought to

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have produced and proved all its Books of Accounts to show that the accounts furnished by the plaintiff were not correct. A

Before we embark upon the rival contentions of the parties, it would be necessary to notice the salient features of the Bank Guarantee. The Bank Guarantee was limited to the extent of Rs.5 lakhs. It was given only against any loss or damage caused to or suffered by the Principal Company, by reason or any breach of contract by the consignment agent their due performance of the duties of consignment agent of the Principal Company, the major terms being settlement of the Principal Company's bills by the consignment agent within 30 days from the date of those bills. The Bank undertook to pay the amounts due without any demur and merely on demand by the Company. Such payment was merely to be made on the basis of a statement that the amount claimed, *inter alia*, is due by way of loss or damage caused to suffer by the Principal Company by reason of any breach of contract for non-payment of the Principal Company's bill by the consignment agent of any of the terms and conditions to be agreed upon in performance of their duties of Consignment Agent on behalf of the Principal Company. Any such demand made on the Bank of India should be conclusive as regards the amount due and payable by the Bank under the said Bank Guarantee. It was furthermore stated : B C D

“.....that the Bank Guarantee shall remain in full force and effect for a period of 12 (twelve) months from the date of issue of this guarantee or till the period that would be taken by the Consignment Agent on behalf of the Principal Company as the terms and conditions mutually agreed upon shall continue to be enforceable till all the dues of the Principal Company have been fully paid and its claim satisfied or discharged or till the managing director or any other director of the Principal Company certified that the due performance of their duties as Consignment Agent have been fully and properly carried out by the Consignment Agent and accordingly discharge the guarantee whichever date is earlier.” E F

In its judgment, the learned Single Judge referring to paragraphs 11, 16 and 19 of the plaint, stated : G

“.....In para 11 it has been stated that “they are not ready for settlement of the account as that would reveal their own fault and misconduct” and the defendant No. 1 intent to somehow or other to obtain huge H

A amount of the plaintiff and thereafter vex and harassed the plaintiff in refunding the same.” Similarly, in para 16 of the plaint it has been stated that defendant No. 1 is guilty of misconduct, irregularity, deception, misrepresentation and fraud etc. and under the circumstances, the defendant has no right to invoke the bank guarantee.”

B Paragraphs 11, 16 and 19 of the pleadings and the evidences adduced on behalf of 1st Respondent, thus, were confined to the issue of inferior quality of supply, late supply and short supply of consignments.

C “Fraud” is defined in Section 17 of the Indian Contract Act, 1872 in the following terms :

D “S.17. *“Fraud” defined.*—“Fraud” means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract :

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- (1) the suggestion, as a fact, of that which is not true, by one who does not believe it to be true;
 - (2) the active concealment of a fact by one having knowledge or belief of the fact;
 - (3) a promise made without any intention of performing it;
 - (4) any other act fitted to deceive;
 - (5) any such act or omission as the law specifically declares to be fraudulent.

F *Explanation.*—Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless the circumstances of the case are such that, regard being had to them, it is the duty of the person keeping silence to speak, or unless his silence is, in itself, equivalent to speech.”

G A bare perusal of the contents of the Bank Guarantee, as noticed hereinbefore, shows that there is no escape from arriving at a conclusion that the guarantee furnished was an unconditional one. It not only provided for loss or damage in case of breach of contract, but also loss or damage by reason of non-settlement of bills. Such bills under the agreement of

H consignment were to be settled within a period of 30 days. In the event the

bills are not settled within the period stipulated in the agreement, the parties intended, as it appears from the tenor of the Bank Guarantee, that the same would constitute a breach of contract. It is not in dispute that some amount was due to the Appellant from the Respondent. The suit was not a suit for settlement of accounts. The suit was, *inter alia*, only for a decree for injunction restraining Appellant from invoking the Bank Guarantee. Respondent No. 2-Bank, indisputably, did not controvert allegations contained in the demand of the appellant. It did not contest the suit. It even did not support Plaintiff-Respondent No. 1 before the learned Trial Judge or before the High Court.

A claim which is denied or disputed, in the event of necessity for determination of the *lis*, may not be found to be correct. If Appellant was to allege a breach of contract in a properly framed suit, Respondent No. 1 could also allege the breach of contract on the part of Appellant herein. Breach of contract by reason of supply of inferior quality of tea or salt or delay in supply or a short supply may render a party responsible for damages for commission of breach of contract, but, breach of contract alone does not lead to the conclusion that a fraud had been committed thereby. It is contended that commission of fraud would include any act to deceive but then such act must be confined to acts committed by a party to a contract with intention to deceive another party or his agent or to induce him to enter into a contract. Fraud, which vitiates the contract, must have a nexus with the acts of the parties prior to entering into the contract. Subsequent breach of contract on the part of a party would not vitiate the contract itself.

“Contract of guarantee” is defined under Section 126 of the Indian Contract Act in the following terms :

“126. ‘Contract of guarantee’, ‘surety’, ‘principal debtor’ and ‘creditor’—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.”

Bank Guarantee constitutes an agreement between the Banker and the Principal, *albeit*, at the instance of the promisor. When a contract of guarantee is sought to be invoked, it was primarily for the bank to plead a case of fraud and not for a promisor to set up a case of breach of contract.

A The discrepancies in the bills or non-submission of the detailed account in respect of business cannot be a ground for denial of encashment of Bank Guarantee if it is otherwise invokable.

B Although, the learned Trial Judge as also the High Court observed that the Bank Guarantee was invokable after lapse of 30 days from date of the bill, as stipulated therein, on its own terms the Bank was bound to pay the amount in question on its invocation, subject of course to the fulfillment of the other conditions laid down therein. It could not have refused to honour its commitment only because the purported accounts were not settled between the parties or the accounts furnished to the Court were wrong ones. The other reasons assigned by the learned Trial Judge as also the High Court that the conduct of Appellant was not clean or it had tried to defraud other customers in other parts of the State, in our considered opinion, are of not much
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D significance in view of the nature of the guarantee furnished by the Bank.

Submission of Mr. Ranjit Kumar that after the judgment of the High Court the 1st Respondent has got all documents released, cannot be a ground to refuse invocation of Bank Guarantee by Appellant, if it was otherwise entitled thereto.

E We, therefore, are of the opinion that the impugned judgments cannot be sustained. They are set aside accordingly. The appeal is allowed. This order shall not, however, come in the way of Respondents to file a suit for accounts or take other measures which are available to them in law. Respondent
F No. 1 shall pay and bear the costs of Appellant in the appeal. Counsel fee assessed at Rs.10,000/-.

N.J.

Appeal allowed.