

VOB LAW JOURNAL



**A Monthly Journal published by
voice of barristers**

ANALYSIS OF STATE BANK OF INDIA & ANR VS MULASAHAKARISAKHAR KARKHANA LTD

VOL No. 1

JANUARY 2022 EDITION

ISSUE NO.5

WWW.VOICEOFBARRISTERS.COM

ABOUT US

Voice of Barristers is a virtual law student association established with the motive of edifying the society about the importance of law and its implementation. The objective is to convey law in the most basic form, so that every layman may comprehend and learn it. To bring out the inquisitive minds of our nation the organization vouchsafe opportunities to write articles, research papers, blogs, book reviews, case commentaries and landmark judgments that can be published in our website, which we consider as the fundamental tool to proffer knowledge among laymen to lawmen.

Law plays a cardinal role in securing Justice and framing a peaceful nation. It provides indispensable guidelines to the citizens and sustains equity among the organs of government. Law acts as a bridge between laymen and justice. It is an elementary weapon to protect justice. It becomes necessary to enlighten the minds of people due to inadequate knowledge of law among people. Law is a pillar which upholds Peace and Justice in the society. The system of democracy loses its potentiality without law.

We the team voice of barristers subsist of savvy law students, researchers, scholars' and professionals with an adequate range of skills and experiences. Here we believe sharing is the root of gaining knowledge. We come up with articles, laws notes, journals, meetings, posters, current affairs which helps in building a strong relationship with law. We at Voice of Barristers believe that equality is the foremost fundamental right, so we provide opportunities to Students, Scholars', Researchers, Professionals from every sector to work with us in the path of law learning.

We the team of Voice of Barristers, are elated to publish our first edition of law journal, which was made possible by the endless efforts of our learned professionals and our students' crew. We acclaim our team's efforts by publishing this journal.

K.S.Charishma, Founder

Jagadish.R, Co-founder

ADVISORY BOARD MEMBERS



DR. R. THIPPA REDDY - Director and
Chairman of Dr. Ambedkar Global Law Institute, Tirupati, Andhra Pradesh



ANAND KUMAR - Senior Advocate, Founder
and Managing Trustee of Shirdi & Co.



SUBBU RANGA BHARATHI - Advocate at
Madras High Court, Managing Partner At Indus Law Associates, Chennai



RAHUL TIWARI - Advocate, Founder of LNS
Associates, Educator at Soo Legal, Panel Member WCSF, Educator at StudyIQ



A.S. SRIKANTH- Assistant Professor at Dr.
Ambedkar Global Law Institute , Tirupati, Andhra Pradesh.



ASHWAD ELEGOVAN - Advocate at Madras

High Court.



B. VIGNAESH Advocate at High Court Of

Madras, Tamil Nadu.



ROHIT NARAYANAN, Advocate and Legal

Associate at SHIRDI & Co.



DR. D. SREEMATHI, Assistant Professor at Dr.

Ambedkar Global Law Institute, Tirupati.



PAKHI GARG, Advisor and IPR Head, WCSF,

In-House Counsel, Gartner (India).

EDITORIAL TEAM

Editor-In-Chief

Bhavya Sree Pasupuleti

Email ID: pasupuleti.bhavya9@gmail.com

Editor

Somesh

Email ID: saxena.somesh8@gmail.com

Associate Editors

Jinal Prajapat

Email ID: jinal.prajapat27@gmail.com

Arjun

Email ID: arjunajarjun12@gmail.com

Junior Associate Editors

Koushik Chittella

Email ID: koushikch551@gmail.com

Garima Sharma

Email ID: sgarimallb20@law.alliance.edu.in

CORE TEAM

Chief Academic Officer

Amulya Anil

Chief Managing Officer

Yash Raj Varma

Chief Administrative Officer

Shreelatha

Managing Editor

A.R. Aravamudhan

Chief Executive Councils

Ragesh Bhagavath

Leeban Arivazhagan

Co-Ordinator Cum Researchers

P.V.L.S. Mounika

Sweatha

Thanuja

Muthulakshmi

**ANALYSIS OF STATE BANK OF INDIA & ANR VS MULSAHAKARI
SAKHAR KARKHANA LTD**

Author - SONIA SHARMA, BALLB (Hons.)(semester3) from Alliance School Of Law ,
Alliance University, Bangalore.

TITLE OF CASE: - *State Bank of India & Anr vs MulaSahakariSakharKarkhana Ltd*

CITATION OF THE CASE: - AIR 2007 SC 2361: (2006) 6 SCC 293

COURT NAME: - Supreme court of India

BENCH OF JUDGES: - S.B. Sinha and P.K. Balasubramanyan

DATE OF DECISION: - 06 July 2006

PETITIONER: -State Bank of India &Anr

RESPONDENT: -Mula Sahakari Sakhar Karkhana Ltd.

ISSUE OF THE CASE: - Whether there was a contract or Indemnity or Guarantee between the petitioner and respondent?

BRIEF FACTS OF THE CASE

In this case, the respondent was a Cooperative Society, who had a Sugar factory and it entered into a contract with M/S Pentagon Engineering Pvt. Ltd for installation of a paper plant on a turnkey basis. It allowed the Cooperative Society to use “Bagasse”, which is said to be a waste of Sugarcane. Pentagon also furnished a “guarantee of performance” for machinery supplied by it. The total cost of the contract was rupees three crores and forty lakh. The contract also carried a clause for retention of 10% of the contract price (34 Lakh) by the Cooperative Society on certain conditions that: - 15.2.4% of the contract price will be paid after 3 months of installation of the paper plant and 15.2.55% of the contract price is to be paid after the successful working of the plant for 6 months. Later, Pentagon asked the Cooperative Society to make a modification in the payment clause and to waive its right for retention of 10% of the contract price. Pentagon also asked for a separate letter of credit for furnishing a correct Bank guarantee for the respondent (MulaSahakariSakharKarkhana Ltd.).

On 4th September 1985, finally, the guarantee was issued by the State Bank of India, Dombivli to the Respondent. Later differences arose between the Cooperative Society and Pentagon Engineering Pvt. Ltd and the respondent (MulaSahakariSakharKarkhana Ltd.) terminated its contract with Pentagon. The respondent then invoked the bank guarantee but it met resistance from the side of the Bank stating that it had accomplished a contract of indemnity and not of guarantee. Thereafter the respondent filed a case in the Court of Civil Judge, Senior Division, Ahmednagar from where the case was transferred to the High Court. In High Court, it was held that it was a contract of guarantee and was not a contract of indemnity. The court ordered the Bank to pay 10% of the contract price i.e. 34 lakh rupees with the interest of @14% per annum to the Cooperative Society. Bank was unhappy with the judgement and filed a petition in the Supreme Court of India against the respondent (MulaSahakariSakharKarkhana Ltd.) and it was held that it was a contract of Indemnity and not of guarantee. Supreme Court of India restored the decree passed by the trial court and also appeal was allowed with costs.

RATIO DECIDENDI

In this case *State Bank of India & Anr vs. MulaSahakariSakharKarkhana Ltd*, the decision was taken based on the following precedents: -

1. *S. ChattanathaKarayalar vs. The Central Bank of India and Others [1965]*, where it was held that whenever the transaction between the same parties are contained in more than one document, then they must be read and examined jointly. The guarantor and principal debtor collaboratively may not agree to pay but the conduct of the party proves him/her to be the surety as per section 126 of the Indian Contract Act, 1872.

2. *P.L. Bapuswami vs. PattayGounder [1966]*, where it was held that the difference between two transactions is because of the relationship between the principal debtor and creditor. The transfer was security for the debtor. The formation of the deed was not at all decisive. The actual nature of the transaction was known from the interpretation of the document in question concerning surroundings conditions and the actual subject matter of the document. If the language of the document is not clear and coherent then, it must be examined concerning surrounding circumstances and subject matter of the document.

3. *Bishwanath Prasad Singh vs. Rajendra Prasad and Anr [2006]*, where it was held that a bank guarantee must be created on its terms and conditions without any unnecessary objection. A Bank guarantee is considered to be a separate transaction.

4. *New India Assurance Company Ltd vs. Kusumanchi Kameshwara Rao and another [1997]*, where it was held that when the guarantee bonds are in express terms then the bond would be a repository of the obligation of the guarantee flowing from the surety bond. Section 91 and 92 of The Indian Evidence Act, 1872 says that no oral evidence can be used by the parties to get out of the express terms.

5. *S. Hindustan Construction Co. Ltd vs. the State of Bihar*, where it was that facts and circumstances of the case cannot be used because here bank has given clear guarantee and it is liable to pay guarantee amount without any further delay.

As directed by the above cases, in the present case also it was held that there was a contract of indemnity because here two parties i.e. Indemnifier and Indemnity holder were involved and it was not a contract of guarantee because it is a separate transaction and requires the involvement of three parties namely, principal debtor, creditor and surety. Moreover, the guarantee has its own and independent basis for construction. Here it was also held that there is no ambiguity in the document so, surrounding conditions are not to be considered.

ARGUMENTS ADVANCED FROM SIDE OF PETITIONER

1. The document dated 4 September 1985, on honest construction basis would have been seen as a contract of Indemnity and not of Guarantee.
2. High Court has made a mistake in considering the oral evidence produced by the parties while interpreting the document in question. This is not applicable as per sections 91 and 92 of the Indian Evidence Act, 1872.
3. The interest rate i.e. 14% per annum is irreconcilable as per the High Court order dated 23rd February 1988.
4. The document is commercial and doesn't carry any ambiguity and surrounding circumstances are only taken into consideration in case of document ambiguity.

5. High Court has made the mistake of terming the “operative portion” of the document as a “preamble”.

6. Words and expressions such as “unequivocal condition” are not used in this contract, which is commonly seen in Bank Guarantee contracts.

ARGUMENTS ADVANCED FROM SIDE OF RESPONDENT

1. As there is ambiguity like document and some words are incoherent in the context of its use so, to interpret the document, surrounding circumstances are very much relevant.

2. The relevant circumstances may include conditions such as: -

1) The document which is in question, was in the form of a letter.

2) By the document Cooperative Society agreed to buy a paper plant from Pentagon on a turnkey basis.

3) It was mentioned in the document that, the final payment would only be made to the supplier after the appropriate Bank Guarantee is furnished to the respondent.

4) Pentagon was the client of the Bank, who approached the bank for furnishing a guarantee.

LAWS APPLIED TO THE CASE

When the case went to the High Court, it was held that it is a contract of guarantee.

As per section 126 of the Indian Contract Act 1872, a contract of guarantee means a contract to perform a promise or to discharge the liability of the third person in case of default. Here three parties are involved mainly, the person giving the guarantee is called “Surety”, the person on whose default the guarantee is given is called “Principal Debtor” and the person to whom the guarantee is given is called the “Creditor”. In this case, the surety is State Bank of India, the principal debtor is M/S Pentagon Engineering Pvt. Ltd. and the creditor is MulaSahakariSakharKarkhana Ltd.

As per section 128 of the Indian Contract Act 1872, surety's liability (State Bank of India) with that of the principal debtor (M/S Pentagon Engineering Pvt. Ltd.) is co-extensive, unless and until it is provided by the contract.

Further, when the suit was filed in the Supreme Court of India, it was held that it is a contract of Indemnity. As per 124 of the Indian Contract Act 1872, a contract of indemnity means a contract by which one party promises to save the other party from loss causes to him by the contract of the promisor himself, or by the conduct of any other party. This contract contains two parties namely, the person who promises to indemnify is called "Indemnifier" and who is to be indemnified is called "Indemnity-holder". In this case, the indemnifier is the State Bank of India and the indemnity-holder is MulaSahakariSakharKarkhana Ltd.

As it is a case of indemnity so as per section 125 of the Indian Contract Act 1872, the indemnity-holder (MulaSahakariSakharKarkhana Ltd.) is entitled to recover all damages, costs and sums from the indemnifier (State Bank of India) with no further delay.

Section 91 and 92 of the Indian Evidence Act 1872 are also applicable in this case which says that no evidence out of the terms of the agreement, whether on paper or oral, can be led by the parties to get out of the express terms. In the present case, oral evidence was considered by the High Court but Supreme Court denied it as per these sections.

ANALYSIS OF THE CASE

In this case, the respondent was a Cooperative Society and had a sugar factory. Its name was MulaSahakariSakharKarkhana Ltd. It entered into a contract with Pentagon Engineering Pvt. Ltd for the installation of a paper plant at Sonai Village on a turnkey basis. It allowed the Cooperative Society to use the leftover Sugarcane called "Bagasse". The total cost of the contract was rupees 3 crores and 40 lakh. Pentagon gave a guarantee of performance for machinery supplied by it. One of the clauses in the contract also said that 10% retention of the contract price by Cooperative Society in the following condition:-

1. 15.2.4% of the contract price will be paid after 3 months of installation of the paper plant
2. 15.2.55% of the contract price is to be paid after the successful working of the plant for 6 months.

Through a letter dated 6 April 1985, Pentagon suggested a modification regarding the change in payment clause regulating the Cooperative Society to waive its right to retain 10% of the contract price i.e. 34 lakh rupees. Pentagon also asked for a separate letter of credit from the Cooperative Society to furnish a guarantee of the bank for the respondent. The cooperative Society agreed to the modification and also asked Pentagon to submit the total performance guarantee and if this is not done then, Karkhana is entitled to recover the amount by deducting it from the balance payment. Pentagon agreed to this by a letter dated 16th April 1985 and said that once the letter of credit is given then, within 10 to 15 days, the bank guarantee would be furnished for them. Finally, on 4th September 1985, a bank guarantee numbered 88/17 was issued to the Cooperative Society by the State Bank of India, Dombivli. The guarantee covered 10% of the contract price. Thereafter disputes and differences arose between the cooperative Society and Pentagon which led to the termination of the contract by the Cooperative Society with the Pentagon. The termination was made by a notice on 17th July 1987. Cooperative Society also claimed amount of rupees three crores, twenty-three lakh, twenty-eight thousand, two hundred and nine. Pentagon in return not only denied termination but also disputed its liability to pay the amount. Pentagon also raised an amount of four crores, sixty-six lakh, seventy-three thousand and three hundred rupees. After this Karkhana invoked the bank guarantee but the Bank denied it and stated that they are only liable to pay if there is any damage or loss due to design, performance, workmanship or supply of defected material by the Pentagon. Cooperative Society further filed a suit against the State Bank of India in the Civil Court, Senior Division, Ahmednagar numbered 310. The case then passed on to the High Court, where it was on 23rd February it was held, that there is a contract of guarantee and State Bank of India was ordered to pay 10% of the contract price to the Cooperative Society at an interest rate of 14% per annum. The reason for this judgement was the involvement of three parties i.e. Creditor (MulaSahakariSakharKarkhana Ltd.), Principal Debtor (M/S Pentagon Engineering Pvt. Ltd) and Surety (State Bank of India) as per section 126 of the Indian Contract Act, 1872. A guarantee is a tri-party contract whereas, an Indemnity is a bi-party contract. Later the appellant (State Bank of India) unsatisfied with the decision of the High Court filed a petition in the Supreme Court of India, where it was held that it was a contract of indemnity (section 124 of the Indian Contract Act, 1872) and not of guarantee (section 126 of the Indian Contract Act, 1872). The reason for this judgement was the involvement of two parties i.e. Indemnity holder (SahakariSakharKarkhana Ltd) and Indemnifier (State Bank of India). Supreme Court of India observed that the document doesn't contain any ambiguity, so here surrounding conditions are not to be considered. It is

very clear from the facts that the appellant was to indemnify the respondent against all losses, claims and damages, it has suffered because of the pentagon. This is a very clear definition of indemnity as per section 124 of the Indian Contract Act, 1872. Supreme Court also said that the document in question doesn't contain any word or expression such as "unequivocal condition" which is used commonly in bank guarantees. The court further followed by saying that the contract of guarantee is a separate, distinct and independent contract between the surety and creditor, which is missing in this case. This contract carries no clause of the Pentagon requiring a Bank Guarantee to be furnished to the respondent. Moreover, a bank guarantee must be created on its independent terms and conditions. Court further added that High Court has made a mistake by considering oral evidence out of the agreement produced by the parties. This is not applicable as per sections 91 and 92 of the Indian Evidence Act, 1872. The court ordered the appellant to indemnify the respondent as soon as possible. Supreme Court restored the decree and appeal was allowed with costs.