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# **A STUDY ON BANK GUARANTEE AND JUDICIAL INTERVENTION**

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## **ABSTRACT**

Bank guarantees play an important part in business expansion, assisting businessmen to develop. As financial companies use guarantee clauses to preserve their loans, companies and business owners are starting to rely on bank guarantees. Currently, major commercial or investment agreements are supported by bank guarantees to give payment assurance and have been regarded as “life-blood” in this scenario. Here, the researcher has made an effort to explain the concept of bank guarantee and its various types. The paper also describes how to invoke a bank guarantee and when it couldn’t be invoked by analyzing exceptions of Bank guarantee. Further, Covid-19 has given rise to various legal disputes so the research also focuses on the “Force majeure” concept which is introduced to deal with cases arising from Covid-19 situations.

**Keywords:** Bank Guarantee, Contract, Encashment, Invocation

## **INTRODUCTION**

A bank guarantee is a three-way contract between “the banker, the beneficiary, and the individual or customer” wherein the beneficiary promises to make the payment and the bank acts as a guarantor and takes the responsibility to release the beneficiary from all liability in case of failure of payment. It is basically a contract which is made on the beneficiary’s behalf. “Bank guarantees are separate and independent contracts as it has nothing to do with the state of relations between the principal debtor and the creditor.”

Section 126 of Indian Contract act, 1872 deals with “Contract of Guarantee” which states that, “it is a contract to perform a third person’s promise or discharge his liability in case of his default.” There might be a spoken or written form of guarantee. It is said that, the beneficiary must use the Bank guarantee on or before the termination date of the guarantee and if the bank does not obtain a request within the stated validity period, it is relieved of its responsibilities. The beneficiary must issue a written letter to the bank outlining the actions that happened and for which they want guarantee to be executed.

“The fundamental reason for instituting bank guarantees is to facilitate the free movement of goods, as bank guarantees protect creditors from losses and, as a result, assist them in claiming the debt in the event of a failure.” Hence, this research focuses to study the concept of Bank guarantee, its various types, exceptions, and also the judicial intervention that took place during the Covid-19 pandemic.

## **OBJECTIVES**

- To study the various types of bank guarantee.
- To understand the exceptions against the invocations of a bank guarantee.
- To investigate the Judicial intervention of bank guarantee during Covid-19.

## **METHODOLOGY**

The study is based on a secondary method. There are different sources used while conducting this research such as articles, journals, research papers and newspapers. Articles and journals helped the researcher in understanding the concept of Bank guarantee as well as the contract act, 1872. They are analyzed, interpreted, and narratively portrayed.

## HYPOTHESIS

H<sub>0</sub>- The Covid-19 pandemic hasn't brought any changes in the contract of Bank Guarantee.

H<sub>1</sub>- The Bank guarantee cannot be granted if the parties have committed fraud.

## RESEARCH QUESTIONS

1. In what ways, a person acquires Bank guarantee?
2. What are the exceptions of the Bank guarantee?
3. How Covid-19 has made judicial intervention of Bank guarantee?

## RESEARCH ANALYSIS

### TYPES OF BANK GUARANTEE

There are two different kinds of bank guarantees that can be provided based on invocation:

1. **Conditional Bank Guarantee:** In this situation, the bank will only make the payment if the debtor meets the specified conditions outlined in the guarantee contract. Conditions can include things like proof of default, consent from a third party, and so on.

In the case of "*Hindustan Construction Co. Ltd. vs State of Bihar and others*," the Supreme Court ruled that the beneficiary of a conditional bank guarantee doesn't provide an unrestricted right to exercise the guarantee and seek immediate payment. The court also ruled that the conditions listed in the bank guarantee contracts must be met in order to activate the bank guarantee's encashment.

2. **Unconditional Bank Guarantee:** In this situation, the bank shall make the payment as soon as the bank guarantee is invoked. In the case of "*UP Coop Federation Ltd. versus Singh Consultants and Engineers (P) Ltd.*," a contractor provided two bank guarantees for the building of a Vanaspati plant. In this scenario, the bank agreed to pay the money 'On First Demand' and not to remove the guarantees until a certain period. There was a disagreement between the Board and the contractor. The contractor demanded an injunction to prevent the bank guarantees from being cashed. The Supreme Court ruled that it is the duty of a bank to make payment at the time when request is received, with no objections or contestation, regardless of the parties' dispute. The court further emphasized that unconditional bank

guarantees should be limited solely in circumstances of fraud, irreparable injury, and specific equities.

### **EXCEPTIONS AGAINST THE INVOCATIONS OF A BANK GUARANTEE**

Even though a bank guarantee is intended to protect the creditor, there are specific circumstances in which the creditor cannot utilize his right of encashment. These exceptions are as follows:

**“Fraud”**- If the bank discovers that there is clear cheating on the side of the beneficiary, then a court proceeding can be granted against encashment of the bank guarantee. The fraud has to be severe enough to corrupt the entire transaction. This principle was highlighted in the case of *“Sztejn v. J. Henry Schroder Banking Corp.”* The fundamental reason for the fraud restraining order is to safeguard this credit system from exploitation. This thought exemplifies the phrase *“ex turpi causa non obiter actio,”* that means *“the truth unravels everything.”* In addition to this, in the case of *“Rigoss Exports International (P) Ltd. v Tartan Infomark Ltd,”* it was determined that because the bank guarantee was acquired through fraud, they were considered to be void in nature and the recipient was not entitled to claim the sum. Furthermore, it was also determined that in such cases of fraud, the court has the authority to take action and restrict the encashment of a bank guarantee.

**“Irretrievable injury/harm or injustice”**- If the injury or injustice is of such unusual and irreversible type that it might exceed the conditions of the guarantee and have a negative impact on economic activities in the country, the judges can recognize such cases as exceptional and issue an injunction appropriately.

**“Special Equity”**- The concept of special equities means compensation for injuries sustained as a result of unusual circumstances and it was introduced in the case of *“Ansal engineering Projects Ltd. vs Tehri Hydro Development Corporation,”*

### **JUDICIAL INTERVENTION OF BANK GUARANTEE DURING COVID-19**

The entire economy has been devastated by Covid-19. Many contracts have been postponed. The Indian government, on the other hand, has classified the circumstances a *“force majeure.”* This declaration has impacted the Bank guarantee as well. Several judges declined to offer injunctions purely because of pandemics.

In the case of “*Haliburton Offshore Service vs Vedanta Limited*,” the petitioner signed a deal with Vedanta Ltd to build infrastructure, comprising oil wells. The job was nearly finished but the nationwide lockdown was enforced, and the petitioner failed to fulfill his contract agreements, and the assignment was not finished within the stipulated timeline. The Delhi High Court gave the decision for the petitioner and ordered the bank guarantees to be cancelled. The court determined that the petitioner’s inability to satisfy contractual obligations was primarily because of nationwide shutdown enforced by the covid-19 epidemic, that was prima facie proof of force majeure. The court also ruled that the simple presence of the covid-19 and the nationwide shutdown did not justify all contract violation or non-performance. The actions of the parties prior to the shutdown will be examined in the light of project delivery, and the judge will then determine whether or not it will grant injunctions.

On the other hand, in the case of “*Standard Retail Pvt. Ltd vs Gs Global Corp*,” the petitioner indicated that the contract was not fulfilled due to Covid-19 and other parties who were in South Korea were capable of doing so. The Bombay High Court dismissed the petitioner’s argument, ruling that covid-19 and resulting shutdown would not be regarded as force majeure in this case since, in order to invoke the force majeure clause and pursue injunctions under specific equities, the agreement has to be entirely unachievable.

## FINDINGS AND SUGGESTIONS

- From the above analysis, it can be found that, Bank guarantee is provided so as to protect the creditor in case of default of payment. However, as the analysis in this paper shows, it has not been free of legal suits because of its nature and the injunction against issuing them.
- Also, types of bank guarantee have been introduced so that the creditor can choose the way in which he wants to acquire guarantee but then too, people conduct fraud and injustice to obtain guarantee from bank which is considered to be void in nature. This proved the hypothesis true.
- Further, the Covid-19 outbreak has raised numerous legal concerns. Force majeure is a complicated topic in a contract because it could save parties from damages while also unfairly benefiting others when another party fails to perform their duties. So, it can be wrong to say that, Covid-19 hasn’t brought any changes in the bank guarantee contract.

- Hence, it can be suggested that bank guarantees can have more strict rules so that no person can obtain it for fraud purposes. These rules can be, high penalty and no further bank guarantee if someone is found committing fraud.

## **CONCLUSION**

It can be concluded from the above study that a bank guarantee is produced by a contract between the bank, the creditor, and the debtor, all of which are independent of one another. There is no involvement from the courts in executing or invoking bank guarantees, though in some cases, such as fraud, and in cases of irreparable loss or injustice, the judiciary must intervene to safeguard the parties' interests. The parties must always be permitted to keep their promises in accordance with the provisions of the contract, with little involvement from the court. Further, the Covid-19 situation has given more burden on courts to decide the judgment of the case. Force majeure was introduced wherein the parties who haven't fulfilled their contractual duties due to lockdown can be saved.

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