

Validity of invocation of bank guarantee to be judged on facts of each case: Supreme Court

Thu 13 Oct. 2016

Legitimacy of invocation of bank guarantees has always been a bone of contention between the parties who have entered into commercial arrangements. While the general view of the courts in India has been that invocation of bank guarantee should generally be not interfered by the courts when challenged, as it will defeat the purpose of such guarantees in commercial contracts. However, there is no dearth of judicial pronouncements against invocation of bank guarantees albeit in exceptional circumstances.

A bank guarantee is a written contract given by a bank on behalf of its customer. By issuing this guarantee, a bank takes responsibility for payment of a sum of money in case, if it is not paid by the customer in performance of its contractual obligations.

There are two types of bank guarantees: i) Unconditional bank guarantee- In an unconditional bank guarantee, the bank/guarantor has to pay the guarantee amount to the beneficiary in whose favour the bank guarantee has been issued on demand, irrespective of any pending disputes; ii) Conditional bank guarantee- In a conditional bank guarantee, the bank/guarantor has to pay the guarantee amount to the beneficiary in whose favour bank guarantee has been issued on demand, only after the specific conditions for invocation in the contract are fulfilled.

The law with respect to the grant of injunction against invocation of bank guarantee has been settled by catena of judicial pronouncements. Courts have consistently held that an unconditional bank guarantee, which is an independent agreement between beneficiary and the Bank, can be invoked by the beneficiary, regardless of the disputes between the beneficiary and principal obligation (i.e. the party on whose behalf the bank guarantee has been given). It is a settled position that invocation of unconditional bank guarantee cannot be stayed by the courts except (i) in case of fraud which would destroy the very purpose for which such bank guarantee was issued and (ii) in a case where encashment of the bank guarantee would result in irreparable harm or injustice to one of the parties concerned. In view of the aforesaid settled position, a party seeking stay against invocation of the bank guarantee used to find it very difficult, nay impossible, to obtain favourable order. However, in its recent pronouncement, the Hon'ble Supreme Court of India seems to have made a paradigm shift by holding that each case of injunction against invocation of the bank guarantee has to be decided with reference to the facts involved therein. The Apex Court in *Gangotri Enterprises v. Union of India* held that while there can be no quarrel to the proposition laid down in the cases pertaining to encashment of bank guarantees, the same would not be applied in every case. Holding that the in the case in hand, law laid down in the case of *Union of India Vs. Raman Iron Foundry* was applicable, the apex court reversed the judgment of Allahabad High Court which declined to grant injunction against invocation of bank guarantee by beneficiary party.

The present ruling of the Supreme Court has widened the so far restrictive parameters with which a case of grant of injunction against bank guarantees were being consider by the courts. The Apex Court has held that facts and circumstances of the case have to be considered and the court has not to apply or follow the general propositions relating to bank guarantee cases, regardless of the facts peculiar to each case. The judgement suggests that invocation of bank guarantee is not justified merely because the party invoking the bank guarantee has some claim of damages against the party who furnished the bank guarantee. It has been held that a claim for damages is not a crystallised or ascertained amount or a sum due and payable *in praesenti* (meaning 'at present'), therefore invocation of bank guarantee would not be justified on the basis of such claim which are yet to the decided by the competent forum. The court further held that bank guarantee given for searching the performance of one contract cannot be invoked for claims or disputes in another contract between the same parties. This judgment has to some extent diluted the position that an unconditional bank guarantee can be invoked regardless of the dispute between the beneficiary and the principal obligation. The Supreme Court in some ways has supplemented to the line of authority of judgments against invocation of bank guarantee by beneficiary like the *Hindustan Construction Co. Ltd. v. State of Bihar*, which held that the invocation of bank guarantee will have to be strictly in accordance with the terms of the contract/Bank guarantee deed.

This judgement of *Gangotri Enterprises* will certainly come to the rescue of litigants, primarily contractors executing work under contracts awarded by government agencies and the said agencies were exercising unbridled discretion in the matter of encashment of bank guarantees furnished by the contractor. A general belief that bank guarantees can be encashed irrespective of the main dispute between the contractor and the department, or for covering the claims for damage, which are yet to be crystallized, has been set right but this judgement. Therefore, whenever any party would seek to encash the bank guarantees provided by other party to the contract on the basis of their claims of damages, such an attempt would not be successful as a claim of damages is not a sum due and payable *in present*. Similarly, bank guarantee given for one contract cannot be encashed for breaches/disputes concerning to another contract



Ravi Singhania
Managing Partner
Email: ravi@singhanian.in