
INTERNATIONAL JOURNAL OF ADVANCED LEGAL RESEARCH

**A CRITICAL ANALYSIS OF WHETHER THE BANK GUARANTEE
CAN BE INTERFERED BY THE COURT: ANSAL ENGG. PROJ. LTD.
V. TEHRI HYDRO DEVELOPMENT CORP. LTD & ANR. 1997**

- Kimaya Vinayak Dalvi¹

ABSTRACT

Section 126² of the Indian Contract Act, 1872 defines a guarantee as a contract to carry out a promise or release a third party from liability in the event that a person's breach or default. In a bank guarantee, the bank, the lending institution, serves as an assurance to the creditor. In the case that the applicant fails to fulfill or comply with the terms of the agreement, the issuing bank will provide a comfort to the beneficiary of losses or damages. When issuing a guarantee, the financial institution guarantees payment of the specified sum of money (as stated with in bank guarantee) towards the beneficiary in the event that a specific contract is not performed according to its rules and guidelines. By offering the bank guarantee, the buyer ties himself towards the seller and implies a duty to uphold the contract's terms and conditions. It will be honoured by the bank if it doesn't follow the same rules. The guarantees aren't only granted in transactions; they are also provided to government agencies for the procurement of land, certain projects like hydropower or mines, etc. For instance, when a corporation submits a bid for a mine, company must provide the city officials in the state where it intends to submit the offer with a guarantee. Bank guarantees are provided for a certain purpose and for a specific length of time, and they automatically expire or are reversed when the intended purpose and/or time period are fulfilled. For instance, if the customer fails to pay the vendor for the items provided, the beneficiary may rescind a bank guarantee. In this case, the bank reimburses the beneficiary up to the amount of the bank guarantee. The idea of a bank guarantee is primarily the topic of this paper. And whether the

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²The Indian Contract Act, S 126, No. 9, Acts of Parliament, 1872 (India).

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judiciary can intervene in such a bank guarantee will be analyzed with the help of various case laws.

Keywords: Section 126, Indian Contract Act, 1872. Liability, Default, Bank guarantees, Reimburses, Revoked, terms & conditions.

INTRODUCTION

Section 126 defines contracts of guarantee. A "contract of guarantee" is an agreement to fulfil a promise made by a third party or release that party from obligation in the event of a breach. The individual providing the guarantee is referred to as the "surety," the party to whom it is provided is referred to as the "primary debtor," and the party to whom it is provided is referred to as the "creditor." A promise may be expressed verbally or in writing. As the name implies, a "bank guarantee" is a guarantee or assurance that a financial institution provides to a third party in the event that a borrower is unable to make payments on a debt or otherwise fulfil its financial obligations. The bank will then reimburse the party who received the guarantee in this situation. A person often qualifies for said guarantee with his or her normal banker, though he or she may do so with any banker. Any bank can apply for bank assurance to ensure its creditworthiness prior to issuing it. A bank may occasionally request additional security from the applicant in place of a bank guarantee. This is often done by issuing a fixed deposit that has a lien formed on it and cannot be liquidated without the bank's and the individual in whose favor it was given approval. This covers the sum of bank assurance. The individual who is issued serves as both a security and guarantees that his finances are covered by bank assurance.

For example: ABC Ltd. and XYZ Ltd. engage into a supply agreement under which XYZ Ltd. is obligated to provide ABC Ltd. with continuous supplies of raw materials. Additionally, ABC Ltd. requests financial assurance from XYZ Ltd. for said contract to cover any shortages in raw materials. As it is necessary to give financial security, XYZ Ltd. may do so by requesting a financial guarantee.

Mr. X and Mr. Y enter into a contract for the project's timely completion. In addition, Mr. Y is required to provide a bank guarantee ensuring that they can recoup Mr. X's losses if the job is not finished within the specified period of time. Given that the execution of the contract is involved in this situation, Mr. Y must submit an application for a performance guarantee.

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The applicant is paid certain costs based on the amount of the bank assurance for the service of granting a bank guarantee towards the applicant. Additionally, the applicant is assessed costs based on the amount of the bank assurance for the service of giving bank guarantees to both the applicant. Additionally, because it is significantly riskier, fees for financial guarantees are higher than fees for performance guarantees. From India in instances of unconditional bank guarantees, a court's jurisdiction may only be invoked if there is irreparable injustice or when there isn't even a remote chance of recovery. The question of whether the bank guarantee can be interfered by the court? In analyzed in detail with the help of various cases.

LITERATURE REVIEW

Articles

P.M. Bakshi, Bank Guarantees (1995)³

- The Supreme Court has reiterated that the absence of misbehaviour and irreparable harm precludes the imposition of an injunction against such a unconditional bank guarantee.
- The court made this decision in *SwenskaHandetsbanken v. Indian Charge Chrome*⁴. After carefully reviewing previous decisions, the court emphasised that a recognized bank guarantee and irreversible credit letters cannot be altered for enforcement reasons unless there is deception as well as irrecoverable unfairness present inside the matter, and fraud must be proven.

Michelle Kelly-Louw, Illegality as an exception to the autonomy principle of bank demand guarantees⁵

- Commercial letters of credit, backup letters of credit, and demand guarantees are all recognised as separate contracts whose performance cannot be influenced by a court as a result of factors may have contributed to the guarantee and credit in question.

³P.M. Bakshi, Bank Guarantees, 37 JILI (1995) 109, <http://www.scconline.com/DocumentLink/10z4n6Z0>

⁴*Svenska Handelsbanken vs Indian Charge Chrome Ltd*, 1994 SCR (1) 261, 1994 SCC (2) 155.

⁵Kelly-Louw, Michelle. "Illegality as an Exception to the Autonomy Principle of Bank Demand Guarantees." *The Comparative and International Law Journal of Southern Africa* 42, no. 3 (2009): 339–86. <http://www.jstor.org/stable/23253107>.

- The premise behind a documentary loan plus demand guarantee activity is that the bank should pay if the credentials (where applicable) presented are in fact compliant with both the loan's terms or guarantees, and the bank really shouldn't reimburse if the documents need not comply.
- Nevertheless, there are only modest restrictions on the independent idea of demand assurances, including such letters of credit. In practise and through time, these limits have been acknowledged and accepted.

Jaideep Khanna, "SPECIAL EQUITIES" As an Exception to Restrain Bank Guarantee Invocation⁶

- Bank guarantees are the cornerstone of security in contemporary commercial contracts and also have largely discouraged interim court intervention.
- Indian courts have established the exceptions of "fraud" or "irretrievable harm" to provide injunctive relief in the exercise of their equitable power by adhering to common law jurisprudence. A party may also show the existence of such a "special situation" under a third exception known as "special equities." However, "particular equities" cannot be claimed in isolation to support the issuance of an injunction. It requires the addition of irreparable hurt or injustice.
- Mostly in Standard Chartered Bank case, the supreme court of India broke with a string of precedents in 2019 by allowing a party to assert "unique equities" as a stand-alone exemption. As a result, the Delhi High Court has recently been given the responsibility of hearing cases where the "COVID-19 epidemic" has been identified as a situation warranting the issuing of injunctions.
- The article makes the case that the Standard Chartered decision's ambiguity has drawn judicial criticism and may lead to a rise in injunction requests that claim the exception of "unique equities" without proving the cause of irreparable harm. Therefore, a "course-correction" is absolutely necessary to maintain the integrity of bank guarantees.

⁶ Khanna Jaideep, "Special Equities" as an Exception to Restrain Bank Guarantees Invocation, (2021) 8.2 GNLU L. Rev. 359 <http://www.scconline.com/DocumentLink/g26G36du>

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Rolf Meyer-Reumann, Rights and Obligations in the Event of Bank Guarantees Being Called in Governmental Projects⁷

- It has been standard practise for owners to take bank guarantees payable immediately upon first demand in place of cash deposits. Thus, two relationships come into play in the event of non-performance: the contract provides information about whether the contractor worked satisfactorily or not, as well as the bank guarantee can also provide that the bank is required to make payment "unconditionally" as well as "on first demand." The issue is how much these various relationships between various parties might influence one another
- This article addresses the issue of whether the owner can also invoke the guarantee may come up if it is obvious that he received no losses or damages as a result of the non-performance.
- It also analyses whether the contractor performed in accordance with the agreement is in question between the parties. The issue may be whether the proof is sufficient to affect the ability to contact or block the calling of the guarantee.

Akshi Narula, Financial Crimes In India⁸

- A sort of bank guarantee known as a LoU is used for both international trade and import transactions. The following provisions can be used to comprehend the legal framework relating to the issue of such instruments: An "agreement of guarantee"
- A "bank guarantee" is what is referred as when the aforementioned guarantee is provided by a bank. After the major debtor has defaulted, the banker may additionally use its right of lien over the guarantor's account amount that is in his control.
- The Reserve Bank of India controls how banks operate, including their plans and operations, by issuing a number of directives. The guidelines for a bank guarantee for situations where the bank acts as the guarantor are as follows:

BOOKS

“Avtar Singh, 2017, Law of Contract and Special Relief Act”⁹

⁷ Meyer-Reumann, Rolf. “Rights and Obligations in the Event of Bank Guarantees Being Called in Governmental Projects.” *Arab Law Quarterly*, vol. 17, no. 1, 2002, pp. 28–38. *JSTOR*, <http://www.jstor.org/stable/3382160> . Accessed 21 Sep. 2022.

⁸ Narula Akshi, financial crimes in India, 5.2 RFMLR (2018) 216, <http://www.scconline.com/DocumentLink/Bc4P7WWq>

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- The commitment made by a bank in the form of a bank guarantee also resembles an independent obligation that is repayable upon demand.
- It is unrelated to how the contract's parties are currently getting along. It is an appropriate way to guarantee payment in business transactions.
- Regardless of any pending disagreements between the parties, the beneficiary is allowed to receive the full sum covered by the guarantee.

“Moitra’s, 2016, Law of Contract and Specific Relief”¹⁰

- Based on the Court's consistent stance in cases that involve this same invocation of bank guarantees in addition to the policing of those guarantees by beneficiaries, ad intervening period injunctions precluding the Bank from implementing the pay out under a letter of credit or even a bank guarantee could only be approved in exceptional circumstances, as well as when there are allegations of fraud.
- The principle that trade should not be interfered with is widely accepted. The Court has further noted that bank agreements must be honoured without interference from the courts. Even so, the Bank cannot use it if a bank guarantee contract has not been granted.

“SN Gupta, 2016, The Banking Law in Theory and Practice”¹¹

- Issues pertaining to the guarantee contract, such as how the surety's or the principal-unilateral debtor's actions influence the subject of limitation. So far as it concerns the issue of limitation, this also entails a consideration of the reciprocal rights and obligations of the principal-debtor as well as the surety.
- Suit based on a guarantee regarding the First Question, this book discovers that the lawsuit based on a guarantee is the lawsuit covered under Part II of the Limitation Act, 1963, which regulates lawsuits relating to contracts under Articles 6 to 55. The statute of limitations for all such lawsuits is three years.

⁹ Avtar Singh, 2017, Indian Contract & Specific Relief Act, published by - Lucknow: Eastern Book Company, 12th Edition, ISBN-10: 9351454533 ISBN-13: 978935145453.

¹⁰ Volume 2, Moitra’s, Law of Contract and Specific Relief, published by- Universal Law Publishing, 7th Edition, 2016. ISBN-06: 9788175344389 ISBN-12: 9789350351055

¹¹ Volume 2, S N Gupta, The Banking Law in Theory and Practice, 1706, published by-Universal Law Publishing, 6th edition, 2016. ISBN-05: 9788175344174 ISBN-18: 9788131253878

“Dutt on Contracts”, The Indian Contract Act, 1872.¹²

- Any performance guarantee provided by a bank must be honoured in accordance with its terms. The courts will only occasionally intervene with the system of irrevocable commitment that banks have assumed.
- This is what keeps the world of trade alive. Bank operations and commitments are on a different scale. Trusts in global commerce may suffer irreparable harm if they are not allowed to be honoured without court intervention.

“P C Markanda, 2018, The Law of Contracts”¹³

- In order to make it clear only when bank guarantee will become encashable, a bank guarantee should state why it has been provided.
- If the objective of submitting a bank guarantee also isn't stated, it is unclear in what situations it would be utilized and when bank guarantees could've been cashed. Consequently, any such bank guarantee just wouldn't satisfy the requirements thereof.

STATEMENT OF PROBLEM

In the Indian Contract Act, under section 126, contracts of guarantee are written which cover the concept of bank guarantee in India. Although it does talk about judicial interference in the bank guarantee in certain cases, it does not take into consideration a holistic view of the same.

It only mentions a few aspects as to when the court can interfere in bank guarantee while there could be many other aspects which could be addressed. With evolving technology, the bank guarantee can also be done online which might create more hurdles in front of the judiciary. We have various views as to the interference of judiciary in the Bank Guarantee and it varies from court to court and the Judge's discrimination.

RATIONALE OF STUDY

Bank guarantee contracts are guarantee contracts which are given as security for funds of the creditor or for specific performance by the surety, but in this case the bank guarantee can be invoked by the creditor as and when the default is committed on his own discretion. The bank

¹² Dutt on Contracts, 767, published by- Eastern Law House, 11th edition. ISBN: 9788171773428

¹³ Volume 2, P C Markanda, The Law of Contract, 1446, Published by- Universal LexisNexis, 4th edition. ISBN: 9788131253946

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does not confirm about the default from the applicant and straight up gives the specific performance or the security which increases chances of fraud. And in cases of misappropriation of funds or frauds the court would interfere in the bank guarantee. By the courts interference the objective of the bank guarantee is lost and hence in this paper we will critically analyze whether the scope of courts interference should be widened or not.

RESEARCH OBJECTIVES

The purpose of this research is

- To research Bank Guarantee's position towards judicial intervention.
- To understand various view of different courts with respect to Judicial Interference in Bank Guarantee in various case laws
- To examine various amendments to the laws governing bank guarantee
- To study committee reports and national guidelines on Bank guarantee
- To understand the scope and important statutes concerning Bank guarantee
- To critically analyze the judicial interference in the bank guarantee and to give respective suggestions for the same.
- To analyze the judgement of cases from the 18th and 19th century
- To learn about the view of judicial interference in bank guarantee in the 20th century

RESEARCH QUESTIONS

- Which provision in the Indian Contract Act, 1874 talks about bank guarantee?
- What are other laws or statutes which are concerning bank guarantee?
- What are the different types of Bank guarantees?
- How can the bank guarantee be invoked?
- What is the limitation period for bank guarantee?
- Can the courts interfere in the contracts of bank guarantee?
- Which are the case laws relating to bank guarantee?
- In what circumstances the court can interfere in the Bank guarantee?
- What are the advantages and disadvantages of the Bank Guarantee?
- What are the recent developments in Bank guarantee?

RESEARCH METHODOLOGY

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The methodology that would be applied for carrying out this research is Doctrinal, Analytical and Comparative research. In this research the primary sources of data are the Constitution, Indian Contract Act, 1872, Limitation Act, Rules, Indian Companies Act, 2013, Government Orders, Judicial Precedents, Report of various Committees. The secondary sources of data comprise of published books, journals, scholarly articles, news releases, print media, online journals, research reports and others were used.

MEANING NATURE AND SCOPE OF BANK GUARANTEE

When a borrower fails on a loan, a lending institution provides a bank guarantee, guaranteeing that the loss will be covered. The guarantee enables a business to purchase items that it would not otherwise be able to, supporting business growth and encouraging entrepreneurship. Bank guarantees come in a variety of forms, involving indirect and direct guarantees. In both domestic and international transactions, banks frequently offer direct guarantees to the beneficiary. Direct guarantees are appropriate when the lender's security is not reliant on the validity, enforceability, and existence of the principal obligation. Regarding cross-border and international transactions, people frequently opt for direct assurances since they are less formal and hence easier to adapt to foreign judicial systems and norms. The export industry is the one that uses indirect guarantees the most, particularly when public enterprises or government agencies are the recipients of the guarantee. Due to regulatory restrictions or other formal requirements, several nations do not support international banks and guarantors. A second bank is employed when there is only an indirect guarantee; frequently, this new bank is a commercial company with a head office in the country of the beneficiary.

Parties to a Contracts

Applicant: The person who asks a financial institution to provide a bank guarantee is known as the.

Beneficiary: The individual or entity in whose favour a bank guarantee being issued and who is eligible to file a suit for reimbursement in line with the guarantee's given terms and conditions.

Guarantor, Surety, or Bank: The financial institution that that responds to a customer's request for a letter of guarantee. A bank that advises or communicates the guarantee towards the beneficiary on behalf of that party is known as a "advising or transmitting bank."

Advantages

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- It helps a person win more contracts that's because the credit burden is decreased;
- The beneficiary is shielded from the fiscal risk associated with a contract.
- After the guarantee is issued, the applicant gains more credibility.
- Ensuring a simple procedure with little paperwork requirements.

Disadvantages

- Some banks go through a highly rigorous process to determine the applicant's financial trustworthiness; in these circumstances, the time it takes to issue a bank guarantee may be considerable.
- Banks examine profitability while determining a company's financial credibility. As a result, guaranteeing a loss-making firm may be challenging.
- A security deposit may be requested as protection against the issuance of a guarantee.

Different Types of Bank Guarantees

BGs are divided into numerous sorts based on their intended uses.

These are a few of them. based on the method of issuing.

I. BG Direct: A direct BG is one in which the account holder requests a guarantee from the bank on behalf of the creditor. Direct BG somehow doesn't rely on the main obligation's existence, legality, or enforceability.

II Indirect BG: An indirect BG is one that is issued in exchange for a direct BG by another bank. In such cases, the issuing bank will ensure that it covers any losses if the other bank has losses as a result of a claim being made against a guarantee.

Taking into consideration the guarantee's terms:

I. Unconditioned BG: Unconditional BGs guarantee that the beneficiary will receive the money "unconditionally and irrevocably" upon making the first demand under the guarantee. As a result, the beneficiary will become the sole arbiter of the contract's performance, and the bank is not permitted to contest the judgement or present evidence or ask questions about it. The beneficiary's demand shall be decisive and final in that regard.

II Conditional BG: These BGs are known as conditional BGs since they have requirements that must be met in favor for the beneficiary to fully invoke the guarantee. Which type of assurance it is depends critically on the guarantee's language. Even while some guarantees use the phrases "unconditionally and irrevocably," they qualify these terms by mentioning a

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condition or an event that makes the underlying guarantee redeemable. In this case, the BG in dispute would be classified as a conditional BG.

Depending on the bank's performance in accordance with the guarantee:

I. BG Financial: A financial BG guarantees repayment of funds in the event that the party (debtor) does not carry out a specific project or operation completely. The bank will pay when a project isn't finished on time in accordance with the financial guarantee agreement.

II. BG for Advance Payment: If the party (debtor) does not fulfil its contractual obligations after receiving a progress, the bank is obligated by this guarantee to return the advance.

III Deferred Payment BG: The beneficiary is given the option of a deferred time frame or a set amount of time for a deferred payment BG. In the event that the debtor is unable to fulfil their contractual obligations, the bank will typically pay the debt in instalments under the terms of this guarantee.

IV Execution of the Performance/Contract BG: This assurance ensures that services will be provided as agreed upon and that items will be delivered on time. In the event of any delayed in rendering services or carrying out the terms of the contract, financial compensation will be paid by the bank.

Invocation of Bank Guarantees

The beneficiary is required to use the BG in accordance with the terms of the contract and before the guarantee expires. The beneficiaries of a BG can also be prevented from claiming the BG because the providing bank is required to abide by and honour the guarantee's conditions. Banks are released from liability if they do not receive any claims on or before the expiration of the guarantee's validity period. In contrast to Conditional BGs, which restrict the beneficiary's ability to invoke the guarantee as well as demand immediate payment, Unconditional BGs ensure that the beneficiary will get payment "unconditionally and irrevocably" upon making the first request under the guarantee. Regardless of any ongoing disagreements between the beneficiary and the debtor, the beneficiary may use BGs. A BG also reflects an agreement between the parties, whereby the banker creditors are sworn to pay the disputed amount.

Limitation Period for invocation of Bank Guarantee¹⁴

A BG claim must be brought it within thirty years if the beneficiary is a governmental agency or local entity, and inside 3 years in any other circumstances, in accordance the with Indian Limitation Act dated 1963. Before the Transactions (Revision) Amendment, 1996 act to the ICA, BGs featured language saying that "the bank would've been liquidated under the assurance unless the demands underneath this guarantee is brought within 6 months after the end of a bank guarantee." Any provision limiting the bank's liability would be void and unenforceable from the beginning if a beneficiary of a BG asserts the guarantee during the claim term for a default which the debtor chooses to commit while the agreement is still in effect.If the bank refused to pay in this situation, the beneficiary could sue the commercial bank within the timespan outlined in the Limitation Act of 1963. Since there are no demands under the guarantee, the bank should either receive a certificate from the beneficiary indicating as much or a bank guarantee which has been duly cancelled by the beneficiary. If the beneficiary fails to deliver the guarantee, properly cancelled or certificate, the bank shall retain the security and cash margin of the Debtor until the expiration of the limitation period of the Limitation Act of 1963.

Stay on Invocation of Bank Guarantee

Giving someone total discretion may occasionally lead to power abuse that leads in corrupt and criminal actions. An illustration of this occurs when a beneficiary applies for BG with the fraudulent intention of making money, while being aware of his defective items and being ineligible for payment. It is critical to establish specific parameters for activating BGs in order to define an independent ambit and the extent of unconditional BGs.Indian courts have simplified the two exceptions that allow for the granting of an injunction just on invocation of irrevocable BG into the following:

1. The bank has knowledge of flagrant fraud that renders the underlying transaction invalid.
2. Particular justices, such as averting irreparable wrong between the parties.

Egregious Fraud

When a beneficiary has committed blatant fraud, which the bank discovers, an injunction against BG encashment may be imposed.Because broad and general promises need not meet the legal standards for any fraud, far less deceit of an egregious nature, the deceit must be so

¹⁴ Indian Limitation Act,1963, NO.36, Acts of Parliament, 1963 (India).

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serious as to contaminate the entire transaction. It is important to keep in mind that a demand filed by the beneficiary under BG may end up being fraudulent—not because the beneficiary defrauded someone when he or she signed the underlying agreement, but rather because of later occurrences or circumstances.

Special equity

Preventing irreparable injustice is a form of special equity. It has been suggested that "Special Equities" is a presumptive basis that would stop irreparable unfairness between the parties. Even though courts haven't yet dared to define or even define the term "Special Equities," each case must be resolved in light of the pertinent facts. However, a claim for special equity may enable the responder to an order prohibiting BG from performing. However, throughout order to be eligible for the deduction from unrepairable death or harm, the party seeking safety would need to show extraordinary cases that'd make it very difficult is for guarantor to recover his losses in case of winning this same main dispute. The courts have commonly noted that allowing the welfare benefits of an unwavering BG will indeed cause great damage or mistreatment to one of the parties involved. In other words, it would be necessary to make a strong case for irretrievable harm and/or irreparable injury.

Scope of a bank guarantee¹⁵

An Agreement Enforceable By Law is a Contract -The Indian Contract Act 1872

- All rupee/INR guarantees are governed by The Indian Contract Act of 1872.
- All rupee/INR guarantees are governed by The Indian Contract Act of 1872. Bank guarantees are governed by a tripartite agreement.
- The FCY Guarantees are all governed by Notification No. FEMA.8/2000-RB, which was issued on May 3, 2000.
- URDG - Standard Rules for Demand Guarantees, an ICC publication 758

¹⁵The Indian Contract Act, S 126, No. 9, Acts of Parliament, 1872 (India).

LEGISLATIVE FRAMEWORK OF BANK GUARANTEE

Key Guidelines for Bank Guarantee by the Reserve Bank of India (RBI)¹⁶

In order to meet the demands of the modern corporate environment, the RBI has developed laws and regulations regarding BGs over time. Among the most important rules are the following:

I. Tenure: Generally, no BG should be more than ten years old.

II. Unsecured Guarantees: The RBI has removed the 20% cap on unsecured guarantees (from June 17, 2004), and bank boards are now free to set their own rules for their unsecured exposures.

III. Security measures to prevent fraud: Banks shouldn't provide guarantees the behalf of clients who don't have access to credit from them. In addition, banks should advise recipients of guarantees to check with the bank that issued the guarantee to ensure its validity.

IV. Inter-institutional Guarantees: Banks may offer guarantees for loans made by other banks, financial institutions, and other finance firms as long as the promising bank assumes a financing responsibility equal to at least 10% of the value of the guarantee.

V. Repayment of Invoked Guarantee: When guarantees are invoked, payments to the beneficiaries must be made promptly and without objection.

Disclosure Requirements of Bank guarantee in Financials

As per schedule III of Companies Act 2013¹⁷:

- Any cash margin safety that can be represented within current the balance sheet assets like profitable cash on BG, like a security deposit, an private investments, etc., must be accompanied by a precondition in the Comments to Accounts.
- The price spent on BG shall be subtracted from Bank Guarantee commission.

¹⁶RESERVE BANK OF INDIA, https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=5130(last visited Sept. 22, 2022).

¹⁷Companies Act, 2013.Acts of Parliament, 2013 (India).

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- The comparable sum should be reported under short-term advances and loans on current assets if the BG charge is paid in advance. The appropriate banker compensates the debtor that whenever a bank guarantee gets utilised, and the sum must appear as a loan in your accounts.

Ghosh Committee Recommendations ¹⁸

The following suggestions from the High Level Committee, which was presided over by Shri A. Ghosh, the former acting governor of the RBI, should be put into effect by banks:

- i. As recommended by the IBA, banking guarantees should be given in serially numbered safety forms to avoid unaccounted issuance of guarantees as well as false guarantees.
- ii. Banks should advise recipients of guarantees that it is in their best interests to check with the bank that issued the guarantee to ensure its validity.

Amendment in General Financial Rules (GFR), 2017 - Acceptance of electronic Bank Guarantee (e-BG).¹⁹

170(i) (Amended) The offer security may well be acknowledged in the form of an insurance recognisance, account beneficiary demand draughts, fixed deposit receipts, banker's checks, bank guarantees (including e-bank guarantees), or payment internet in an appropriate condition, as long as they safeguard the purchaser's attention in every way.

171(i) (Amended) Achievement security may be provided in the form of health coverage surety bonds, account beneficiary demand draughts, receipts for fixed deposits from commercial banks, bank guarantees (including E-bank guarantees) from commercial banks, or online payments in a format that protects the buyer's interests in every way.

¹⁸RESERVE BANK OF INDIA, https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=5130(last visited Sept. 22, 2022).

¹⁹ AMENDMENT IN GENRAL FINANCIAL RULES 2017- ACCEPTANCE OF ELECTRONIC BANK GUARANTEE,<https://doe.gov.in/sites/default/files/Amendment%20in%20General%20Financial%20Rules%202017%20-%20Acceptance%20of%20electronic%20Bank%20Guarantee.pdf> (last visited Sept. 22, 2022).

JUDICIAL PRECEDENTS IN 18TH AND 19TH CENTURY

United commercial bank V/S Bank of India, 1981²⁰

It was decided that courts shouldn't issue orders preventing parties from carrying out agreements resulting from bank guarantees or letters of credit between two institutions. In that case, the High Court's order prohibiting the appellant-bank from remembering a payment made to respondent No. 1 "under reserve" was reversed after it was determined that it was difficult to determine from the evidence on file whether the plaintiffs used to have a prima facie case, that they had not proven they would suffer irreparable harm absent the issuance of an interim injunction, and that the balancing act of convenience did not favour the plaintiffs.

Maharashtra SEB v Official Liquidator, 1982²¹

In response to a demand from the SEB, a bank agreed to pay them a payment of up to Rs 50,000 before 48 hours. The supplier who had placed enough securities with the bank presented the guarantee on their behalf. The Board's demand was the only restriction on the bank's responsibility. The Board made a payment demand. The provider was a business that into dissolution. The bank's payment of the guarantee by the Board and the liquidator's attempt to stop them from doing so. Such a relieve was not permitted. The Board seemed to have the authority to require the guarantee's payment, as well as the bank had a authority to using the securities to pay for itself. If the liquidator believed the Board's actions in executing the guarantee were. He ought to take legal action against the Board.

United City Merchants (Investments) Ltd v Royal Bank of Canada, (1983)²²

According to the International Trade Organization, "this same system of announced unrepairable documentary funds has actually been established in international trade for the actual service purpose of providing towards the seller an assured loan agreement already before he parts with regulatory oversight of the goods and that does not permit whatever quarrel with the purchaser regarding the contract is performed of sale to be utilized as a surface for semi, reduction, or postponement of payment."

Ex turpi causa non oritur actio, or "fraud unravels all," if simple English must be selected is a maxim that is communicated through the exclusion for fraudulent conduct on the part of the

²⁰United commercial bank V/S Bank of India, 1981 AIR 1426, 1981 SCR (3) 300

²¹Maharashtra SEB v Official Liquidator, 1982 AIR 1497, 1983 SCR (1) 561

²²United City Merchants (Investments) Ltd v Royal Bank of Canada, ADA. [1982] 2 W.L.R. 1039.

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beneficiary attempting to find to advantage himself of something similar to the credit. His Lordship mentioned American authorities to the actual impact that the only case wherein court should stay misallocation of a credit system.

U.P. Co-Operative Federation Ltd vs Singh Consultants & Engineers (P) , 1987²³

That only major disputes, fraud, or unusual circumstances should cause the functioning of a bank guarantee to be suspended. A contractor provided two bank guarantees to ensure the appropriate building and commissioning of a Vanaspati plant. Up to a specific date, the institution was not allowed to cancel the guarantees and was required to pay unconditionally upon demand. In determining yet if the contractor had adhered to the provisions of the contract, the Board was to serve as the only arbiter. There were disagreements over the construction and operation of the facility between the Board and the contractor. In order to prevent the Board from implementing the guarantee, the contractor requested an injunction. The court saw no compelling reason to do so. The court believed that the expansion and growth of trade required the legitimacy and dependability of the ensured means of payment, such as verified letters of credit for foreign trade, bank guarantees in domestic trade.

Rachita builders and financiers pvt. Ltd. V/S Chetak construction lmtd and another, 1990²⁴

In accordance with the Madhya Pradesh High Court, except in cases of fraud or suspicion of irreparable injustice, the courts will not intervene with the execution of bank guarantees and letters of credit. In order to avert irreparable unfairness between parties, there either needs to be solid prima facie proof of fraud or of unique equities.

UP. State Sugar Corpn. V/s Sumac International Ltd. [1996 (12) TMI 294 - SUPREME COURT]²⁵

The SC ruled that regardless of any objections put forth by its client, a bank providing a guarantee is required to honour it in accordance with its terms. Giving a such bank guarantee would be pointless in any other case. Therefore, while ordering an injunction to prevent the

²³U.P. Co-Operative Federation Ltd vs Singh Consultants & Engineers (P) 1988 AIR 2239, 1988 SCR Supl. (2) 859

²⁴ Rachita builders and financiers pvt. Ltd. V/S Chetak construction lmtd and another [1990 (5) Madhya Pradesh high court]

²⁵UP. State Sugar Corpn. V/s Sumac International Ltd. [1996 (12) TMI 294 - SUPREME COURT]

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fulfilment of this type of bank guarantee, the courts should proceed cautiously. Only two exceptions have been established by the courts. One such bank guarantee would be void from the start if there was fraud in association with it. So in the event of a fraud and the beneficiary wants to take advantage of it, he can be stopped.

The second restriction relates to situations where granting such an unqualified bank guarantee's entitlements would result in irreparable harm or unfairness for one of the parties. Since the compensation of money pursuant to such a bank guarantee will indeed typically have a negative impact on the bank including its customer upon whom the guarantee is given, the harm or injustice considered actually under this head must be of such an incomparable but rather irrecoverable nature because to supersede the circumstances of the guarantee in addition to the damaging effect of such an injunctive relief on commercial the country's transactions. Although they occasionally coexist, the two grounds aren't always related.

Hindustan Steelworks Construction Ltd v Tarapore & Co, 1996²⁶

"(A) A contract of guarantee is a distinct agreement between the bank and the beneficiary that has no bearing on the underlying contract or the main contract between the party requesting the guarantee and the beneficiary.

(B) In the case of an unambiguous bank guarantee, the bank's obligation is unaffected by any legal action or other disagreement between both the beneficiary and or the party who requested the bank guarantee.

(D) A bank guarantee must be honoured without interference from the court, and only in rare circumstances, such as fraud or situations in which allowing a bank guarantee to be redeemed would result in irreparable injustice, would the court step in "

Due to the distributed nature both of unconditional and documentary credits on demand guarantees, some litigation involving bank or demand guarantees was brought about by the possibility of abusive or unjust callings. The beneficiary has an absolute or nearly absolute entitlement to payment. The need that the beneficiary must indicate in his statement invoking bank guarantee the existence of some form of violation of the underlying contract and what is the type of violation which is involved is one way that has been recommended and which has actually been used. The party making a claim under the assurance must prove that the necessary circumstances are present.

²⁶Hindustan Steelworks Construction Ltd v Tarapore & Co 1996 SCC (5) 34, JT 1996 (6) 295

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Ansal Engg. Proj. Ltd. v. Tehri Hydro Development Corp. Ltd. & Anr. 1997²⁷ (If there is no fraud, the court plays no part)

FACTS: In accordance with the provisions of the contract, the petitioner/appellant (A) agreed to conduct some construction work for the defendant/respondent (R) and provided a bank guarantee (BG) to ensure faithful execution and to obtain a preparedness forward to against construction contract. A failed to complete the structures in the allotted amount of time. R attempted to cash in on the bank guarantee. A used arbitration and requested in High Court should BG not be used while it was underway.

CONTENTION (Appellant):

1. BG cannot be utilized because the amount owed and due by A wasn't really established in the lawsuit.
2. In order for him to sign the contract and request a time extension, R committed fraud against
A. The contract was ended despite the pledge to give the construction & extension of BG more time.

ISSUE: Whether A had established a claim of irreparable harm through evidence of exceptional equity or fraud in order to request the court's jurisdiction and obtain an injunction preventing R from redeeming the bank guarantee.

HELD:

HIGH COURT: dismissed the petition, rejected the contentions, answered the issue in negative

SUPREME COURT: (K. RAMASWAMY, S.SAGHIR & G.B.PATTANAIK, JJ.)

1. (w.r.t 2nd contention of A) This is an instance of contract compliance, not fraud.
2. (w.r.t 1st contention of A) The bank guarantee contract's stipulations must be read collectively. Without any hesitation or disagreement regarding the conditions of the bank guarantee, the Bank fully and irrevocably committed to paying the amount of responsibility assumed in the guarantee upon demand.
3. Invoking the bank guarantee does not need final adjudication, and thus is not a basis for issuing an injunction prohibiting the beneficiary from enforcing the bank guarantee. The

²⁷Ansal Engg. Proj. Ltd. v. Tehri Hydro Development Corp. Ltd. & Anr. 1997⁸⁸ CompCas 149 SC
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bank's liability is unambiguous and absolute, so it is unnecessary for the bank to worry about the court's final ruling in these situations.

INTERPRETATION: A bank guarantee is a distinct and independent contract between the bank and the beneficiary in this instance, unrelated to the terms of the underlying agreement or the validity of the primary contract between the person that demanded the guarantee as well as the beneficiary. The beneficiary can always be prevented from entrapping the bank guarantee if a disagreement emerges during contract performance, excluding fraud or special equity.

JUDICIAL VIEW IN 21ST CENTURY

Himadri Chemicals Industries Ltd vs Coal Tar Refining Company 2007²⁸

Provides the following principles for obtaining injunctions to stop the claims of bank guarantees:

- The bank wishing to provide the assurance is obligated to honour it in accordance with its provisions, regardless of any objections voiced by its customer.
- Regardless of any objections put forth by its client, the bank desiring to provide such an affirmation is obligated to honour and respect it in accordance with its own terms.

M/S. Techtrans Construction India vs M/S. Reliance Utility Engineers Ltd, 2014²⁹

The petitioner requested an order preventing the first respondent from cashing the bank guarantees it had requested from the second respondent, as well as an order preventing the second respondent from honoring/paying the guarantee quantity under both bank guarantees, as shown in the schedule the bank had given the first respondent.

M/S. Kse Electricals Pvt. Ltd vs The Project Director, 2021³⁰

In response to a worldwide tender conducted by respondent No. 1, the petitioner was given a contract for the delivery of conductor and associated accessories. A carriage plus insurance paid contract with a price tag of USD 830,290 Plus BDT 371,000 was signed on November 15, 2015. In accordance with the applicable provision of the Contract's General Conditions of Contract, the Petitioner was obligated to provide a performance security in the amount of

²⁸Himadri Chemicals Industries Ltd vs Coal Tar Refining Company, [2007 (8) TMI 704 - SUPREME COURT]

²⁹M/S. Techtrans Construction India vs M/S. Reliance Utility Engineers Ltd 2014 (9) TMI 1252 - ANDHRA PRADESH HIGH COURT

³⁰M/S. Kse Electricals Pvt. Ltd vs The Project Director, [2021 (12) TMI 1105 - CALCUTTA HIGH COURT]

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USD 83,505 for a 24-month period. A learned Single Judge prohibited respondent No. 2 from receiving additional payments below a bank guarantee used by respondent No. 1 by order dated 10.05.2021. A different learned judge modified the original ruling on May 18, 2021, confirming the temporary injunction and further prohibiting respondent No. 1 from cashing in the bank guarantee.

The petitioner has met two of the three requirements, namely exceptional equity as well as the invoking not being in accordance with the guarantee, the High Court observed. The contract's provisions, especially the General Conditions Contract, make it abundantly obvious that a To bank guarantee were provided as performance security. Since the petitioner already has collected 90% of a contract price, there cannot be a performance concern. The invocation letter further establishes that there is no possibility of a performance problem with respect to the petitioner's suppliers. There is no mention of a petitioner performance requirement breach in the invocation letter. The equity is also fulfilled since, if the payment is given to respondent No. 1 in accordance with the Letter of Invocation, the petitioner will suffer an immediate and irreparable financial damage. If Citibank NA, Dhaka does have the audacity to defy the injunction orders issued against the respondents, then it must also incur the risk and repercussions of doing so.

The interim orders issued by experienced judges on May 10 and May 18 were based on a specific set of information before affidavits were filed. If the respondent No. 2 had later disclosed compelling information via affidavits, the court might have thought about changing or further amending the orders of injunction. No alternative justifications have been pled or demonstrated that, after the learned Judges considered all the facts, would justify changing the orders aside from territorial jurisdiction. The fact that Respondent No. 1 really hasn't attended or objected to these proceedings, and that Respondent No. 2 had begun "shadow boxing" on behalf of the non-appearing wrongdoer, is likewise relevant.

Recent Scenarios Related to Bank Guarantee

1. HDFC becomes the first bank in the country to issue an Electronic Bank Guarantee (e-BG)³¹

³¹ LITEMINT, <https://www.livemint.com/industry/banking/hdfc-bank-issues-india-s-first-electronic-bank-guarantee-ebg-11662968625500.html> (last visited Sept.27, 2022).

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In partnership with National E-Governance Services Limited, the largest private-sector institution in India, HDFC Bank, issued very 1st electronic bank guarantee (e-BG) in the country (NeSL). Bank guarantees may now be issued, stamped, certified, and handed quickly with increased security thanks to contemporary technology, which has replaced the labor-intensive, paper-based approach. This is a substantial change, and to best serve each of its clients, the Bank will migrate to e-BG.

2. Bank Guarantee going from paper to blockchains³²

An unqualified promise from a bank or an insurance to guarantee the fulfilment of a borrower's obligation is known as a bank guarantee. Prospective tenants routinely use guarantees to secure commercial property leases in place of cash transactions and rental bonds. They are also used in monetary operations across many industries to secure contracts. Currently, handwritten paper warranties are used by about 11,500 shops in Australia and New Zealand. This causes the procedure of issuing guarantees to be drawn out.

The guarantee process is susceptible to fraud since paper documents are simple to forge. Additionally, monitoring it is expensive and difficult. Landlords are responsible for managing and storing the guarantees, generally in fireproof safes, and physically balancing them against the property leases. Banks also stop keeping track of the document as soon as it is issued. The process is cumbersome for end customers, and each delay cuts into the time they have available to perform business.

CRITICAL ANALYSIS

Bank Guarantee as mentioned in the paper earlier is of various types one of the most important one out of the categories is the one which is based on 'terms and conditions' that is unconditional and conditional Bank Guarantee. But in the provision given about bank guarantee in the Indian contract act not much is mentioned about the conditional bank guarantee. Conditional bank guarantee is the one which puts several terms and condition on the BG for it to be invoked while the other type that is the unconditional BG is one of the most controversial ones. As it gives boundless and seamless possibilities for the bank guarantee to be invoked which gives any person to take undue advantage of the same causing misappropriation of funds and chances of fraud.

³²IBM, <https://www.ibm.com/case-studies/lygon/> (last visited Sept. 27, 2022)

The same was stated in the case *Ansal Engg. Proj. Ltd. v. Tehri Hydro Development Corp. Ltd. & Anr.* 1997³³. In the judgement of the case it was stated that “the Bank fully and irrevocably committed to paying the amount of responsibility assumed in the guarantee upon demand.” Which gives the beneficiary numerous reason to invoke the bank guarantee with the slightest inconvenience from the applicant, the beneficiary just needs to prove that his case is not a case of egregious fraud or of special equities and of irreparable injustice and he would have all powers to invoke the BG without any investigation or questioning or without any judicial intervention from the court. Which gives the beneficiary an easy way to extract funds from the applicant via bank guarantee. This judgement specifically mentions that the bank is required to reimburse the beneficiary of his loss without any inquiry or due diligence paving an easy way for the beneficiary to get the compensation without any actual loss or real damage. In the judgement it also mentions ‘Invoking the bank guarantee does not need final adjudication, and thus is not a basis for issuing an injunction prohibiting the beneficiary from enforcing the bank guarantee.’ Which means the bank has no rights in order to stop the beneficiary from invoking the BG by just mere proving of absence of fraud.

This judgement also mentions that the court can only interfere in the case of frauds or special equities and in no other circumstances which limits the powers of the court, any individual with sound mind would invoke the guarantee with just mere unfulfillment of a particular term or a condition which might not even be material to a contract hence earning extra profits from the same as the beneficiary has been given unquestioned rights except in the cases of fraud. There might be cases of misappropriation of fund or embezzlement of funds which when concealed strategically or proved to not be a fraud can be given an action. Therefore, BG does not take a holistic view of possibilities of financial crimes and does not take into consideration other aspects by which the funds under the BG can be inappropriately utilized.

The BG specifically mentions that the court will interfere only when there arises a case of Fraud or Special equities which is in a retrospective tone or in form of a ‘protective measure’. While it should have been in a prospective tone or in form of a ‘preventive measure’, ‘Prevention is better than cure’ and in the context of BG the courts intervention is in a protective form which might or might not help in recollecting the embezzled funds while if it was in a preventive measure than the crimes of fraud via bank guarantee would not have

³³*Ansal Engg. Proj. Ltd. v. Tehri Hydro Development Corp. Ltd. & Anr.* 1997 88 CompCas 149 SC
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taken place. And hence more provision to the statute of bank guarantee should be added. Because of all the reason mentioned above the beneficiary is the one should be protected as after the invocation of bank guarantee the bank indemnifies itself from the properties of the applicant.

In the recent times the concept of Electronic bank guarantee has also come into the picture. The contract of BG being entered online does not comprehensively check the documents submitted by the parties and hence more chances of fraud or not proper utilization of funds can arise and hence there should be more verification and validation of documents in the concept of BG. The Electronic BG due to being online slows the process of the contract which may cause hindrance to implementing the contract of BG. Hence more attention is required for the above mentioned aspects.

SUGGESTIONS AND CONCLUSION

Bank Guarantee given in the Indian Contract act, 1872 lacks certain criteria. as mentioned above the court can interfere in the BG only in cases of egregious fraud and special equities, it does not take into consideration various other aspects of economic crimes and hence more analysis should be done and provisions should be added for other types of economic crimes possible from the Bank Guarantee's. And such newfound economic crimes should be added in the provision of the bank guarantee which comes under the jurisdiction of the courts. The statute of BG with respect to courts interference should be given a preventive measure. Which might help curtail more financial crimes happening vis BG. Generally, in the process of electronic bank guarantee there only 2 steps for verification which might not be fulfilling in verifying the authenticity of the documents and hence in order to increase the safety more steps of verification should be introduced. There should be more focus and emphasis should be given on the conditional bank guarantee. New provisions should be added to limit the powers of the beneficiary so that he does not take advantage under unconditional BG. An amendment should be made adding more powers and rights to the applicant of a Bank Guarantee.

BGs have shown to be a tremendous asset in today's corporate environment. BGs are separate agreements between both the lender and the creditor that have no bearing on the underlying agreement between both the beneficiary as well as the party in whose name they are issued.

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However, under certain circumstances (egregious fraud, irreparable harm/injustice, and special equity), courts may interfere and grant stays on invoking such bank guarantees. This is done to avoid injustice or to stop one party from abusing a legal gap.

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