

“Revocation of Bank Guarantees during COVID-19 & Lockdown”**Tanuj Modi**NMIMS Kirit P. Mehta, School of Law,
Mumbai****Bhakti Premchandani**NMIMS Kirit P. Mehta, School of Law,
Mumbai*

Due to the unprecedented situation of Covid-19, the Government of India has made containment strategies of lockdowns, restrictions on movement and public assembly, while allowing essential services to be carried out during the period of nation-wide lockdown. These restrictions on business transactions have caused several impediments to business operations and has made it difficult to fulfil or perform all sorts of contractual obligations. Hence, keeping the current situation in sight, there is an impending possibility that the affected enterprises/companies may invoke Performance Bank Guarantees (‘PBG’) on the failure of the other parties’ contractual liabilities for the reason of National Lockdown/ COVID-19.

The outbreak of COVID -19 was stated to be considered as a case of natural calamity under the force majeure clauses appearing in the manual for Procurement of Goods, 2017¹ of the Government of India by the Ministry of Finance, Department of Expenditure procurement policy division vide its office memorandum dated 19 February 2020.

WHAT IS A BANK GUARANTEE?

A Bank Guarantee is a promise from a bank or a financial institution that if a debtor defaults on a loan or fails in the performance of certain pre-agreed obligations with the creditor or the beneficiary, the bank will cover the loss or pay the pre-stated amount to such a beneficiary.

Parties to a Bank Guarantee –

- i. The Bank or financial institution giving guarantee – Surety
- ii. The Company or business in respect of whose default the guarantee is given – Principal Debtor
- iii. The Company or business to whom the guarantee - Creditor or beneficiary

Through a PBG, a bank as a surety will take the responsibility for payment of the amount in case of default by the principal debtor for performance of its contractual obligations. Thereby, the Creditor or beneficiary will receive payment from the Bank when it presents a demand as per terms of the contract.

¹ Government of India Ministry of Finance, Force Mejeure Clause, (19th February, 2020)
<https://doe.gov.in/sites/default/files/Force%20Majeure%20Clause%20-FMC.pdf>

TYPES OF BANK GUARANTEE –

1. Unconditional 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.
2. Conditional 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.

GROUNDNS FOR INJUNCTION BY COURTS –

The law with respect to the grant of injunction against invocation of bank guarantee has been settled by various judgements of courts. The grounds for injunction by courts are –

- **In Case of Fraud** – In such a case, the Surety bank cannot be compelled to honour its guarantee under the contract. It is to be noted that the fraud would be of the Beneficiary and not of any other unrelated person/entity. If it is found out by the bank that any fraudulent action has been committed on the Beneficiary's behalf then the payment can be lawfully declined. However, mere allegation of fraud is not sufficient, there must be evidence of fraud which should be cogent enough, both as to the fact of fraud and as to the Bank's Knowledge regarding the same.
- **For preventing irretrievable injustice or injury** – In such case, the courts will injunct the invocation where the payment of money by a Surety Bank would adversely affect the bank its customer at whose instance the guarantee was given. In this the injury or injustice is of such an extreme degree and of irretrievable nature that fulfilling the terms of the guarantee would cause a detrimental effect. To take the benefit of this ground and for overriding the terms of the guarantee the Principal debtor has to showcase that exceptional and emergent circumstances are present which renders it impossible for the fulfilment or repayment of the guaranteed sum by the Principal Debtor to the surety.
- **Special Equities** – Lately, it has been accepted as a separate ground for the injunction on invocation of PBG. While earlier, the understanding the special equities was a conformation to a scenario causing irretrievable injustice, of late the decision of the Supreme Court of India in *Standard Chartered Bank Ltd. Vs Heavy Engineering Corporation Ltd*². has provided for an enabling distinction of circumstances prevailing, the existence of which is a justified ground for passing an order of injunction.

In the judgement, the Supreme Court has observed that *“there appears to be no gainsaying the proposition that, where ‘Special equities’ exist, the court is empowered, in a given set of facts and circumstances to injunct invocation, or encashment, of a bank guarantee”*.

² Standard Chartered Bank Ltd. Vs Heavy Engineering Corporation Ltd, Civil Appeal No(S).9288 (2019).

RECENT JUDGE MENTS IN THE TIMES OF COVID-19 CONCERNING BANK GUARANTEES –**1. M/s. Halliburton Offshore Services vs. Vedanta Limited [Delhi HC]³**

The Delhi High Court held that the countrywide lockdown should be prima facie considered in the nature of force majeure and therefore, the same were to be a justifiable ground for granting injunction to the invocation of bank guarantees by the respondent company in the present case.

The decision of the Delhi HC to grant an interim relief of injunction for reasons of special equities on account of force majeure event incapacitating a company from performance of its obligation is a welcome move for the business vulnerable and suffering in this regard.

2. Standard Chartered Bank Limited vs. Heavy Engineering Corporation Limited [SC]⁴

The Hon'ble Supreme Court extended the exceptions to three, where a court can injunct invocation and encashment of bank guarantee and included 'Social equities' as one of the grounds, as mentioned earlier. The concept of special equities has been traditionally linked to irretrievable injustice. The criteria were said to be fulfilled where the court is satisfied that the party seeking refuge under special equity is likely to suffer losses, which cannot be recovered if the matter is finally adjudicated in favour of the said party seeking the interim injunctive relief. The Supreme Court in the said Standard Chartered Bank Limited case, however, extended the scope of avenues available to a petitioner by visualizing irretrievable injustice and special equities as distinct circumstances.

3. Jindal Steel & Power Ltd. vs. State Trading Corporation of India Ltd⁵ [Delhi HC]

In this ongoing case, the submissions were made by the petitioner as a) the respondent No. 1 had not exhibited any intention to invoke the PBGs; b) the parties were ad-idem on continuation of the PBGs till the contract was over i.e. till on expiry of the guarantee period; c) even the conduct of the petitioner in extending the PBGs at least seven times prior, would indicate such intention; and d) the CG or the PDCs as offered cannot be considered to be an alternative for the PBGs; and e) a bare perusal of the terms and conditions of the agreement dated 24.09.2014 as also of the PBGs would only show these PBGs need to be continued till the term of the agreement is over.

Accordingly, no relief as sought for regarding release of PBGs can be granted. Thus, while directing the petitioner to extend the PBGs till the disposal of this petition and further directing respondent No. 1 not to encash/invoke it till such time, this petition be listed before the Roster Bench for directions on 15.07.2020.”

³ M/s. Halliburton Offshore Services vs. Vedanta Limited, SCC OnLine Del 542 (2020).

⁴ Standard Chartered Bank Ltd. Vs Heavy Engineering Corporation Ltd, Civil Appeal No(S).9288 (2019).

⁵ Jindal Steel & Power Ltd. vs. State Trading Corporation of India Ltd, SCC OnLine Del 620 (2020).

4. Technimont Private Limited and Another vs. Ongc Petro Additions Limited⁶ [Delhi HC]

In this petition, the petitioners, under Section 9 of the Arbitration and Conciliation Act, 1996 (hereinafter referred to as “the Act”), sought an order restraining the respondent from invoking or encashing the following PBG, furnished by the petitioner during the course of execution of the work contract with the respondent, as well as a direction to the effect that the petitioner would not be required to keep these bank guarantees alive any further.

Though the matter was heard at considerable length, learned Senior counsel for the parties, on instructions, submit that they are agreeable to an ad interim arrangement, whereby and whereunder the petitioner would keep the Performance Bank Guarantees at serial nos. 1, 2, 3 and 4 in the tabular statement contained in the prayer clause in the OMP alive, till the next date of hearing, and the respondent would not take any further steps, towards invocation of the said Bank Guarantees, till the next date of hearing, be passed. Learned Senior Counsel agreed on these terms, to the invocation of the said Bank Guarantees remaining in abeyance, till the next date of hearing. Charges, for keeping the said Bank Guarantees alive till the date next of hearing, would continue as per the terms set out in the order dated 13th March, 2020 of the learned Single Judge in O.M.P. (I) (Comm) 73/2020.

Interestingly, in Contrast with the above reasonings and findings, a case of Bombay High Court, Standard Retail Pvt. Ltd. vs. M/s. G.S. Global Corp⁷, where Standard Retail was denied an ad interim relief by the court for encashing the underlying letters of credit, on account of the plea of the lockdown. In this case, GS Global had already performed its part of the contract by shipping the goods from South Korea. The court outrightly rejected the inability of Standard Retail to perform its part of the obligations due to the lockdown and the damages that it would entail. Therefore, it was observed that the lockdown is for a ‘limited period’ and the lockdown cannot come to the rescue of Standard Retail to prevent it from its contractual obligations.

Similarly, in the case of Delhi High Court, **Indrajit Power Private Limited vs Union of India & Ors.⁸** has dismissed the writ seeking to refrain the invocation of a bank guarantee by the Union of India *inter alia* due to financial distress caused by the national lockdown and that the COVID - 19 pandemic was a force majeure under the agreement between the parties.

Relying on the decisions of the Delhi High Court in **Umaxe Projects Private Limited v Air Force Naval Housing Board & Anr⁹** and **Classic KSM Bashir JV v Rites Limited & Ors¹⁰**, wherein the law related to invocation of bank guarantees has been analysed in detail, the

⁶ Technimont Private Limited and Another vs. Ongc Petro Additions Limited, SCC OnLine Del 527 (2020).

⁷ Standard Retail Pvt. Ltd. vs. M/s. G.S. Global Corp, Commercial Arbitration Petition (L) NO. 404 (2020).

⁸ Indrajit Power Private Limited vs Union of India & Ors., W.P.(C) 2957/2020, (2020).

⁹ Umaxe Projects Private Limited vs. Air Force Naval Housing Board & Anr., SCC OnLine Del 9126 (2019).

¹⁰ Classic KSM Bashir JV vs. Rites Limited & Ors., SCC OnLine Del 8888 (2018).

Court held that merely because invocation would cause financial distress is not a ground of stay, except in cases of irrevocable injury.

The Court further held that the Petitioner i.e., Indrajit Power Private Limited was in non-compliance of milestone since April-June 2018 and despite the extension of 12 months, its position remained the same. The court held that the reliefs granted in the cited orders are not applicable in the present case for the simple reason that the lockdown came into force in India with effect from 24 March 2020 whereas the Petitioner had been in default much before that date.

CONCLUSION

In my opinion, the approach Delhi High Court took in the recent case of **M/s. Halliburton Offshore Services vs. Vedanta Limited** is correct since the was prima facie in the nature of force majeure since such a lockdown is unprecedented, and was incapable of having been predicted by either of the parties and that special equities do exist in the case, justifying a grant of the prayer of the Petitioner. The Court has tried to adequately balance the equities in a nuanced manner by observing that in case the bank guarantees are allowed to be encashed, even while the lockdown is in place, the resultant injury and prejudice to the Petitioner would be irretrievable and since, they are interim reliefs that can be reviewed later and the parties are given an opportunity to perform their obligations.

However, a different approach was taken in the cases of **Bombay High Court, Standard Retail Pvt. Ltd. vs. M/s. G.S. Global Corp.** and similarly, in **Indrajit Power Private Limited vs Union of India & Ors.**, but the primary reasoning for rejecting these petitions was other than just the imposition of lockdown in the country. Hence, the courts have set strict standards for seeking relief in such cases, but at least in genuine cases where businesses are facing losses due to the pandemic the courts are granting due relief.