

**Client Alert**

**COVID-19 and invocation of bank guarantees**

The legality of invocation of bank guarantees is often a point of discord between the parties that have entered into commercial arrangements. The courts in India usually do not interfere in the invocation of bank guarantees, taking into consideration the fact that intervening with an invocation of a bank guarantee would defeat the purpose of the same. However, there are many judicial precedents against invocation of bank guarantees albeit in exceptional circumstances. Since the performance of many contracts would be hindered in the wake of the COVID-19 outbreak and the subsequent lockdown imposed by the government, this is likely to lead to invocation of bank guarantees where the same exist. The important point for consideration in such a case would be whether an injunction against such invocation could be sought by the party furnishing the bank guarantee.

A bank guarantee is a contract of guarantee as defined under section 126 of Indian Contract Act, 1872 (the “**Contract Act**”), which defines it as

*“a contract to perform the promise, or discharge the liability, of a third person in case of his default. The person who gives the guarantee is called the ‘surety’; the person in respect of whose default the guarantee is given is called the ‘principal debtor’, and the person to whom the guarantee is given is called the ‘creditor’.”*

Therefore, a bank, on behalf of its principal debtor/ customer, issues a bank guarantee to a creditor/ beneficiary and assumes the responsibility for payment of monies in case the customer fails to perform/ fulfil its contractual obligations under a commercial contract.

Judicial precedents on the law pertaining to bank guarantees have crystallised and settled the legal position relating to said subject. Courts in India have unfailingly held that a bank guarantee is an independent agreement between the beneficiary and the bank, and the same can be invoked by the beneficiary regardless of any disputes under commercial agreements. Courts have carved out two exceptions with regard to granting a stay/ injunction for the invocation of a bank guarantee, which are as follows:

- a. Fraud – in case the bank guarantee is invoked fraudulently; and
- b. Irreparable harm or injustice – If the invocation of a bank guarantee would result in irreparable harm or injustice to one of the parties concerned, then invocation of the bank guarantee is not allowed. The courts, while applying this exception, take into consideration whether special circumstances or special equities exist which would result in irretrievable harm or injustice to the party concerned.

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<sup>1</sup> U.P. State Sugar Corporation v. Sumac International Limited  
[AIR 1997 SC 1644]

There are many cases to reflect that earlier, the grant of invocation of bank guarantee was allowed straightforwardly. However, in recent times, we have seen a paradigm shift in the court's view with respect to invocation of bank guarantees, and the courts have observed that they would not apply or follow the general propositions relating to bank guarantee cases, regardless of the facts peculiar to each case<sup>2</sup>.

It is noteworthy to mention that the COVID-19 pandemic and the prolonged lockdown imposed by the Government of India and various state governments is an unprecedented and unanticipated event. It may be argued that the present circumstances can be categorised as 'special circumstances'; and in the event bank guarantees are invoked for non-performance of the contractual obligations due to the fact that companies/businesses have been mandatorily shutdown, the same would cause an irretrievable harm and injustice to the parties providing such bank guarantees.

It is interesting to note that recently, the Delhi High Court deliberated on the issue of the invocation of bank guarantee in a petition<sup>3</sup> filed by Halliburton Offshore Services Inc. ("**Halliburton**") against Vedanta Ltd. ("**Vedanta**") and another, where it observed that:

*"the countrywide lockdown, which came into place on 24<sup>th</sup> March, 2020 was, in my opinion, prima facie in the nature of force majeure. Such a lockdown is unprecedented and was incapable of having been predicted either by the respondent or by the petitioner."*

In the abovementioned petition, the Delhi High Court granted an interim relief to Halliburton for a period of seven days from the expiry of the lockdown, by injuncting Vedanta from invoking or encashing nine bank guarantees, six of which are due to expire on June 30, 2020, and the remaining three on November 24, 2020, issued by the ICICI Bank in favour of Vedanta Ltd., under instructions of Halliburton. It was argued that a substantial part of the project was completed prior to the lockdown, and owing to a complete lockdown in wake of COVID-19 pandemic impacting industrial activities as well as movement of persons in the country, Halliburton was unavoidably handicapped in performing the contract and invoked the force majeure clause in the contract concerned seeking the benefit thereof.

While deciding the above mentioned matter, the Delhi High Court relied on a plethora of judicial precedents such as the recent ruling of the Supreme Court in *Standard Chartered Bank Ltd v. Heavy Engineering Corporation Ltd.*<sup>4</sup>, which encapsulates that:

*"the settled position in law that emerges from the precedents of this Court is that the bank guarantee is an independent contract between bank and the beneficiary, and the bank is always obliged to honour its guarantee as long as it is an unconditional and irrevocable one. The dispute between the beneficiary and the party at whose instance the bank has given the guarantee is immaterial and is of no consequence. There are, however, exceptions to this Rule when there is a clear case of fraud, irretrievable injustice or special equities. The Court ordinarily should not interfere with the invocation or encashment of the bank guarantee so long as the invocation is in terms of the bank guarantee."* (emphasis added)

<sup>2</sup> Gangotri Enterprises Ltd. v. Union of India & Ors. [Civil Appeal No. 4814 of 2016]

<sup>3</sup> O.M.P. (I) (COMM) 88/2020 & I.A. 3697/2020

<sup>4</sup> 2019 SCC Online SC 1638

Based on various judicial precedents, the Delhi High Court, in the abovementioned petition filed by Halliburton held that:

*“....prima facie, in my view, special equities do exist, as would justify grant of the prayer, of the petitioner, to injunct the respondent from invoking the bank guarantees of the petitioner, forming subject matter of these proceedings, till the expiry of a period of one week from 3rd May, 2020, till which date the lockdown has been imposed.”*

As held by the courts in various judgements, the position with regard to the grant of an injunction on invocation of a bank guarantee would be dealt with on a case to case basis. However, the present unprecedented event and the Delhi High Court's interim order as discussed above in the matter of Halliburton and Vedanta would have persuasive value in

similar matters which are likely to be litigated in the near future.

Consequently, the courts across India may consider this pandemic as a force majeure event, and injunct the invocation of bank guarantees relying on the principle that this pandemic is a special circumstance and invocation of such bank guarantees would result in irretrievable harm or injustice to the party whose bank guarantee is invoked. However, it must be borne in mind that the aforesaid order passed by the High Court is only an **interim order** stating the *prima facie* view of the judge concerned, and not the court's final order. Therefore, subsequent orders in the said matter should be closely watched to further understand the issue at hand and the impact thereof on similar matters.

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