

Claim period under Bank Guarantees

In 2013, Section 28 of the Indian Contract Act, 1872 (“Contract Act”) was amended and Exception 3 was introduced. Questions of interpretation arose as to whether Exception 3 was meant to prescribe a minimum claim period of one year for bank guarantees, failing which the bank would be liable to the beneficiary during the limitation period prescribed under law. The limitation prescribed under law being 3 years for private claimants and 30 years where the claimant was the Government.

Exception 3 reads as under:

“Exception 3 - Saving of a guarantee agreement of a bank or a financial institution: - This section shall not render illegal a contract in writing by which any bank or financial institution stipulate a term in a guarantee or any agreement making a provision for guarantee for extinguishment of the rights or discharge of any party thereto from any liability under or in respect of such guarantee or agreement on the expiry of a specified period which is not less than one year from the date of occurring or non-occurring of a specified event for extinguishment or discharge of such party from the said liability.”

(emphasis added)

That said, the banks have often been stipulating a claim period of one year, or in some instances of less than one year.

Based on legal advice received, the Indian Banks’ Association had also issued a circular on December 5, 2018 advising banks to issue every bank guarantee with minimum claim period of one year on top of the guarantee period.



The Delhi High Court has now rendered a judgement in *Larsen & Toubro Ltd Vs Punjab National Bank* (pronounced on July 28, 2021) holding that:

- ⌈ Exception 3 to Section 28 of the Contract Act does not require the banks to stipulate a minimum claim period of one year. The banks are at liberty to provide for shorter claim periods contractually decided.
- ⌈ The circular of the Indian Banks’ Association dated December 5, 2018, to the extent that it reproduces an erroneous interpretation of Exception 3 to Section 28 of the Contract Act is vitiated.

As per the judgement of the Delhi High Court, a bank/ financial institution is free to provide for a claim period shorter than 1 year. Such a claim period would be legal and enforceable and would not be hit by Exception 3 to Section 28 of the Contract Act.

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