



cyril amarchand mangaldas
ahead of the curve

The Law Pertaining to Injunctions against the Invocation of Bank Guarantees Legal Compendium



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A Thought Leadership Publication

We now present this handbook to enable readers to have an overview of the systems and legal rules and regulations that are essential for business operations in India.

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Introduction

The rationale and purpose of this compendium is for it to serve as a ready reckoner for practitioners advising clients on injunctions against the invocation/ encashment of bank guarantees.

The law on this subject has been, more or less, cast in stone. Therefore, the endeavour here is to really provide an exhaustive analysis of all such exceptional circumstances where Courts may injunct the invocation/ encashment of a bank guarantee, against the grundnorm of non-interference.

A. General Principles Pertaining to Bank Guarantees

Commercial transactions are often riddled with several complexities, including high commercial and strategic exposure and risk of non-performance of contractual obligations, among others. The ability, therefore, to safeguard one's investments or interests in a commercial contract remains paramount. Contracts of guarantee have accordingly become popular as they mitigate the chances of losses arising out of non-performance or improper performance of contractual obligations. Such guarantees have therefore emerged as commonly employed instruments for securing payments or obligations under commercial transactions.

In a bank guarantee transaction, generally three parties exist, i.e., (i) the creditor; (ii) the principal debtor; and (iii) the bank. A bank guarantee is an independent agreement, distinct from the underlying contract. As a consequence, even the liability arising thereunder is not contingent upon the parent contract.

Given the significance of a bank guarantee *vis-à-vis* commercial transactions, there ideally ought to be no impediment in its invocation and encashment, save in exceptional circumstances. Courts have therefore been rather circumspect in interfering with or injuncting the invocation or encashment

of a bank guarantee without just, adequate, and exceptional cause. Any unwarranted interference with the invocation of a bank guarantee could have an irreparable effect on domestic as well as international commerce, thereby having disastrous ramifications on economic growth and development.

B. Conditional Bank Guarantee

Invocation of a conditional bank guarantee is contingent upon the fulfilment of conditions/ terms mentioned therein¹. After all the conditions stipulated thereunder are fulfilled, the holder is entitled to encash the same²; failing which the bank is obligated to refuse payment³. In order to ascertain whether a bank guarantee is conditional or unconditional, it is necessary to examine its terms, and if there exists an express clause indicating certain stipulations, which ought to be fulfilled before its invocation, the guarantee in question can then be said to be a conditional bank guarantee⁴.

For instance, in the case of a performance bank, subject to the terms thereof, the bank is liable to make payment only after (a) a breach of contract; and (b) after the affected party has suffered loss or damage due to such breach. However, in the case of an advance payment guarantee, there is an absolute obligation on the bank to make payment to the beneficiary in the event of non-performance of contract, irrespective of the reason behind such non-performance⁵.

C. Unconditional Bank Guarantee

A bank guarantee which provides for payment by the bank solely upon a demand by the creditor is an unconditional bank guarantee. Under a bank guarantee, which is an independent contract between a bank and a beneficiary, the bank is obligated to honour its irrevocable and unconditional guarantee, irrespective of the existence of any disputes in the underlying contract between the beneficiary and the party at whose instance the bank guarantee has been furnished⁶.

¹ *Karnataka State Khadi & Village Industries Board v. Punjab National Bank* (2014) 1 SCC 625 (Para 9, 10)

² *National Project Construction Corporation Ltd. v. G. Ranjan*, AIR 1985 Cal 23 (Para 23, 24)

³ *Banerjee & Banerjee v. Hindusthan Steel Works Construction Ltd. and Ors.*, AIR 1986 Cal 374 (Para 23, 24)

⁴ *Man Industries India Ltd. v. N.V. Kharote Engineer and Contractors & Ors.*, AIR 2005 Bom 311 (Para 9, 11, 12)

⁵ *Explore Computers Pvt. Ltd. v. Cals Ltd. & Anr.*, 2006 SCC OnLine Del 701 (Para 37)

⁶ *Ansal Engineering Projects Ltd. v. Tehri Hydro Development Corporation Ltd. and Another*, (1996) 5 SCC 450 (Para 4 and 5), *ViniteElectronic Private Ltd. v. HCL Infosystems Ltd.*, (2008) 1 SCC 544 (Para 11)

An unconditional bank guarantee is distinguishable from an ordinary contract for guarantee, governed under Section 126 of the Indian Contract Act, 1872 (“**Contract Act**”). In the case of an ordinary contract for guarantee, the liability of the surety is co-extensive with that of the principal debtor, and the surety becomes liable only when the latter is liable. On the other hand, in case of an unconditional bank guarantee, the bank’s liability to pay arises even when the principal debtor has not been in default, or when his/her actual liability under the transaction is less than the amount payable under the said bank guarantee⁷.

It is an established principle of law that when the operative portion of a bank guarantee does not refer to any condition for payment, it is an unconditional bank guarantee. Merely because a bank guarantee makes a reference to the principal agreement between the parties in its preamble, it does not make the said bank guarantee a conditional bank guarantee, unless any particular clause of the agreement has been made a part of it. The recitals in the preamble of the bank guarantee do not control the operative part of the deed⁸. It is also pertinent to note that in case of any ambiguities arising from the interpretation of the terms of a guarantee, the same are to be interpreted *contra preferentem*, i.e. against the guarantor. However, it must also be borne in mind that the guarantor cannot, in any case, be made liable beyond the terms of his engagement⁹.

*In Hindustan Construction Co. Ltd. v. State of Bihar & Others*¹⁰, an “unconditional” bank guarantee was issued by the bank, where its liability to pay was qualified i.e., it was obligated to pay only in the event (a) the obligations under the contract were not fulfilled by the Appellant; or (b) if the Appellant misappropriated any portion of the “*advance mobilization loan*”. The Supreme Court in this case held that the bank guarantee cannot be said to be unconditional or unequivocal. As per the Court, an unconditional bank guarantee should unequivocally be unconditional and recite that the amount shall be paid without demur or objection, irrespective of any dispute that may have cropped up or may have been pending between the beneficiary and the principal debtor.

⁷ *Kryshnjay Developers Pvt. Ltd. v. Kapil M. Mahtani & Ors.*, Appeal (L) No. 50 of 2020, in Notice of Motion No. 1490 of 2018 in Commercial Suit No. 948 of 2018; (Bombay High Court) (Para 4, 5, 6, 7, 11)

⁸ *Vintec Electronic Ltd. v. HCL Infosystems Ltd.*, (2008) 1 SCC 544 (Para 19, 22, 23)

⁹ *State of Maharashtra v. Dr. M.N. Kaul (Deceased)*, AIR 1967 SC 1634 (Para 7)

¹⁰ (1999) 8 SCC 436 (Para 8, 9, 14)



Injunction Against Invocation Of A Bank Guarantee

The Supreme Court has, in a series of judgements, observed that Courts should ordinarily refrain from granting injunctions to restrain the performance of contractual obligations arising from a letter of credit or bank guarantee. The commitment of banks must be honoured, free from the interference of the Courts. An irrevocable commitment in the form of a confirmed bank guarantee cannot be interfered with, otherwise trust in commerce, both internal and international would be irreparably damaged¹¹. In situations where such injunctions are readily granted in a transaction, the whole banking system in the country fails¹².

A bank issuing a guarantee is not concerned with the underlying contract between the parties, including any dispute arising therefrom¹³. The duties of a bank under a guarantee/ letter of credit are created by the said document itself. However, in the absence of appropriate provisions in the guarantee/ letter of credit, the bank has the power and is subject to the limitations that are given or imposed by itself¹⁴. Once the documents are in order, the bank issuing a guarantee must honour the same and make the payment, provided the guarantee is invoked within its validity period¹⁵. Parties to the underlying contract may settle their disputes by resorting to the dispute resolution mechanism stipulated under the contract. The remedy arising *ex contractu* is not barred and the cause of action for the same is independent of the enforcement of guarantee¹⁶. For instance, the Bombay High

¹¹ *U.P. Food Cooperative Federation Ltd. v. Singh Consultants & Engineers (P) Ltd.*, (1988) 1 SCC 174 (Para 17, 21, 24, 28, 34, 45, 53, 54)

¹² *United Commercial Bank v. Bank of India*, (1981) 2 SCC 766 (Para 41)

¹³ *Stein v. Hambro's Bank of Northern Commerce*, (1921) 9 LI LR 433

¹⁴ *United Commercial Bank v. Bank of India*, (1981) 2 SCC 766, (Para 40)

¹⁵ *State of Maharashtra v. Dr. M.N. Kaul (Deceased)*, AIR 1967 SC 1634 (Para 6, 8, 10); *Bank of India v. Nangia Constructions (I) Pvt. Ltd. & Ors.*, (2008) 7 SCC 290 (Para 11, 12)

¹⁶ *United Commercial Bank v. Bank of India*, (1981) 2 SCC 766 (Para 32); *Centex (India) Ltd. v. Vinmar Impex Inc.*, (1986) 4 SCC 136 (Para 5 & 6); *U.P. Food Cooperative Federation Ltd. v. Singh Consultants & Engineers (P) Ltd.*, (1988) 1 SCC 174 (Para 53)

Court, in the case of *Drive India Enterprise Solutions Ltd. v. Haier Telecom (India) Pvt. Ltd.*¹⁷, in a suit for injunction against the encashment of certain Stand By Letters of Credit (“**SBLC**”), refused to consider the terms of the underlying contract and held that a suit of such nature ought to consider only the terms of the SBLC, and nothing else.

Thus, the settled legal position is that a bank guarantee is ordinarily a contract quite distinct and independent of the underlying contract, the performance of which the bank guarantee seeks to secure. To that extent, it can be said to give rise to a cause of action separate from that of the underlying contract¹⁸. However, the cause of action in relation to any dispute pertaining to the invocation of a bank guarantee shall lie before the Courts, which exercise jurisdiction over the disputes arising from the parent/ underlying contract. This principle has been followed in *M/s South East Asia Shipping Co. v. Nav Bharat Enterprises Pvt. Ltd.*¹⁹, where the bank guarantee was executed in Delhi, however, it was sent to Bombay where the underlying contract was executed, and was to be performed. The Supreme Court held, inter-alia, that merely because the bank guarantee was executed in Delhi and transmitted for performance in Bombay, it does not give rise to a cause of action before the Delhi High Court. As per the Apex Court, the plaint for perpetual injunction against the enforcement of the bank guarantee, therefore, ought to be returned for presentation to the proper Court, i.e. the Courts of Bombay.

Further, in *The State of Maharashtra and Another v. National Construction Company, Bombay*²⁰, a performance bank guarantee was executed by the bank, whereby it guaranteed that the contractor would faithfully conform to the terms and conditions of the contract between the Appellant and the contractor. The bank therein was jointly and severally liable, along with the contractor for the latter’s default in performance. Upon abandonment of work by the contractor, the Appellant initiated two separate proceedings, (a) one against the bank, praying for recovery of the sum stipulated under the performance bank guarantee; and (b) the other against both the contractor and the bank, claiming damages for

¹⁷ 2011 SCC OnLine Bom 1666 (Para 8, 11, 12, 13)

¹⁸ *State of Maharashtra and Another v. National Construction Company, Bombay*, (1996) 1 SCC 735 (Para 14); *I.T.C. Ltd. v. Debt Recovery Appellate Tribunal*, (1998) 2 SCC 70 (Para 17); *M/s Tarapore & Co., Madras v. M/s V.O. Tractors Export, Moscow & Anr.*, AIR 1970 SC 891 (Para 15, 23)

¹⁹ (1996) 3 SCC 443 (Para 2, 3, 4)

²⁰ (1996) 1 SCC 735 (Para 14)

breach of contract. The claim under the latter included a claim against the bank as well, under the performance guarantee. Upon a challenge on the grounds of *res-judicata*, the Supreme Court held that the two suits arose from two distinct and separate causes of actions i.e., one for the enforcement of the bank guarantee and the other claim for damages for breach of contract.

Lastly, in a performance bank guarantee, the beneficiary is generally the best judge as to when and for what reason the bank guarantee could be encashed. It is not the obligation of the bank and/ or the Court to enquire as to whether the breach in performance, entitling invocation of the bank guarantee, has occurred or not²¹.

²¹ *BSES Ltd. (Now Reliance Energy Ltd.) v. Fenner India Ltd. And Another*, (2006) 2 SCC 728 (Para 26)



Grounds for grant of Injunction against the Invocation of Bank Guarantee

There are two broad exceptions basis which the invocation or encashment of a bank guarantee may be restrained.

The first is in the case of an egregious fraud, which (a) the bank has notice of; and (b) is perpetrated by the beneficiary, and from which the beneficiary seeks to benefit. The fraud must be of an egregious nature so as to vitiate the underlying transaction. The second exception to the general rule of non-intervention is when there are “special equities” in favour of an injunction, i.e., when “*irretrievable injury*” or “*irretrievable injustice*” would occur if the injunction is not granted²². A plea with regard to the existence of fraud and/ or irretrievable injustice cannot be vague and unsupported by evidence²³.

The Supreme Court has, in the landmark case of *Himadri Chemicals Industries Ltd. v. Coal Tar Refining Co.*²⁴ summarised the extant position of law relating to injunctions against the invocation of bank guarantees. After a comprehensive analysis of a plethora of case laws on the subject, the Court has laid down certain principles for the grant or refusal of an injunction, to restrain the encashment of a bank guarantee. These guidelines are reproduced as under:

²² *Andhra Pradesh Pollution Control Board v. CCL Products (India) Limited*, (2019) 20 SCC 669 (Para 15, 16, 17, 18, 19, 20, 21), *Millenium Wiers Private Limited v. State Trading Corporation of India Limited and Others*, (2015) 14 SCC 375 (Para 11), *BSES Ltd. (Now Reliance Energy Ltd.) v. Fenner India Ltd. And Another*, (2006) 2 SCC 728 (Para 26), *U.P. State Sugar Corporation v. Sumac International Ltd.*, (1997) 1 SCC 568 (Para 12, 14, 16.), *State of Maharashtra v. National Construction Co.*, (1996) 1 SCC 735 (Para 13, 14), *United Commercial Bank v. Bank of India*, (1981) 2 SCC 766 (Para 32, 34, 39, 40), *U.P. Coop. Federation Ltd. v. Singh Consultants and Engineers (P) Ltd.*, (1988) 1 SCC 174 (Para 17, 21, 24, 28, 34, 45, 53, 54)

²³ *Vintec Electronic Ltd. v. HCL Infosystems Ltd.*, (2008) 1 SCC 544 (Para 28, 29)

²⁴ (2007) 8 SCC 110 (Para 10, 11, 14, 15)

- i. While dealing with an application for injunction in the course of commercial dealings, and when an unconditional Bank Guarantee or Letter of Credit is given or accepted, the Beneficiary is entitled to realize such a Bank Guarantee or a Letter of Credit in terms thereof irrespective of any pending disputes relating to the terms of the contract.
- ii. The Bank giving such guarantee is bound to honour it as per its terms irrespective of any dispute raised by its customer.
- iii. The Courts should be slow in granting an order of injunction to restrain the realization of a Bank Guarantee or a Letter of Credit.
- iv. Since a Bank Guarantee or a Letter of Credit is an independent and a separate contract and is absolute in nature, the existence of any dispute between the parties to the contract is not a ground for issuing an order of injunction to restrain enforcement of Bank Guarantees or Letters of Credit.
- v. Fraud of an egregious nature which would vitiate the very foundation of such a Bank Guarantee or Letter of Credit and the beneficiary seeks to take advantage of the situation.
- vi. Allowing encashment of an unconditional Bank Guarantee or a Letter of Credit would result in irretrievable harm or injustice to one of the parties concerned.”

A. Fraud

i. Nature of the fraud

In *United Commercial Bank v. Bank of India & Ors.*²⁵, decided in 1981, the Supreme Court for the first time judicially recognised fraud as an exception to the grant of an injunction against the invocation of a bank guarantee. The Supreme Court relied upon the decision of the House of Lords in R.D. Harbottle (Mercantile) Ltd.²⁶ v. National Westminster Bank Ltd., wherein it was held:

²⁶ [1977] 3 W.L.R. 752

²⁵ AIR 1981 SC 1426 (Para 39, 40, 42, 43)

“Except possibly in clear cases of fraud of which the banks have notice, the courts will leave the merchants to settle their disputes under the contracts by litigation or arbitration as available to them or stipulated in the contracts.”

Further, in *U.P. Cooperative Federation Ltd. v. Singh Consultants and Engineers*²⁷, certain bank guarantees were invoked by the Appellant on account of delay in performance of the contract. The Supreme Court went on to lay down certain principles in respect of exceptions for an injunction against invocation of a bank guarantee. In doing so, the Court relied upon several foreign decisions to hold that the only defence available against the invocation of a bank guarantee is fraud, which as per the Court (a) must be present in the underlying contract, and (b) the bank ought to have notice thereof. In this landmark judgement, the Court further held that:

- a. The obligation of the banks would be absolute, in cases of both traditional letters of credit, and even under the more commonly employed performance bank guarantees. In such cases, if the documentary credits are irrevocable, the banks must make full payments when called upon to do so. However, the bank’s obligations need not be extended to protect an unscrupulous party, who is responsible for perpetuating the fraud in question, but the banker must be certain of the veracity of the allegations before resorting to them.
- b. While accepting the presence of fraud as a defence against the invocation of a bank guarantee, the Court adverted to the rationale which was adopted by the House of Lords in *UCM (Investment) v. Royal Bank of India*²⁸, thereby applying the maxim, *ex turpi causa non oritur actio*, which translates to “*fraud unravels all*”. Hence, the Courts ought not to allow their processes to be used by a dishonest person to carry out fraud.
- c. The fraud in question must be of an egregious nature, to vitiate the entire underlying transaction, i.e., the transaction between the lender(s) and the borrower(s), which led to the issuance of the guarantee²⁹.

²⁷ (1988) 1 SCC 174 174 (Para 17, 21, 24, 28); *National Highway Authority of India v. Ganga Enterprises & Ors.*, (2003) 7 SCC 410 (Para 10)

²⁸ [1982] 2 All E.R. 720

²⁹ *CRSC Research and Design Institute Group Co. Ltd. v Dedicated Freight Corridor Corporation of India*, 2020 SCC OnLine Del 1526 (Para 7, 15, 16, 17); *SES Energy Services India Ltd. v Vedant A Limited and Others*, 2021 SCC OnLine Del 4196 (Para 13); *Coronatoir Mktg. Services Ltd. v MMTCLtd.*, 1995 (35) DRJ 658 (Para 22), *ABG Ports Ltd. v. PSA International Pte. Ltd.*, 2013 (2) Bom CR 300 (Para 27, 29)

The Supreme Court, relying upon the aforesaid principles, has time and again reiterated the settled legal proposition that (a) an injunction against the invocation of a bank guarantee is permissible only where there is a fraud going to the root of the agreement; (b) of which the beneficiary seeks to take advantage of; and (c) where the invocation of the unconditional guarantee would result in irreparable harm or injustice to the parties concerned³⁰. Further, carving the contours of the nature of fraud as an exception, the Court has held that mere breach of contract would not lead to a conclusion that a fraud has been committed. As regards the allegations of fraud, it must be shown that the alleged fraud vitiates the entire contract and it has nexus with the acts of the parties, prior to entering into of the contract³¹.

Hence, it may be argued that the obligation of payment of a bank, under the guarantee, which constitutes an independent contract between the bank and the beneficiary, may be avoided where the guarantee itself is vitiated by fraud. The fraud, therefore, must be such that it vitiates the guarantee itself and not merely its invocation. As such, a submission that the invocation of the bank guarantee is contrary to the terms of the contract between the parties, howsoever compelling or meritorious, cannot make out a case of egregious fraud, to justify injuncting its invocation. Even if the invocation is fraudulent, no case for interdiction may be said to exist, unless the bank guarantee itself is vitiated by fraud³².

ii. Knowledge of Fraud

In *U.P. Cooperative Federation Ltd. v. Singh Consultants and Engineers*³³, the Supreme Court cited, with approval, the remarks of Sir John Donaldson M.R. in the case of *Oil SA v. Chase Manhattan Bank & Ors.*³⁴, which read as under:

“The wholly exceptional case where an injunction may be granted is where it is proved that the bank knows that any demand for payment already made or which may thereafter be made will clearly be

³⁰ *Adani Agri Fresh Ltd. v. Mahboob Sharif & Ors.*, (2016) 14 SCC 517 (Para 8, 9, 10, 14)

³¹ *Reliance Salt Ltd. v. Cosmos Enterprises and Anr.*, (2006) 13 SC 599 (Para 17, 19, 20)

³² *SES Energy Services India Ltd. v Vedant A Limited and Others*, 2021 SCC OnLine Del 4196 (Para 13)

³³ (1988) 1 SCC 174 (Para 54)

³⁴ [1984] 1 A11E.R. 351

fraudulent. But the evidence must be clear both as to the fact of fraud and as to the bank’s knowledge. *It would certainly not normally be sufficient that this rests on the uncorroborated statement of the customer, for irreparable damage can be done to a bank’s credit in the relatively brief time which must elapse between the granting of such an injunction and an application by the bank to have it discharged.”*

From the aforesaid, it is evident that it is not enough to merely allege fraud, but there must be clear evidence, both as to the fact of fraud, as well as the bank’s knowledge of such fraud.

The said legal position has also been reiterated by the Supreme Court in Millenium Wires (P) Ltd. and Ors. v. The State Trading Corporation of India Ltd. & Ors.³⁵, where although the Plaintiffs did make specific allegations as to fraud, but failed to make averments as to the knowledge of such fraud by the confirming bank. In their pleadings, the Plaintiffs apprehended that the negotiating banks were in active collusion with the beneficiaries, but they provided no explanation or justification for such apprehension.

In this case, the Court opined that although not all the evidence with respect to the allegations is to be adduced in a plaint, nonetheless, a comprehensive narration of facts that constitute the cause of action will have to be given. On this ground, the Supreme Court upheld the rejection of the Plaint under Order VII Rule 11 of the Code of Civil Procedure, 1908 (“**CPC**”), since the Plaintiffs could neither prove the existence of fraud nor that the confirming bank had any knowledge of such fraud.

Further, in another case³⁶, a question arose before the Supreme Court regarding unconditional leave to defend a summary suit pertaining to a bank guarantee transaction. In the said case, despite repeated demands, the Respondent bank did not reimburse the Appellant bank the amount paid to the beneficiary under certain letters of credit. In view of such refusal, the Appellant bank instituted three summary suits for recovery. The High Court granted the Respondent

³⁵ (2015) 14 SCC 375 (Para 5, 7, 9, 11.3)

³⁶ UBS Ag v. State Bank of Patiala, (2006) 5 SCC 416 (Para 34, 35, 36)

bank unconditional leave to defend, which was challenged before the Supreme Court. The short question before the Supreme Court, therefore, was whether unconditional leave to defend could be granted for the Respondent's refusal to reimburse the Appellant bank, before being informed of the fraud allegedly perpetrated by the beneficiary. On the aspect of the allegation of fraud, the Court found that fraud had been detected only after the letters of credit were negotiated, and therefore such a ground could not be set up as a plausible defence in the Suit, warranting the grant of unconditional leave to defend. The Court went a step further after having examined the facts of the case and held that there could be no triable issues, which would justify the grant of unconditional leave to the Respondent bank to defend the suit filed by the Appellant bank.

Therefore, in order to succeed, the party seeking the injunction is under an obligation to show prior knowledge of the fraud by the bank, on the basis of sufficient and relevant material, instead of merely relying on a broad statement/ allegation made in the plaint³⁷.

III. Duty of care on the part of the negotiating bank

The Uniform Customs and Practice for Documentary Credits (UCP 600), issued by the International Chamber of Commerce, prescribes a certain minimum duty of care that must be exercised by banks in the event a letter of credit/ guarantee is sought to be invoked. These guidelines set out the standard of examination of documents, compliances in respect of the terms of presentation, procedure of refusal in cases of discrepant documents, etc³⁸.

In *Federal Bank Ltd. v. V.M. Jog Engineering Ltd. & Ors.*³⁹, the Supreme Court, while tracing the similarities between common law and the Uniform Customs and Practice for Documentary Credits (1983), held that the principle of reasonable care is equally applicable to all such transactions involving bank guarantees/ letters of credit. The Court held that a bank would be dutybound

³⁷ *Petroleum India International v. Bank of Baroda*, 2008 (6) Mh. L.J. 487 (Para 25, 31); *ITC Limited v. Depts Recovery Appellate Tribunal and Others*, (1998) 2 SCC 70 (Para 22)

³⁸ Articles 14-17, Uniform Customs and Practice for Documentary Credits (UCP 600), International Chamber of Commerce, 2007- <http://static.elmercurio.cl/Documentos/Campo/2011/09/06/2011090611422.pdf>

³⁹ (2001) 1 SCC 663 (Para 55, 56, 59, 60, 65)

to honour the demand for encashment if the beneficiary *prima facie* complies with the terms of the bank guarantee/ letter of credit, i.e. the beneficiary produces the documents enumerated in the bank guarantee/ letter of credit.

In the present case, the negotiating bank had released certain sums of money for payment under a bill of exchange, which was encashed against a letter of credit. The negotiating bank before releasing such payment, had confirmed the genuineness of the documents from the issuing bank. The beneficiary in this case had forged the documents, when in reality, the performance of the contract was not carried out. Upon ascertaining the peculiar facts and circumstances of this case, the Supreme Court held that the Appellant, i.e. the negotiating bank, had in fact taken extra precaution by sending all the relevant documents to the issuing bank for confirmation and had released payment only upon such confirmation. Further, applying the principles of duty of care, the Court observed since the negotiating bank, on the basis of a clearance given by the issuing bank as to the genuineness of documents, had sought reimbursement of payment released by it, therefore as a holder in due course it was entitled to such reimbursement. Hence, the Court rejected the contention that the negotiating bank had any knowledge of the fraud, since it had exercised due diligence in having the legitimacy of the documents verified and had therefore taken adequate precaution in getting clearance from the issuing bank.

However, the negotiating bank cannot refuse encashment of a guarantee on grounds that are in excess of the basic standard of duty of care. In Asian Cricket Council v. Indian Overseas Bank⁴⁰, the Appellant/ Original Plaintiff sought to invoke a Stand-by letter of credit (“**SBLC**”). However, the invocation was refused by the Defendant, citing certain discrepancies in the documentation *vide* which the invocation was sought. Although the Appellant/ Original Plaintiff contended that there were no discrepancies, the Appellant/ Original Plaintiff re-invoked the SBLC, rectifying the discrepancies allegedly raised by the Defendant, on a without prejudice basis. This re-presentation was also rejected by the Defendant stating *inter-alia* that the SBLC could not be re-negotiated. The

⁴⁰ SLP (C) No. 29566-67 of 2015 arising out of Summons for Judgment No. 19 of 2014 in Summary Suit No. 314 of 2014

Appellant/Original Plaintiff filed a summary suit before the Bombay High Court for recovery of the sums under the SBLC. The Bombay High Court granted the Defendant unconditional leave to defend the summary suit on two grounds i.e., (a) the bill of exchange/ draft drawn upon the Defendant contained certain infirmities; and (b) the issue of interest claimed by the Appellant/Original Plaintiff in the summary suit was not covered by the SBLC.

Finally, the Supreme Court set aside the order of the Bombay High Court and granted the Defendant conditional leave of defend the summary suit, subject to the Defendant depositing the amount covered under the SBLC before the Bombay High Court. In its order, Apex Court stated *inter-alia* that (i) the Appellant/ Original Plaintiff had submitted a fresh bill of exchange/ draft, rectifying the defects raised by the Defendant; and (ii) the Appellant/ Original Plaintiff had given up its claim for interest.

IV. Specific averments as to the allegation of fraud

Order VI Rule 2, read with Rule 4 of the CPC requires any party pleading misrepresentation, fraud, or undue influence to specify the necessary particulars in their pleadings to substantiate the allegations. This requirement is equally applicable to any allegation of fraud, sought to be alleged in order to seek an injunction against the invocation of a bank guarantee.

In *Svenska Handelsbanken v. Indian Charge Chrome & Ors.*⁴¹, a full bench of the Supreme Court has held that mere pleadings in a plaint do not make out a strong *prima facie* case of fraud, as such pleadings make out only allegations, or averments as to the facts of the alleged fraud.

In this case, the Plaintiff alleged, that the recalcitrant party fraudulently misrepresented their intention to supply the pre-determined goods and induced the Plaintiff to enter into an agreement for supply of the same. The Supreme Court, upon appreciation of the evidence on record, concluded that the High Court was not justified in granting the injunction merely on the basis

⁴¹ AIR 1994 SC 626 (Para 41, 42)

of a suspicion of fraud made out from the allegations in the plaint, without there being a *prima facie* case of fraud being explicitly spelt out from the material evidence.

In another case, the Plaintiff had not raised any allegations of fraud in the plaint; and had raised them only in the applications for injunction against their invocation. The Supreme Court held that the latter was devoid of any facts or particulars in support of the allegations of fraud and therefore constituted mere bald averments. The Court rejected the plea of fraud as neither was the main contract sought to be avoided by alleging fraud, nor was it at any time alleged that the bank guarantee had been issued because any fraud had been played by the Appellant in question⁴².

A similar stance was maintained by the Supreme Court in *Mahatma Gandhi Sahakra Sakkare Karkhane v. National Heavy Engg. Coop. Ltd. & Ors.*⁴³ In this case, the Respondent failed to commission the plant as per the terms of the agreement, due to which a conditional bank guarantee was sought to be invoked. The High Court granted an injunction against the invocation of the bank guarantee while holding that the said guarantee was conditional in nature, and its invocation, without informing the bank regarding the alleged breach of the agreement itself amounted to fraud. However, the Supreme Court held *inter-alia* that there was no factual finding in support of the allegation of fraud, and there was no serious allegation of the same, except for the mere use of the word 'fraud'. In light of these findings, the Court held that the injunction was wrongly granted.

A series of judgements delivered by the Apex Court have settled the position of law that, in the absence of a specific plea of fraud, injunction against invocation of a bank guarantee cannot not be granted⁴⁴. Even in a summary suit under Order XXXVII of the CPC, in the absence of any such plea, the Court has refused to grant an unconditional leave to defend the suit⁴⁵. Thus, merely mentioning in the pleadings that a bank guarantee has been encashed fraudulently may not be sufficient. A plea of fraud must be categorical, with

⁴² *Dwarikesh Sugar Industries Ltd. v. Prem Heavy Engineering Works Pvt. Ltd & Anr.*, (1997) 6 SCC 450 (Para 28)

⁴³ AIR 2007 SC 2716 (Para 25, 28)

⁴⁴ *Edward & Owen Engineering v. Barclays Bank International*, (1978) 1 All ER 976; *I.T.C. Ltd. v. Debt Recovery Appellate Tribunal & Ors.* (1998) 2 SCC 70 (Para 16)

⁴⁵ *Oil & Natural Gas Corporation Ltd. v. SBI, Overseas Branch*, AIR 2000 SC 2548 (Para 6, 7, 8)

specific language of events and the parties must lead evidence in support of such plea⁴⁶. To enable a party to succeed on the ground of fraud, the details of fraud must be given in the petition. Merely stating in the petition that the bank guarantee furnished by the petitioner is rendered incapable of being invoked on account of the contract having been frustrated and the invocation is therefore fraudulent and liable to be quashed, shall not suffice. Courts have held that pleadings should be more specific to demonstrate acts of fraud committed by a party. A mere allegation that on account of the contract having been frustrated, the invocation of the bank guarantee is fraudulent is not enough for the petitioner to have the bank guarantee stayed.⁴⁸

V. Arbitrability of fraudulent invocation of a bank guarantee

The Supreme Court, in N.N. Global Mercantile Pvt. Ltd. v. Indo Unique Flame Ltd. &Ors.⁴⁹, dealt with the issue of arbitrability of a fraudulent invocation of a bank guarantee. The principal allegations of the Appellant in the instant case were *inter-alia* that the bank guarantee was fraudulently invoked against the terms of the work order between the parties and that it was a conditional guarantee linked to the performance of work.

The Supreme Court, on the question of arbitrability of fraudulent invocation of a bank guarantee, observed that such allegations are arbitrable as the disputes arose between the parties *inter se*, and they are not in the realm of public law. The court made a distinction between cases that entail a serious allegation of fraud, and fraud simpliciter. The Court held that mere allegations of fraud simpliciter would not constitute a sufficient ground to decline a reference to arbitration. Relying on the judgement of A. Ayyasamy v. A. Paramasivam &Ors.⁵⁰ and Rashid Raza v. Sadaf Akhtar⁵¹, the Court followed the twin test to adjudge the arbitrability of such disputes, i.e. (a) the plea of fraud should permeate the entire contract, and above all, the arbitration agreement, rendering it void; and (b) the allegations of fraud should touch upon the internal affairs of the parties *inter se*, having no implication in the public domain.

⁴⁶ Punj Lloyd Insulations Ltd. v State Bank of India, AIR 2006 Delhi 256 (Para 11); Ansal Properties & Industries (P) Ltd. v. Engineering Projects (India) Ltd., 1997 (41) DRJ 618 (Para 33)

⁴⁷ Coronatoin Mrktg. Services Ltd. v. MMTC Ltd., 1995 (35) DRJ 658 (Para 18)

⁴⁸ Coronatoin Mrktg. Services Ltd. v. MMTC Ltd., 1995 (35) DRJ 658 (Para 18)

⁴⁹ (2021) 4 SCC 379 (Para 39-51)

⁵⁰ (2016) 10 SCC 386 (Para 2, 6, 25, 26)

⁵¹ (2019) 8 SCC 710 (Para 3, 4, 5)

Based on the said criteria, the Court held that it would be justified to refuse reference of parties to arbitration in cases where there may be serious allegations of fraud, which would make out a criminal offence of fraud or where the allegations are so complicated that they would have to be adjudicated by a civil court to record voluminous evidence. Having said that, the Court further opined that any civil/ commercial, or contractual/ non-contractual dispute could be referred for arbitration, since the Arbitration and Conciliation Act, 1996 (“**Arbitration Act**”) does not exclude any category of disputes. Lastly, the Court also held that the civil aspect of fraud is considered to be arbitrable under contemporary arbitration jurisprudence, except where allegation is that (a) the arbitration agreement is itself vitiated by fraud/ fraudulent inducement; and (b) the fraud goes to the validity of the parent contract, thereby impeaching the arbitration clause itself.

With these findings, the Court refused to interfere with the invocation of the bank guarantee, since such disputes were between the parties *inter se*, and were not within the realm of public law. However, the Court did observe that the Appellant was at the liberty to seek any interim relief under Section 9 of the Arbitration Act, since the dispute was held to be arbitrable.

B. Special Equities

The expressions “extraordinary special equities” or “irretrievable injustice/ injury” are not statutorily defined expressions. Therefore, they ordinarily have such connotation and meaning, as may be justified with reference to the facts and circumstances of each case and which would avoid any repugnancy.

In one of the earlier cases decided by the Calcutta High Court⁵², the ground of “Special Equities” was given judicial recognition, where the Court observed:

“13. In my opinion, the position in law is as follows, whether the bank is obliged to pay and pay on what terms must depend upon both in the case of bank guarantee and in the case of letter of credit on the terms of the document. With respect to the Court of Appeal, it is not necessary for this Court to go to the extent of saying whether the performance guarantee

⁵² *Texmaco Ltd. v. State Bank of India*, AIR 1979 Cal 44 (Para 13)

*stands on a similar footing of a letter of credit but so far as the Court of Appeal says the bank must pay according to the guarantee on demand, if so stipulated, without proof or conditions, I respectfully agree. **The Court of Appeal has referred to the exception of a clear fraud. I venture to suggest there may be another exception in the form of special equities arising from a particular situation which might entitle the party to an injunction restraining the performance of bank guarantee. But in the absence of such special equities and in the absence of any clear fraud, the Bank must pay on demand, if so stipulated, and whether the terms are such, must have to be found out from the performance guarantee as such.***

The requirement for special equities is akin to that of irretrievable injustice. “Special equities” are special circumstances, which justify granting the exceptional relief for interdicting a bank guarantee, considering that the non-grant of such relief would result in irretrievable harm or injury to the party who has otherwise established a compelling case. It is necessary to bear in mind that unconditional bank guarantees are furnished during commercial transactions to enable the beneficiary to invoke the same without recourse to any adjudicatory process. Thus, clearly, commercial disputes arising in relation to transactions do not present any special equities⁵³.

The resulting irretrievable injury must be such that it makes it impossible for the guarantor to reimburse himself. Moreover, it must be proved to the satisfaction of the Court that it would be impossible to recover the amount from the beneficiary through restitution. In the encashment of a bank guarantee, the principle of undue enrichment has no application⁵⁴.

It must be kept in mind that terms of the bank guarantee are extremely material. Since bank guarantees represent an independent contract between the bank and the beneficiary, therefore, both parties would be bound by the terms thereof. The invocation, thus, will have to be in accordance with the terms of the bank guarantee, or else, the invocation itself would be bad⁵⁵.

⁵³ Consortium of Deepak Cable India Limited & Abir Infrastructure Private Limited (Dcil-Aipil) The Abir v. Teestavellay Power Transmission Limited, 2014 SCC OnLine 4741 (Para 145-147), Zee Entertainment Enterprises Ltd. and Another v. Railtel Corporation of India Ltd. and Another, 2021 SCC OnLine Del 5004 (Para 31)

⁵⁴ Dwarikesh Sugar Industries Ltd. v. Prem Heavy Engineering Works (P) Ltd. and Another, (1997) 6 SCC 450 (Para 21, 22, 29)

⁵⁵ Hindustan Construction Co. Ltd. v. State of Bihar and Others, (1999) 8 SCC 436 (Para 9)

i. Balance of Convenience and Prima Facie Case

In the landmark *United Commercial Bank v. Bank of India*⁵⁶, a letter of credit was opened by one *Bihar Food and Civil Supplies Corporation Ltd.* with the Appellant bank, against the supply of certain goods by *Godrej Soaps Ltd.*, on whose behalf the Respondent was the negotiating bank. Pursuant to the supply of goods, when the relevant documents were presented to the Appellant, the latter made the payment to the Respondent “under reserve”, despite the knowledge that the goods described in the presented papers were not in conformity with the description provided in the letter of credit. The said payment was made “under reserve” and in terms of the letter of guarantee or indemnity executed by the Respondent. The Appellant made a demand for refund of the said amount upon dishonor of the bills of exchange by *Bihar Corporation*, consequent to which, *Godrej Soaps* moved the High Court, seeking an injunction under Order XXXIX Rules 1 and 2 of the CPC. Aggrieved by the grant of a temporary injunction by the High Court, the instant special leave petition was preferred before the Supreme Court.

The Court while rejecting the High Court’s order of injunction, *inter alia*, held that:

- i. The High Court erred in granting a temporary injunction as it neither determined as to where the balance of convenience lay, nor did it deal with the question of whether or not the Plaintiffs would be put to irreparable loss if there was no injunction granted.
- ii. The High Court’s assumption of existence of breach of contract by the Appellant was arbitrary and without any basis. The said question of breach was an issue of trial.
- iii. No injunction could be granted under Order XXXIX Rule 1 and 2 of the CPC unless a *prima facie* case is established, meaning thereby that there existed a *bona fide* contention between the parties or a serious question which needed to be tried.

⁵⁶ (1981) 2 SCC 766, (Para 52, 53, 54, 55)

- iv. In banking transactions, payment “under reserve” means that the recipient of the money may not deem it as his own but must be prepared to return it on demand. The balance of convenience in such circumstances lies in allowing normal banking transactions to go forward.
- v. The powers of the Supreme Court under Article 136 of the Constitution of India even though are untrammelled, are subject to certain self-ordained restrictions. The Court does not, as a matter of rule, interfere with interlocutory orders, save under very exceptional circumstances. The instant case called for such interference by the Court on account of lack of justification on the part of the High Court for grant of the injunction.

ii. Genuine Apprehension of Irretrievable Injury

The scope of exceptional special equities has been extended by Courts and is one of the main factors, which they are called upon to consider, while adjudicating the rights and obligations of the parties under a bank guarantee. The existence of a *prima facie* case is only a matter of ancillary consideration, and the cases must fall within the category of “*exceptional special equities*” to justify judicial intervention⁵⁷.

In *U.P. Cooperative Federation Ltd. v. Sigh Consultants and Engineers (P) Ltd.*⁵⁸, the Supreme Court set aside an injunction granted to the Respondent by the High Court against the invocation of an unconditional and on demand bank guarantee against the Appellant. The Court, while dismissing the High Court’s reasonings that the Respondent had made out a *prima facie* case and that the injunction was sought not against the bank but against the Appellant, held that the net effect of the injunction sought was to restrain the bank from performing the bank guarantee. Therefore, as per the Court, one cannot do indirectly what one is not free to do directly. The Court also held that the Respondent in such a scenario is not remediless and can sue the Appellant for damages. The Court further observed that in such cases, the issue is not that there should be a *prima facie* case, but a legitimate apprehension that irretrievable damage would be caused in the event the injunction is not granted.

⁵⁷ *Continental Construction Ltd. v. Satluj Jal Vidyut Nigam Ltd.*, 2006 SCC OnLine Del 56 (Para 20)

⁵⁸ (1988) 1 SCC 174 (Para 28)

iii. Outstanding liability of the beneficiary in the underlying contract

Reiterating the aforementioned principles of law, the Supreme Court, in the case of *General Electric Technical Services Company Inc. v. Punj Sons (P) Ltd. & Another*⁵⁹, set aside the injunction granted by the High Court against the invocation of an on demand and unconditional bank guarantee with costs. The Court, in this case, additionally observed that the bank is not concerned with the outstanding amount payable by the beneficiary in the underlying contract. The right to recover the amount in the underlying contract has no relevance on the liability of the bank under the bank guarantee, which remains intact, irrespective of the recovery of any sum in the underlying contract. Any omission/ failure on the part of the beneficiary to specify such outstanding amount in the letter for encashment is of little consequence to the liability of the bank under the guarantee.

iv. Threshold of Irretrievable Injury as set out in the *Itek Corporation* case

The Supreme Court, in the landmark judgement of *Svenska Handelsbanken v. M/s Indian Charge Chrome & Others*⁶⁰, has laid down the scope of the expression, “to prevent irretrievable injustice”, relying upon the principles of law settled in the judgement of *Itek Corporation v. The First National Bank of Boston etc.*⁶¹ of the United States District Court, Massachusetts.

The facts of the *Itek Corporation* case relate to the period of the Iranian Revolution, when the American Government had cancelled Iran’s export license and blocked all Iranian assets. The Plaintiff therein invoked force majeure, but the Iranian importer resorted to encashment of the bank guarantee. The US exporter, therefore, brought an action seeking an order terminating its liability under the stand-by letter of credit by the American Bank in favour of the Iranian Bank as part of the contract. The Learned District Court held that the contractor was entitled to the issuance of preliminary injunction, since, even if the claim for damages is decreed by the American Courts, the situation in Iran

⁵⁹ (1991) 4 SCC 230 (Para 10)

⁶⁰ (1994) 1 SCC 502 (Para 88, 89), *Himadri Chemicals Industries Ltd. v. Coal Tar Refining Co.*, (2007) 8 SCC 110 (Para 11 and 13)

⁶¹ 566 Fed Supp 1210, 1217

was such that the decree could not have been executed in Iran.

Accordingly, the United States District Court, Massachusetts, observed that such a factual situation was an actual demonstration of non-existence of an adequate remedy at law and that the allegations of irreparable harm are not speculative but genuine and immediate. As per the said Court, irreparable harm would be caused to the other party, at whose insistence the bank guarantee was issued, if the requested relief was not granted.

The Apex Court, therefore, in the case of *Svenska Handelsbanken (supra)*, held that the law relating to injunction against the invocation of bank guarantee demanded that, a *prima facie* case of, *inter-alia*, irretrievable injury has to be shown, which has to be of the nature as noticed in the *Itek Corporation (supra)* case. The Court held that once the Plaintiff is able to obtain a decree for *inter-alia* damages, no problem in relation to recoveries in a friendly country would arise. The Court further observed that in international banking transactions, irretrievable injury will be caused to the Indian guarantor bank for not honouring the bank guarantee in the international market as this would cause grievous and irretrievable damage to the interest of the country as opposed to mere loss of money to the borrower/ plaintiff.

The said threshold of the ground of “*irretrievable injury*” as laid down in the *Itek Corporation (supra)* case was further applied by the Court in the case of *National Thermal Power Corporation Ltd. v. Flowmore Pvt. Ltd. & Another*⁶². In the said case, the Respondents sought to justify the injunction granted by the High Court on the grounds that *inter-alia* (a) the said guarantees were not invoked with respect to the terms thereof; and (b) the Appellant had invoked the said guarantees during the existence of arbitration between the parties, when the parties had proceeded with arbitration on the basis that the said bank guarantees would not be invoked until the arbitration was over and an award was made. The Court, while dismissing the said grounds, held that the aforesaid circumstances did not result in any irretrievable injustice to the Respondent, as referred to in the *Itek Corporation case (supra)* and hence the guarantees could be realised.

⁶² (1995) 4 SCC 515 (Para 9, 10, 11)

v. Existence of disputes in and/ or breach of the underlying

In *Hindustan Steelworks Construction Ltd. v. Tarapore & Co. & Another*⁶³, the High Court while granting an injunction against the invocation of a bank guarantee, took the view that (a) a term in the bank guarantee which made the beneficiary thereof the sole judge on the question of breach of contract as also the extent of loss or damages resulting thereof, was invalid; and (b) no amount could be said to be due till an adjudication on that behalf was made either by a court or an arbitrator, as the case may be. As per the High Court, no irretrievable injustice would be caused to the beneficiary if the injunction is granted, as the beneficiary could recover damages from the bank and its interest would be safeguarded by directing the other party to keep extending the bank guarantees till the disputes were settled between the parties.

However, the Supreme Court, while rejecting the grant of the injunction by the High Court as also its reasoning, reiterated the principles of unconditional bank guarantee and its independent nature from the underlying contract. The Court dismissed the Respondent's contention that special equities existed on the basis that there was a serious dispute on the question as to who had committed breach of contract, the existence of a counter claim, and that the said disputes had been referred to arbitration, where no award had been passed. The Court held that such factors were not sufficient to make the instant case an exceptional one, justifying interference of the Court⁶⁴.

An unconditional guarantee executed by a guarantor cannot be dissected, and the terms thereof are required to be read together. Any contention that there is a dispute between the parties in the underlying contract cannot be entertained to grant an injunction from the invocation of a bank guarantee⁶⁵. Acceptance of such an argument would make the guarantee entirely meaningless and inoperative. Moreover, the absence of any explicit term in

⁶³ (1996) 5 SCC 34 (Para 14 and 23); *Zee Entertainment Enterprises Ltd. and Another v. Railtel Corporation of India Ltd. and Another*, 2021 SCC OnLine Del 5004 (Para 34); *Tata Teleservices Ltd. Hughes Ispat and Essar Commision v. Union of India*, 1999 (49) DRJ 431 (Para 12, 14, 16, 17); *Coronatoin Mrktg. Services Ltd. v. MMTC Ltd.*, 1995 (35) DRJ 658 (Para 17)

⁶⁴ *Ansal Engineering Projects Ltd. v. Tehri Hydro Development Corporation Ltd. and Another*, (1996) 5 SCC 450 (Paras 4, 5)

⁶⁵ *M/s. Meena Advertisers v. Delhi Metro Rail Corporation Limited*, 2015 SCC OnLine Del 10430 (Para 3), *Indu Projects Limited v. Union of India*, 2013 (139) DRJ 397 (Para 3, 6, 7)

the guarantee that the guarantor shall require proof of liability of payment before paying the sum demanded under the guarantee, fortifies the principle of non-interference by Courts⁶⁶.

In another important judgement in the case of Gujarat Maritime Board v. Larsen and Turbo Infrastructure Development Projects Limited & Another⁶⁷, the Supreme Court dealt with the issue of discretionary jurisdiction of the High Court under Article 226 of the Constitution of India, for restraining the invocation of an unconditional bank guarantee. The Court held that in a performance bank guarantee, an explicit condition that the decision of the beneficiary on the breach thereof (as a ground for invocation), is binding on the bank. The justifiability of the decision of the breach, i.e., a dispute in the underlying contract, is a different matter between the parties and it is not for the High Courts, in proceedings under Article 226, to go into that question, since several disputed questions of facts are involved. The Apex Court also held that between the bank and the beneficiary, the moment there is a written demand for invoking the bank guarantee, pursuant to the breach of a covenant in the underlying contract, the bank is bound to honour the payment under the guarantee once the breach is established by the beneficiary.

vi. Invocation of the bank guarantee by a third party

In another landmark case of Hindustan Construction Co. Ltd. v. State of Bihar, & Others⁶⁸, the Supreme Court upheld the order of injunction granted by the High Court against the invocation of a performance bank guarantee. In the instant case, the bank made the payment against the invoked bank guarantee to a third party, who was not a party to the guarantee. The Apex Court, reiterating the settled legal principle that a bank guarantee is a separate, independent and a distinct contract, held that the instant bank guarantee was between the bank and the Defendants, and therefore it could

⁶⁶ *Standard Chartered Bank v. Heavy Engineering Corporation Limited and Another*, (2020) 13 SCC 574 (Para 17, 20, 21, 22, 23), *Mahatma Gandhi Sahakra Sakkare Karkhane v. National Heavy Engg. Coop. Ltd. And Another*, (2007) 6 SCC 470 (Para 22, 25), *Yograj Infrastructure Ltd. v. Ssang Yong Engineering and Construction Company Limited and Another*, (2012) 3 SCC 425 (Para 15, 16, 17); *Kuber Enterprises v. Doosan Power Systems India Pvt. Ltd.*, 2021 SCC OnLine Del 5049 (Para 20, 21, 29, 30) (Para 17, 18); *Mohan Meakin Breweries Ltd. v. Oceanic Imports & Exports Corporation & Anr.*, 1980 MhLJ 803 (Para 9, 10, 11, 13)

⁶⁷ (2016) 10 SCC 46 (Para 9, 11, 12, 13)

⁶⁸ (1999) 8 SCC 436 (Para 21, 22)

not be invoked by a third party. Therefore, the invocation in the instant case was wholly wrong and the bank was under no obligation to pay the amount covered by the performance guarantee. The Court held that “special equities” were wholly in favour of the Appellant and that the injunction granted by the High Court against the invocation of the performance bank guarantee is correct.

vii. **Recovery of the amount in the underlying contract**

In *BSES Ltd. (Now Reliance Energy Ltd.) v. Fenner India Ltd. & Another*⁶⁹, it was the Respondent’s contention that the bank guarantees, the invocation of which were sought to be injuncted, were primarily given for two purposes i.e., (i) to secure payment of advances; and (ii) to secure performance of the underlying contract. Therefore, as per the Respondent, special equities existed as all the amounts of the bank guarantee that were provided to secure advance payments, had been recovered from the running bills of the Respondent.

Rejecting this argument, the Apex Court, opined that the right to recover the amount under the running bills had no relevance to the liability of the bank under the guarantee, which remained intact, irrespective of the recovery of mobilisation advance or the non-payment of running bills.

However, in direct contrast to the above, in the case of *Gangotri Enterprises Limited v. Union of India & Ors.*⁷⁰, the Supreme Court of India had in fact granted an injunction against the invocation of a bank guarantee on the ground that the guarantee in question which was sought to be invoked pertained to a different contract altogether. In this case, the Appellant was awarded two contracts by the Respondent, wherein a bank guarantee was submitted by the Appellant to the Respondent in the second contract. Certain disputes arose between the parties in the first contract and arbitration proceedings thereunder were commenced. The Respondent sought to encash the bank guarantee provided under the second contract. The Appellant filed applications under Section 9 of the Arbitration Act, seeking injunction against the invocation of the said bank guarantee, which was ultimately rejected by the High Court.

⁶⁹ *BSES Ltd. (Now Reliance Energy Ltd.) v. Fenner India Ltd. & Another*, (2006) 2 SCC 728 (Para 28, 29, 30)

⁷⁰ (2016) 11 SCC 720 (Para 40)

In appeal, the Apex Court, granted the injunction, restraining the encashment of the bank guarantee, *inter-alia*, stating that (a) the sum claimed by the Respondent from the Appellant in the arbitration proceeding did not pertain to the contract under which the bank guarantee was actually furnished, but for another contract (first contract) for which no guarantee had been furnished; and (b) the bank guarantee in question, was in the nature of a performance bank guarantee, and the works under the second contract had been satisfactorily completed.

Further, in *Larsen & Toubro Ltd. v. Maharashtra State Electricity Board & Ors*⁷¹, the Appellant had furnished five bank guarantees i.e., (a) one for security against advance payment; (b) one for performance; (c) two for partial release of retention money; and (d) one for security against liquidated damages. The said five guarantees pertained to a single underlying contract for the supply and commissioning of a coal handling plant. Owing to some delays in the project works, arbitration proceedings were commenced in relation to the underlying contract and all the guarantees were sought to be invoked, except for the performance guarantee. The High Court refused to grant injunction against the invocation of the said guarantees. In appeal, the Supreme Court refused to interfere with the invocation of all the guarantees, but one, being the guarantee given for partial release of retention money. The Apex Court on ascertaining the terms of the guarantee, held it to be a conditional guarantee, which was to remain active only till the time the plant was handed over. As per the Court, once the plant had in fact been handed over, the purpose of the said guarantee therefore had been achieved. Hence, in order to prevent irretrievable injustice, injunction against invocation was granted by the Court, *albeit* only in relation to the said bank guarantee.

viii. Absence of assets of the beneficiary in India

One of the most common grounds pleaded by litigants under the garb of special equities/ irretrievable injury *inter-alia* is the absence of assets of the beneficiary in India, thereby making the recovery of the invoked sum difficult.

⁷¹ (1995) 6 SCC 68 (Para 5-13)

In the landmark judgement of *Himadri Chemicals Industries Ltd. v. Coal Tar Refining Co.*⁷², there were disputes between the parties in the underlying contract regarding the quality of goods, pending which an application for injunction was filed by the Appellant against the release of payment under the letter of credit. The injunction was sought by the Appellant, *inter-alia*, on the ground that the Respondent was a foreign company, which did not have any assets in India. The Supreme Court held, *inter-alia*, that exceptional circumstances have not been made out by the Appellant, which would make it impossible for the guarantor to reimburse himself if he ultimately succeeds in the underlying disputes between the parties. Merely an apprehension in the application for injunction, to the extent that if the injunction is ultimately not granted it would be impossible to recover the encashed sums because the beneficiary is a foreign company with no assets in India, cannot come within the second exception of special equity/ irretrievable injury.

ix. Violation of principles of natural justice

In *Andhra Pradesh Pollution Control Board v. CCL Products (India) Limited*⁷³, three bank guarantees were furnished by the State Bank of India to the Appellant to secure compliance of the conditions stipulated in the consent given by the Appellant for the establishment and operation of the Respondent in terms of the applicable environmental standards. Certain violations were observed in the requisite environmental compliances, due to which the bank guarantees were invoked. Aggrieved by the said invocation, the Respondent moved the National Green Tribunal, which held that the principles of natural justice were required to be followed prior to the invocation of the bank guarantees. The Tribunal held that the invocation was unwarranted, and the amount received by the Appellant pursuant to the said invocation should be refunded. The Tribunal further observed that the purpose of the bank guarantee was not “commercial, contractual or industrial” since the guarantees were issued to secure compliance with the directions of the Appellant regarding environmental norms, which had to be followed by the Respondent. Therefore, as per the Tribunal, before the invocation, it was incumbent upon the Appellant to serve notice and furnish a hearing to the Respondent.

⁷² (2007) 8 SCC 110 (Para 14, 15, 17)

⁷³ (2019) 20 SCC 669 (Para 15, 20, 21)

The Supreme Court, whilst rejecting the order and observations of the Tribunal held, *inter-alia*, that:

- i. A bank guarantee is an independent contract, independent of the underlying contract between the beneficiary and the third party, at whose behest the bank guarantee is issued.
- ii. The principles of law that have been formulated by the Tribunal cannot be accepted as reflecting the correct legal position. The Tribunal erred in applying the principles of natural justice as a condition to invoke the guarantee and it is contrary to the settled legal position.
- iii. It was not for the bank to determine whether the invocation of the bank guarantees were justified so long as the invocation was in terms of the bank guarantee. A demand once made would oblige the bank to pay under the terms of the bank guarantee.

x. *Invocation of bank guarantee should be in accordance with the terms thereof*

The *Delhi High Court in Continental Construction Ltd. & Anr. v. Satluj Jal Vidyut Nigam Ltd.*⁷⁴, while emphasising the importance of the terms of a bank guarantee, held that:

- i. The terms of the bank guarantee are extremely material, and it should be invoked strictly in terms thereof, free of fraud or irretrievable injury being caused to the guarantor/ contractor.
- ii. The bank guarantee must be construed and read as a complete document in itself and recitals of the document cannot be construed to be irrelevant or of no material consequence.
- iii. The bank guarantee must be invoked in accordance with its terms and the actions of the Respondents should be free of any established fraud, resulting in irretrievable injury/ injustice, and must not tilt the balance of extraordinary special equities entirely in favour of the Petitioners.

⁷⁴ 2006 SCC OnLine Del 56, (Para 17, 20, 22)

Further, in *Mohan Meakin Breweries Ltd. v. Oceanic Imports & Exports Corporation & Anr.*⁷⁵, the Bombay High Court held that the rights and liabilities of the parties ought to be governed solely by the terms of the agreement, and it was not open to the Court to read into a written contract. To interpret such a contract in a manner not warranted by its terms would amount to the Court making a new contract for the parties, which in no way is permissible.

However, while interpreting the terms of a bank guarantee, it is necessary to distinguish between recitals in a bank guarantee which set out the purpose for issuing the bank guarantee, and recitals which set out the conditions for invoking the bank guarantee. For instance, a recital in the bank guarantee that it is being issued to ensure performance of the contract does not make the performance of the contract by the contract-awardee a condition precedent for the invocation of the bank guarantee. Therefore, while encashing a bank guarantee, a bank needs to identify the condition which governs the obligation(s) of the bank thereunder.⁷⁶

xi. Imposition of lockdown on account of the Covid-19 pandemic

The Delhi High Court, in *Halliburton Offshore Services Inc. v Vedanta Limited & Another*⁷⁷, recognised the delay in completion of the project on account of the lockdown imposed due to the Covid-19 pandemic as a special equity, warranting grant of injunction against the invocation of a bank guarantee. The Court observed that in the event no interim protection is granted, and the bank guarantees are allowed to be encashed while the lockdown is in place, injury and prejudice would result to the Petitioner. Such injury and prejudice merit being categorised as irretrievable, even if the Petitioner may still be able to recover the amounts.

However, some Courts have, on certain occasions, rejected the ground of commercial and financial hardship on account of the Covid-19 pandemic a special equity to seek injunction against the invocation of a bank guarantee. To this effect, Courts have held that if the Petitioner has any claim, the same

⁷⁵ 1980 MhLJ 803 (Para 7, 8, 9, 11, 13, 14)

⁷⁶ *Garg Builders, Through Shri Mohinder Pal Garg v. Hindustan Prefab Ltd. and Anr.*, 2022 SCC OnLine Del 1264, (Para 37 and 40)

⁷⁷ 2020 SCC Online Del 542 (Para 19, 20, 21 and 28)

would be subject to readjustment, measurement, and reconciliation as per the terms of the contract, and it would be appropriate to agitate these grounds at the appropriate stage⁷⁸. In such cases, Courts have held that there exists no *prima facie* case of fraud or irretrievable injustice⁷⁹.

xii. Proportionality

In *Chennai Metro Rail Ltd. v Transtonnelstroy – Afcons (JV) & Ors.*⁸⁰, the Hon'ble High Court of Madras recognised the concept of proportionality as a special equity, which would constitute a valid exception against the invocation/ encashment of an unconditional bank guarantee. In the instant case, the Respondents (*Original Claimants*) had invoked arbitral proceedings against the Appellants (*Original Respondents*) for breach of contract. Meanwhile, even before crystallizing claims against the Respondents, the Appellant invoked the bank guarantee. The Arbitral Tribunal granted the order of injunction, restraining the invocation/ encashment of the bank guarantee. Additionally, the Tribunal had also directed the Respondents to keep the bank guarantee alive till the disposal of the arbitration and protected the Appellant's interest.

Upon challenge, the Madras High Court found that in the event the Arbitral Tribunal finds that the Respondents do not owe any money to the Appellant, or if it is found that the Respondents are liable to pay a much lesser sum than the bank guarantee value, it would amount to irretrievable injustice, and the Respondents would find it difficult to recover the unjust enrichment made by the Appellant. Since the claim amount was large in the instant case, the Court held that proportionality of the claim would certainly play a role in deciding whether an injunction could be granted. Further, the Court also observed that given the facts of the case, a balancing act would have to be done by the Court, since the Appellant had neither crystallized their losses, nor given a break-up, explaining the same. Therefore, applying the test of balance of convenience, the Court dismissed the Appeal and upheld the orders of the Arbitral Tribunal.

⁷⁸ *Zee Entertainment Enterprises Ltd. and Another v. Raitel Corporation of India Ltd. and Another*, 2021 SCC OnLine Del 5004 (Para 36,40,42,43); *Shaarc Projects Limited v. Indian Oil Corporation Limited and Ors.*; OS WP LD VC No. 379 of 2020 (Para 12, 13, 14, 15, 17, 18, 20, 21, 22, 25, 26)

⁷⁹ *CIPTEL v. Indian Oil Corporation Ltd. and Ors.*, 2020 SCC OnLine Bom 2396 (Para 8)

⁸⁰ 2021 SCC OnLine Mad 5637 (Para 27)

In another important case⁸¹, the Hon'ble Delhi High Court further shed light on the concept of proportionality as a special equity against which an injunction against the invocation of an unconditional bank could be sought. In this case, the Appellant pleaded that only a proportionate amount of the guarantee may be permitted to be encashed by the Respondent as against the full sum since the undisputed amount of the Appellant was much less than the total value of the bank guarantee.

Upon analysing the facts of the case, as well as the correspondence exchanged between the parties, the Court observed that while proportionality could be included in the exception of special equities, the same could be applied only where the crystallized liability is significantly lower than the value of the bank guarantee furnished, and the contract is a concluded one. Therefore, as per the Court, in light of the settled principles pertaining to irretrievable injury, it must be gauged whether it would be impossible for the guarantor to get back the money if it succeeds in a claim against the beneficiary. Since, in the present case, none of these ingredients were satisfied, the Court dismissed the appeal and refused to interfere with the invocation of the guarantee.

⁸¹ *Hindustan Construction Co. Ltd. v. National Hydro Electric Power Corporation Ltd.*, 2020 SCC OnLine Del 1214 (Para 26, 29, 34, 35)



Conclusion

The law in India in relation to bank guarantees, more specifically on injunctions against the invocation thereof, has been fairly settled. The legal jurisprudence in India demonstrates an understanding of the significance of such guarantees in international and domestic trade and commerce. A bank guarantee plays a pivotal role in hedging, protecting, and reducing the risks involved in business transactions, more pertinently in cross border transactions, where, per the mutual commercial understanding of the parties, a banking institution provides security for payment. Therefore, in the interest of faith in trade and commerce, it is imperative that there is minimal interference with invocation of bank guarantees. The general rule followed by Courts, as has been set out above, is that of non-interference, save in certain exceptional situations, in the interest of justice and commercial well-being.

Therefore, the Courts' intervention in the invocation of a bank guarantee is not a rule, but an exception, which can be exercised only upon a *prima facie* establishment of a case of (a) "egregious" fraud in the underlying transaction, to the notice of the bank, which vitiates the genesis of the bank guarantee itself; and/or (b) special equities resulting in irretrievable loss and injury, as discussed in detail hereinabove. Courts have not stepped beyond these two limitations; however, their scope continues to expand with the changing times, with new exceptions being included within their ambit.

As far as the exception of fraud is concerned, the same is hinged on the age old settled principle that "*fraud vitiates everything*". It follows that a bank guarantee obtained fraudulently is void and unenforceable. For this, it must be shown that the underlying contract itself stands vitiated owing to such fraud, more so, that the fraud sought to be alleged is of an "egregious" nature, which is to the notice of the bank. In cases of fraud that does not vitiate the underlying contract, it is always open to the parties to pursue their legal remedies and seek damages,

warranting limited judicial interference at the stage of invocation of the bank guarantee. Additionally, the fraud sought to be established must be specifically pleaded in the plaint and substantiated with particulars, failing which the mere allegation of fraud may stand rejected.

As far as the ground of special equities is concerned, the threshold cannot be understood to be a mere commercial difficulty or financial hardship in recovery of the money from the beneficiary post invocation. The threshold evidently is very high, comparable with what has been established in the *Itek Corporation (supra)* case. With the passage of time, various factual scenarios have been pleaded by litigants in India under the garb of special equities, for instance, existence of disputes and/ or breach in the underlying contract; and/ or absence of assets of the beneficiary in India; however, Courts have refused to accept such pleas and have consistently held a bank guarantee to be independent of the underlying contract between the beneficiary and a third party, and have time and again buttressed the importance of the bank's absolute obligation to pay, subject to the invocation being in accordance with its terms.

In summation, and at the risk of repetition, it may not be out of place to state that Courts have been extremely circumspect in granting injunctions against the invocation of bank guarantees owing to reasons that have been explained above. Therefore, litigants must be extremely cautious in approaching Courts seeking injunctions against invocation of bank guarantees and must do so only if their case fits within the four corners of the settled law on the subject.

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2	Arad Metering Technologies Ltd. v. Xelia Utility Management Pvt. Ltd. & Ors.	2014 (4) Bom CR 97	24-26.
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4	ITD Cementation India Ltd. v. Reliance Infrastructure Limited & Ors.	2014 (2) Bom CR 1	20-24.
5	Karam Chand Thapar and Bros. (Coal Sales) Ltd. v. Hindustan Construction Company Limited.	2014 (3) Bom CR 302	12.
6	Mercator Oil & Gas Limited v. Oil & Natural Gas Corporation Limited & Ors.	AIR 2020 Bom 86	38, 39, & 40.

7	Parwani Builders v. Konkan Railway Corporation Ltd. & Ors.	(1996) 85 Comp Cas 676 (Bom)	4 & 6.
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2	Biba-Chem Pvt. Ltd. v. Hi-Tech Carbon & Anr.	1995 (34) DRJ	20, 33 & 35.
3	Dewan Chand v. Indian Oil Corporation Limited & Anr.	1999 (50) DRJ	15.
4	Independent Television Co(P) Ltd. v. Monica Electronics Ltd.	1996 (36) DRJ (DB)	5, 6 & 7.

5	New Era Industries v. Star Alubuild Pvt. Ltd. & Anr.	2014 SCC OnLine Del 3258	35, 39, 42 & 43.
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4	Sai Wardha Power Generation Limited v. Western Coalfields Limited & Ors.	2018 (2) ABR 403	17, 25 & 27.

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