

NCLAT rules: An Irrevocable and Unconditional Bank Guarantee can be Invoked even during Moratorium Period

Judgment Date: 10th January, 2023

The National Company Law Appellate Tribunal (in short NCLAT) comprising of Justices Mr. Anant Bijay Singh (Judicial Member) and Ms. Shreesha Merla (Technical Member) in the appeal matter of IDBI Bank Ltd vs Indian Oil Corporation Ltd, (in short IOCL) ruled that Bank Guarantees are outside the scope of the moratorium under Section 14 of the Insolvency and Bankruptcy Code, 2016 (herein after referred to as 'The Code') and Section 3 (31) of the code specifically excludes Performance Bank Guarantees (in short PBGs).

The backdrop of the case is that the present appeal was preferred by M/s. IDBI Bank Ltd. under Section 61 of the code. By the impugned order, the Adjudicating Authority has dismissed Interlocutory Application filed by the 'Resolution Professional' (in short RP) of Punj Lloyd Ltd. (also known as Corporate Debtor/PLL) seeking encashment of the Bank Guarantees issued by the Appellant and Central Bank of India. The Bank Guarantees were issued on behalf of the Corporate Debtor, as required under the terms of IOCL's EPCC-2 package of 'Aishwarya Project' at its Haldia Refinery in West Bengal.

The appellant contended that the 'Advance Bank Guarantees' (in short ABG) issued by the Appellant Bank had been wrongfully utilized by the IOCL, contrary to the terms of the Bank Guarantee. It was submitted that the Advance Bank Guarantee was provided to secure part of the mobilization advance of Rs. 107 Crore and against ten per cent supply payment which had been wrongfully utilized by the Corporate Debtor to secure some other additional advances from IOCL, contrary to the contract and without concurrence from the appellant bank, which was the issuer of the Advance Bank Guarantee and a party to the Bank Guarantee (in short BG) Agreement.

However, during continuance of the execution of the Contract, Corporate Debtor went into Corporate Insolvency Resolution Proceedings (in short CIRP). Subsequently, contractual disputes arose between the parties. IOCL invoked the Bank Guarantees for breach of the contract. Thereafter, Corporate Debtor had filed an application before National Company Law Tribunal, Principal Bench, New Delhi (in short NCLT) under Section 60(5) of the Code seeking restrain on the encashment of the Bank Guarantees, arraying those Bank issuing the Bank Guarantees, i.e., IDBI Bank and Central Bank also as, a party.

The NCLT, Principal Bench, New Delhi had observed that *“it is a well settled proposition that the bank guarantees constitute an independent contract between the Respondent Banks and the Applicant and therefore the Respondent Banks are under obligation to honor the request made by the IOCL, unless and until the transaction is hit by Section 14 of the Code, therefore CIRP cannot be a ground to deny encashment of the bank guarantees. It is evident on record that neither the Corporate Debtor indulged in fraud nor the IOCL had indulged in fraud giving scope to the bankers to raise objections against the bank guarantees because the Banks are under obligation to permit IOCL to encash the bank guarantees.”*

It was argued by the IDBI Bank that the Bank Guarantees cannot be invoked during the continuation of the moratorium under section 14 of the IBC. Moreover, IOCL has wrongfully sought to encash the Advance Bank Guarantees, contrary to the terms of these Guarantees.

It was contended that the Corporate Debtor had illegally promised to keep the BGs issued by the appellant alive for full value on its own, without any concurrence from the appellant Bank. It was vehemently asserted that the Advance Bank Guarantees were fraudulently misused by IOCL and PLL in contravention of the Bank Guarantee terms as well as their inter-se contract

The NCLAT was of the view that under the amended Section 14(3)(b) of the Code, irrevocable and unconditional Bank Guarantees are beyond the moratorium and can be invoked even during the moratorium period, as such, the invocation and encashment of the Bank Guarantees by IOCL was valid and legal.

Furthermore, it observed, that the allegation of the fraud by the IDBI Bank is of no basis on the premise that no injustice or harm was caused to the bank by encashment of the irrevocable and unconditional Bank Guarantees.

The NCLAT noted that IDBI Bank despite alleging fraud had not taken any steps/ actions. The Tribunal placed reliance on the judgment passed in U.P. Cooperative Federation Ltd vs. Singh Consultants and Engineers Pvt. Ltd (1988) wherein the NCLAT held that Banks are bound to encash the unconditional Bank Guarantees without any demur as and when the same is demanded by the beneficiary.

Based on the foregoing reasons the NCLAT dismissed the appeal filed by IDBI Bank and affirmed the view of the NCLT that Bank Guarantees are beyond the scope of moratorium as envisaged under Section 14 of the Code.

REFERENCE- <https://www.livelaw.in/amp/law-firms/bank-guarantees-ibc-nclat-bank-guarantees-ibc-219681>