

### **Bank Guarantee – A status note on encashment problem faced by construction firms**

Indiscriminate application of the power to encash bank guarantees by the client organizations in recent years has been seriously aggravating the precarious financial situation of the infrastructure construction firms. This was one of the key issues brought to the attention of the Union Finance Minister and senior most government officials at the meeting held on April 24, 2015 by CFI representatives. The key suggestion made at the meeting was to have a set of guidelines in line with the URDG 758 published by International Chamber of Commerce (ICC) in July 2010.

The objective of this communication is to provide certain useful information and key links having a bearing on the subject matter.

1. A note titled “A contractor’s view of URDG” by Christopher R. Seppala Partner, White & Case LLP, Paris and Legal Advisor, FIDIC Contracts Committee (1) Presented at the ICC Conference, Paris; 15 May 2001  
(<http://fidic.org/sites/default/files/3%20The%20ICC%20Uniform%20Rules%20for%20Demand%20Guarantees.pdf> ). The writer traces the nature of the problems faced by the contractors at that stage which were aimed to be resolved through the ICC / URDG 458. It may be seemed that the current problems faced by the civil contractors in India in this regard are almost same.
2. An abstract of ICC publication No. 758 titled “Uniform Rules for Demand Guarantees” (URDG). URDG 758 as mentioned above is the current set of rules and lays down the elements of the due process to be followed. (Attached .pdf file) and also a useful write-up (<http://www.erdem-erdem.av.tr/en/articles/uniform-rules-for-demand-guarantees/> )
3. Complete text of the URDG Rules <http://www.scribd.com/doc/82388395/URDG-2010-Final-Adopted-Text-PDF#scribd>
4. URDG 758 Rules are stated to be clearer, more precise, more comprehensive and offering a fair balance between the competing interest of the parties to the guarantees as compared to the URDG 458. The World Bank has updated its Model Guarantee Form to include URDG 758 and the Rules are increasingly being incorporated into International Trade Contracts. See news report  
  
(<http://www.tfreview.com/news/legal-regulatory/urdg-758-close-becoming-international-standard-demand-guarantee-practice>)
5. This development was noted in Business Standard “New Uniform Rules for Demand Guarantees offer a fair balance” dated July 05, 2010 while also remarking that RBI may like to take note and issue suitable instructions “In India, the Master Circular on guarantees issued by the Reserve Bank of India (RBI) does not insist that the guarantees issued by banks should be subject to the disciplines of the URDG although the banks are required to state on letters of credit that they are subject to the UCP 600. The ICC says that the new Rules for Guarantees are destined to become the international standard for all demand guarantees. RBI may like to take note and

issue suitable instructions.” ([http://www.business-standard.com/article/economy-policy/new-uniform-rules-for-demand-guarantees-offer-a-fair-balance-110070500110\\_1.html](http://www.business-standard.com/article/economy-policy/new-uniform-rules-for-demand-guarantees-offer-a-fair-balance-110070500110_1.html))

6. The instruction to the banks in this matter, however, as per the RBI Circular dated July 02, 2012 continues with the old stated position. Clause 2.5 states that “where guarantees are invoked, payments should be made without delay and demur”. The clause goes on to explain that this position is based upon a 1988 Supreme Court judgment and quotes the abstract

“We are, therefore, of the opinion that the correct position of law is that commitment of banks must be honoured free from interference by the courts and it is only in exceptional cases, that is, to say, in case of fraud or any case where irretrievable injustice would be done if bank guarantee is allowed to be encashed, the court should interfere’.”

The Clause 2.5.9(V) further says that “Non-compliance of the instructions in regard to honouring commitments under invoked guarantees will be viewed by Reserve Bank very seriously and Reserve Bank will be constrained to take deterrent action against the banks. “ For complete text of RBI Circular please see

(<http://rbidocs.rbi.org.in/rdocs/notification/PDFs/69MG010712CF.pdf>)

7. The above mentioned judgment of Supreme Court [U.P. Co-operative Federation Private Ltd. versus Singh Consultants and Engineers Private Ltd. (1988 IC SSC 174)], has formed the basis for most court judgments. The text can be read at (<http://indiankanoon.org/doc/329587/>). Further, another Supreme Court judgment (<http://indiankanoon.org/doc/854142/>), further reiterated this position and even gave a set of guidelines.

It would appear from the above that a re-thinking is required in the country in order to make policy changes with an appropriate set of guidelines in tune with URDG 758 in order to adopt best international practices and to improve the “ease of doing business” scenario in the country.

This is for your information and request for further suggestions please.