

BANKING AND FINANCE

Breach of Main Contract no ground for stopping payment under Bank Guarantee

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Recently, the Delhi High Court, in *Satish Kansal vs Synergy Tradeco NV and others*, reiterated that letter of credits (LC)/bank guarantees are independent of the main contract and a dispute under the main contract cannot be a ground for injuncting payment under the **LC/ bank guarantee.**

Plaintiff contended that the description of goods/material supplied did not match with the shipment and fraud has been committed. It was further contended that irretrievable injustice would be caused to the plaintiff, if the aforesaid amounts under the LCs are remitted to the defendant. The defendants, on the other hand, argued that out of the four containers supplied by the defendant to the plaintiff, only two containers have alleged to have defective goods. Therefore, at best, the case made out by the plaintiff is regarding breach of contract and it is not the case of fraud.

The Court referred *United Commercial Bank vs Banks of India* which settled the laws relating to judicial intervention on LCs/bank guarantee. It is a settled position of law that contracts in respect of Bank Guarantees and LCs are independent of the main contract between the parties. Therefore, even if there is a breach of the main contract between the parties, that cannot be a ground for injuncting payments under the Bank Guarantees/LCs. Bank Guarantees/LCs are irrevocable obligation undertaken by the issuing bank, to honour the same if the documents in terms of the said LCs/ Bank Guarantees are submitted by the beneficiary. LCs/ Bank Guarantees are the bedrock on which international trade and commerce is based. The goods are supplied by the seller to the buyer on the strength of the LCs/ Bank Guarantees provided by the buyer in favour of the seller, which functions as an assurance that once the goods are shipped and the documents in respect thereof are presented by the seller, the payment would be assured. The courts should be loath to interfere with the mechanism of LCs/ Bank Guarantees as it would have an impact on the efficacy and functioning of international trade.

The Court held that merely because there is a dispute between the buyer and the seller regarding the contract of supply of goods, that cannot be ground for interfering with the LC/ Bank Guarantees. There are only two exceptions to the aforesaid principle where courts would pass an injunction respect of payments under an LC/ Bank Guarantees, in cases of ‘egregious fraud and irretrievable injustice’. It has repeatedly been held by the courts that ‘egregious fraud’ has to be a fraud of the kind which goes to the very root of the matter.

Applying the aforesaid principles, while dismissing the appeal, the Court held that no case for interference with the LCs has been made out by the plaintiff