

EXPERTS CORNER

Unconditionally Bound: Decoding the Law of Bank Guarantees in India



Vasanth Rajasekaran
Founder and Head



Harshvardhan Korada
Counsel

Unconditionally Bound: Decoding the Law of Bank Guarantees in India

by Vasanth Rajasekaran* and Harshvardhan Korada**

Published on July 17, 2026 - By Editor



Introduction

Bank guarantees occupy an important place in commercial transactions. They are routinely used in infrastructure contracts, public procurement arrangements, construction contracts, supply agreements, and other commercial dealings where one party seeks security for the performance of contractual obligations and/or the repayment of a mobilisation advance. The commercial utility of a bank guarantee lies in its immediacy. The beneficiary of a bank guarantee is assured that upon invocation, the issuing bank will honour its commitment without requiring the beneficiary to first establish a breach or quantify damages in a contested adjudicatory process.

This commercial function has shaped the judicial approach to bank guarantees in India. The courts have consistently recognised that an unconditional bank guarantee is not merely an accessory to the underlying contract. It is an independent commercial instrument. The bank's obligation flows from the guarantee itself, and not from the merits of the dispute between the beneficiary and the party at whose instance the guarantee was furnished.

The Supreme Court has, therefore, repeatedly cautioned against routine judicial interference with the invocation or encashment of bank guarantees. In *United Commercial Bank v. Bank of India*¹, while dealing with a letter of credit, the Supreme Court emphasised the need to preserve the sanctity of independent banking commitments. The same commercial logic has informed the court's later approach to bank guarantees. This approach was carried forward in *U.P. Coop. Federation Ltd. v. Singh Consultants and Engineers (P) Ltd.*², where the court held that the commitments of banks must be honoured free from interference by the courts, failing which, trust in domestic and international commerce would be damaged.

At the same time, the rule of non-interference is not absolute. Indian Courts recognise limited exceptions where an injunction may be granted against the invocation or encashment of a bank guarantee. These exceptions are generally

formulated as fraud of an egregious nature, irretrievable injustice and/or special equities. However, special equities have not been treated as a broad equitable ground divorced from the settled threshold of exceptional prejudice. In several decisions, special equities are understood as circumstances akin to, or resulting in, irretrievable injustice. A separate and conceptually distinct category arises where the invocation is not in accordance with the terms of the guarantee itself. The law, therefore, attempts to balance commercial certainty with a narrow judicial safety valve for truly exceptional cases.

Nature of bank guarantees as independent contracts

A bank guarantee generally involves three relationships. *Firstly*, there is the underlying contract between the beneficiary and the principal debtor. *Secondly*, there is the arrangement between the principal debtor and the bank pursuant to which the bank issues the guarantee. *Thirdly*, there is the bank guarantee itself, which constitutes a contract between the bank and the beneficiary.

The law has consistently treated the third relationship as distinct from the underlying contract. In *State of Maharashtra v. National Construction Co.*³, the Supreme Court recognised that a claim for enforcement of a bank guarantee and a claim for damages under the underlying contract may constitute separate causes of action. The independence of the guarantee is essential because the beneficiary bargains for a form of security which can be realised without awaiting adjudication of the principal dispute.

This feature also distinguishes bank guarantees from ordinary contracts of guarantee under Section 126, Contract Act, 1872. In an ordinary contract of guarantee, the surety's liability is ordinarily coextensive with that of the principal debtor. In the case of an unconditional bank guarantee, however, the bank's liability is governed by the terms of the guarantee itself. The bank is not required to investigate whether the principal debtor has in fact committed a breach, whether the beneficiary has suffered loss, or whether the beneficiary may ultimately succeed in the underlying dispute.

In *Ansal Engg. Projects Ltd. v. Tehri Hydro Development Corpn. Ltd.*⁴, the Supreme Court reiterated that the bank must honour an unconditional guarantee according to its terms, irrespective of disputes between the parties to the underlying contract. Similarly, in *Vinitec Electronics (P) Ltd. v. HCL Infosystems Ltd.*⁵, the court held that mere reference to the underlying contract in a bank guarantee does not make the bank's obligation conditional, unless the operative part of the guarantee itself imports such conditions.

The jurisdictional aspect also flows from the nature of the transaction. In *South East Asia Shipping Co. Ltd. v. Nav Bharat Enterprises (P) Ltd.*⁶, the Supreme Court held that merely because a bank guarantee was executed in Delhi and transmitted to Bombay, it did not give rise to a cause of action before the Delhi High Court, when the underlying contract was executed and performed in Bombay. The decision indicates that although the guarantee is independent, proceedings concerning an injunction against its invocation may still be tested by reference to the material facts giving rise to the dispute.

Conditional and unconditional bank guarantees

A correct understanding of the terms of a bank guarantee is central to the law on encashment. The courts do not proceed on labels alone. A guarantee described as "unconditional" may still contain operative conditions, and a guarantee referring to an underlying contract may still remain unconditional if the payment obligation is framed as an independent demand obligation.

A conditional bank guarantee is one where the bank's obligation to pay arises only upon the fulfilment of conditions expressly stipulated in the guarantee. If the guarantee requires certification of breach, a particular form of demand, invocation by a specified authority, or the satisfaction of any other condition precedent, the beneficiary must comply with those requirements. In *Karnataka State Khadi & Village Industries Board v. Punjab National Bank*⁷, the Supreme Court recognised that the terms of the guarantee determine whether the bank's obligation is conditional.

By contrast, an unconditional bank guarantee is one where the bank undertakes to pay upon demand, often using expressions such as “without demur”, “on demand” or “irrespective of any dispute”. In such cases, the bank is bound to honour the demand so long as the invocation conforms to the terms of the guarantee.

The distinction was considered in *Hindustan Construction Co. Ltd. v. State of Bihar*⁸. There, although the guarantee was described as unconditional, the bank’s obligation was linked to specified events and to the manner of invocation contemplated by the instrument. The Supreme Court held that the instrument could not be treated as an unconditional and unequivocal guarantee. The decision illustrates that the operative language of the guarantee is determinative.

In *Standard Chartered Bank v. Heavy Engg. Corpn. Ltd.*⁹, the Supreme Court again emphasised that the bank guarantee must be read as a whole, and the bank’s liability cannot be enlarged beyond the terms of the instrument. Separately, in *Mahatma Gandhi Sabakra Sakhare Karkhane v. National Heavy Engg. Coop. Ltd.*¹⁰, the Supreme Court cautioned that mere use of the word fraud or the existence of disputes cannot justify injunction where the guarantee is otherwise invocable in terms of its language.

Therefore, the first step in any dispute concerning encashment is not to examine the merits of the underlying claim. It is to examine the bank guarantee itself.

The rule of judicial non-interference

The governing rule is that courts should be slow in granting injunctions restraining the invocation or encashment of bank guarantees. This principle is rooted in commercial certainty. Bank guarantees are intended to provide immediate security. If courts were to routinely restrain encashment whenever contractual disputes arise, the instrument would lose its commercial value.

In the *United Commercial Bank case*¹¹, the Supreme Court held that courts should not interfere with the normal course of banking transactions except in exceptional circumstances. In the *U.P. Coop. Federation case*¹², the court went further and observed that the commitments of banks must be honoured, failing which irreparable damage would be caused to commerce. The court also clarified that the fact that the principal debtor has a dispute with the beneficiary is not a ground to restrain the bank from honouring its obligation.

This position was reiterated in *General Electric Technical Services Co. Inc. v. Punj Sons (P) Ltd.*¹³, where the Supreme Court held that the bank is not concerned with disputes as to the outstanding amount under the underlying contract. In *National Thermal Power Corpn. Ltd. v. Flommore (P) Ltd.*¹⁴, the court held that even the pendency of arbitration between the parties does not, by itself, justify restraining encashment of an unconditional bank guarantee.

In *Hindustan Steelworks Construction Ltd. v. Tarapore & Co.*¹⁵, the Supreme Court rejected the contention that serious disputes regarding breach, pending arbitration, or counterclaims constituted sufficient grounds to injunct an unconditional bank guarantee. The court recognised that allowing such arguments to defeat encashment would undermine the very purpose of the guarantee.

The principles were comprehensively restated in *Himadri Chemicals Industries Ltd. v. Coal Tar Refining Co.*¹⁶ The Supreme Court held that in commercial dealings involving unconditional bank guarantees or letters of credit, the beneficiary is entitled to realise the guarantee in terms thereof irrespective of pending disputes. The bank is bound to honour its commitment. The courts should be slow in granting injunctions. The existence of disputes under the underlying contract is not a ground to restrain enforcement. Interference is permissible only in recognised exceptional cases, namely, egregious fraud or irretrievable injustice.

The result is that the party opposing encashment carries a heavy burden. It is not enough to show that the beneficiary may

be wrong, that the invocation is commercially harsh, or that the underlying dispute is pending. The case must fall within the narrow exceptions recognised by law.

Fraud as an exception

Fraud is the first recognised exception to the rule of non-interference. However, not every allegation of fraud is sufficient. The fraud must be egregious in nature. It must go to the root of the transaction. The beneficiary must be seeking to take advantage of that fraud. Further, the bank must have notice of the fraud.

In the *U.P. Coop. Federation case*¹⁷, the Supreme Court recognised fraud as a limited exception, but emphasised that the fraud must be of such a nature as to vitiate the very foundation of the bank guarantee or the underlying transaction. This exception is not attracted merely because one party alleges breach of contract or wrongful invocation.

In *Svenska Handelsbanken v. Indian Charge Chrome*¹⁸, the Supreme Court held that mere allegations in the plaint do not establish a strong prima facie case of fraud. The court must be satisfied that the material on record discloses fraud of a serious character. Suspicion is not enough.

The pleading threshold was further clarified in *Dwarikesh Sugar Industries Ltd. v. Prem Heavy Engg. Works (P) Ltd.*¹⁹ There, the Supreme Court held that bald allegations of fraud, without particulars, cannot justify an injunction. The Court also criticised the tendency to ignore settled law on bank guarantees by granting injunctions on grounds that do not fall within the recognised exceptions.

In *Reliance Salt Ltd. v. Cosmos Enterprises*²⁰, the Supreme Court observed that mere breach of contract would not amount to fraud. The allegation must be such that it vitiates the transaction. In the *Vintec Electronics case*²¹, the Supreme Court reiterated that a plea of fraud must be clear and supported by evidence. Vague allegations cannot defeat an unconditional bank guarantee.

The requirement of the bank's knowledge is equally important. In *Millenium Wires (P) Ltd. v. State Trading Corpn. of India Ltd.*²², in the context of letters of credit, the Supreme Court rejected vague and unsupported allegations of collusion against the negotiating bank. The decision is useful to show that fraud must be pleaded with material particulars and cannot rest on apprehension.

Therefore, fraud as an exception is narrow. It does not cover every wrongful demand. It covers only those cases where fraud is clear, egregious, adequately pleaded, supported by material particulars and known to the bank.

Special equities and irretrievable injustice

The second recognised exception is special equities, often expressed in terms of irretrievable injury or irretrievable injustice. This exception too has been construed narrowly. The injury must not be merely financial. It must be of such a nature that the party opposing encashment would be left without an adequate remedy, even if it ultimately succeeds in the underlying dispute.

In the *Svenska Handelsbanken case*²³, the Supreme Court adopted the high threshold of irretrievable injustice by reference to *Itek Corpn. v. First National Bank of Boston*²⁴. The situation in the *Itek Corpn. case* involved exceptional circumstances where, due to the political situation in Iran and the blocking of Iranian assets, recovery would have become practically impossible. Indian Courts have consistently treated this as an illustration of the level of exceptional hardship required.

In the *National Thermal Power Corpn. case*²⁵, the Supreme Court applied this standard and held that the pendency of arbitration and alleged understanding between parties did not amount to irretrievable injustice. In *U.P. State Sugar Corpn. v. Sumac International Ltd.*²⁶, the Supreme Court held that irretrievable injustice must be of a kind that makes it impossible for

the guarantor to reimburse himself if he ultimately succeeds. A mere apprehension of difficulty in recovery is not enough.

In the *Dwarikesh Sugar case*²⁷, the Supreme Court further clarified that special equities cannot be used as a broad equitable ground to restrain bank guarantees. The court warned against diluting the rule of non-interference by invoking general notions of fairness.

Several circumstances have been held insufficient to constitute special equities. The existence of disputes under the underlying contract is not enough. Claims and counterclaims pending in arbitration are not enough. Alleged breach by the beneficiary is not enough. Financial hardship is not enough. In *BSES Ltd. v. Fenner India Ltd.*²⁸, the Supreme Court held that the beneficiary is generally the best judge of when and for what reason a performance bank guarantee should be invoked, and it is not for the court to examine whether breach has occurred at the stage of invocation.

In the *Himadri Chemicals case*²⁹, the Supreme Court rejected the contention that the absence of assets of a foreign beneficiary in India was sufficient to establish irretrievable injustice. The court held that a mere apprehension that recovery may be difficult does not meet the exceptional threshold.

The essence of the law is, therefore, clear. Special equities must be truly special. They cannot be equated with ordinary commercial prejudice.

Invocation in accordance with the terms of the guarantee

There is a separate category of cases where courts may interfere because the invocation itself is not in accordance with the terms of the bank guarantee. This is not strictly an exception to an otherwise valid invocation. Rather, it is a consequence of the principle that the bank guarantee is an independent contract and must be enforced according to its own terms.

In the *Hindustan Construction case*³⁰, the Supreme Court held that where the guarantee required invocation in specified circumstances, the beneficiary could not treat it as a general unconditional guarantee. The case demonstrates that the bank's obligation cannot be divorced from the language of the instrument.

In *Larsen & Toubro Ltd. v. Maharashtra SEB*³¹, the Supreme Court considered multiple guarantees furnished under the same contract. The court refused to interfere with most of the guarantees, but restrained invocation of one guarantee which was linked to retention money and whose purpose had already been served. The decision shows that each guarantee must be examined independently.

In *Gangotri Enterprises Ltd. v. Union of India*³², the Supreme Court restrained encashment where the guarantee furnished in relation to one contract was sought to be invoked in connection with disputes arising from another contract. This decision must be understood on its facts. It does not dilute the rule of non-interference. It only reinforces the principle that a guarantee must be invoked for the purpose and in the manner for which it was furnished.

The same approach applies where invocation is attempted by a person who is not the beneficiary, or where the guarantee requires a specific form of demand which has not been followed. In such cases, the court does not examine the merits of the underlying dispute. It only examines whether the beneficiary has brought itself within the terms of the bank guarantee.

Bank guarantees and arbitration

Disputes concerning bank guarantees frequently arise in arbitration-related proceedings, especially under Sections 9 and 17, Arbitration and Conciliation Act, 1996. A party may seek interim protection from a court before or during arbitration, or from an Arbitral Tribunal after its constitution. However, the forum does not alter the substantive standard. Whether the application is under Section 9 or Section 17, the party seeking restraint must satisfy the settled tests governing bank guarantees.

The pendency of arbitration is not, by itself, a ground to restrain encashment. This position follows from the independence of the bank guarantee. If the party opposing invocation ultimately succeeds in arbitration, it may seek restitution, damages or adjustment in accordance with law. However, arbitration cannot be used to convert an unconditional bank guarantee into a conditional security.

The Supreme Court's decision in *N.N. Global Mercantile (P) Ltd. v. Indo Unique Flame Ltd.*³³ is relevant in this context, although its subsequent history on the issue of stamp duty should be kept distinct from its discussion on arbitrability of fraud. The Court considered allegations of fraudulent invocation of a bank guarantee and held that such disputes are arbitrable where they are essentially civil or commercial disputes between parties *inter se* and do not involve serious allegations affecting public law or criminality. The Court drew upon *A. Ayyasamy v. A. Paramasivam*³⁴ and *Rashid Raza v. Sadaf Akhtar*³⁵ to distinguish between serious allegations of fraud and fraud simpliciter.

The *N.N. Global case*³⁶, to this limited extent, is significant because it clarifies that allegations of fraudulent invocation do not automatically oust arbitration. At the same time, it does not lower the threshold for restraining encashment. Arbitrability and injunctive relief are separate questions. A dispute may be arbitrable, but interim restraint against encashment would still require satisfaction of the recognised exceptions.

Contemporary developments: Covid-19, proportionality and regulatory guarantees

Recent decisions show that parties continue to invoke newer grounds under the umbrella of special equities. Three areas require particular caution.

First, in *Halliburton Offshore Services Inc. v. Vedanta Ltd.*³⁷, the Delhi High Court granted limited ad interim protection in the extraordinary factual context of the sudden Covid-19 lockdown. The decision should not be read as creating a general Covid-based exception to the settled law on bank guarantees. The decision was rendered in the context of extraordinary disruption caused by the pandemic. However, later decisions have been careful not to treat Covid-19 or commercial hardship as an automatic ground for restraint. In *Zee Entertainment Enterprises Ltd. v. Railtel Corpn. of India Ltd.*³⁸, the Delhi High Court indicated that financial difficulty or commercial hardship would not, by itself, amount to special equities.

Second, some courts have considered proportionality in the context of bank guarantee invocation. In *Chennai Metro Rail Ltd. v. Transtonnelstroy – Afcons (JV)*³⁹, affirmed in *Chennai Metro Rail Ltd. v. Transtonnelstroy Afcons (JV)*⁴⁰, the Madras High Court treated proportionality as a part of the special-equities analysis in a highly fact-specific setting, including the substantial value of the guarantee, the issue whether the guarantee ought to have stood reduced, the absence of crystallisation of the claim, liquidity concerns, and the direction to keep the guarantee alive. The decision should therefore be used as an exceptional case, not as a general licence for merits-based proportionality review.

Third, bank guarantees furnished in regulatory or statutory settings may raise slightly different considerations. In *A.P. Pollution Control Board v. CCL Products (India) Ltd.*⁴¹, the Supreme Court applied the ordinary bank guarantee principles even to guarantees furnished to secure compliance with environmental directions. The Court held that where invocation is in terms of the guarantee, neither the bank nor the court should examine the justification for invocation in the absence of fraud, irretrievable injustice or special equities.

These developments demonstrate that the doctrine continues to evolve. However, the central rule remains intact. Judicial intervention remains exceptional.

Conclusion

The law on encashment of bank guarantees in India is ultimately guided by commercial certainty. The beneficiary of an unconditional bank guarantee is ordinarily entitled to realise the guarantee in accordance with its terms. The bank is not required to adjudicate disputes between the beneficiary and the principal debtor. Equally, at the stage of invocation, the

court is not expected to undertake a merits review of the underlying contract.

The reason is straightforward. Parties bargain for bank guarantees precisely because they provide immediate liquidity without requiring prior adjudication of contractual disputes. If every contractual dispute, pending arbitration, counterclaim or allegation of breach were allowed to restrain encashment, bank guarantees would cease to function as reliable commercial security. Indian courts have, for this reason, consistently adopted a restrained approach.

At the same time, autonomy does not mean that invocation is beyond scrutiny in every case. The recognised exceptions remain narrow and demanding. Fraud must be egregious, specific, supported by particulars and known to the bank. Irretrievable injustice must be real and exceptional, not merely a case of financial hardship or difficulty in recovery. Separately, the invocation must conform to the terms of the guarantee, since the bank's obligation is ultimately governed by the instrument itself.

Recent decisions concerning Covid-19, proportionality and regulatory guarantees show that parties continue to test the boundaries of the doctrine. These developments may have a limited role in exceptional facts. However, they do not displace the general rule of judicial restraint.

In practice, this balance is critical. It ensures that bank guarantees continue to serve their intended purpose as immediate and dependable security, while preserving a narrow jurisdiction to prevent misuse in cases of fraud, truly irretrievable injustice, or invocation contrary to the terms of the guarantee. Consequently, parties challenging invocation would be well advised to focus on the language of the guarantee and the recognised exceptions, rather than the merits of the underlying contractual dispute, which would ordinarily fall for determination in separate proceedings.

In the final analysis, the continued commercial relevance of bank guarantees depends on preserving this balance. A legal regime that protects the autonomy of the instrument while confining judicial intervention to genuinely exceptional cases ensure that bank guarantees remain what they are intended to be: immediate, dependable, and commercially meaningful security.

***Founder and Head, Trinity Chambers.**

****Counsel, Trinity Chambers.**

1. (1981) 2 SCC 766 : (1982) 52 Comp Cas 186.
2. (1988) 1 SCC 174 : (1989) 65 Comp Cas 283.
3. (1996) 1 SCC 735 : (1998) 92 Comp Cas 21.
4. (1996) 5 SCC 450 : (1997) 88 Comp Cas 149.
5. (2008) 1 SCC 544 : (2008) 1 SCC (Civ) 342.
6. (1996) 3 SCC 443.
7. (2014) 1 SCC 625 : (2014) 1 SCC (Civ) 502.
8. (1999) 8 SCC 436 : (2000) 99 Comp Cas 297.
9. (2020) 13 SCC 574.
10. (2007) 6 SCC 470.
11. *United Commercial Bank v. Bank of India*, (1981) 2 SCC 766 : (1982) 52 Comp Cas 186.
12. *U.P. Coop. Federation Ltd. v. Singh Consultants and Engineers (P) Ltd.*, (1988) 1 SCC 174 : (1989) 65 Comp Cas 283.
13. (1991) 4 SCC 230 : (1992) 74 Comp Cas 624.
14. (1995) 4 SCC 515 : (1995) 84 Comp Cas 97.
15. (1996) 5 SCC 34.

16. [\(2007\) 8 SCC 110](#) : (2007) 139 Comp Cas 706.
17. *U.P. Coop. Federation Ltd. v. Singh Consultants and Engineers (P) Ltd.*, [\(1988\) 1 SCC 174](#) : (1989) 65 Comp Cas 283.
18. [\(1994\) 1 SCC 502](#) : (1994) 79 Comp Cas 589.
19. [\(1997\) 6 SCC 450](#) : (1997) 89 Comp Cas 619.
20. [\(2006\) 13 SCC 599](#) : (2006) 134 Comp Cas 645.
21. *Vinitec Electronics (P) Ltd. v. HCL Infosystems Ltd.*, [\(2008\) 1 SCC 544](#) : (2008) 1 SCC (Civ) 342.
22. (2015) 14 SCC 375.
23. *Svenska Handelsbanken v. Indian Charge Chrome*, [\(1994\) 1 SCC 502](#) : (1994) 79 Comp Cas 589.
24. 566 F Supp 1210.
25. *National Thermal Power Corpn. Ltd. v. Flowmore (P) Ltd.*, [\(1995\) 4 SCC 515](#) : (1995) 84 Comp Cas 97.
26. [\(1997\) 1 SCC 568](#) : (1997) 89 Comp Cas 179.
27. *Dwarikesh Sugar Industries Ltd. v. Prem Heavy Engg. Works (P) Ltd.*, [\(1997\) 6 SCC 450](#) : (1997) 89 Comp Cas 619.
28. [\(2006\) 2 SCC 728](#) : (2006) 130 Comp Cas 8.
29. *Himadri Chemicals Industries Ltd. v. Coal Tar Refining Co.*, [\(2007\) 8 SCC 110](#) : (2007) 139 Comp Cas 706.
30. *Hindustan Construction Co. Ltd. v. State of Bihar*, [\(1999\) 8 SCC 436](#) : (2000) 99 Comp Cas 297.
31. (1995) 6 SCC 68.
32. [\(2016\) 11 SCC 720](#) : (2016) 4 SCC (Civ) 480.
33. [\(2021\) 4 SCC 379](#) : (2021) 2 SCC (Civ) 555.
34. [\(2016\) 10 SCC 386](#) : (2017) 1 SCC (Civ) 79.
35. [\(2019\) 8 SCC 710](#) : (2019) 4 SCC (Civ) 503.
36. *N.N. Global Mercantile (P) Ltd. v. Indo Unique Flame Ltd.*, [\(2021\) 4 SCC 379](#) : (2021) 2 SCC (Civ) 555.
37. 2020 SCC OnLine Del 542.
38. 2021 SCC OnLine Del 5004.
39. 2021 SCC OnLine Mad 5637.
40. [\(2024\) 6 SCC 211](#) : (2024) 3 SCC (Civ) 79.
41. (2019) 20 SCC 669.