
THE CONUNDRUM OF LIMITATION PERIOD OF BANK GUARANTEE WITH RESPECT TO SECTION 28 OF INDIAN CONTRACT ACT 1872

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ABSTRACT

This article delves into the legal complexities surrounding Section 28 of the Indian Contract Act, 1872, which deals with the validity of bank guarantees. The bank plays a pivotal role in a bank guarantee as the lending institution, acting as a surety for transactions between a creditor and a debtor. Originally, Section 28 of the Indian Contract Act invalidated agreements that imposed an absolute restraint on legal proceedings. Initially, Section 28 rendered agreements void if they absolutely restricted or prevented parties from enforcing their rights under a contract through legal proceedings or restricted the time for such enforcement. An amendment in 1997 introduced a new provision, rendering void agreements that extinguish rights or discharge liabilities after a specified period, restricting parties from enforcing their rights through legal proceedings. The ambiguity arose when parties to contracts faced confusion over whether the aggrieved party could make a claim and the time period within which they could enforce their rights. In the case of *Union of India v. M/s Indusind Bank Ltd.*, a crucial question arose concerning the application of the 1997 amendment to Section 28. Various court iterations followed on the application of the amended Section 28 and whether it should be applied retrospectively. The Supreme Court intervened and clarified that the 1997 amendment was substantive and remedial in nature, hence applicable prospectively. The Court further differentiated between limiting the time for making a claim and limiting the right's enforceability. In conclusion, this article underscores the significance of asserting rights within the stipulated period in bank guarantee agreements. The Supreme Court's clarifications have provided valuable guidance to parties involved in such agreements, ensuring a better understanding of Section 28 and its application.

INTRODUCTION

The contract of guarantee is defined as a contract to perform the promise or to discharge the liability of a third party in case of breach or default on part of that person.¹ The bank is the lending institution in a bank guarantee that acts as a surety for transactions between a creditor and a debtor.² In the case of *Rehmatunnisa Begum v. Price*³, it was observed as a general principle that, 'No man can exclude himself from the protection of the courts' on the ground of public policy. This means that any agreement would be rendered void if its clause provides that neither of the parties can have the right to effectuate the agreement via legal proceedings.

Originally, Section 28 of the Indian Contract Act made those agreements void which were in absolute restraint of legal proceedings. However there has been an amendment which has caused confusion to the parties to the contract much to their displeasure with regard to the question whether the aggrieved party can make a claim and the time period within which they can enforce their rights.

In the case of *Union of India v. M/s Indusind Bank Ltd.*⁴, a question arose with regard to the application of the amendment of 1997 made to Section 28 of the Act. In this case various cotton importers issued a bank guarantee in favor of Union of India which provided for invoking a bank guarantee in a period of three months past the period of validity (which was six months). However, Union of India invoked the bank guarantee after the time limit of 3 months had expired. The bank thus refused to make any payment since the claim was made after the claim period had elapsed i.e. after the expiry of the validity period. In view of Section 28 of the Act of 1872, the Union of India opined that the time period for making a claim cannot be restricted to a period less than the limitation period which was prescribed under the limitation act. Therefore, the primary question that arose in this case was whether Section 28 was to be applied in its original form or as per the amendment made in the year 1997.

In order to understand whether this Section would be applied in its original form or as per the amendment, it is first necessary to understand Section 28 in both these contexts.

¹ The Indian Contract Act, 1872 § 126, No. 9 of 1872, Acts of Parliament, 1872 (India)

² Akshay Anurag, *Bank Guarantee and Judicial Intervention*, MANUPATRA (Jul. 17, 2023, 3:32 PM) <http://docs.manupatra.in/newslines/articles/Upload/1A60C2E6-874F-4655-8821-CA4915F9D4F6-%20banking.pdf>

³ (1918) 20 BOMLR 714

⁴ 2016 Latest Caselaw 656 SC

STATUS OF VALIDITY OF BANK GUARANTEE IN ACCORDANCE WITH SECTION 28

Original text of Section 28

According to the original proviso of the Section 28,

*“Every agreement, which absolutely restricts or prevents any party from enforcement of his rights under or in respect of any contract, by way of usual legal proceedings in the ordinary tribunals, or which restricts the time within which he may thus enforce his rights, is void to such extent.”*⁵

This Section prohibits the parties to the agreement to substitute any other stipulated time in place of the time already stipulated under the Limitation Act, 1963. The Limitation Act, 1963 prescribes the time period within which an aggrieved party can approach the court for redressal by way of suit, appeal or application. The law of limitation prescribes a time limit for different suits within which an aggrieved party can knock the doors of the court in order to obtain a decree as against the principal debtor and the surety.

It provides a time period of 3 years for the enforceability of the right for the suits that is to be instituted by the party. Therefore, the provision of Section 28 renders void those agreements which put a restriction on the rules of limitation.

Section 28 after Amendment with effect from 08.01.1997

Before the amendment made in 1997, Section 28 rendered void, those agreements which put a restriction on the rules of limitation. With the passage of the amendment made in 1997, as per the *suo motu* recommendations given by 97th Report of Law Commission of India, the original section became 28(a), and (b) was added to the section. The amended Section 28 can be read as follows:

‘Every Agreement,

(b) that extinguishes the rights of any party or discharges any party from any liability accruing in respect of any contract on expiry of a specified period so as to restrict any party from

⁵ The Indian Contract Act, 1872 § 28, No. 9 of 1872, Acts of Parliament, 1872 (India)

enforcing his rights by way of usual legal proceedings, is void to that extent.'

Thus, Section 28 (b) rendered void those agreements which curtails the time period within which the contract may be enforced.

ITERATIONS BY THE COURTS AND INTERVENTION OF HIGHER JURISDICTION

1. Iteration vide Judgement of learned Single judge of Bombay High Court

The clause in the agreement with regard to the bank guarantee, that prescribed the stipulated period during which, the plaintiffs could lodge a complaint, was rendered to be void by the Single Learned Judge, as the clause was inconsistent with the amended provision of Section 28 of the Act of 1872. The Judge ruled that the bank was not discharged of its obligation to make payment and was also not justified in denying to make payments on the ground that the claim was not made during the stipulated period. Hence, the decision was decreed against the Bank and in favour of Union of India.

2. Iteration vide Judgement of Division Bench of Bombay High Court

The Division Bench in this case considered whether the clause of the agreement that prescribed the time limit to make a claim is void or not.

The Bombay High Court Division Bench quoted the cases of *Explore Computers Pvt. Ltd. v. CALS Ltd.*⁶ and *Pandit Construction Company v. DDA*⁷, where the Delhi High Court adjudged that the time limit prescribed in the agreement within which the beneficiary can lodge a claim under bank guarantee will remain unaffected by the provisions of Section 28 of the Indian Contract Act, 1872. However, if there is a curtailment on the right to enforce a claim by way of such agreement, then it would be considered to be ultra vires to Section 28.⁸

Therefore, the Bombay High Court held the opinion that the curtailment of the limitation period is impermissible as per Section 28, however, the extinguishment of a right, unless it is exercised

⁶ (131 (2006) DLT 477)

⁷ 2007 (3) RBLR 205 Delhi

⁸ Rajesh Narain Gupta and Sanjay Gupta, THE DILEMMA OF ENFORCEMENT OF INDIAN BANK GUARANTEES, SNGPARTNERS (Jul 23, 2023, 9:14 PM) <https://www.sngpartners.in/2019/06/01/the-dilemma-on-enforcement-of-indian-bank-guarantees/>

within a specific period of time, is permissible as per Section 28.

In light of this, the court held that since the Union of India did not invoke the bank guarantee within the specified time period, thus it is not entitled to make such claim and that the bank is discharged of its liability to make any such payment.

3. Observations of Supreme Court on Iteration 1 &2

The Supreme Court while dealing the case brought to its scrutiny, a question - whether the 1997 amendment to Section 28 would apply to the case with retrospective effect or not. In order to answer this question, the court went through its previous judgments.

In the case of *Purbanchal Cables and Conductors (P) Ltd. v. Assam*⁹, the Supreme Court opined that a substantive law must operate prospectively unless the language of the statute explicitly mentions of its retrospective operation. Only declaratory or procedural laws operate retrospectively since there is no vested right in procedure.

Thus the view that remedial statutes are considered to be prospective but declaratory statutes are regarded to be of retrospective nature was also laid down in the case of *Sukhram v. Harbheji*¹⁰.

Similarly, in the case of *CIT v. Vatika Township (P) Ltd.*¹¹, the Supreme Court in deciding the prospectivity of the proviso of Income Tax Act, 1961 relied on the principle of law known as '*lex prospicit non respicit*' which means that 'law looks forward not backward'.

From the 97th Law Commission Report and the Statement of Objects and reasons for the amendment by the same, the Supreme Court was of the view that the amendment made to Section 28 was not declaratory or clarificatory in nature. Rather, it sought to bring about a significant change in the law by stating that even though there is an extinguishment of a right or a discharge of a liability of a party which causes restriction on the enforcement of a right, such an agreement would be rendered void only to that extent.

⁹ (2012) 7 SCC 462

¹⁰ (1969) 3 SCR 752

¹¹ (2015) 1 SCC 1

These imperative changes in the law are remedial and prospective in nature. They cannot have a retrospective effect.

Therefore, the Supreme Court adjudged that the amendment being substantive and remedial in nature shall be applied prospectively and that both - the Single Judge and the Division Bench of Bombay High Court were erroneous in applying the amended Section 28.

4. Iteration vide Judgment of Supreme Court

On holding the view that the Single Judge and Division Bench were mistaken in applying the amended Section 28, the Supreme Court considered that the un-amended Section 28 was to be applied. In order to apply the unamended Section 28, it is pertinent to list its essential ingredients.

- First, there has to be an absolute restriction on a party from having its rights enforced with regard to any contract.
- Secondly, such absolute restriction must be in regard to approach the ordinary Tribunals set up by the State, by way of usual legal proceedings.
- Thirdly, such restriction may also be in respect to the time limit within which the party may thus enforce its rights.

Precisely, neither clause of the agreement shall purport to limit the period of limitation within which a suit may be filed in order to enforce the bank guarantee.

The Supreme Court thus, made references to several similar cases adjudged by it in the past that brought to its scrutiny whether a clause of the agreement was hit by the original Section 28 or not.

In view of this, the Supreme Court in the case of *Union of India v. M/s Indusind bank Ltd.*, applied its earlier judgment of *Food Corporation of India v. New India Assurance Co. Ltd.*¹², in which the Court held the view that none of the clauses in the agreement provided that a suit should be initiated by the plaintiff for enforcement of its rights within the stipulated time as mentioned in agreement since the date of termination of the contract. The limitation period

¹² (1994) 3 SCC 324

mentioned in the clause envisaged that the Corporation was to file a claim based on the agreement, and that if this was satisfied, then a suit can be filed to invoke rights under the agreement but within the limitation period as set out in the Limitation Act, 1963. Ergo, it was construed that the condition precedent for filing a suit is that the Corporation must have exercised its right within the time period as stipulated in the agreement.

Assertion of a right is different from enforcing the right in a court of law. The assertion of the right can be made time bound under the agreement however the enforceability of a right cannot be, as it would be in infringement of Section 28.¹³ The assertion of right, therefore, can be said to be governed by the agreement. In this case, since the Corporation had issued notice prior to the expiry of the stipulated time since the termination of contract, therefore, the suit filed by the Appellant was within such stipulated time period.

In the case of *Kerala Electrical & Allied Engineering Co. Ltd. V. Canara Bank & Others*¹⁴, the agreement clause provided that the bank's liability exists only for a period of 6 months since the termination of the period of guarantee. It further provided that the rights of the plaintiff under the guarantee would be forfeited after the period of expiry. Thus the plaintiff's right is extinguished under the agreement and the bank is also discharged of its liability. It was adjudged that the time limit as imposed by the clause does not offend Section 28.

Same scenario arose in the case of *National Insurance Co. Ltd. v. Sujir Ganesh Nayak and Co.*¹⁵. The Supreme Court was to decide - whether a particular clause in an insurance policy was hit by the original Section 28. After having referred to several relevant case laws and a detailed reference to the Food Corporation judgment, the Court adjudged that -

As per the agreement, the insurer (i.e. the insurance company) would not be obliged to redeem for any damage or loss after the expiration of stipulated time from the happening of such specific event unless the claim is a subject of any pending action or arbitration. In this case the claim was not subject to any action or arbitration proceedings. As per the agreement, if the claim was not made within the stipulated time period from the occurrence of such specific event, the Insurance Company would be discharged of its liability. There is no dispute with respect to the fact that no claim was made nor was the claim subject of any pending action or

¹³ 1 POLLOCK & MULLA, COMMENTARY ON THE INDIAN CONTRACT ACT. 676 (14th Ed.)

¹⁴ AIR 1980 Ker 151

¹⁵ (1997) 4 SCC 366

an arbitration proceeding during the stipulated period. The Clause therefore has the effect of ceasing the right itself and consequently, the liability also.

In *Vulcan Insurance case*¹⁶, the clause in the agreement couched similar terms as the above case to which the court adjudged that the case was not hit by section 28.

CONCLUSION

The Supreme Court rendered both the judgments given by the Single learned Judge and the Division Bench of the Bombay High Court as made in error since the amended Section 28 (by way of 1997 amendment) could not be applied to the case in retrospective effect. The amended section was not of declaratory or clarificatory nature but of remedial nature. The law being substantive is therefore applied prospectively. The court after the analysis of several judgments also adjudicated that limiting the period to make a claim against a guarantee is distinct from fixing a time period within which a claim can be lodged. It means that if a claim is not lodged within the time stipulated as under the agreement, no claim can be made thereafter. However, if a claim is made within the prescribed time and if no payment is made against the claim, then the claimant is entitled to enforce its right by way of suit, appeal or application within the limitation period as under the Limitation Act, 1963. In the *Indusind* case, the plaintiff did not lodge a claim of guarantee within the stipulated period (as mentioned in the clause of the agreement), thus the Supreme court ruled in favour of bank stating that since the claim was not made within the time period, the bank is discharged of its liability to make any such payment. Ergo, it can be construed that the assertion of right within stipulated period is different from filing a suit within the limitation period. Only the time period of assertion of right can be limited under the agreement but not the right for the enforceability of the claim.

¹⁶ (1976) 1 SCC 943