

THE INDIAN CONTRACT (AMENDMENT) ACT, 1996 - BENEFITS ONLY TO BENEFICIARIES

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Recent amendment made to Section 28 of Indian Contract Act has paved the way for innumerable debates among bankers from both legal and operational angles. Due to the incorporation of new Clause (b) in the said Section right of the guarantor to put an end to the claim beyond certain period has been taken away. In other words, forfeiture of right to enforce the contract and, consequently, the liability thereto is hit by this amendment which came into force on 8-1-1997 through Gazette notification. Banks and insurance companies are poised in catch 22 situation on account of this amendment.

While tracing back to the pre-January 8th dispensation, it is seen that bankers were able to limit their liability to a certain period by adding non-obstante clause as last para of the guarantee bond which invariably sets forth that unless a claim or demand is made on such and such date, guarantor is discharged and relieved from the liability under the guarantee. Limiting the extinguishment of right of the beneficiary under the guarantee bond was challenged before various High Courts and Supreme Court on the plea that it falls under the mischief of Section 28. Supreme Court, by putting an end to this controversy, finally, held that limiting the right of the beneficiary for enforceability of the claim is not hit by Section 28 of the Contract Act. What Section 28 of the Contract Act, as it stood prior to the recent amendment, meant was the extinguishment of the enforceability of right and discharge from the liability consequent thereupon. In other words, limiting the period of

enforceability of the claim and discharging the guarantor from the liability does not tantamount to limiting period of limitation prescribed by the law to a shorter period and hence, it does not fall under the mischief of Section 28 of Contract Act. This position has been perfected by Supreme Court decisions in *Vulcan Insurance Company Ltd. v. Maharaj Singh* (AIR 1976 SC 287) and *Food Corporation of India v. New India Assurance Company Ltd.* (AIR 1994 SC 1889). Recent decision of the Supreme Court in *National Insurance Co. v. S.G. Naik* reported in 1997 (3) Scale 236 further reiterates the aforesaid legal position.

The recent amendment made in Section 28 by incorporating an additional clause (b) which came into force with effect from 8-1-1997 turned the aforesaid settled legal principles upside down. It takes away or nullifies the effect of non-obstante clause which being inserted normally by bankers to limit their liability to a stipulated period. As limiting the liability of the claim to a shorter period is taken away through the amendment, period of limitation to contemplate legal action as prescribed under the Limitation Act comes into operation. As a result of this, an individual beneficiary can invoke the guarantee within three years irrespective of the claim period stipulated therein. In case of guarantee executed in favour of the Government, the period of limitation shall invariably be 30 years. To put it in other way, the guarantee executed in favour of the Government shall be kept open for a period of 30 years as the Government could invoke

it at any time during the said period. This is a boon to the beneficiaries as they need not make any claim on the guaranteed amount within the claim period as contained in the guarantee bond. Conversely, beneficiaries can sleep over the matter for years together and can wake up at any time and contemplate action against the guarantors before the right to sue is barred by period of limitation. The bankers will have to keep the books of accounts open during this period as its contingent liability continue irrespective of whether the claim period has expired or not. This further puts bankers in difficult position as they do not collect commission for execution of the guarantee during the period beyond the claim date. A reasonable and prudent banker cannot collect the commission in advance from the party on whose behalf the guarantee is executed for a period beyond the date of expiry of the bank guarantee.

It is common that bankers execute guarantees on the security of immovable properties as well. If no invocation is made by the beneficiary within the claim period, the constituent normally approaches the bank and seeks release of the securities. In case, beneficiary does not return the guarantee bond even after giving reasonable notice for return of the same, bankers usually reverse the entries in their books of accounts and release the securities to the constituent

thereafter. This procedure cannot be resorted to in view of the amendment effected in the Contract Act because the beneficiary can stake claim under the guarantee bond any time within the period of limitation prescribed under the Limitation Act. Therefore, bankers will have to hold the security or security documents until the original guarantee bond is returned duly discharged by the beneficiary or till the period of limitation ends, whichever occurs first.

Another point for consideration is the applicability of the amended provision on guarantees executed prior to 8-1-1997, where the claim period falls subsequently, Bank Guarantee is an independent contract entered into between the banker and the beneficiary. Once a contract is concluded, the terms and conditions thereof are legally binding on the parties concerned. An amendment cannot take away or nullify or modify the right of the parties concerned in concluded contract. Besides, an amendment cannot have retrospective operation unless the legislation intends to do so. If the legislation has intended to give retrospective operation of the amendment, it would have been clearly provided in the amendment itself. As it is not done in the instant amendment, it could be safely concluded that the amendment to Section 28 does not have any bearing on the pre-January, 8th dispensation.
